The State of Fashion 2017

A world that is uncertain, changing, and challenging by Craig & Karl
The State of Fashion 2017 was created to provide a comprehensive view of the fashion industry—one whose coverage remains fragmented and not systematically reported. Its principal aim is to lay out the interconnectedness of the entire fashion ecosystem across market segments and product categories by distilling the industry’s current and projected performance, and addressing the factors shaping and driving fashion today and in the year to come.

To accomplish this, the report relies on extensive qualitative and quantitative analyses, drawing on industry and proprietary sources, including executive interviews, the new BoF-McKinsey Global Fashion Survey, the McKinsey Global Fashion Index, which tracks industry sales, operating profit, and economic profit (value creation) and McKinsey’s FashionScope, a city-level growth forecasting tool for the fashion industry.

The report is split into two sections: Section 1 provides a review of the industry in 2016, highlighting the industry’s performance across sales, operating profit (EBITA), and economic profit—a measure of value-add that takes into account both the explicit and implicit costs of generating income—and recapping the ten key themes that shaped 2016; Section 2 provides an outlook for 2017, forecasting for the first time expected growth for the fashion industry across market segments and product categories, highlighting the top priorities for executives, and defining the ten trends that we believe will set the agenda for the industry over the next 12 months.

In order to present a full picture of the ecosystem and bring to life the complex and multifaceted aspects of the industry, the report also includes a series of deep dives and executive interviews on some of the most exciting developments, including the growth of Russia’s fashion market, the new wave of digitisation of the supply chain, and the rise of new consumer capitals in China, the Middle East, and Latin America.

McKinsey&Company
时尚是世界最重要的行业之一，驱动着全球经济的显著部分。2016年，该行业预计将达到2.4万亿美元的总价值。1如果按单个国家的GDP进行排名，全球时尚行业将排名世界第七大经济体。2

然而，对于一些观察者来说，时尚仍然被同时视为肤浅和挥霍的；而且，有关该行业的信息来源往往是分散的、不完整的，或者不可靠的。

现在，麦肯锡公司和《时尚商业》(BoF)正试图填补这一空白。我们的第一份《时尚状态报告》奠定了严格深入研究和分析全球时尚行业的基础，聚焦于影响该领域及其表现的议题、问题和机会。

在过去的几个月里，我们聚集了一张全球网络的专家，进行研究和分析，以提供一份对时尚各市场细分、产品类别和地理的视角，都能理解的报告。

我们的目标是三重：首先，建立对塑造该行业力量的共同理解；其次，为行业性能的透明度提供一些清晰度；最后，为2017年商业和创意领导者的头脑风暴设定议程，为我们在2016年12月1日至3日举办的年度聚会《声音》(VOICES)的讨论与对话设定方向。

通过将我们的两个组织联合起来，我们汇集了资源，利用《时尚商业》的行业专业知识和知情人士的进入，以及麦肯锡的功能性、分析性和行业见解，提供了一个难得的混合，即定量的严谨性和敏锐的定性见解，关于时尚领域。

为了进行分析，我们对来自世界各地的高级行业高管进行了调查，并对一些最有影响力和有前瞻思维的行业人士进行了深入访谈。我们的集体知识创造是独一无二的，也是这份报告的重要组成部分，我们分享的见解将对所有参与时尚业务的人群，无论是董事会成员、正在创业建立初创公司的企业家，还是在高街上作为知情的购物者，都是相关的。

这份报告还揭示了一个新的行业基准：麦肯锡全球时尚指数(MGFI)。拥有超过450家时尚公司的数据库，这个指数将允许对一家时尚公司相对于同类竞争者、产品类别，甚至经营模式的性能进行分析和比较。随着时间的推移，数据集将增长，成为洞察影响时尚的行业压力，以及将从全球时尚市场上动荡中出来的机会和新的收入和创新来源的宝贵信息来源。

对于创意领导者和业务执行者来说，这可能是有史以来最不确定的经营环境。然而，我们希望，通过《时尚状态》和《麦肯锡全球时尚指数》，全球时尚社区将处于一个更强的位置来面对市场的挑战，并描绘出通往成功的道路。”

伊姆兰·阿米德和阿奇姆·伯格

* Imran Amed and Achim Berg

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As founder, editor-in-chief, and CEO of The Business of Fashion, Imran Amed is one of the fashion industry's leading writers, thinkers, and commentators. Fascinated by the industry's potent blend of creativity and business, he began BoF as a blog in 2007, which has since grown into the pre-eminent global fashion industry resource serving a three-million-strong community from over 200 countries and territories. Previously, he was a consultant at McKinsey in London.

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ACKNOWLEDGEMENTS

The authors would like to thank all the members of the BoF and McKinsey community for their contribution to research and participation in our Global Fashion Survey. In particular we would like to thank: Princess Deena Aljuhani Abdulaziz, Avery Baker, Angelica Cheung, Laurent Claquin, Colin Henry, Tommy Hilfiger, John Hooks, Andrew Keith, Daniel Lalonde, Daniel Lopez, Karla Martinez, Natalie Massenet, Alexander Pavlov, François-Henri Pinault, Nadja Swarovski, Mimma Viglezio, Jason Wachob, and David Zhao for their input into the report.

The authors also give thanks to Jörn Kupper, Kate Smaje, Richard Dobbs, Greg Kelly, Antonio Achille, Nathalie Bensy, Aimee Kim, Jennifer Schmidt, Jessica Mounton, Bjorn Timelin, Kai Peter Rath, Adriana Clemens, Marcus Jacob, Benjamin Durand-Servoingt, Helen Mullings, Jonathan Ablett, Mafalda Hipolito, Christoph Goek, Neha Nangia, Abhishek Goel, David Honigmann, Anja Weissgerber, Michael Seva, and Rachel Mclean of McKinsey and the entire team from The Business of Fashion who have played an instrumental role in creating this report—in particular, Sarah Guttridge, Robin Mellery-Pratt, Anouk Vlahovic, Jan-Nico Meyer and Cyrus Yu.

In addition, the authors would like to thank Patrick Li and Joan Cheng at Li Inc. for their creative input and direction into our first State of Fashion report, Craig & Karl for our cover illustration and Getty Images for supplying imagery to bring our findings to life.
Looking back at 2016 — one of the toughest years on record
As fashion executives around the world reported to us in the first BoF-McKinsey Global Fashion Survey, 2016 can be summarised in three words: uncertain, changing, and challenging.

Indeed, this has been one of the toughest years ever for the global fashion industry. Terrorist attacks in France, the Brexit vote in the UK, and the volatility of the Chinese stock market have created shocks to the global economy, which has not been this volatile since the depths of the financial crisis of 2009. Meanwhile, consumers have become more demanding, more discerning, and less predictable in their purchasing behaviour, which is being radically reshaped by new technologies.

But the shockwaves have not only been external. Fashion companies have also been looking inward, implementing changes to their core operations—from shortening the length of the fashion cycle to integrating sustainable innovation into their core product design and manufacturing processes—re-evaluating the entire fashion system itself.

Perhaps unsurprisingly then, 67 percent of the executives surveyed reported that conditions for the fashion industry have worsened over the past 12 months, a fact that is clearly borne out in the industry’s financial performance this year. Sales growth is on track to slow to just 2–3 percent by the end of 2016, with stagnating profit margins. Speculation and uncertainty over the impact of the outcome of the election in the United States could further impact sales if consumer sentiment dampens. This is in stark contrast to the fashion industry’s performance over the previous decade, which saw the industry grow at 5.5 percent annually according to the McKinsey Global Fashion Index, outpacing overall GDP growth.³

It is important to note that industry performance in 2016 has not been even across all market segments and categories. This year

“Terrorist attacks in France, the Brexit vote in the UK, and the volatility of the Chinese stock market have created shocks to the global economy. Meanwhile, consumers have become more demanding, more discerning, and less predictable.”
was particularly difficult for the luxury and mid-market players, who were hit by the slowdown in China and the US and are expected to grow at rates below the industry average at 0.5-1% and 2-2.5%, respectively. One category that is experiencing significant deceleration is watches and jewellery. While it was the fastest growing category between 2005 and 2015 – having enjoyed a compounded growth rate of 11% according to the MGFI –watches and jewellery is expected to grow just 1.5-2% this year. The luxury end of the category suffered an especially hard blow.

But in spite of these and other challenging circumstances, fashion remains one of the key value-creating industries for the world economy. If it were ranked alongside individual countries’ GDP the global fashion industry would represent the seventh-largest economy in the world. Moreover, 2016 also saw many exciting changes: the advance of digital, the launch of “see-now, buy-now”, and a thorough creative shake-up at fashion houses.

**Outlook for 2017: Glimmers of recovery**

In 2017 we expect the fashion industry to see the glimmers of a rebound.

This recovery has several foundations. First macroeconomic indicators, including GDP growth forecasts, are projected at 3.4 percent compared with 3.1 for 2016, however these have not been adjusted to reflect the ongoing impact of important political shifts in the United States and the United Kingdom.

Second, the investment community and the fashion brands themselves forecast improvement across the industry next year. Some 40 percent of executives we interviewed for this report expect conditions for the fashion industry to improve in 2017, compared with the 19 percent who reported improving conditions in 2016. This is particularly true for the major players within each of the market segments and product categories.

Many of them have already undertaken significant cost-cutting and restructuring exercises, and are now primed to capture the benefits. All things considered, we fashion industry growth could increase from 2-2.5 percent in 2016 to 2.5-3.5 percent in 2017, although the days when the industry outpaced GDP growth by more than 1-2 percentage points, as it has done over the past decade, seem to be over.

Performance will vary according to the individual dynamics of specific market segments and categories. Value and affordable luxury are likely to be the big winners, both outpacing the industry average at a projected 3.0-4.0 percent and 3.5-4.5 percent growth, respectively; however, all of the market segments—for example the discount market—should see a slight sales growth improvement of 0.5–1.5 percentage points.

Product categories are expected to grow in line with the overall industry average, but the biggest winners will be those companies with coherent channel strategies and clear value propositions. Athletic wear is positioned to be the absolute category winner, maintaining 6.5–7.5 percent sales growth, albeit no longer growing at a double-digit rate overall. The affordable luxury segment seems likely to continue benefiting from consumers “trading down” from luxury, while signs point to the continued growth of the value segment in line with the international expansion of large global players.

In short, the industry now has the opportunity to stabilise and reset. Next year’s success stories are most likely to come from those that are already planning for the year ahead. They should do this in the context of the following trends that we believe will shape the fashion industry in 2017:

**TRENDS THAT WILL DEFINE THE FASHION AGENDA IN 2017**

1. **INTENSIFYING VOLATILITY**
   Volatility is the new normal. Geopolitical instability, terrorism, Brexit, and stalled trade deals will all increase a pervasive sense of uncertainty in the global economy.

2. **CHINA’S COMEBACK?**
   China’s fundamentals, including growth of the middle and upper classes, remain strong and the government’s new fiscal policies are expected to improve conditions in 2017, but uncertainty remains.

3. **URBAN ENGINES**
   City-based strategies trump country-based strategies: a new class of rapidly growing wealthy cities in newly influential markets are becoming central to the evolution of fashion.

4. **SHREWDER SHOPPERS**
   Working harder to keep up with smarter shoppers: “always-on” consumers are becoming ever more sophisticated, more technology-driven, and harder to predict.

5. **GENERATION CORRELATION**
   Opportunities to serve the young and the old better: fashion companies should consider how to fine-tune and diversify the way they approach both retired and millennials consumers.

6. **THE WELLNESS DIVIDEND**
   Feeling good is the new looking good: more fashion players can start profiting from the wellness movement rather than competing with it.

7. **CHANGING THE RHYTHM**
   Disruptions to the fashion cycle: expectations set by the faster pace of fashion and consumer desire for instant gratification must be addressed to deliver fashion immediacy.

8. **ORGANIC GROWTH**
   Investing more to nurture local clientele: 2017 has the potential to be the year of organic growth based on deeper relationships with existing clients rather than geographic, channel, and store network expansion.

9. **UPSTREAM TECHNOLOGY**
   Digital innovation goes behind the scenes: digitisation is a key to supply-chain efficiency, lower procurement costs, and enhanced sourcing opportunities.

10. **OWNERSHIP SHAKE-UP**
    Emotionless reappraisal of brand portfolios: fashion conglomerates can be expected to further intensify their focus on big brands, creating space for other brands and industry outsiders such as private equity and family owners to acquire targets.
I. INDUSTRY REVIEW 2016
“Across all market segments, product categories, and geographies, the industry has been shocked by tremors in the global macroeconomic and geopolitical sphere, largescale shifts in consumer behaviour, and intensifying business pressures to produce more for less—less time, less money, and less effort.”

This has been one of the hardest years the fashion industry has ever experienced. Across all market segments, product categories, and geographies, the industry has been shocked by tremors in the global macroeconomic and geopolitical sphere, largescale shifts in consumer behaviour, and intensifying business pressures to produce more for less—less time, less money, and less effort.

Indeed, the prevailing business sentiment amongst fashion industry insiders reflects the challenges of managing in this complex environment. According to the BoF-McKinsey Global Fashion Survey, 67 percent of respondents—a mix of top fashion executives, creatives, investors, and other industry insiders—believe that conditions for the fashion industry have become worse over the past 12 months (Exhibit 2). Not only are they overwhelmingly pessimistic about the year’s performance, but the top three words they selected to describe the industry today are: uncertain, changing, and challenging (Exhibit 1).
This is in part due to the wide range of challenges the industry has faced in 2016. Top of the list of survey respondents’ worries were volatile shifts in the global economy, followed by competition from online players and decreasing foot traffic, and the speed of changing consumer preferences (Exhibit 3). In addition, businesses were concerned about both their top and bottom lines, with margin erosion from increased discounting and a general slowdown of sales growth this year. The last group of concerns centred on the increased speed to market and changes in the fashion cycle seen in 2016.

All this notwithstanding, the industry remained positive about growth opportunities, highlighting digitisation and e-commerce as by far the single biggest opportunity of 2016. Interestingly, while some businesses saw increased speed to market as an industry challenge, others saw “see-now, buy-now” as an excellent new opportunity. Finally all market shifts result in winners and losers—and those smart enough to master this time of unprecedented change have the best chance to emerge as winners in the coming year.
2016 YEAR IN REVIEW: FASHION INDUSTRY TRENDS

GLOBAL ECONOMY

Age of uncertainty
01. Geopolitical and economic instability intensifies, raising concerns about the impact of destabilising forces such as terrorism, growing volatility and uncertainty on the fashion industry

China interrupted
02. Chinese growth hits a soft patch: a stock market dip and real estate concerns have decelerated Chinese growth, and shifted attention to India, Turkey, and other high-growth markets

ConSUMER SHIFTS

Discount culture
03. Promotions and discounts are the new normal: Consumers have come to expect frequent discounts and promotions, buying less and less at full-price

Consumer kinship
04. New customer lifestyles come into focus: Emerging consumer tribes are driven by casualisation, inclusivity and active lifestyles, giving rise to athleisure, genderless, plus-size and modest wear fashion

Digital upgrade
05. The fashion industry gets more proficient with the digital realm: Digital platforms and strategies become more prevalent, integrated and sophisticated, with e-commerce rising, pure-play brands emerging, and brands engaging with consumers through virtual reality

THE FASHION SYSTEM

System breakdown
06. Fashion’s fragile system hits a breakdown: The fashion industry faced a year marked by low sales growth, price volatility and overstocking

Cost cutting
07. It’s getting harder to reduce costs: Sourcing won’t solve the cost problem any longer; more companies are turning to restructuring, job cuts, and even store closures

Instant gratification
08. “See-now, buy-now” adds to channel pressures: New cycle models are promising immediate consumer gratification, from off-the-runway fashion to instant delivery

A creativity crisis
09. The accelerated pace of fashion industry cycles prompts a creativity crisis: More collections and shorter design cycles are leading to high turnover among creative directors, and putting strains on the creative process

Responsible innovation
10. Ethical innovation offers a way forward: Consumers and brands have prioritised sustainable fashion, which is transforming product design and manufacturing

67% of executives believe that economy will worsen in 2016

19% Became Better

14% Remained the Same

67% Became Worse

Chinese GDP continues to slow-down in 2016

Number of full-price stores in the US and Canada lower than discount stores.

More people wearing casual clothes - Growth of sales of sport-inspired apparel 5x higher than general Clothing in 2016

E-commerce luxury fashion sales will increase fourfold from 2010 to 2020

Sales growth lower today than 5 years ago - e.g. Clothing y-o-y growth: 1-2% in 2016 vs. 8% in 2011

Throughout the year, major fashion companies announced programmes to reduce headcount, close stores, and review their processes

Lead time reduction from 6 months to 0. Lead time from catwalk to shopping bag eliminated

~30 high-profile creative director rotations

More than 65% of emerging market consumers actively seek sustainable fashion versus 32% or less in mature markets

E-commerce luxury fashion sales will increase fourfold from 2010 to 2020

The State of Fashion 2017

Google results “fashion restructuring”

Emerging Markets

65 percent

Mature Markets

32 percent
“Fashion purchases are often emotional ones, and if consumers are feeling uncertain or scared, they are less likely to buy. Many fashion players are working to develop the agility they need to respond to short-term changes, such as abrupt drops in demand that occur when consumers stay away.”

Global disruptions caused by political conflicts, terrorism, and financial crises have made the world more volatile and uncertain. Only one thing is certain: instability is here to stay. According to McKinsey’s Global Executive Survey among over 1,600 global CEOs, concerns about the threat of terrorist attacks, the slowdown of China’s economic activity, geopolitical instability, and the exit of one or more countries from the Eurozone have increased over the past year (Exhibit 4). Terrorism provides an example of how instability can affect the entire
value chain for the fashion industry. Not only have sourcing regions suffered from attacks in the past, but fears of terrorist activity can keep shoppers out of certain areas or discourage tourists from visiting destinations that depend on them as consumers. For much of the year, the outcome and impact of the recent US election was the main topic of speculation.

As a fast-moving, globally connected industry, fashion is uniquely exposed to this dynamic. Fashion purchases are often emotional ones, and if consumers are feeling uncertain or scared, they are less likely to buy. Many fashion players are working to develop the agility they need to respond to short-term changes, such as abrupt drops in demand that occur when consumers stay away.

Volatility takes many forms. Currency has been more volatile in 2016 than it was on average for the past five years. Meanwhile, a study from the McKinsey Global Institute (MGI) shows global debt has risen faster than GDP. Many factors are continuing to amplify these trends. For example, the world is increasingly interconnected: by 2020 MGI expects some 940 million online shoppers to spend almost $1 trillion on cross-border e-commerce transactions. Industrialisation and urbanisation in emerging economies, aging populations in established markets, and new technologies further complicate the current environment.

As highlighted by the BoF-McKinsey Global Fashion Survey, a key topic of discussion over the past year has been the economic slowdown in China, which has been one of the key growth markets for fashion since the 2008 financial crisis. Chinese GDP growth has slowed to 6.7 percent this year, from 70 percent in 2015 and 10.0 percent in 2010. While this slowdown is not severe, it is notable all the same given the absolute size of this market. What makes 2016 noteworthy is the combination of the CSI 300 Index turbulence early in 2016, and the oversupply of apartment buildings and other real-estate issues that have emerged to cloud the investment outlook in China. Moreover, according to McKinsey’s 2016 China Consumer report, which surveyed 10,000 Chinese consumers, shopping patterns are changing fast: Chinese consumers are becoming more selective about their spending, allocating more of their income to lifestyle services and experiences, and trading up from mass products to premium products.

While China remains a large and important market, these headwinds are decreasing sales growth and therefore shifting the spotlight to other emerging markets, where consumers are still improving living standards at a higher pace. FashionScope’s projected growth this year compared with annual growth for the past five years shows that the highest-growth countries are expected to be India and the United Arab Emirates but lag far behind in size compared to China and the United States (Exhibit 5). The size of the fashion industry in some of these countries is smaller, but there are still interesting opportunities for growth, particularly compared with other emerging countries where foreign-exchange fluctuations and economic slowdowns have taken their toll on consumer spending, such as Brazil and Russia.
CONSUMER SHIFTS

03. Discount culture

In 2016, the consumer landscape for fashion also saw significant shifts. Naturally, the increased economic and geopolitical uncertainty led to a decline in consumer and fashion spend across the board. Not only are consumers demanding more customised and personalised fashion, but they are also increasingly expecting it at lower prices. In particular, the North American market continues to be characterised by its high share of off-price sales. So far in 2016, off-price shoppers account for 75 percent of apparel purchases across all channels, and some traditional retailers now have more outlet stores and discount stores than full-price shops. This focus on promotions and discounts is, moreover, becoming increasingly prevalent in other markets, such as China—where outlet malls are booming, and set to double in number by 2020—and in Europe, where, for example, there are now six mark-down periods scheduled across the year in the United Kingdom. Similar trends are playing out in Germany and other EU countries. While such tactics are useful to drive footfall in the short-term, they are generally unhealthy for fashion companies, as mark-downs and promotions eventually lead to a “race to the bottom” that shrinks profit margins and eats away at brand value.

04. Consumer kinship

Consumer lifestyles also continued to evolve, and this year saw a marked rise in fashion companies responding to these lifestyles with tailored offers and collections. In particular, four fashion categories surged in 2016 in response to new or growing consumer lifestyles. First, athletic wear has grown significantly in response to consumers’ push for casualization, having grown at 10 percent over the past ten years, according to the McKinsey Global Fashion Index, while apparel and footwear overall were growing at 4 percent. Second, genderless fashion collections have emerged for those unwilling to conform to the traditional male- or female-only clothing staples. Zara launched their first “genderless” collection in March this year, following earlier moves by the likes of Selfridges to reconfigure its gender departments the year before. Third, the focus on plus-size fashion is at an all-time high, with the number of mentions of “plus-size” in the fashion press so far in 2016 tripling versus last year. Fashion brands are rapidly responding to a cultural shift towards body positivity and a growing appreciation of curvy figures, by designing specifically for a larger range of sizes rather than just expanding their size range as an afterthought. Fourth, modest wear has also gained in prominence in the past year, highlighting the unique needs and growing importance of devout Islamic consumers, especially from the Middle East and South East Asia; this has been particularly led by brands such as Uniqlo and Dolce & Gabbana which unveiled hijab and abaya collections in Europe at the beginning of this year. According to the Global Islamic Economy report, the modest-wear market alone is forecast to be worth $327 billion by 2020. Not only are mainstream brands becoming more aware of this opportunity but the market itself is expanding.

Taken as a whole, these markets may well create sizeable new opportunities for mid-market and luxury players. More importantly they all highlight an overarching consumer lifestyle need for personalisation and customisation. Brands have started to respond to that in innovative ways, leveraging consumer data to offer digital personalised shopping services at a mass-market level—something that just a few years ago was exclusively the preserve of high-end luxury players.
THE FASHION SYSTEM

Part of the reason why consumers have been able to seek discounts and promotions has been their uptake on e-commerce and digital tools, which has created price transparency across brands and regions. Over the past few years, consumers have grown more comfortable with digital interactions and buying online. While online sales are growing at a steady pace—even in luxury from 3 percent of sales in 2010 to 12 percent of sales in 2020—one of the challenges fashion companies face is striking the right balance between online and in-store assortments and, of course, pricing. In 2016, digital platforms and strategies became more prevalent, integrated, and sophisticated. One such example is Amazon.com, which has decided to enter the fashion business as a strategic choice, given its existing competencies. In February it launched seven of its own pure-play brands sold exclusively on its site. This adds further pressure to store-based retailing, which continues to ebb away, slipping particularly badly in the department store category.

While e-shopping is certainly quickening the competitive metabolism of the fashion industry, 2016 saw a surge in the innovative use of digital tools to engage with consumers in a new way, and drive sales. For instance, virtual reality (VR) headsets are introducing the industry to the immersive world of three-dimensional fashion shows. During the September 2016 New York Fashion Week, 13 shows in all were broadcast in 360-degree VR, including collections from Prabal Gurung, Rebecca Minkoff, and Erin Fetherstone. Dior and Tommy Hilfiger are just two of the brands using VR in stores to transport headset-clad shoppers to prerecorded catwalk shows. While VR is currently a novelty, many industry insiders believe it holds immense promise as a new medium for immersive storytelling in future.

05. Digital upgrades

06. System slowdown

Because of today’s volatile global economy and an increasingly demanding consumers, significant pressures are being introduced to an inherently fragile fashion system. Since the financial crisis of 2008 and 2009, industry sales have slowed across every significant category, from clothing and footwear, to bags and luggage, watches and jewellery. As shown by McKinsey’s Global Fashion Index projections for 2016, there are early signs some of these categories are staging a mild recovery (Exhibit 12).

Increasing price and demand volatility have also complicated the picture. In comparison with the price index of consumer goods, the price index for apparel fluctuates more strongly across countries throughout the year as brands adjust to demand. Inevitably, that uncertainty in demand places more inventory at risk. In the first half of this year, for example, the US retail industry’s inventory-to-sales ratio hit a new high since 2009. This is not the healthiest metric for US retailers, so this point bears close monitoring.
Experimenting with fashion cycles is not new. The pace of fashion has accelerated greatly in recent years, with many brands increasing the number of collections—now averaging six per year—and ratcheting down the lead times for pieces, even at the luxury end of the spectrum. Running counter to cost-reduction measures, fashion companies are attempting to increase sales by responding more rapidly to consumer demand. Though the rapid lifecycle of mass-market collections in the fast-fashion category is well known, it is now reaching the luxury and affordable luxury segments, putting additional pressure on supply chains and distribution management in 2016. This shows no sign of abating: whether feeding instant gratification or building out delivery channels, brands have pushed boldly into the digital era where customers globally have virtual access to fashion shows and buy collections at the click of a button. Some luxury brands, led by Burberry, Tom Ford, and Tommy Hilfiger, have experimented with the “see-now, buy-now” approach, extending it all the way to the runways of September’s fashion shows. Others—both luxury and mass-market brands—are experimenting with same-day, or in specific markets, even one-hour delivery. The jury is still out on whether these new approaches will win over the most demanding customers while also maintaining margins and profitability over the longer term.

09. A creativity crisis

Experimenting with fashion cycles is not new. The pace of fashion has accelerated greatly in recent years, with many brands increasing the number of collections—now averaging six per year—and ratcheting down the lead times for pieces, even at the luxury end of the spectrum. Now, however, this combined with other pressures has led to an unprecedented level of turnover among creative directors for several major luxury and fashion brands, with designer exits and arrivals at Christian Dior, Lanvin, Calvin Klein, Saint Laurent, Ermenegildo Zegna, Berluti, Balenciaga, Oscar de la Renta, Brioni, and Carven, amongst others. At the same time, the reduced time between cycles has led to an increase in alleged plagiarism, as the pressure to create new collections is as much a concern for mass-market players as it is for luxury brands. Even fast-fashion companies are adjusting their processes to accommodate even shorter design cycles.

Another form of pressure bearing down on creativity comes from the way new designs are sanctioned for production. Fashion designers are being encouraged to take more input from the buying and merchandising teams to react to what is selling rather than defining what will sell through forward-looking design risks.

How the various pressures on fashion players will reach equilibrium remains, for now, an open question.
10. Responsible Innovation

Finally, if 2016 was a year of opposing forces clashing, the push for sustainability was one common thread across the industry. Sustainability is becoming an important new driver of consumers’ purchasing decisions. In emerging markets, for example, more than 65 percent of consumers actively seek out sustainable fashion. Global population growth, climate change, land and water scarcity, and the increasing cost of key resources have a direct impact on the bottom line of every company. The speed of fast fashion amplifies these issues and magnifies five fundamental problems for the fashion industry: high water consumption, discharge of hazardous chemicals, violation of human rights, labor standards, greenhouse-gas emissions, and waste production. For fashion companies, responding to these issues has become an area of potential differentiation and creative inspiration underscored by the theme for the 2016 Copenhagen Fashion Summit, “Responsible Innovation.”

A number of cross-industry initiatives has highlighted the potential for identifying more sustainable ways to work across a product’s whole lifecycle. For several years now some of the largest fashion companies, such as H&M and Nike, have publicly set sustainability goals, and established awards to promote collaboration and set standards for closed-loop fabric imports and other forms of material innovation. This year, Nike unveiled its European Logistics campus in Belgium, founded on responding to sustainability challenges and maximising performance while minimising footprint. This is an area that offers real benefits for fashion brands, whether mass-market or luxury, as all companies are under pressure to increase transparency on inputs and reveal more of the pedigree of their products.
MOSCOW, Russia — For Alexander Pavlov, the decision to dramatically cut prices at Russia’s famed luxury department store was a risk worth taking. Though it was at a time when local customers were tightening their belts, Tsum’s general director saw an opportunity where others did not.

Over the last few years, Russia has witnessed a new kind of tourist hoping to take advantage of the weak rouble — one of the world’s worst-performing currencies over the 2014-15 period. The Russian economy has been suffering due to a combination of factors including low oil prices and international sanctions resulting from geopolitical tensions with the West.

“After barely avoiding a recession in 2014 — with 0.7 percent growth — the economy contracted by 3.7 percent in 2015,” says Alex Sukharevsky, a Moscow-based senior partner at McKinsey & Company. “The recession continues into 2016, but it is expected to be limited to 1-2 percent with forecasts improving as oil prices rebound. Most analysts expect a return to modest growth in 2017 at around 1 percent.”

Official data released in August 2016 by Rosstat, Russia’s statistics service, showed that Russians’ real disposable incomes had fallen at the fastest pace in seven years. Many Russian consumers have been struggling to maintain the lifestyles to which they became accustomed in the boom years.

“Consumer confidence experienced a double-dip decline in 2014-16, although the drop has been more modest than during the 2009 crisis. Overall retail sales were down 10 percent in 2015 and keep decreasing in 2016,” Sukharevsky adds.

Yet one silver lining in the country’s otherwise dim market environment is that Russia has emerged as a more affordable place for foreigners to shop. Typically, Russian retailers are at a disadvantage because of euro-denominated designer fashion and heavy import duties. This can amount to luxury goods being 20 to 30 percent more expensive than the same items at retailers in France or Italy, depending on product category.

However, by the middle of 2016, the rouble was trading at half the value it was to the dollar two years earlier. For affluent shoppers willing to travel from abroad, unlikely though it seemed, Russia suddenly had the potential of a bargain hunter’s paradise.

If they were fast and bold enough in their approach, Russian retailers could now finally offer globally competitive prices to help compensate for the shortfall in domestic spend. Pavlov wasted no time adjusting Tsum’s prices down to make the department store even more attractive to international customers hungry for anything from Armani to Zegna.

After slashing the prices of handbags, Pavlov says the company soon tripled sales of its accessories business which led him to cut prices on shoes and finally on ready-to-wear. The risk he took to lure in foreign shoppers by discounting paid off, he says, resulting in an estimated 40 percent year-on-year sales increase for Tsum between 2015 and 2016.

What makes Tsum’s 2016 business illuminating is...
not only its role in helping to make Russia an unexpected international shopping destination. It is the fact that many of those who Pavlov attracted were from China.

After we lowered our prices, we started advertising inside airports and airplanes and we connected later with them on social networks so we were able to increase sales with the Chinese by five-fold,” says Pavlov. “For Asian tourists in particular, it is often easier to come to Moscow rather than travel to Europe,” he adds, referring to the shorter flight time from cities in China to Moscow compared to destinations in Western Europe.

The Chinese spent around $1 billion just in Russia in 2015 and 60 percent of it was on shopping, according to various estimates. Rosstat’s data reveals that the number of Chinese tourists increased 65 percent year-on-year from 2014 to 2015. It counted 677,619 of them in 2015, but this figure does not include Chinese visitors coming for business or other purposes besides tourism. Therefore the total number of Chinese visitors to Russia was actually twice as high.

The positive trajectory continued in the first half of 2016. In fact, a Federal Agency for Tourism tally of all inbound tourists to Russia revealed something interesting. While the total number of foreign visitors was down 5 percent year-on-year, Chinese visitors were up 9 percent, earning them the rank of fifth highest out of all nationalities visiting Russia.

The Rise of ‘Red Tourism’
The Chinese view Russia as an exotic yet familiar enough destination, a place where tourists are emboldened by the weak rouble, visa-free group travel and a growing nostalgia for visiting communist sites beyond those in China.

A peak in so-called ‘red tourism’ has made sites such as Karl Marx’s house in Germany and Vladimir Lenin’s birthplace in Russia popular among a certain profile and generation of Chinese travellers. Cuba is also expected to profit from this phenomenon now that Air China opened a flight from Beijing to Havana.

But Russia, as the successor state to the Soviet Union, is by far the destination with the greatest diversity of perceived landmarks and memorabilia outside China itself. “The backdrop of an historic alliance between the two countries certainly helps. In 2015, the neighbours signed a $25 billion deal to boost flagging trade and Chinese lending to Russian companies. As part of an agreement to deepen economic cooperation between the two, they also decided to open more ‘red tourism’ routes in the future.

Growing Chinese tourism is one way Tsum hopes to continue to defy the downturn in Russia’s economy. Pavlov says he expects the number of tourists to increase by 3 to 5 times in 2017 and he hopes to convert as many of them as he can to become Tsum shoppers.

However, critics consider this revenue stream precarious at best, as it is predicated on a continually weak rouble against other major currencies that make up the currency basket behind the Chinese yuan. Nevertheless, Pavlov nevertheless remains optimistic.

“After we lowered our prices, we started advertising inside airports and airplanes and we connected later with them on social networks so we were able to increase sales with the Chinese by five-fold.”

He aims to grow the number of Chinese customers to 30 percent in the next two to three years, from the current 9 percent that Chinese account for in terms of overall sales at Tsum’s Moscow flagship. At its sister department store DLT in St Petersburg, which like Tsum is part of Russia’s largest luxury retail group Mercury, the number is even greater. There, the Chinese account for 22 percent of overall sales, he says.

“We want to increase awareness in China and make Chinese customers know that Russia is the best place to travel and shop in Europe,” Pavlov says. “We’re very China-friendly. We have Chinese navigation in both department stores, department store guides in Chinese, Chinese speaking staff, special offers for our foreign customers, and we’ll keep on improving our loyalty programme for them too.”

The company is working closely with Russian and Chinese tour operators, as well as the Russian tourism board to promote its stores to Chinese tourists.

“Tsum is definitely taking advantage of the trend,” says Christian Kwok, art director at Vogue Russia, who has noted the increase in Chinese visitors. “They have already put up signs in Chinese indicating that tourists are welcome to purchase goods with a similar price to Milan and Paris, and even a Chinese sign in the parking lot. There was only Russian and English before.”

The company is also offering a special discount to overseas tourists. Kwok observes, to perhaps make up for the current lack of a duty-free shopping regime in Russia — though there are reports that the country may introduce one in 2017.

Another draw for some Chinese is the perception of security in Russia. Moscow is increasingly considered to be a safe option compared to cities in Western Europe, says Kwok, noting that past terror attacks in France and Belgium remain a concern for many Chinese travellers.

It is important to note that Russia still attracts comparatively few Chinese shoppers when seen in the context of those travelling to retail hotspots in Europe, South Korea, Hong Kong and Japan.

However, Pavlov stresses that even in relatively small numbers, the Chinese have already been a welcome relief for luxury fashion players like Tsum operating in a sector that is clearly struggling in Russia. And he remains as enthusiastic about their potential in the coming years as he does about his plan to attract more through his doors.

Tsum Store in Moscow Bloomberg / Getty Images
The fashion industry is one of the largest and most value-creating industries in the world—above media, transportation, and even commercial and professional services—yet its performance tracking remains largely fragmented and is not reported systematically across market segments, product categories, operating models, or regions. Although not directly comparable, if the fashion industry were a country, its market size would equal the seventh-largest GDP in the world, before the likes of India and Italy. The McKinsey Global Fashion Index (MGFI) was developed to fill the gap in understanding around this ecosystem and provide a global and holistic benchmark for the entire fashion industry—from luxury to discount players. The index is composed of more than 450 public and private companies, representing almost 50 percent of the global market in terms of its size; the companies included are a representative sample of companies across market segments, product category focus, geography, operating model, and sales.

Whereas other industry performance indices focus on particular segments, product categories or regions, MGFI looks at the entire industry as a whole is important because all the segments are interconnected, and consumers shop across the whole range, so when one part of the ecosystem changes this will affect all the other parts. MGFI tracks three key performance variables—sales, operating profit, and economic profit—going back to 2005. In addition to the top and bottom line, the index also tracks economic profit (s. glossary) as a measure of value creation to determine how much each company had to invest to generate its performance. These variables are further broken down for six price segments: luxury, affordable luxury, premium/bridge, mid-market, value, and discount. The index covers six product categories: clothing, footwear, athletic wear, bags and luggage, watches and jewellery, and other accessories. All of these categories have different dynamics across different markets so granularity is vital.

Given the number of opinions and sources with varying definitions on market segments, each
Despite the wider economic slowdown in 2016, fashion has been a key value-creating industry for the world economy. Over the past ten years, economic profit has outpaced sales growth, growing at 8 percent per year. This has been driven both by margin increases and by increased capital efficiency. Nonetheless, most of the industry value is captured by a small percentage of players, with the top 20 percent creating 100 percent of total economic profit and the bottom 20 percent contributing an economic loss of 18 percent (Exhibit 11). Among the top 20 percent are: Adidas, Burberry, Chow Tai Fook, Richemont, Fast Retailing, Hermès, H&M, Inditex, L Brands, Luxottica, LVMH, M&S, Michael Kors, Next, Nike, Nordstrom, Pandora, Prada, Ralph Lauren and TJX. Fashion is essentially a winner-takes-all industry—a handful of companies that make the right decisions and execute flawlessly are the ones that reap the lion’s share of the rewards.

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**Exhibit 10** Throughout the report, we refer to 6 fashion market segments, which have been created using a price index across a wide basket of goods and geographies.

<table>
<thead>
<tr>
<th>PRICE</th>
<th>SEGMENTS</th>
<th>BRAND EXAMPLES</th>
<th>BASKET EXAMPLE Men’s jeans¹</th>
</tr>
</thead>
<tbody>
<tr>
<td>High</td>
<td>Luxury</td>
<td>Tom Ford</td>
<td>&gt;$315</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Chanel</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Affordable luxury</td>
<td>Tory Burch</td>
<td>$156–$315</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Michael Kors</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Premium / Bridge</td>
<td>Nike</td>
<td>$96–$155</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Esprit</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Mid-Market</td>
<td>Zara</td>
<td>$41–$95</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Topshop</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Value</td>
<td>TJ Maxx</td>
<td>$21–$40</td>
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<tr>
<td></td>
<td></td>
<td>boohoo.com</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Discount</td>
<td>Primark</td>
<td>&lt;$20</td>
</tr>
<tr>
<td></td>
<td></td>
<td>George at Asda</td>
<td></td>
</tr>
</tbody>
</table>

¹ Plain men’s straight/slim cut jeans (no rips). Exemplary 1 out of 9 total items used in basket calculation.

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**Exhibit 11** Over the past decade, the top 20% of fashion companies created 100% of the economic profit for the industry.

- **Top 20%**: 21-80%
- **Bottom 20%**: 18%
- **-18%**

**SHARE OF COMPANIES**

**ECONOMIC PROFIT SHARE**


Despite the wider economic slowdown in 2016, fashion has been a key value-creating industry for the world economy. Over the past ten years, economic profit has outpaced sales growth, growing at 8 percent per year. This has been driven both by margin increases and by increased capital efficiency. Nonetheless, most of the industry value is captured by a small percentage of players, with the top 20 percent creating 100 percent of total economic profit and the bottom 20 percent contributing an economic loss of 18 percent (Exhibit 11). Among the top 20 percent are: Adidas, Burberry, Chow Tai Fook, Richemont, Fast Retailing, Hermès, H&M, Inditex, L Brands, Luxottica, LVMH, M&S, Michael Kors, Next, Nike, Nordstrom, Pandora, Prada, Ralph Lauren and TJX. Fashion is essentially a winner-takes-all industry—a handful of companies that make the right decisions and execute flawlessly are the ones that reap the lion’s share of the rewards.
Overall industry performance
The business sentiment captured above is also borne out by the actual outcomes we expect in 2016. After years of stable growth rates, the industry is expected to face a major slowdown in 2016, dipping from 5.0 percent growth in 2015 to 2.0–2.5 percent growth in 2016 (Exhibit 12). As the McKinsey Global Fashion Index shows, this is the slowest growth fashion has seen in the past decade, a period during which the industry has consistently outpaced global GDP growth, having recorded 5.5 percent between 2005 and 2015 (Exhibit 7). The 2016 slowdown has affected all market segments and product categories across the board. Nonetheless, fashion is still outperforming global GDP growth at 2.0–2.5 percent though not at its historical excess of one to two percentage points. The negative impact on sales across all segments is the result of a volatile global environment, reduced tourism, and the economic slowdown in China. Speculation and uncertainty over the impact of the outcome of the election in the United States could further impact the critical holiday shopping season if consumer sentiment dampens.

In line with slowing sales growth, there has also been no margin improvement: the amount by which revenues exceed costs is down by up to 0.5 percentage points. Over the past three years, profitability growth has tailed off in spite of continued sales growth, expected to deliver a profit margin of only 9.0–9.5 percent in 2016. This is the result of wider sales growth slowdown, rising costs, and also lower pricing power by fashion companies, due to increased competition, price transparency and rampant discounting.

The lack of significant differences in performance of product categories for the most part suggests that the main driver of sales and profit is the positioning of each brand and the value proposition it communicates to consumers.

Market segment performance
In terms of market segments, the biggest winners in 2016 have been affordable luxury and value, which have outperformed all of the other segments by 1.0–1.5 percentage points (Exhibit 9). This is consistent with their growth over the past three years, which has seen a 6 percent compound annual growth rate (CAGR) for value and 9 percent for affordable luxury, the highest rate for any of the segments since 2013.

Affordable luxury players benefited from consumers trading down from luxury, particularly amongst Chinese consumers. In North America especially, the affordable luxury segment’s growth was driven by new players operating with the positioning of designer quality at affordable prices. However, their profit margins are expected to continue to decline, especially after 2016, due to a pricing arbitrage disadvantage across geographies and fluctuating foreign exchange rates.

The value segment also continued to grow in 2016, particularly as a consequence of large global players expanding geographically. As indicated by the MGF1, the only segments that have seen sales and profit margins increase are discount and value players, which have increased their economic profit over the past five years and created significant value for the industry. With its clearly defined value proposition, the value segment has been taking share from discount this year. Moreover, supermarkets and hypermarkets selling items at discount prices are also suffering, with many of these closing this year; accordingly this has led to mixed results and a neutral projection for this segment.

The biggest losers, however, have been the luxury and mid-market segments. Hit by challenges in the past decade’s most-bankable growth markets, such as China and the United States, lower pricing power by fashion companies, due to increased competition, price transparency and rampant discounting.

The lack of significant differences in performance of product categories for the most part suggests that the main driver of sales and profit is the positioning of each brand and the value proposition it communicates to consumers.

Product category performance
In 2016, athletic wear is projected to grow at 8.0–8.5 percent—more than twice as fast as any other category. This is consistent with its 10 percent CAGR of the past decade, driven by consumers’ more active lifestyles, the rise of “athleisure”, emerging brands in the high-end segments, and product innovations. As athletic wear continues to grow, it will become a category with the ability to compete on equal terms with clothing and footwear, particularly in the mid-market and premium segments. In line with the general slowdown of the luxury segment, subdued growth of just 1.0–1.5 percent is expected for clothing and footwear.

Over the past decade, bags and luggage have been a consistently impressive source of growth, at rates often as high as 10.0 percent. This growth is slowing rapidly: in 2016, it is forecast to be down to 3.5–4.0 percent. This development is due to former luxury consumers trading down to cheaper options, which puts pressure on profit margins.

Similarly, although watches and jewellery are expected to maintain a constant growth of 1.5–2.0 percent in 2016, this is a slowdown from the previous decade. According to MGF1, compounded annual sales growth here between 2005 and 2015 was the highest of any category at 11.0 percent. The largest impact is due to the shift on luxury spending, particularly for watches. Watches have suffered especially from reduced gifting in China, decreased tourism over the past year, and competing wearable technology gadgets. The same is true for higher-end jewellery, so actual growth in this category will come from mass offerings.

Exhibit 12 We expect fashion industry growth will slow to 2-2.5% in 2016 – slowest in Luxury at 0.5-1%, fastest in Athletic wear at 8-8.5%

<table>
<thead>
<tr>
<th>GLOBAL FASHION SALES GROWTH 2015-2016</th>
</tr>
</thead>
<tbody>
<tr>
<td>FASHION INDUSTRY GROWTH</td>
</tr>
<tr>
<td>-------------------------</td>
</tr>
<tr>
<td>GLOBAL</td>
</tr>
<tr>
<td>SEGMENT</td>
</tr>
<tr>
<td>Luxury</td>
</tr>
<tr>
<td>Affordable luxury</td>
</tr>
<tr>
<td>Premium/Bridge</td>
</tr>
<tr>
<td>Mid-Market</td>
</tr>
<tr>
<td>Value</td>
</tr>
<tr>
<td>Discount</td>
</tr>
<tr>
<td>CATEGORY</td>
</tr>
<tr>
<td>Clothing</td>
</tr>
<tr>
<td>Footwear</td>
</tr>
<tr>
<td>Athletic wear</td>
</tr>
<tr>
<td>Bags and luggage</td>
</tr>
<tr>
<td>Watches and jewellery</td>
</tr>
<tr>
<td>Other accessories</td>
</tr>
</tbody>
</table>

II. INDUSTRY OUTLOOK 2017
“After a slowdown in 2016 marked by volatility and uncertainty, our analysis suggests a slight recovery next year, where the industry may see 2.5–3.5 percent growth. However, a significant number of fashion heavyweights—especially in the high-end segments—do not foresee any kind of recovery in 2017.”

Exhibit 13 40% of survey respondents believe conditions for the fashion industry will improve in 2017

Fashion business sentiment for next 12 months
% of respondents (vs. % sentiment for last 12 months)

<table>
<thead>
<tr>
<th>Question</th>
<th>How do you expect conditions for the fashion industry to develop over the course of the next 12 months?</th>
<th>Source: BoF-McKinsey Global Fashion Survey, September 2016</th>
</tr>
</thead>
<tbody>
<tr>
<td>Will get better</td>
<td>40% (36% in 2016)</td>
<td>37% Will get worse (67% in 2016)</td>
</tr>
<tr>
<td>Will get worse</td>
<td>37% (67% in 2016)</td>
<td>40% Will get better (36% in 2016)</td>
</tr>
<tr>
<td>Will remain the same</td>
<td>23% (13% in 2016)</td>
<td>23% Will remain the same (13% in 2016)</td>
</tr>
</tbody>
</table>
In terms of sales our analysis suggests that the fashion industry will grow 2.5–3.5 percent in 2017, up from 2.0–2.5 percent in 2016 (Exhibit 14). While this represents a slight recovery, it is not yet at the historical 5.5 percent annual growth it enjoyed for many years. Driven by the factors above, and in particular a rebalancing environment in China and North America, growth in 2017 will likely be in line with GDP growth expectations. Given the ongoing impact of political changes across countries and recent election in the United States, world GDP forecasts and other macroeconomic indicators such as oil and commodity prices are highly speculative. Due to continuing global challenges, fashion will not again in 2017 outpace GDP growth by multiple percentage points, as it did over the past decade.

**Market segment performance**

In 2017, we expect general growth improvements for all segments except discount. The probable winners will continue to be the value and affordable-luxury segments, which we believe will see 3.0–4.0 percent and 3.5–4.5 percent sales growth, respectively. Both segments should benefit from shifts from other segments, as more consumers trade down from luxury to affordable luxury and trade up from discount to value.

Although growth improvement is anticipated for the luxury and mid-market players, they are still expected to underperform in terms of both overall industry growth and their own historical growth. Anticipated growth rates in 2017 for the luxury and mid-market segments are 1.5–2.5 percent, approximately half the rate they achieved from 2005 to 2015 (6.0 percent CAGR for luxury, and 5.0 percent for mid-market). Nevertheless, this is still an improvement over 2016. Both segments should benefit from the rise of fast-growing e-commerce players, particularly in the mid-market. Growth could also be further impacted by new economic policy in the United States, including international trade and taxation.

However, we expect the discount segment to continue to grow at 2.0–3.0 percent for another year—the slowest-growing of all segments—and below historical growth levels. Some players will almost certainly struggle to grow and defend their market share against value players and discounters offering higher-quality products at low prices, adopting their offer to reach consumers through multiple channels. Others, nonetheless, will likely continue to grow by expanding their geographic footprint, store networks, and channel offerings. Though growth between 2016 and 2017 will not improve, some players should be able to counter the pressures on the discount segment exerted by the growing value players.

**Product category performance**

We do not expect a single hero product category in 2017, as most will grow in line with the overall industry, increasing one or two percentage points from 2016. Athletic wear is expected to remain the absolute category winner next year, maintaining sales growth of 6.5–7.5 percent, but this represents a weaker pace than in 2016. Although double-digit growth for athletic wear overall appears to be a thing of the past, its sub-category

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**Exhibit 14** In 2017, McKinsey Global Fashion Index predicts fashion industry growth will improve to 2.5-3.5%, in line with GDP but not above.

**GLOBAL FASHION SALES GROWTH 2015–2017**

<table>
<thead>
<tr>
<th>CATEGORY</th>
<th>FASHION INDUSTRY GROWTH 2015–16</th>
<th>2016–17</th>
</tr>
</thead>
<tbody>
<tr>
<td>GLOBAL</td>
<td>Total industry</td>
<td>2–2½%</td>
</tr>
<tr>
<td>SEGMENT</td>
<td>Luxury</td>
<td>½–1%</td>
</tr>
<tr>
<td></td>
<td>Affordable luxury</td>
<td>3–3½%</td>
</tr>
<tr>
<td></td>
<td>Premium/Bridge</td>
<td>2–2½%</td>
</tr>
<tr>
<td></td>
<td>Mid-Market</td>
<td>1½–2%</td>
</tr>
<tr>
<td></td>
<td>Value</td>
<td>2½–3%</td>
</tr>
<tr>
<td></td>
<td>Discount</td>
<td>2–2½%</td>
</tr>
<tr>
<td>CATEGORY</td>
<td>Clothing</td>
<td>1–1½%</td>
</tr>
<tr>
<td></td>
<td>Footwear</td>
<td>1–1½%</td>
</tr>
<tr>
<td></td>
<td>Athletic wear</td>
<td>8–8½%</td>
</tr>
<tr>
<td></td>
<td>Bags and luggage</td>
<td>3½–4%</td>
</tr>
<tr>
<td></td>
<td>Watches and jewellery</td>
<td>1½–2%</td>
</tr>
<tr>
<td></td>
<td>Other accessories</td>
<td>2½–3%</td>
</tr>
</tbody>
</table>

**Exhibit 14** In 2017, McKinsey Global Fashion Index predicts fashion industry growth will improve to 2.5-3.5%, in line with GDP but not above.

**GLOBAL FASHION SALES GROWTH 2015–2017**

<table>
<thead>
<tr>
<th>CATEGORY</th>
<th>FASHION INDUSTRY GROWTH 2015–16</th>
<th>2016–17</th>
</tr>
</thead>
<tbody>
<tr>
<td>GLOBAL</td>
<td>Total industry</td>
<td>2–2½%</td>
</tr>
<tr>
<td>SEGMENT</td>
<td>Luxury</td>
<td>½–1%</td>
</tr>
<tr>
<td></td>
<td>Affordable luxury</td>
<td>3–3½%</td>
</tr>
<tr>
<td></td>
<td>Premium/Bridge</td>
<td>2–2½%</td>
</tr>
<tr>
<td></td>
<td>Mid-Market</td>
<td>1½–2%</td>
</tr>
<tr>
<td></td>
<td>Value</td>
<td>2½–3%</td>
</tr>
<tr>
<td></td>
<td>Discount</td>
<td>2–2½%</td>
</tr>
<tr>
<td>CATEGORY</td>
<td>Clothing</td>
<td>1–1½%</td>
</tr>
<tr>
<td></td>
<td>Footwear</td>
<td>1–1½%</td>
</tr>
<tr>
<td></td>
<td>Athletic wear</td>
<td>8–8½%</td>
</tr>
<tr>
<td></td>
<td>Bags and luggage</td>
<td>3½–4%</td>
</tr>
<tr>
<td></td>
<td>Watches and jewellery</td>
<td>1½–2%</td>
</tr>
<tr>
<td></td>
<td>Other accessories</td>
<td>2½–3%</td>
</tr>
</tbody>
</table>
of athleisure is expected to continue growing at that pace through 2017. Watches and jewellery will likely see a single-percentage-point increase in growth rate in 2017 to 2.0–3.0 percent. Although conditions will improve for high-end watches and jewellery, with projected growth of 1.0–2.0 percent, the main growth driver is projected to be mass (fine, costume/silver) jewellery. Overall, the homogeneity projected across product categories makes channel strategy and clear value propositions all the more important for companies to emerge as the winner among product categories.

Sources of growth

Though more positive about industry performance in 2017 than 2016, industry players remain aware of the challenges that lie ahead in 2017. According to survey respondents, the most-pressing challenge next year will continue to be dealing with volatility, uncertainty, and the shifts in the global economy (Exhibit 15), followed by growth in sales and profitability. In addition, fashion executives continue to see competition from online players as one of their top three challenges for next year. Last, supply chain improvements, decreasing foot traffic, and the speed of the fashion cycle weigh equally on their mind as challenges to face in 2017. One the one hand, this combination of challenges underlines the pressures executives will face from the global economy, changes in consumer behaviour, and the internal workings of the fashion system. On the other hand, these challenges are countered by the opportunities they see to improve their performance through focusing on improving the customer experience, omnichannel integration, and the digitisation of the value chain.

Interestingly, in 2017 the fashion industry plans to focus on organic growth over cost

<table>
<thead>
<tr>
<th>% of executives</th>
<th>Global economy</th>
<th>Consumer</th>
<th>Fashion system</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>TOP 6 CHALLENGES</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Dealing with volatility, uncertainty and shifts in the global economy</td>
<td>16</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Sales and profitability growth</td>
<td>10</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Competition from online and pure-play players</td>
<td>9</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Supply chain improvement</td>
<td>6</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Decreasing foot traffic and offline retailing pressure</td>
<td>6</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Speed to market and the fashion cycle</td>
<td>6</td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>TOP 6 OPPORTUNITIES</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Customer engagement and improvement of channel experience</td>
<td>13</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Omnichannel integration</td>
<td>9</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Digitalisation of the value chain</td>
<td>8</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Product innovation and creativity</td>
<td>6</td>
<td></td>
<td></td>
</tr>
<tr>
<td>See now, buy now</td>
<td>5</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Improvement in China</td>
<td>3</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Question: What do you think will be the single biggest challenge and the single biggest opportunity for the fashion industry in 2017?

cutting. According to the BoF-McKinsey Global Fashion Survey, only 5 percent of business executives believe that cost alone—rather than sales—will be the key focus for increasing profits (Exhibit 16). The sentiment is that the potential to cut costs further is about to be exhausted: over recent years companies have deployed multiple levers to further reduce cost and have still had to find profits elsewhere. This seems likely to produce a renewed focus on top-line growth coupled with an emphasis on continuous performance management. Key investments for growth are expected to come from omnichannel integration, e-commerce, and digital marketing (Exhibit 17). Additionally, organic growth through improved consumer relationship management (CRM) and in-store experiences should remain key drivers in 2017. In an effort to improve profits, fashion companies will also rely on some cost-improvement levers that go beyond the low-hanging fruit, such as the standard sourcing optimisation. Instead, executives plan to focus on productivity and process improvements, which shows the maturity of sourcing as a lever for cost cutting (Exhibit 18).

In 2017, the fashion industry has the opportunity to stabilise and reset. Next year offers an opportunity for fashion companies to work hard to grow, learning from the lessons of 2016. The ten key trends for next year reflect the complex yet exciting journey the fashion industry can expect. These are derived from a variety of qualitative and quantitative analyses, desk research, expert interviews, the BoF-McKinsey Fashion survey of industry executives and the foundation of existing BoF and McKinsey research.

Exhibit 16 Only 5% executives said that they would focus more on cost improvements to improve company performance in 2017

<table>
<thead>
<tr>
<th>% of executives</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cost improvement</td>
</tr>
<tr>
<td>Combination of the above</td>
</tr>
<tr>
<td>Sales growth</td>
</tr>
</tbody>
</table>

Exhibit 17 62% of executives surveyed say they will invest in omnichannel integration, e-commerce and digital marketing in 2017

<table>
<thead>
<tr>
<th>% of executives</th>
</tr>
</thead>
<tbody>
<tr>
<td>Omnichannel integration, e-commerce, digital marketing</td>
</tr>
<tr>
<td>CRM capabilities and VIP loyalty programmes</td>
</tr>
<tr>
<td>In-store experiences</td>
</tr>
<tr>
<td>IT capacity for value chain digitisation</td>
</tr>
<tr>
<td>Expand into new product categories</td>
</tr>
</tbody>
</table>

Exhibit 18 27% of executives surveyed say they will reduce costs in 2017 by increasing employee productivity and leveraging lean processes

<table>
<thead>
<tr>
<th>% of executives</th>
</tr>
</thead>
<tbody>
<tr>
<td>Org structure and employee productivity</td>
</tr>
<tr>
<td>End to end (lean process) opportunities</td>
</tr>
<tr>
<td>Review store network</td>
</tr>
<tr>
<td>Reduce product assortment complexity</td>
</tr>
<tr>
<td>Prepare and risk assess macro geopolitical events</td>
</tr>
</tbody>
</table>

1 Responses split into 3 groups to produce pie chart


2017

INDUSTRY OUTLOOK
NEW YEAR, NEW PATTERNS

GLOBAL ECONOMY

Volatility intensifies
01.

Volatility is the new normal. Geopolitical instability, terrorism, Brexit, and stalled trade deals will all increase a pervasive sense of uncertainty in the global economy.

China’s comeback?
02.

China’s fundamentals, including growth of the middle and upper classes, remain strong and the government’s new fiscal policies are expected to improve conditions in 2017, but uncertainty remains.

Urban engines
03.

City-based strategies trump country-based strategies: a new class of rapidly-growing wealthy cities in newly influential markets are becoming central to the evolution of fashion.

CONSUMER SHIFTS

Shrewder shoppers
04.

Working hard to keep up with smarter shoppers, ‘always-on’ consumers will become ever-more sophisticated, more technology-driven, and harder to predict.

Generation correlation
05.

Opportunities to serve the young and the old better: fashion companies will need to fine tune and diversify the way they approach both retired and millennials consumers.

THE FASHION SYSTEM

The wellness dividend
06.

Feeling good is looking good: more fashion players will start profiting from the wellness movement, rather than competing with it.

Changing the system
07.

“See-now, buy-now” and other disruptions to the fashion cycle: expectations set by the faster pace of fashion and consumer desire for instant gratification must be addressed.

Organic growth
08.

Investing more to nurture local clientele: 2017 will be the year of organic growth by deepening relationships with existing clients, rather than through geographic, channel and store network expansion.

Upstream technology
09.

Digital innovation plays behind the scenes: digitisation will be the key to supply chain efficiency, lowering procurement costs and the enhancement of sourcing opportunities.

Ownership shake-up
10.

Fashion conglomerates will continue to intensify their focus on big brands, creating space for other brands and industry outsiders such as private equity and family owners to acquire targets.

A variety of political events remain unsolved and will cause volatility in 2017 as the world adjusts to them.

Growth of Upper/Middle class households in the next ten years

25% new Upper/Middle class households by 2025 helps to secure long-term fundamentals

New emerging cities will have larger populations than mature countries, e.g. by 2020 Istanbul > Austria

The consumer spends more and more of his digital time on mobile devices – by 2018 4x times as much as on the desktop

The 60-plus age segment will account for nearly 60 percent of consumption growth in Western Europe and Northeast Asia

The amount of money spent on gym memberships/ yoga classes is constantly increasing

15+ major fashion labels have announced See-Now, Buy-Now collections for 2017

Growing a compound annual growth rate of more than 50 percent, the global location-based-advertising market is expected to exceed 10 billion USD in 2018

25% Fashion Executives see IT capacity for value chain digitization as the key investment area for 2017

Strong growth in M&A activity expected in 2017
01. Intensifying volatility

Every year, MGI asks over 1,600 senior executives across all industries around the globe what they think the macroeconomic and geopolitical environment will look like in the year ahead: for 2017, almost half of them predict that economic conditions will remain challenging and that the world will experience uneven and volatile growth (Exhibit 19). In addition, domestic conflicts and terrorism still cause concern for businesses in many regions, since, as we have seen, they have the potential to disrupt the entire fashion value chain. Indeed, a recent report by the U.S. Senate Committee on Armed Services reflects the potential for an increase in activity from various terror organisations in the year ahead, perhaps to record levels.47

As volatility becomes the new normal in 2017, fashion companies could see all dimensions of their business affected: overall consumer demand, flows of tourism, price adjustments and exchange rate arbitrage, and labour and resource costs. As a result, companies will likely need to adjust their strategies in four ways: 1) adopt a consumer-driven mindset that adjusts in real time to changes in consumer needs; 2) build agile supply chains that guarantee operational readiness; 3) diversify their brand, category, and geographical portfolios: as a top executive of a global conglomerate advised, to balance performance it is important to know how to take advantage of one region while another one is in a downturn; 4) safeguard their cash flow by managing costs. Finally, even the most successful strategy requires an agile organisational model to have impact.

Sources: McKinsey’s Global Economics Intelligence analysis; McKinsey Global Executive Survey Results, Sept 2016
With China playing such a significant role in the global fashion business, and especially as it has been the source of so much growth over the past few years, the question on everyone’s mind is: will China come back in 2017?

Fashion executives believe that the slowdown is temporary. Indeed, over the long term, the fundamentals of China’s fashion market are still sound: the increasing wealth of its middle class, the growth of mobile shopping, and the increase in personal consumption. China is still expected to contribute 28 percent of the world’s new upper-middle and upper-class households between 2015 and 2025, versus the United States’ 3 percent (Exhibit 20). In addition, China is expected to pull further macroeconomic levers in order to stimulate investment and consumption. For instance, rating agency Moody’s raised its forecast for China’s 2017 economic growth

### Exhibit 20  China will remain central to fashion with 28% of growth in the number of upper middle and upper class households until 2025

<table>
<thead>
<tr>
<th>Country</th>
<th>% of global U/UM class household growth</th>
<th>Million U/UM class households 2025</th>
</tr>
</thead>
<tbody>
<tr>
<td>China</td>
<td>28</td>
<td>247</td>
</tr>
<tr>
<td>India</td>
<td>23</td>
<td>174</td>
</tr>
<tr>
<td>Indonesia</td>
<td>23</td>
<td>42</td>
</tr>
<tr>
<td>United States</td>
<td>15</td>
<td>126</td>
</tr>
<tr>
<td>Brazil</td>
<td>10</td>
<td>39</td>
</tr>
<tr>
<td>Pakistan</td>
<td>10</td>
<td>21</td>
</tr>
<tr>
<td>Egypt</td>
<td>9</td>
<td>23</td>
</tr>
<tr>
<td>Russia</td>
<td>8</td>
<td>40</td>
</tr>
<tr>
<td>Mexico</td>
<td>8</td>
<td>28</td>
</tr>
<tr>
<td>Nigeria</td>
<td>8</td>
<td>16</td>
</tr>
<tr>
<td>Other</td>
<td>30</td>
<td>620</td>
</tr>
</tbody>
</table>

**Global growth** 100 1376

Source: McKinsey Global Institute

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02. China’s comeback?

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Alibaba Singles’ Day Online Shopping Event  Bloomberg / Getty Images
in the wake of “significant” fiscal and monetary stimulus policies in 2016. Chinese authorities have shored up the economy through cheap credit and policy support, including the central bank’s monetary easing and lowering banks’ reserve requirement ratios and cutting interest rates. Combined, these factors should offset the reduction in “gifting” consumption that was eliminated through policy changes in recent years.

Chinese consumers will also have increasing access to fashion in 2017. E-tailers such as Alibaba and Shangpin are making fashion more accessible for consumers across the country. Additionally, the growth of mobile has been one of the most significant developments for the fashion industry in China. Historically, consumption of fashion had been driven by travel and tourism: Chinese consumers had to travel to America or Europe, and consumers from third-tier cities had to travel to Beijing or Shanghai to seek out fashion goods. However, the emergence of mobile has made it easier for consumers to access global brands.

Global luxury goods will also become more attractive in 2017. This will be driven by products arriving in China without delays and at the same prices. The shortening of distances and concentration of information will lead to a consolidation of channels. With the growing integration of online-to-offline channels, Chinese consumers won’t need to worry about where to buy from and paying different prices.

Of course, there are also headwinds to contend with. While the internal macroeconomic foundation is solid, pending foreign and international economic policy in the United States due to the upcoming political transition can directly impact Chinese consumption. Further, an economic stimulus does not directly translate to the consumer buying more. For example, after years of rapid growth, brands will also have to reckon with the fact that people’s closets are full, customers are becoming more discerning, and an increasing numbers of Chinese consumers are putting more effort into acquiring new experiences as well as learning, personal improvement, and health.

3. Urban engines

For many years, forecasters have been highlighting urbanisation as a key trend. A new class of rapidly growing cities in newly influential markets is becoming wealthy enough to provide shopping hubs for consumers in a way that makes them for the first time central to the evolution of fashion. Over the last 30 years as many as 400 million Chinese citizens moved to cities, but the new wave of urbanisation taking hold now in China, India, and other populous nations is focused this time on middle-weight cities, which are now beginning to reach key population thresholds, prompting the rise of urban centres that will provide continued growth opportunities for fashion companies. Pune in India and Harbin in China, both middleweight cities in their respective countries, will have seven million and eight million citizens, respectively, in 2017—almost as many as London or Paris. As these second-tier cities attract more and more residents, and workers and families continue to migrate from rural to urban settings, the opportunities for fashion companies expand accordingly. Over the next few years growth will shift globally toward the east and south, and stem from the urbanisation of emerging cities, as identified by McKinsey's FashionScope—a city-level growth forecasting tool for the fashion industry.

In the global low-growth environment, what growth does exist will be highly granular and uneven when viewed by categories. It is important, therefore, to look at cities specifically through a category lens. For example, according to projections from FashionScope, between now and 2025 Hong Kong may be the number one city for jewellery sales and the number two for bags and luggage, yet it is not even in the top ten fastest-growing cities for clothing or footwear. When making decisions in 2017, fashion companies need to refine the way they deploy their product assortment at a city level, and assess where to invest in future growth. Cities such as Tianjin in China and Delhi in India are among the fastest-growing jewellery markets, while one of the footwear hotspots is Mexico City. Winning in one city will not necessarily translate into winning across categories and vice versa.

The importance of cities suggests that designs will have to be aimed at specific cities and specific demographics within them. Kuwait City in the Middle East, Guadalajara in Mexico, and fourth-tier Chinese cities are becoming hubs for creativity and product inspiration. More broadly, we should see fashion companies shifting from basing decisions at the national market level, which has become a blunt instrument, and instead monitoring, strategizing, and activating business on a city level. The challenge for global brands in the next year will be to nurture deeper local relationships with clients in the cities that matter for them.

In addition to tailoring their strategies to local clients and growing urban centres, fashion players that operate in emerging markets should expect increased competition from local brands stepping up their game and professionalising to take advantage of the same opportunity. In the Indian market, for example, overseas mid-market players such as H&M, Zara, Uniqlo, and Mango are now facing competition from India’s own largest retail groups, which are entering the fast-fashion space, aiming to compete not only on price, but on product offering and speed to market. Our analysis suggests, that in the coming year more local competitors will try similar moves in Africa, the Middle East, China, Korea, and other important growth markets.
ANGLICA CHEUNG
EDITOR-IN-CHIEF OF VOGUE CHINA

Cautiously optimistic about China’s comeback in 2017

“People here are not easily impressed anymore,” cautions Angelica Cheung, editor-in-chief of Vogue China. “Now, even in China, consumers look at their wardrobe and they have everything, so they say, ‘Okay, if I get anything new, it must be for a good reason.’”

An increasingly discerning, educated and fragmented consumer profile is not the only issue that luxury brands will have to unpick in China next year. “Now that Chinese are spending overseas, they put more effort into experiences and learning, personal improvements and health. Anything to do with a healthy lifestyle and a healthy self,” she adds.

These and other consumer changes have added another layer of complexity for brands trying to penetrate deeper into China, especially at a time when its economy has been slowing. Deceleration of Chinese market growth has taken a heavy toll on the global luxury industry, which has come to rely heavily on the region and given rise to concerns about its future.

“Everything is changing; the world is changing; China is changing. And in China, because it was complicated to start with, it’s even more difficult for people to catch what’s happening,” she concedes.

“This is what Vogue China is trying to do: introduce a certain structure into a chaotic market,” she adds, referring to the magazine’s newer services providing creative and marketing solutions for luxury brands.

Cheung is optimistic that the Chinese market will get back on track, likening much of the current spending slowdown to a “passing mood” among consumers that is an inevitable consequence of the volatility of the Chinese stock market in 2016 and ongoing questions around the long-term stability of the property market.

“Obviously when you’ve just lost millions on the stock market, you are not in the mood to go out and buy diamonds or an Hèrmes bag,” she concedes. “Some kind of market adjustments [do] affect how people spend, but usually that’s quite temporary.”

The ongoing urbanisation of the country and growth of its third- and fourth-tier cities provide longer-term growth opportunities, believes Cheung. “China is still a growing market and...there are a lot of other Chinese cities still waking up to this whole new world [of luxury fashion].”

“You can’t really treat China as one whole thing. The North, South, East, West, Centre — they are all different. The climate is different, the lifestyle can be different, the language is often very different and what they are influenced by is different.”

Another very distinctive demographic in the country is the millennial consumer, a segment many luxury brands are turning their focus towards and one that Cheung understands well, having this year launched Vogue Me, a bimonthly spin-off magazine targeting China’s post-1990s generation.

“It’s a totally different generation. You need to know how their mind works and how you influence them and who influences them. It’s the ‘Me Generation.’ It’s about my identity, it’s about my feelings, it’s about how I see the world. They’re not just a younger version [of the existing consumer]. That’s why I was adamant I wouldn’t call it Vogue Girl or Teen Vogue [because] I don’t want people to mistake me for just doing a younger Vogue.”

Young Chinese consumers like the readers of Vogue Me have significant spending power but they also have very different attitudes and values in comparison to the next generation up. Typically, they are less wedded to brands and more open to mixing global brands with local labels and at a variety of price points.

As for whether local brands will be a growth vector in 2017, Cheung is cautiously optimistic. “I went to the shopping mall a couple of months ago and...I feel that a lot of the Chinese brands are doing much better products now because they’ve been learning fast...some of them are becoming a lot stronger.”

“You can’t really treat China as one whole thing. The North, South, East, West, Centre — they are all different. The climate is different, the lifestyle can be different, the language is often very different and what they are influenced by is different.”

“Obviously when you’ve just lost millions on the stock market, you are not in the mood to go out and buy diamonds or an Hèrmes bag,” she concedes. “Some kind of market adjustments affect how people spend, but usually that’s quite temporary.”
DEENA ALJUHANI ABDULAZIZ  
EDITOR-IN-CHIEF OF VOGUE ARABIA

Key cities will continue to drive the Middle Eastern market

“I’m the only editor-in-chief I know who was a retailer,” says Deena Aljuhani Abdulaziz, the Saudi princess who was appointed editor-in-chief of Vogue Arabia, a new Condé Nast edition that launched in 2016 as a digital-first publication. The print magazine is due to be released across the Middle East and North Africa (MENA) region in early 2017.

“It’s 250 million women; 21 countries. Arabs are ready for Vogue: it’s long overdue,” adds Abdulaziz, who for 10 years owned a multibrand designer fashion boutique called D’NA with branches in Riyadh, Saudi Arabia and Doha, Qatar.

Highlighting the diversity of the Arab market region, Abdulaziz points to the very distinctive nature of the urban markets that she will target next year. Beirut, Lebanon and Cairo, Egypt remain very important but the region has experienced instability.

“Kuwait City is very interesting and cool and I think it will keep on going for a long time. The reason is that the natives, at one point, started to understand that they don’t necessarily have to travel to shop, and Kuwait’s market is all about the natives. You don’t see foreigners as much.”

“I think that Doha has definitely tried to learn from Dubai’s mistakes,” she says. “So Doha has always separated itself as trying to be the cultural centre, a little bit of a sophisticated outlook… But Jeddah has become interesting and Vogue Italy just did an event there — though it’s not where the [biggest] spending is. Riyadh is definitely where the money is.”

In addition to their unique demographics and variety of wealth profiles, the major cities of the MENA region can have very divergent styles and tastes. Designs popular in Jeddah are not necessarily popular in Riyadh, for example, even though they are both in the same country, Saudi Arabia.

“It’s just like [the differences between] Miami and Los Angeles or comparing Washington to New York. We are global citizens.”

“KARLA MARTINEZ  
EDITOR-IN-CHIEF OF VOGUE MEXICO & VOGUE LATIN AMERICA

Latin American fashion players come into their own

“We all speak Spanish but very different culturally one of my biggest challenges is to be sure that we’re speaking to these different countries.”

“A lot of people don’t understand this [but] we do two issues every month,” says Karla Martinez, the editor-in-chief of Vogue Mexico and Vogue Latin America.

“First we do the Latin America edition, which means the whole region except Brazil [which has its own separate edition of Vogue in Portuguese] and the Caribbean. We also put special local inserts in our edition for [distribution in] Chile, Peru and Colombia and then we do our Mexican edition, which obviously goes to Mexico.”

Martinez, who was appointed in June 2016, explains: “We all speak Spanish but [we’re] very different culturally [so] one of my biggest challenges is to be sure that we’re speaking to these different countries. Especially now that the Latin American region has really come into its own in terms of spending power and the influence of their local fashion weeks. There’s [already] a lot more people buying local Mexican and Colombian design [and] when the dollar and the euro are so strong, you get less of us Latin Americans [shopping in Europe and North America but] that is an opportunity for our own fashion industries here,” she explains.

Now, even more Latin American retailers are beginning to accent their international product offering with local designers scouted at growing South American fashion weeks held in Buenos Aires, Argentina, Santiago, Chile and Lima, Peru. “Peru has a huge cotton industry and now they have some interesting fashion too,” she says.

Some regional retailers have recently begun to source hard-to-find merchandise from smaller Central American fashion weeks in Guatemala, Honduras and Panama.

“I think people are kind of specialising in what they do best.”
One of the most dramatic aspects of global development is the growing power of cities and the extreme growth and concentration in a limited number of megacities. According to McKinsey Global Institute, the world’s top 600 cities (in terms of absolute GDP growth) are expected to drive almost two-thirds of global economic growth by 2025. This urbanisation is also seen in GDP growth) are expected to drive almost two-thirds of global growth globally and at a city level in some detail.

The analysis covers five categories across all market segments: clothing, footwear, athletic wear, jewellery, and personal accessories. For each one, we looked to identify the precise factors that drive growth—from real GDP to real price, gender balance, share of low-to-high income households, and tourism—to see which were the most important in predicting growth.

Looking at more detailed segments, the more surprising the answers become. It is widely acknowledged that growth in fashion is shifting to China and emerging countries in Asia Pacific. The FashionScope analysis indicated that by 2025 approximately 31 percent of global fashion sales will come from China, while another 11 percent will come from the emerging countries in Asia Pacific. Today these two regions combined account for just 30 percent of sales. As these regions grow, the share of more developed regions—especially Europe and North America—will decrease.

More interesting is the concentration of that growth in cities, particularly those of emerging-market countries. These countries have more than 400 middleweight cities, which are expected to account for 50 percent of global GDP growth by 2025. Between 2015 and 2025, the majority of the top ten fastest-growing fashion cities are in emerging market nations, including Shanghai, Chongqing, Shenzhen, Mexico City, and Delhi.

Nonetheless, mature cities remain important in terms of absolute size, and are also continuing to grow. New York, Tokyo, and London in particular remain some of the biggest fashion markets across all categories (Exhibit 21).

The most unexpected insights come from looking closely at what drives growth in specific segments. The different market segments have very different drivers. High rates of tourism translate into higher sales of bags and luggage and personal accessories, but jewellery sales depend much more on the share of the female population (where self-purchase is on the rise).

## Analysing long-term fashion growth at city level

Growth is also granular and varies by category and city. Over the next decade, as the fashion industry grows, value is expected to shift across categories. Some categories, such as athletic wear, footwear, watches, and personal accessories, should remain relatively stable, continuing to make up approximately 40 percent of the market. These categories are driven by common macroeconomic factors, such as category price and share of high-income households.

The main anticipated shift involves jewellry growing in relative importance at the expense of clothing. Two main factors are behind this development. First, urban consumers should be able to redirect a larger share-of-wallet from basic needs—clothing and food items—to discretionary needs such as healthcare, education, recreation, and personal purchases, including jewellery. This shift is happening particularly fast in China; while basic consumption, including clothing, accounted to almost 70 percent of consumer spending in 1985, this figure is projected to be roughly 30 percent in 2025. Second, growth in the number of households in China and India, which are traditional jewellry-consuming countries, and the general growth of high-income households—which are expected to grow by 78 percent globally over the next ten years—will likely have a direct impact on the growth of jewellery sales over the long term.

What it takes to win in one category in one city is not necessarily the same as what it will take in a different category in the same city, or the same category in a neighbouring city. At a time when organic growth is essential but resources for investment are in short supply, FashionScope offers granular insight into the specific drivers of success for each category in each geography.
**FASHIONSCOPE 2025**

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<th>CLOTHING</th>
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Source: McKinsey FashionScope

Exhibit 21 New York, Tokyo and Los Angeles will continue to be among the top 10 largest fashion markets by 2025, but new emerging cities including Beijing, Mumbai, and Shanghai will enter the rank.

Ranking of largest cities by 2025 sales forecast

(#) Rank in 2015

(–) New to Top 10 in 2025
**CONSUMER SHIFTS**

4. Shrewder shoppers

In 2017 consumer needs and behaviours will likely become more sophisticated, more technology-driven, and harder to predict than ever, with fashion companies struggling to keep up. Today’s consumers are “always on”—better informed, better connected to others, more demanding, and more conscious of values and authenticity—and yet perhaps more unpredictable (Exhibit 22). This is a new consumer altogether who chooses to blend elements from different brands and designers, and shops more broadly than was common in the past. The driving forces behind their behavioural changes are the availability of information and accessibility of brands, as well as the desire for personalisation and connection to deep-rooted values. With brand promiscuity on the rise and more consumers inclined to shop across market segments, the market is becoming increasingly complex for brands that have relied on tradition-

ally loyal consumers buying from a particular segment of products.

The changing competitive landscape—more brands, more channels, more retailers—should further amplify the complexity of the consumer. Brands will likely need to rethink the future of the store and focus on a customer-experience redesign, particularly by leveraging the omnichannel consumer decision journey to create a seamless consumer experience. This may take the form of stores being reshaped to resemble the online experience more closely, or amplifying the mobile and digital connections available in-store, and introducing the notion of community-based retail.

As consumers engage with technology to enhance their shopping behaviour, brands can leverage this to their advantage and further gain insights into their consumers. Investment in CRM is crucial for 2017. More than ever, fashion brands need to have a global view of their consumers in order to understand what they want, what they like, what they don’t like, and where and how they shop. Consumers have so many choices that fashion companies need to leverage the information they have to segment and then segment again. Emerging brands have been founded on the realisation that there are many untapped consumers for whom today’s fashion brands fail to cater. These emerging brands, such as Olivia von Halle, Cambridge Satchel Company, Mansur Gavriel, and Common Projects, are scaling up niche businesses through best-in-class or best-in-category strategies, or building a business on the strength of a single best-selling product.

At the same time, new technologies are coming online, often with the promise of opening new sorts of connections with consumers. Virtual reality is a big theme, with some companies rolling out immersive fashion show access, while others are developing mobile payments infrastructure, such as Alibaba’s VR pay, which aims to allow customers to purchase items with simply the nod of a head for those connected to a brand show. The winners of 2017 will probably be those companies that invest in the right technology to help them understand and serve their consumers and tap into their currently unmet needs.

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**Exhibit 22 In 2017, the shrewder shopper will be characterised by 6 main qualities**

- **Better Informed**
  - Online search on demand, even in store...

- **More Volatile**
  - Alternative shopping options are just one click away

- **Always “On”**
  - Always connected, shopping around the clock, but time constrained

- **More Demanding**
  - Seeking personalization and seamlessness

- **More Conscious**
  - Values oriented and in search for authenticity

- **Connected to Others**
  - Product review and experience sharing on blogs and other social media

Source: McKinsey

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**VR shopping technology Buy+**

VCG/ Getty Images
5. Generation correlation

Two key but contrasting consumer groups are about to grow exponentially: the elderly and retired and the millennials. To succeed, fashion companies will likely need to focus the way they serve both these groups.

McKinsey’s analysis suggests that the number of retiring and elderly people in developed countries will grow by more than one-third over the next 15 years, from 164 million to 222 million by 2025. The global population aged over 60 should reach 30 percent in advanced economies and 13 percent in emerging economies (Exhibit 23). This translates to 51 percent of urban consumption growth in developed markets, or $4.4 trillion, in the period to 2030.58

This is a significant opportunity for fashion, so brands should identify ways to reach and communicate with these valuable consumers. Part of the challenge will be to balance the call by some for an ageless approach, whereby brands are more fluid in their designs, rather than designing for a particular age group, with the reality that there are others who are nevertheless conscious of age-appropriate fashion. In the words of fashion icon Iris Apfel, “I think a woman has her own style and knows who she is; she doesn’t have to dress for being 60 or 20 or 90.”59

The second most important growing consumer segment is the millennial generation. As of spring 2016, millennials are the largest living generation in the United States; over the next decade their total income of $1 trillion is expected to grow to be 30 percent more than that of Generation X and 7.5 times that of the Baby Boomers.60 On a global scale, 85 percent of them live in emerging markets and have a spending power of approximately $2.5 trillion, which is expected to grow three times by 2025.61 However, capturing that opportunity requires engaging more effectively with millennials and responding more quickly to their needs.

Doing so depends on understanding the underlying attitudes and behaviours that drive millennial consumers to spend their money on fashion, starting with the fact that they should not be categorised as a single group but as distinct attitudinally driven segments of consumers. According to the 2016 McKinsey Millennial Survey of 11,000 US consumers,62 the key drivers for millennials can be divided into three: value, quality, and image. Different segments of consumers emphasise some drivers more than others, creating niche segments – a segment that is motivated by price; a segment that cares less about the brand; a segment that makes controlled and thoughtful decisions; a segment driven by self-expression; and a segment willing to pay premiums, among others. Much more compelling for millennials than other age groups, according to McKinsey, is the idea that they are global citizens living in borderless environments with converging education and culture, and are values driven in search for meaning and a connection to brands.

In 2017 fashion companies should consider tailoring their strategies for the old and the young not by focusing on their age, but by identifying the distinct values that resonate with members of those two groups.
Deepening consumer relationships over expanding the store network

“Since our project is medium to long-term... we have a commitment to build this one-to-one relationship with the consumer irrespective of the macro-economic situation”

Q&A

DANIEL LÓPEZ
VICE-CHAIRMAN AND MEMBER OF THE BOARD OF DIRECTORS AT MANGO

Deepening consumer relationships over expanding the store network

“There are certain areas of the world where we’re present that the forecast for the next 12 months is not very optimistic,” concedes Daniel López, who, in less than a decade, rose from Mango’s legal management team to the rank of vice-chairman.

Citing the ripple effect of terrorist activity and other forms of geopolitical instability in markets such as the Middle East, Russia and the CIS countries, López acknowledges that there will be challenges facing the Spanish fast fashion brand in 2017.

“Number one [is] uncertainty and volatility linked to currency exchanges... like the rouble and the dollar [and] there are all these Brexit consequences that everyone is still discounting but we have still yet to see over a 12-month period,” says López, who has overall responsibility for the company’s international markets, franchise management and global expansion.

Given how exposed Mango is across international markets, López admits that it will not be easy to mitigate uncertainty and maintain growth. The company currently operates over 2,200 own-brand stores in 109 countries around the world. Approximately 80 percent of brand turnover corresponded to markets outside Spain in 2015.

Yet López is confident that there are ways for Mango to expand next year despite the volatile climate in some territories. “We are going to be cautious depending on the market but we are not going to decelerate our expansion plans,” he says.

“Our focus right now is to be more capillary in markets that account for the biggest percentage of our turnover, so this is going to be mainly big markets in Europe [and] Russia now that the situation seems to be a little bit more stable. This means also growing in the Middle East.”

Rather than conquering entirely new emerging markets, López will boost the company’s presence by penetrating more deeply in substantial but still underserved cities where the brand has already proven itself.

“We’re going to keep more or less the same number of stores [but] work towards transforming into a network of stores where we can establish a more clear relationship with our customers rather than the transactional type of stores that we used to have.”

“We come from a footprint of stores that has an average of 300 square metres [so] what we’ve been doing since 2013 is to change this footprint into...the region of 800 square metres on average — including the majority of the women’s wear, plus kidswear, plus menswear. This is a process...which is still far from being finished so we have this idea of growing another 100,000 square metres...in 2017.”

By bringing a greater assortment of merchandise and a wider selection of ranges into larger format megastores, López aims to expose consumers to a more comprehensive vision of the brand universe and thereby create a deeper connection. He plans to enhance the relationship further by improving the localisation of the offering and increasing speed-to-market. To this end, the company has completed a colossal new logistics centre in Lliçà d’Amunt, outside Barcelona.

“Since our [expansion] project is medium to long-term...we have a commitment to build this one-to-one relationship with the consumer irrespective of the macro-economic situation [in 2017],” he says.

6. The wellness dividend

Traditionally, wellness and fashion have not been allied industries, but the rise of the wellness movement leaves fashion players with the choice of either learning to profit from it or having to compete with it. Over the past couple of years, fashion companies have started to pay attention to new lifestyle trends founded on health and wellness—hence the rise of casualisation and athletic wear. To take advantage of this opportunity, fashion brands have released their own athletic wear and activewear lines. An evolution of this product offering has been to present wellness experiences to customers, an approach that chimes with the younger and more active segments of the customer base. Examples include some of the Nike running clubs and Reebok’s mobile CrossFit gyms. These events and other experiences are important, as the consumer segment is interested in personal, transformative experiences, often on the journey to a “better you”. They also help create differentiation in segments such as running shoes that would otherwise be tending toward commodities.

Currently, fashion is responding to only some, and often isolated, layers of the wellness movement. It has focused predominantly on the physical component, responding to people’s desire to be more physically fit. Some brands have focused on storytelling and creating an emotional connection of wellbeing to consumers, while others have championed consciousness for the environment and the use of organic fabrics. However, our expert interviews indicate that this is a limited interpretation. Wellness extends to a more holistic sense of a person and appeals to mental, physical, spiritual, emotional, and environmental attributes. The more of these attributes that a brand can reflect and connect to, the stronger it will be, and the deeper the relationship it can create with the consumer. Today, however, fashion’s offer is not sustainable because it does not connect to the whole person, but only a part.

Fashion companies can both benefit from the wellness movement and compete with the wellness industry by adopting a more holistic view of its consumers in 2017. The alternative for the consumer will be to spend a larger share of wallet on other products and services that do just that. The fashion industry can make that connection by extending its repertoire and value touch points, and by basing its proposition on making a person feel good beyond simply making a person look good.

The State of Fashion 2017
LESSONS IN FASHION IMMEDIACY

Tommy Hilfiger and Burberry are two of the largest and most committed players to adopt the so-called ‘See Now, Buy Now’ experiment to their operating model. What can these disruptions tell us about how fashion immediacy might evolve in 2017?

by Imran Amed and Robin Mellery-Pratt
LONDON, United Kingdom — Following months of industry speculation on the subject, on February 5th 2016, Burberry became the first major fashion house to announce a realignment of its show calendar by combining men’s and women’s collections into twice-annual seasonless shows. That very same day, Tom Ford announced a plan to postpone his fashion show for six months to show in September and make the collection immediately available to consumers.

Within a week, they were joined by Tommy Hilfiger, Paul Smith and a number of smaller designer brands — all publicly announcing a shift to some form of fashion immediacy strategy, seeking to better rationalise the fashion show calendar for consumers and capitalise on immediate demand for runway products.

However, the global fashion industry has been neither united nor unanimous in its view on this break from tradition. In fact, some of its most influential figures went on record against the shifts in strategy, including senior representatives of the two biggest luxury fashion conglomerates LVMH and Kering, as well as the leaders of national fashion associations such as the Fédération Française de la Couture du Prêt-à-Porter des Couturiers et des Créateurs de Mode and the Camera Nazionale della Moda Italiana.

Kering’s chairman and chief executive François-Henri Pinault said in a statement that fashion immediacy “negated the dream of luxury,” and that delayed gratification (rather than instant gratification) is what “creates desire.” The task force put together by Ralph Toledano, president of the Fédération Française de la Couture, which comprised of Sidney Toledano, chief executive of Christian Dior, and Bruno Pavlovsky, Chanel’s president of fashion, amongst others, took the position that, “the present system was valid.”

While some industry leaders — based mostly in New York and London — advocated for rapid change, the French and Italian designer establishment seemed to prefer the status quo. And given the latter’s collective weight in the global fashion industry, the move toward fashion immediacy became a matter for companies to tackle individually.

Despite the industry’s internal divisions, a variety of fashion immediacy strategies have emerged throughout 2016. Some of these reflect a longer-term evolution that has been sweeping the industry in recent years. As high-street players increasingly adopted the fast-fashion business model, more high-end designers introduced pre-fall, cruise, resort and holiday collections. This effectively increased the pace and number of deliveries from the traditional Spring/Summer and Autumn/Winter seasons.

Consequently, today, many luxury brands present six shows for the three different ready-to-wear collections: two each for womenswear mainline, womenswear pre-collections and menswear. But although they had increased the number of product drops throughout the year, brands found themselves creating publicity around these collections months before consumers were able to buy them at retail.

“I’ve always felt a little alien, inviting people from around the world to tune in and to watch, to Instagram, share and like and all of those things, but then not be able to buy it, or look at it, until four to six months [later]. I found [the shift to fashion immediacy] great — a natural thing,” says Christopher Bailey, chief creative officer and chief executive of Burberry.

Looking ahead, several contemporaneous factors will continue to drive the industry’s adoption of fashion immediacy strategies in 2017. The first is the need for organic growth in a challenging global economic climate. Ninety-five percent of the business executives polled in the BoF-McKinsey Global Fashion Survey, believe that driving sales growth, rather than cutting costs, will be the key focus to increase profits in 2017.

Brands can view fashion immediacy as an attractive potential growth lever, to address the traditional fashion system’s inability to concurrently serve the needs of a global consumer base and to better capitalise on the media and consumer interest in fashion shows.

Another factor is the belief that some consumers demand fashion immediacy and view it as a natural progression for fashion brands. “We listened to the consumer and understood that [what] they are demanding is instant gratification and experiences,” says Tommy Hilfiger, founder and designer of his eponymous brand.

Arguably, the rise of B2C fashion shows, photo-sharing social media apps and e-commerce have already shifted consumer preferences toward immediate gratification and heightened expectations for newness. Some believe that changing the fashion cycle is simply a sign that brands are catching up. “The traditional ‘attraction of anticipation’ will still exist, but there has to be some change. We are living in a radically different world,” says Bailey.

But what does it take for fashion brands to operationalise fashion immediacy to their consumers — and is it worth it?
“It’s always felt a little alien, inviting people from around the world to tune in and to watch, to Instagram, share and like and all of those things, but then not be able to buy it, or look at it, until four to six months.”

Baker says that Tommy Hilfiger’s pivot toward fashion immediacy was also a boost for creativity: “It was an extremely dynamic process, having that adaptability and agility of introducing and fresh ways to tell a story, actually found [it] to be super creative. I think our own team was even inspired and surprised at how the final show came together because it felt really fresh,” she says.

To disrupt the established fashion calendar, which fails to take into account seasonal differences in southern and northern hemisphere markets, Burberry and Tommy Hilfiger completely shifted execution deadlines and decision-making processes. “It took a lot of work to recreate the show, but the new schedules mean they are made around three months before the show,” Bailey asserted. “You normally design the full show, then you show the show, and then your supply chain starts to kick in,” Bailey told BoF when he announced the change. But for the latest Burberry show, Bailey had to develop production techniques, deadlines and budgets as a part of the design process. Now, as we are designing the show we will be passing things over immediately to our supply chain partners to say, ‘Let’s look at the lead times on this; how can we work with this factory to get this on the date that we need it?’” he continues.

There are also implications for wholesale partners and press, who must see the collection before the show and place their orders in advance. Restricted showrooms were set up for key international wholesale buyers and press to view the collection in the strictest of confidence, at times secured through non-disclosure agreements. In Burberry’s showroom, accessories were also displayed as well as inspiration boards with images, photographs and swatches of fabric to give the clearest possible sense of the collection’s themes.

A Positive or Negative Impact on Creativity?

More pessimistic observers have questioned the impact of fashion immediacy on the creative process, predicting that collections would inevitably become watered-down, overly commercial or lack the dream and anticipation that have sustained fashion marketing for decades. But according to both Bailey and Hilfiger, rather than a creative constraint, the earlier deadlines have helped designers adapt to the latest Burberry show, impacting the highly measured work schedules of the creative teams who craft communications strategies, from photographers to art-directors, make-up artists to hair stylists. In September 2016, when Mario Testino took his place front row at the Burberry show, he had the accompanying ad campaign, which was already in the hands of Anna Wintour, American Vogue’s editor-in-chief, to run in the magazine.

In practice, it seems likely that maintaining “the dream” aspect of luxury will be sustained through key runway pieces. For example, Burberry’s military band jackets featured heavily in the show as well as the ad campaign, with the accompanying “See Now, Buy Now” collection of the Burberry show, impacting the highly pressured work schedules of the creative teams who craft communications strategies, from photographers to art-directors, make-up artists to hair stylists. In September 2016, when Mario Testino took his place front row at the Burberry show, he had the accompanying ad campaign, which was already in the hands of Anna Wintour, American Vogue’s editor-in-chief, to run in the magazine.

One of the things that we did around the last show was to really tackle how can we take this opportunity to create fantastic content that we can then use later in the season, weeks or even a month or two after the show, to create another spike of engagement and interest with our followers,” explains Baker.

To sustain interest in its collection, Hilfiger entered into partnerships with Facebook and Vogue, among others. “Partnerships create fresh interest around the show. I think that definitely can and should evolve significantly in the future, to be able to showcase new content linked simultaneously with new product drops,” she concludes.

Whether it is possible to maintain margins while keeping fashion’s fussiest consumers excited and engaged by investing heavily in the manipulation of an increasingly complex product ecosystem? Only time will tell. Neglecting the tectonic shifts being felt in a marketplace led by ever demanding consumers — always switched on and expecting brands to constantly stimulate them — carries a significant risk too.

As Bailey says, “Everyone is changing the way they live, work, shop, eat — our industry is not immune to that change, and our customers are not immune to those changes [either]."
8. Organic growth

2017 is expected to be a year of organic growth. Gone are the days of growth driven by store expansion; next year, we should see brands focusing on like-for-like sales, increasing domestic demand, and growing through value rather than volume. Indeed, the “race for space” is long over. The traditional means of fast growth—geographic, channel, and store network expansion—have been exhausted, as those few companies still stuck in the old paradigm are discovering to their cost. Further, a decline in retail space productivity and price increases offset by the use of promotions have also been threatening growth. As a result, we believe that in the next year successful companies will be those that focus more tightly than ever on organic growth, particularly through branding and developing their local clienteles.

There are several steps involved in this journey. To start, fashion players will redouble their focus on creating products for their local clienteles. Deepening relationships with local clienteles also offer an effective way to deal with regional headwinds and—especially for luxury brands—to reduce dependency on tourism, which is susceptible to economic and geopolitical volatility. Cultivating a local clientele can help global fashion players deal with volatility, as they can intensify their focus on one geography during a prosperous time, and shift to another when the first hits a low.

Technology plays a key role in activating brands and clientele. By exploiting developments in upstream technology, particularly predictive analytics, fashion companies can gather and analyse more data to tailor their branding strategy. More practically, this enables them to focus on creating products for their local clienteles, including limited-edition and specialised products, with reduced risk of overstock and markdowns.

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9. Upstream technology

Placing big bets on technology in 2017 increases a company’s chances of being a future winner. Technology investments will have two rationales. First, the clear market trends—cycle acceleration, omnichannel, localisation, and sustainability—pull in different directions: they cannot all be delivered simultaneously without a technological enhancement across the whole value chain. Second, technology will also be seen as the solution to addressing sourcing and supply-chain challenges in an effort to improve margins.

Together, these pressures will likely make automation, robotics, and the digital supply chain become more prevalent in the fashion industry. The International Labour Organisation estimates that within a few decades more than half of all salaried workers in emerging countries could be displaced by automation and advanced technologies, and that this disruption will be led by the textiles and clothing industry.8

Signs of transition to automated processes should already be visible in 2017. Global players have announced large-scale projects, such as the Adidas “speed factory”82 and the new Nike distribution centre in Belgium designed around a sustainable supply chain. In 2017, key themes for the fashion industry’s digital supply chain are expected to be prototyping, personalisation, end-to-end transparency, and inventory planning. Digitised inventory management and predictive analytics—aligned to investments in CRM—have the potential to allow fashion companies to link inventory around the world to a single view for the consumer. This in turn makes it possible to sell a product that could have lingered on a shelf to a consumer who wants it halfway around the world. Nonetheless, being too dazzled by data is a danger. If all brands replace the creative process with data analysis to predict what consumers want, a downward spiral in which they create too much of the same product could be difficult to avoid.

The need to adopt a digital process effectively will presumably place added pressure on creatives across all market segments to take up new tools—from virtual design to virtual sampling—to increase efficiency and integrate design-to-cost.

For one set of companies the natural choice will probably be to continue to look for new, cheaper sourcing countries, because their processes are not as sophisticated or they lack the capital to invest in automation and robotics. But others will likely push further into the digital realm.

With fashion companies facing the dilemma of doing more with less, the spotlight is on sourcing companies. The apparel companies, which are their customers, worry about trade agreements, the rising terrorist threat in some of the main sourcing countries, and the amplification of the volatility of sourcing costs by foreign exchange rate effects. At the same time, they have seen labour costs continuing to rise in the main garment-manufacturing countries, energy costs increasing, and raw material prices creating additional pressure to improve efficiency along the entire value chain, all while options for alternative sourcing countries are running out.

The changing landscape on the demand side amplifies this pressure. The themes of this year and next—from the slowdown in sales to the rise of omnichannel—make it necessary for companies to adapt quickly and move from transactional sourcing to performance-based procurement.

In October, more than 25 apparel sourcing executives and McKinsey experts came together in Hong Kong for the Firm’s third annual Apparel Sourcing Roundtable to discuss how they can respond to the challenge by digitising apparel sourcing.

Discussions ranged from procurement digitisation and Industry 4.0 topics on the backdrop of the challenging sourcing environment. Top-of-mind questions for the sourcing industry are how digitisation can drive efficiency and improve service both in procurement and throughout the value chain. The good news is that, as many of the participants agreed, “digital procurement plays into doing more with less”.

Advances in virtual design, digital printing, robotics, and automation are transforming the way companies in many industries design and make their products. Yet, with so much groundwork still to be done in optimising apparel-sourcing processes, the majority of participants felt that the apparel industry is at a very early stage in terms of adopting these approaches.

In light of the high share of manual process management in the industry, even simple automations in the procure-to-pay workflow are viewed as a big step forward. Other relevant initiatives from participating companies include automation in production to increase the “local-for-local” share and drive up flexibility. The executives also cited the potential of the Internet of Things—a network connecting devices, garments with sensors, and advanced analytics—to enable new opportunities to improve planning and processes throughout the apparel value chain. For now, only the more advanced players are even exploring this technology.

Participants in the roundtable clearly see digitising apparel sourcing as a part of the solution to solving today’s sourcing equation of “doing more with less”. However, a survey conducted during the event underlined that their most pressing questions still focus on optimising traditional, non-digitised sourcing to prepare for digital procurement.

Not surprisingly, end-to-end efficiency improvement, corporate social responsibility (CSR), and compliance issues are among the top five topics mentioned. Today’s visibility discussion has widened to include true co-creation of innovations between multiple stakeholders to find circular solutions and to “be in a purpose-driven sourcing situation”, as one participant put it.

Supplier collaboration and development is a main concern for sourcing executives. To secure success over the long run, participants believe that they will need to support suppliers in order to build skills for the digital future.

New skills and knowledge in the product-develop ment and sourcing process will be essential in-house as well. During a discussion on talent, the group recognised, however, that digital know-how alone may not be enough. Instead, the question to be answered in the hiring process is: “Can this leader adeptly navigate the organisation’s existing deep culture and processes, and deal patiently with legacy issues while building relationships with others?” This question is becoming even more important as the next generation of sourcing leaders arises, since they have a different perspective on how to grow their careers. Companies need to invest in continuous learning and training as well.

The consensus among the roundtable participants was that apparel sourcing is currently behind in its development compared with other sectors. Only a few companies were mentioned as exhibiting true best practices in moving towards digital procurement.

Pronouncements such as “digitise or die” and “the country of digital procurement is the next sourcing country” are sometimes heard at the conference—may seem like overstatements, especially since true digitisation is a long way off for most sourcing players. However, the participants at the Apparel Sourcing Roundtable were confident that sweeping change is on the way. While few outward signs of digitisation are evident today, many companies are busy laying the groundwork for digital innovation. Those who can make progress quickly—and therefore will be the leaders in this transformation—will thrive, rather than just survive the inevitable transformation of sourcing and procurement.

Each year McKinsey & Company hosts the Apparel Sourcing Roundtable to provide sourcing executives with the opportunity for an open exchange about the challenges and opportunities they face.

McKinsey Apparel Sourcing Roundtable

DOING MORE WITH LESS — SOLVING TODAY’S APPAREL-SOURCING EQUATION
Lastly, we believe the pressures of 2017 may shake up ownership in the fashion industry. On the supply side, many fashion conglomerates are under pressure to perform, and may try to weather the storm by looking more closely at their brand portfolio and divesting non-core brands. This translates to a "powerbrand strategy," whereby groups look to focus on their performing brands. In 2016, the divestment of individual brands became apparent with the sale of Donna Karan by LVMH. As the first divestment by the group since 2005, it opened the door for further reallocation within large conglomerates in future. The move to sell underperformers would allow these organisations to focus their attention on further propelling their better-performing brands, particularly the luxury segment, which commands higher margins.

While the supply of investment opportunities in fashion is increasing, so is demand. The private equity (PE) industry is facing its own pressures, particularly to deploy money. As of June 2016, according to the research firm Preqin, firms had a record $818 billion in "dry powder"—available capital, coupled with experience and success cases in the fashion industry over the past couple of years, means that private equity should have the capacity to take on the increasing number of brands that require investment and professionalisation.

The fashion industry also presents an interesting set of investment targets in 2017. While luxury is largely concentrated in the conglomerates, there are opportunities in the affordable luxury and premium/bridge space. As evidenced by the McKinsey Global Fashion Index, this space is fragmented and operating profit performance ranges widely between the best and worst-performing companies. Nonetheless, both affordable and premium are fast-growing segments with emerging brands. Therefore, two major trends are likely to emerge among investors: the first is finding tired or poorly operated, poorly managed brands to turn around; the other is finding brands that are scalable.

10. Ownership shake-up

Agility is the key for next year," declares Daniel Lalonde, president and chief executive officer of SMCP, the French group that owns affordable luxury brands Sandro, Maje and Claudie Pierlot. "It’s about agility in keeping the consumer excited; agility providing the relevant product offer fast; and agility interacting with a very connected customer who is also very channel-agnostic."

Lalonde cites an increasingly smart and savvy consumer as the main driver for this. "The overall sophistication of the customer has increased rapidly last year and it’ll be a theme for the next years as well. They’re very smart and they’re very comfortable moving between different segments, categories, channels, brands and geographies."

"It’s a more modern way of consumption that we’re seeing than in the past... Consumers make trade-offs to consider what is the best value." In a flat market, the company posted a 19.2 percent rise in sales for the first half of 2016, driven by strong demand for all of its brands across its regions. Last year marked a milestone for SMCP, as it was the first time that total international sales outweighed sales generated in the French home market. "We have a very, very clear ambition and a very clear strategy that everyone in the company knows and it’s quite simple. We want to be the global leader in accessible luxury," he says.

"[We also have] a very clear direction on where we’re going, how we’re going to fund the growth and we have a very granular plan even on, for example, new store openings. I can tell you in the next three years exactly where we are opening what store, in what city and in what mall. [But] I’d say our secret sauce is our business model [which] is unique in two ways: we’re retail pure players and we blend the codes of luxury and fast fashion."

Lalonde believes that despite the increased volatility facing the fashion industry next year, private equity houses will continue to acquire fashion brands. "We’re allergic to the traditional way of doing wholesale," he explains, "Ninety-four per cent of our business is done through direct retail [and] there are big, big advantages of being a retail pure player today. You control your distribution, the control you have, that you can replenish the stores quickly. We know what sells right away... It’s also great for omnichannel because I can tie all my stores together."

In March, one of China’s largest textile producers, Shandong Ruyi, bought a majority stake in SMCP from private equity (PE) firm Kohlberg Kravis Roberts & Company (KKR), which had acquired a majority stake in the company three years earlier. "For us, it has been a very good period with KKR bringing in their knowledge. They know what they know; they know what they don’t know, and I think it’s been a very good partnership. They’ve certainly added value, [especially] with the management and our international expansion, so it’s been very positive."

"This myth of PE companies coming in and driving — well, they do drive performance, there’s no doubt about that, but with a mindset of long-term value creation and taking the right decisions and the right investments for the brands for the long-term. So it’s not been short-term thinking and decision-making. [In my experience], PE firms can be very performance-driven, priority-driven and they’re great sparring partners for CEOs."

However, Lalonde concedes that not all private equity firms are interested in the long-term health and desirability of the fashion brands they acquire. "It depends," he says. "Not all PE companies are the same. Some have more success and more experience in turnarounds and others more in taking a company up to the next level."

Lalonde believes that despite the increased volatility facing the fashion industry next year, private equity houses will continue to acquire fashion brands in 2017. "Listen, on the PE side of M&A... there will be a continuation of activity," he says. "They have the resources and I think they’ve developed solid experiences now."
**Athleisure**
Athletic-inspired way of dressing rooted in joggers, leggings, tank tops, and sneakers—designed to be worn for exercising, streetwear, and daywear.

**Baby boomers**
Demographic cohort born in the years following the Second World War (approximately 1946–64), when there was a temporary marked increase in the birth rate.

**Compound Annual Growth Rate (CAGR)**
Annualised average rate of growth between two given years, assuming growth takes place at an exponentially compounded rate.

**Casualisation**
Consumer trend reflecting the adoption of casual wear in more and more non-casual settings.

**Customer relationship management (CRM)**
A strategy for managing all your company’s relationships and interactions with existing and potential customers.

**EBITA**
Operating profit measure—Earnings Before Interest, Taxes, and Amortisation. It is a financial indicator used widely as a measure of efficiency and profitability of businesses.

**Economic profit**
Measure for value add created by businesses, whereby opportunity costs are deducted from revenues earned. This measure takes into consideration explicit costs and implicit costs, while operating profit reported in accounts only utilises explicit costs. Economic profit is defined as invested capital times the difference of ROIC (see below) minus WACC (see below).

**Fashion Cycle**
The process by which a given collection goes through the value chain (from design to sell-out). Can also refer generally to the life cycle of a fashion trend.

**FashionScope**
Proprietary McKinsey tool that builds on CityScope data to forecast market sizes of the leading fashion categories based on their respective unique identified drivers in the 2,600 largest cities on the globe.

**Gross Domestic Product (GDP)**
Macroeconomic measure of the market value of all final goods and services produced in a country within a defined period.

**Genderless**
(synonyms: unisex, genderneutral) Fashion designed to be suitable for both sexes in order to live individual life choices uninhibited by mainstream gender norms of society.

**Generation X (Gen X)**
Following the baby boomers and preceding Generation Y (born circa 1965–81).

**Generation Y (Gen Y/Millennials)**
Demographic cohort born circa 1982–99. The name is based on Generation X, the generation that preceded them.

**Invested Capital**
Sum of all cash that has been invested in a company over its life without regard to financing form or accounting name. It is the total of investments in a business from which operating revenue is derived.

**McKinsey CityScope**
McKinsey advanced econometric analytics to identify the specific economic and demographic drivers of market growth. Based on a unique Cityscope database of ~2,600 cities worldwide and 2025 projections of over ten demographic and economic drivers, at country and city level.

**McKinsey Global Fashion Index (MGFI)**
Proprietary and copyrighted McKinsey tool that provides a global and holistic fashion industry benchmark for the entire fashion industry—from luxury to discount players. It is focused on the financial metrics of fashion companies across all geographies, business models, and product categories.

**McKinsey Global Institute (MGI)**
Business and economics research arm of McKinsey, established in 1990 to develop a deeper understanding of the evolving global economy. MGI’s mission is to provide leaders in the commercial, public, and social sectors with the facts and insights on which to base management and policy decision.

**Millennials**
See Generation Y.

**Modest wear**
Fashion that complies with Islamic interpretations of modesty and ethics in design, production, and presentation. General representation includes loose clothing and covering of the body according to religious principles.

**Omnichannel**
Sales approach that provides the customer with an integrated shopping experience across a multitude of online and offline sales channels.

**Plus-size**
Term for clothing proportioned specifically for people whose bodies are larger than the average person’s. The application of the term varies from country to country.

**Pure-play**
Company that focuses exclusively on a particular product or service. In fashion, it usually refers to companies that operate only on the Internet.

**Ready-to-Wear**
Garments or footwear produced toward standardised measurements in mass production and sold through retail stores rather than made to measure for an individual customer.

**Return on Invested Capital (ROIC)**
Percentage amount that a company is making for every percentage point over the actual cost of capital (WACC). It is an indicator of how well a company is using its money to generate returns.

**Sales**
 Reported net sales (net of excise duty). Sales growth is shown at nominal values and at fixed 2015 exchange rates.

**See-Now, Buy-Now**
Shoppable runway shows that allow consumers to buy their collections immediately after they debut on the catwalk.

**Stock-Keeping Unit (SKU)**
Specific item of merchandise stored to a specific location. The SKU is intended as the most disaggregated level when dealing with inventory.

**Unique Selling Proposition (USP)**
Real or perceived benefit of a good or service that differentiates it from competing products or services and gives its customers a tangible or intangible reason to prefer it over other products or services.

**Weighted Average Cost of Capital (WACC)**
Calculation of a firm’s cost of capital in which each category of capital is proportionately weighted. It is the rate that a company is expected to pay on average to all its debtors.
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