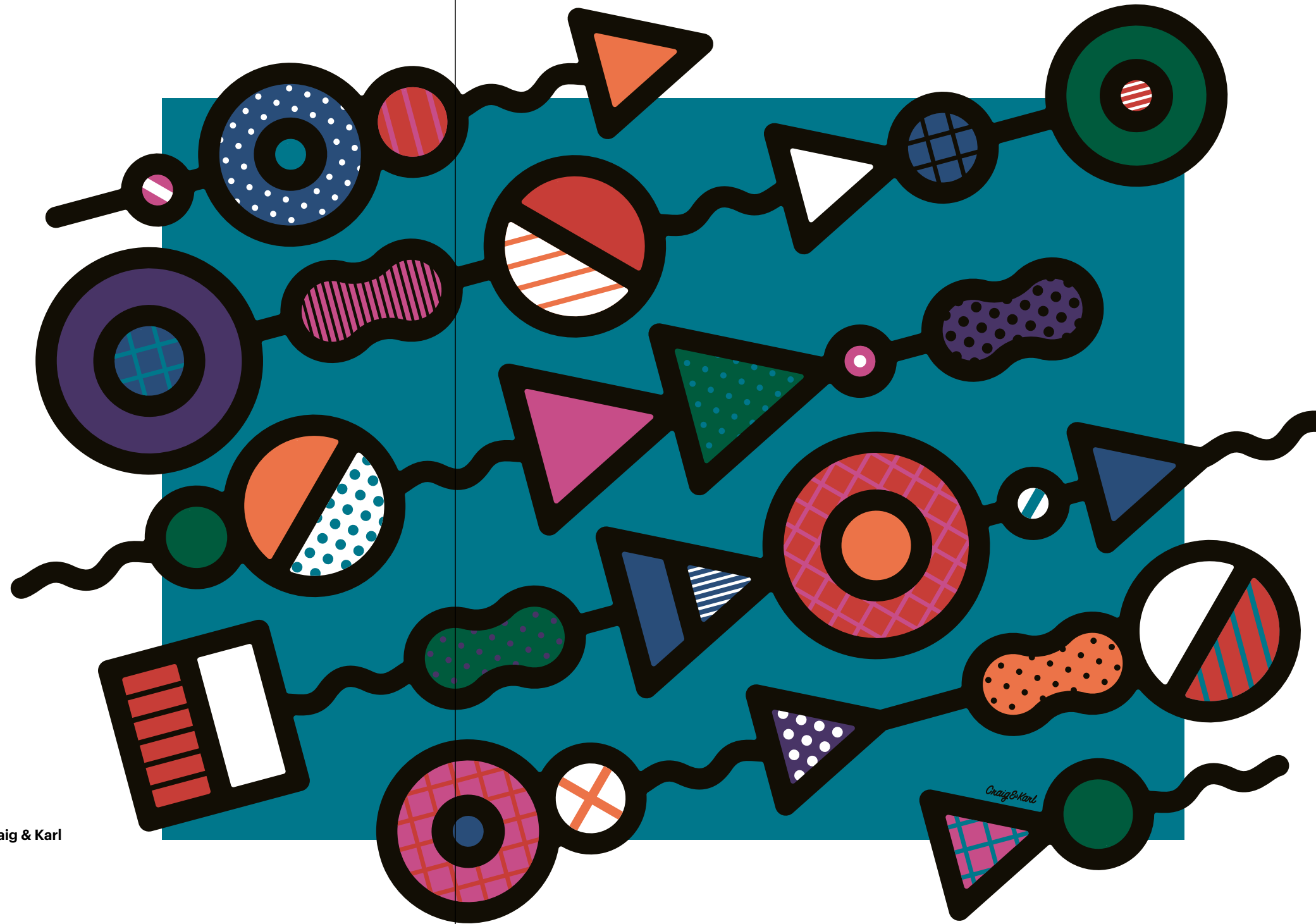


The State of Fashion 2018



BOF McKinsey&Company

The State of Fashion 2018



An emerging sense of optimism by **Craig & Karl**

Craig & Karl

The State of Fashion 2018 was created to provide a comprehensive view of the fashion industry. Its principal aim remains to lay out the interconnectedness of the entire fashion ecosystem across regions, 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 BoF-McKinsey Global Fashion Survey, and the McKinsey Global Fashion Index, which tracks industry sales, operating profit and economic profit (value creation).

The report is split into two sections: Section 1 provides an overview of some of the massive long-term changes in the fashion industry that serve as a backdrop for everything that is happening. These are overarching, interconnected forces that will drive and shape the trends in years to come. Section 2 provides an outlook for 2018, forecasting the expected growth for the fashion industry across regions, 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 the impact of artificial intelligence on ecommerce platforms and a once in a generation tipping point that could change the balance of power in the global fashion industry.

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FOREWORD



One year ago, McKinsey & Company and The Business of Fashion (BoF) set out to transform the level of debate about fashion by providing a foundation for rigorous in-depth research and analysis of the global fashion industry, focusing on the themes, issues and opportunities driving the sector and its performance.

Now, we are publishing our second annual report. Over the last months we have again put together an unrivalled global network of experts, research and analysis to bring you a report that makes sense of fashion's myriad segments, categories and geographies. Our aim remains threefold: first, to establish a common understanding of the forces that are shaping the industry; second, to provide clarity and transparency on the industry's performance; and third, to set the agenda for the topics that should be top of mind for business and creative leaders in 2018. By bringing together our two organisations, we have pooled resources to draw on BoF's deep industry expertise and insider access alongside McKinsey's functional, analytical and industry insight to offer a rare blend of quantitative rigour and sharp-eyed qualitative insights about the fashion sector. This year we surveyed more than 200

senior industry executives around the world and conducted in-depth interviews with some of the most influential and forward-thinking people in the industry. If you're engaged in the business of fashion – in the boardroom, as an entrepreneur building a start-up, or even as an informed shopper on the high street – this report will tell you what you need to know about the business trends shaping our industry's future.

This report includes the second readout of our industry benchmark: the McKinsey Global Fashion Index (MGFI). With a database of nearly 500 fashion companies, this index will allow for analysis and comparison of how a fashion company is performing against others in its market segment and product category, and this year we have also added a regional view. Already, the data set has grown and is becoming ever-more valuable as a source of insight into both the pressures on fashion and the opportunities emerging from the world's increasingly turbulent fashion markets.

Last year we made predictions about how the fashion world would pan out in 2017. In this report we make a new set of predictions for the year ahead. We believe that 2018 will be a watershed year in fashion. It is the year when Asia comes into its own: for the first time, more than half of apparel and footwear sales will originate outside of Europe and North America, and the beneficiaries will be emerging market countries across not only Asia-Pacific but also Latin America and other regions.

It is also the year when the industry will face unprecedented disruption – from ever-more-demanding customers, from the polarisation into high-end and value segments, from continuing changes to the fashion system.

It is a year that, more than ever, will have clear winners – and clear losers. The difference between the two will be their level of boldness, ambition, and courage. So ask yourself – what is yours?

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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In 2018, an important tipping point will be reached when, for the first time, more than half of apparel and footwear sales will originate outside of Europe and North America, as the main sources of growth are emerging market countries across Asia-Pacific, Latin America and other regions.

EXECUTIVE SUMMARY

Anticipating a new sense of optimism

The fashion industry is turning a corner. Looking towards 2018, there is a new sense of optimism in an industry plagued by uncertainty. And while “uncertain” and “challenging” remain the most common words that executives in the BoF-McKinsey Global Fashion Survey have used to describe the state of the industry this year, right behind them in third place is “optimism.”

The McKinsey Global Fashion Index forecasts industry sales growth to nearly triple between 2016 and 2018, from 1.5 percent to between 3.5 to 4.5 percent. But the rebound is not being felt evenly across the globe. In fact, 2017 signals the end of an era. The West will no longer be the global stronghold for fashion sales. In 2018, an important tipping point will be reached when, for the first time, more than half of apparel and footwear sales will originate outside of Europe and North America, as the main sources of growth are emerging market countries across Asia-Pacific, Latin America and other regions. Not surprisingly, this is also reflected in fashion executives’ sentiments, as respondents from emerging markets are more optimistic about the industry’s outlook in 2018.

This outlook varies across value segments too. The ongoing polarisation of the industry with consumers trading up or down from mid-market price points continues to create headwinds for mid-priced fashion players while those operating in the luxury, value and discount segments further pick up speed. What is new is that the absolute luxury segment is accelerating alongside affordable luxury.

These developments take place at the same time as the fashion industry is undergoing other transformative shifts. Alongside consumers’ adoption of digital are raised expectations of customer experience and a higher scrutiny on convenience, price, quality, newness and a personal touch. Leading players are therefore creating innovative business models, using granular customer insights as a source of differentiation and pushing the limits of their end-to-end product development process. The performance gap between frontrunners and laggards continues to widen: from 2005 to 2015 the top 20 percent of fashion companies contributed 100 percent of the economic profit, while in 2016 the top 20 percent contribution had increased to 144 percent.

The challenges of operating in a fundamentally changing industry and an unpredictable macroeconomic environment has led fashion players to “toughen up.” Industry players are coming to accept unpredictability as the new normal, and fashion executives will respond by focusing their energy on improving what is within their control. We expect to see several themes emerge as defining features of 2018, from Asian fashion players asserting their power on the global stage to personalisation at scale and cutting-edge deployment of artificial intelligence. For those leaning forward and willing to help design the new features of the modern fashion system, the opportunities at hand to truly connect with fashion consumers across the globe have never been greater.

THE STATE OF FASHION 2018

DISRUPTIONS

GLOBAL ECONOMY

- Volatility and uncertainty
- Global interconnectedness and competition
- Growth shift from West to South and East
- Disruptive technologies with accelerated adoption
- Urbanisation

CONSUMER SHIFTS

- Connected and in control
- Seamlessly move omnichannel during shopping journey
- Expecting zero friction
- Sharing peer-to-peer: information, reviews, opinions
- Expecting it all: convenience, quality, values orientation, newness and price

THE FASHION SYSTEM

- Digitisation across the value chain, with redefined cost structure
- Accelerated industry pace: Leaders push the limits of time from design to shelf
- Brands experimenting with direct-to-consumer
- New innovative business models
- Brick-and-mortar traffic in decline - reinventing the store
- Proliferation of data, providing business opportunities and challenges in control and security

TRENDS

Predictably unpredictable

01.

Geopolitical turmoil, economic uncertainty and unpredictability are the new normal.

Globalisation reboot

02.

Despite the rise of nationalism, isolationist rhetoric and reshoring, globalisation will not stall.

Asian trailblazers

03.

Asian players will assert their power and leadership even more through pioneering innovations and global-scale investment and expansion.

Getting personal

04.

Personalisation and curation will become more important to the customer.

Platforms first

05.

The question for fashion brands is no longer "if" but "how" to collaborate with big online platforms.

Mobile obsessed

06.

As consumers' obsession with mobile grows, the end-to-end transaction will also move to mobile.

AI gets real

07.

Leading innovators will reveal the possibilities of artificial intelligence across all parts of the fashion value chain.

Sustainability credibility

08.

Sustainability will evolve to be an integral part of the planning system where circular economy principles are embedded throughout the value chain.

Off-price deception

09.

Off-price sector growth continues to be driven by the notion that it provides a solution to challenges like excess stock and slow growth.

Startup thinking

10.

Due to an urgent and intense need for innovation across the industry, a growing number of fashion companies will aim to emulate the qualities of startups.

FORCES SHAPING FASHION

The fashion industry is going through a seismic shift. While The State of Fashion 2018 aims to look ahead and uncover the trends shaping the fashion industry in 2018, it is also important to take stock of some of the massive long-term changes that serve as a backdrop for everything that is happening. These are overarching, interconnected forces that will drive and shape the trends in years to come.

Exhibit 1 The many challenges that have been facing the fashion industry over the past few years continue to persist

Challenges identified by respondents to BoF-McKinsey Global Fashion Survey 2018
% of executives¹

TOP CHALLENGES IDENTIFIED FOR 2018

Dealing with volatility, uncertainty and shifts in the global economy 12

Competition from online and omnichannel 10

Value chain improvement and digitisation 9

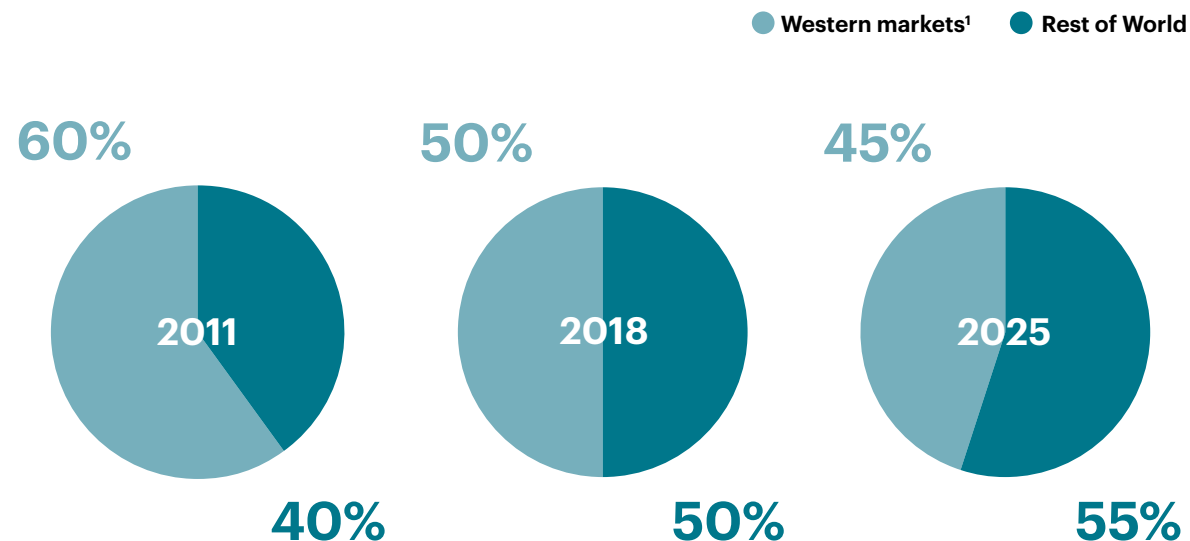
Decreasing foot traffic and offline retailing pressure 9

¹ % of respondents to BoF-McKinsey Global Fashion Survey 2017, N = 223

Question What do you think will be the single biggest challenge for the fashion industry in 2016 / 2017 / 2018
Source BoF McKinsey Global Fashion Survey 2017

Exhibit 2 By 2018 more than half of apparel and footwear sales will originate outside of Europe and North America

Global apparel and footwear sales forecast 2011-2025



¹ Includes North America and Europe (Mature and Emerging)

Source McKinsey Fashion Scope

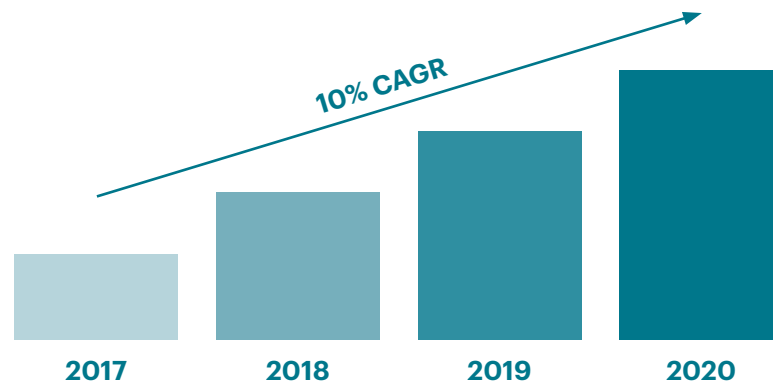
MACRO ECONOMY

Gone are the days when Western markets were the global economic stronghold. Economic growth is shifting from mature regions in the West to emerging markets in the South and East. According to McKinsey FashionScope, by 2018 more than half of apparel and footwear sales will originate outside of Europe and North America (Exhibit 2). Rapidly growing cities in emerging markets are particularly important growth centres for the fashion industry. Many incumbents with developed countries as their core markets face a stagnating sales outlook and profitability, and must seek new pockets of growth.

Furthermore, adoption of disruptive technologies like advanced robotics, mobile internet, advanced analytics, virtual- and augmented reality and artificial intelligence is accelerating, with the potential to disrupt entire industries – including fashion. And with increased digital cross-border trade, it becomes harder for “local heroes” with an average value proposition to compete when anyone who is best at what they do could in theory become a global champion.

Exhibit 3 Mainstream fashion customers are adopting digital channels**Growth in online sales of apparel and footwear globally 2017-2020**

%



Source: Euromonitor

CONSUMER SHIFTS

The global fashion industry is moving into a decisive phase of digital adoption by the mainstream consumer, and online sales of apparel and footwear is projected to grow rapidly (Exhibit 3) not the least in emerging markets. On average, consumers in Southeast Asia spend about eight hours a day online; from social media to video streaming and shopping amongst other things.¹ The modern shopper's comfort with digital channels and content has changed the consumer purchase journey from a traditional linear model, to a complex journey across online and offline touchpoints. But regardless of touchpoint, consumers expect a consistent brand experience at all times.

Digital-first e-commerce companies from Amazon to Zappos, and Alibaba to Net-a-Porter are continuing to raise the bar – not least for fashion companies aspiring to provide an even-more-premium experience. Many consumers today expect perfect functionality and immediate support at all times. They are becoming habituated to rapid delivery times as players are constantly competing to expedite products more quickly, as we have seen through the partnership between Farfetch and Gucci, which offers delivery in selected cities from the store to a customer's home in 90 minutes or less. Customer attention is also tuned to new communications channels. In the Philippines, Brazil and UAE, social media users report that they are now spending more than three hours per day on average on these

Exhibit 4 New influences to consumers' purchase decisions**Customer shopping habits**

Sources: Kissmetrics, Social Media Week

platforms.² This has a profound impact on fashion, as purchase decisions are influenced by social media, peer reviews and influencer marketing (Exhibit 4).

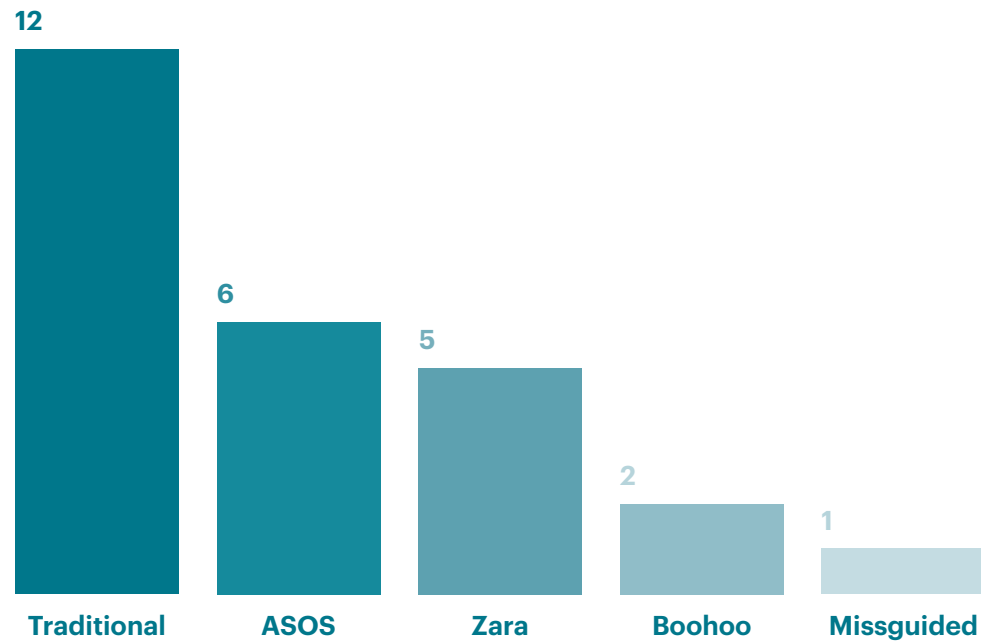
With information and the ease of comparison at their fingertips consumers are becoming less brand loyal: among millennials, two-thirds say they are willing to switch brands for a discount of 30 percent or more. But while they are very price sensitive, they also base more of their purchasing decisions on whether a company's practices and mission align with their values. This is a generation that has higher expectations on what a company should be able to deliver: convenience, quality, values orientation, newness – and price.

THE FASHION SYSTEM

Hand-in-hand with the online movement, many fashion companies are experiencing a steep decline in brick-and-mortar traffic. They are simultaneously looking for ways to reduce store operating costs, re-evaluate store networks and innovate the in-store experience to attract customers. The digital shift has hit some harder than others. For example, US department store sales have fallen drastically in recent years and mall closures are expected to increase. Sluggish sales in the department store channel, combined with a desire to improve margins and control brand presentation, markdowns and customer data, are causing brands to move to direct-to-consumer-models. While many

Exhibit 5 Leading fashion players accelerate time from design to shelf

Average time to shelf
in weeks

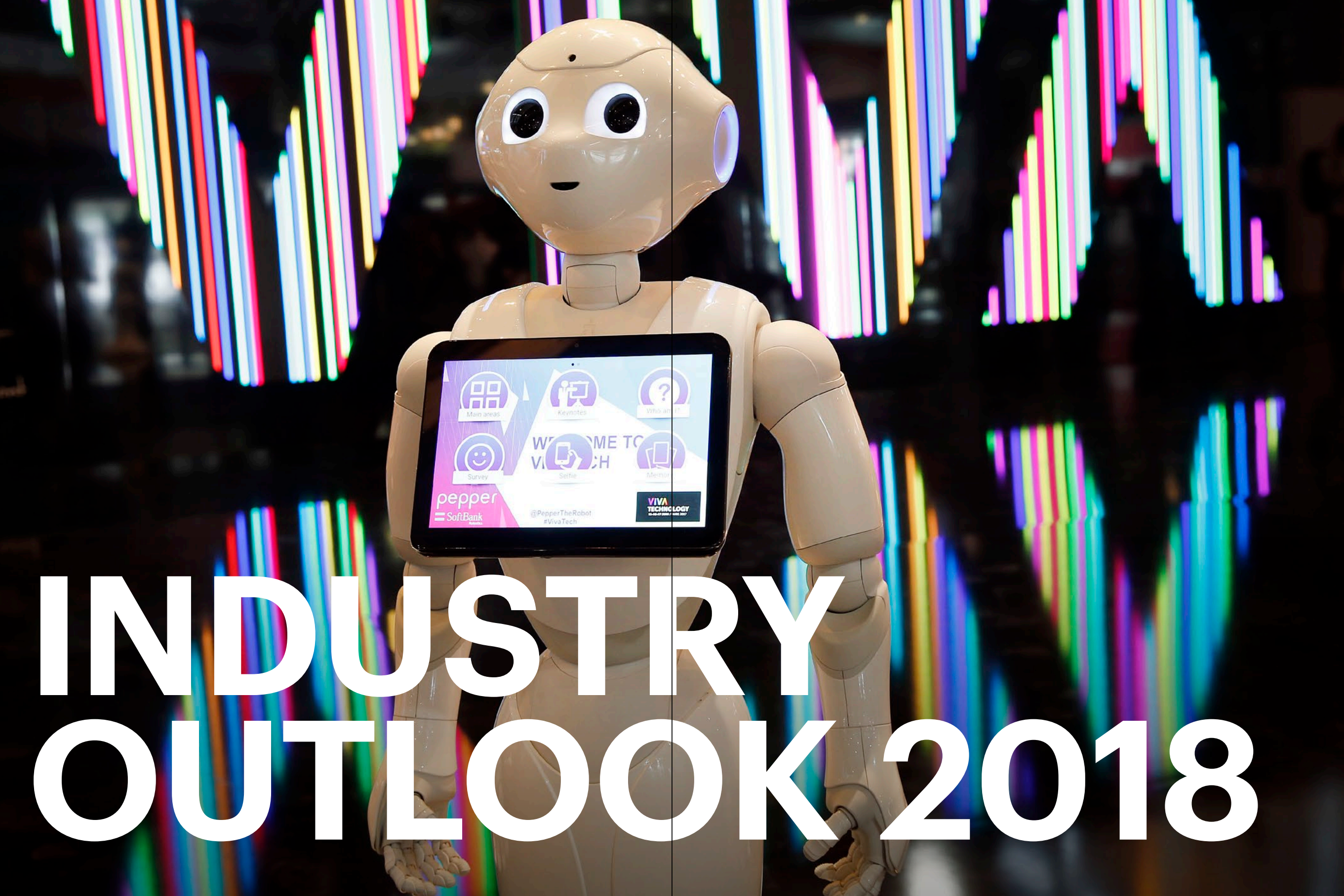


Source: Business Insider UK

fashion players are working hard to deliver a seamless, integrated shopping journey across touchpoints, the hurdles remain high with complex technology implications, as well as operational, logistical, organisational and governance headaches. Furthermore, omnichannel efforts have often proved difficult to deliver profitably. Meanwhile, the fashion industry is being disrupted by innovative business models. Examples range from data-driven subscription-based services like Stitch Fix, to sharing economy startups such as VillageLuxe and peer-to-peer selling at Grailed.

The proliferation of data and exponential increases in technology performance have opened the door to the use of big data. The use of rich data and granular customer insights to inform decisions offers business opportunities across the fashion value chain, in areas ranging from dynamic pricing to optimised product replenishment. While the benefits of leveraging data can be significant, new challenges also arise, such as protecting customer data and privacy.

The fast pace of the industry is shaking up the fashion system. Sales of the traditional fast fashion-sector have grown rapidly, by more than 20 percent over the last three years, and new online fast fashion players are gaining ground.³ To keep up, leading fashion players are accelerating the time from design to shelf, including the recent announcement from Gucci that it will focus on supply chain optimisation and responsiveness (Exhibit 5). This “need for speed” is driven partly by social media bringing fashion trends to more consumers at a faster pace than in the past. Industry leaders are also pushing up standards as analytics and customer insights enable them to meet customer needs better and improve responsiveness. But speed and flexibility bring new challenges. Shortening lead times requires major changes to the traditional business model and supply chain setup, and a shift in focus to a customer-centric model – with the customer as the principal driver of design, production and merchandising. How fashion companies play today varies widely. Companies still playing by the old rules, with prolonged end-to-end product development processes, face increased fashion risk and excess inventory if they are not able to match customer demand. But others are building agile supply chains supported by higher-quality consumer insights. Fashion players that lead on speed are pushing the limits of their creative process and are performing supply chain acrobatics, with the frontier being close to a real-time supply chain fed by “test and learn” and data analytics.



INDUSTRY OUTLOOK 2018

After a tough but improving 2017, a continued recovery is on the horizon for 2018. But economic volatility and demanding consumers continue to make a full recovery across all regions unlikely. But executives responding to our survey highlight several opportunities for growth in 2018 – but only for those who are courageous enough to lean in and capture them.

2018 OUTLOOK

After a tough but improving 2017, a continued recovery is on the horizon for 2018. The McKinsey Global Fashion Index projects global fashion industry sales to grow by 3.5 to 4.5 percent in 2018 (see page 74 for details on the MGFFI outlook for 2018). But this growth is not spread evenly across all regions or segments. Growth is being driven by emerging markets ([Exhibit 6](#)), where executives in Asia-Pacific, emerging European countries, and Latin America responding to the BoF-McKinsey Global Fashion survey, are more positive about the overall business outlook ([Exhibit 7](#)).

Indeed, economic volatility and demanding consumers continue to make a full recovery across all regions unlikely. But executives responding to our survey highlight several opportunities for growth in 2018 – but only for those who are courageous enough to lean in and capture them. These range from omnichannel integration to the digitisation of the value chain. In a time of disruptive shifts, a clear majority of companies will focus on growth management: 66 percent of survey partici-

Exhibit 6 McKinsey Global Fashion Index sales growth forecasts for 2018, total fashion and selected geographies and segments

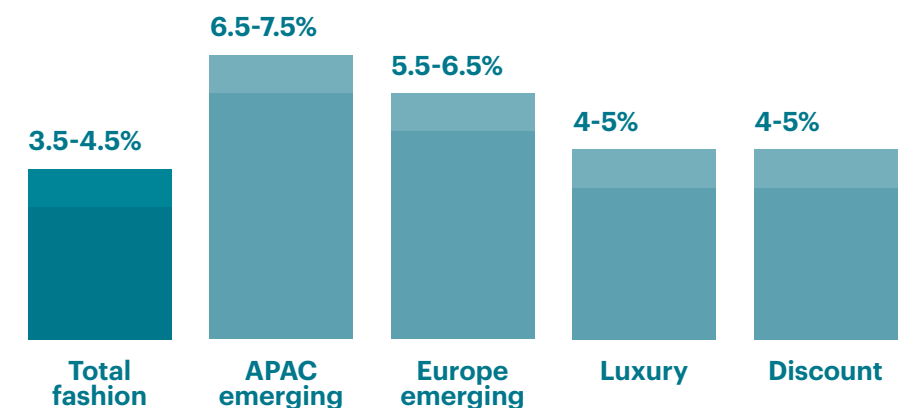
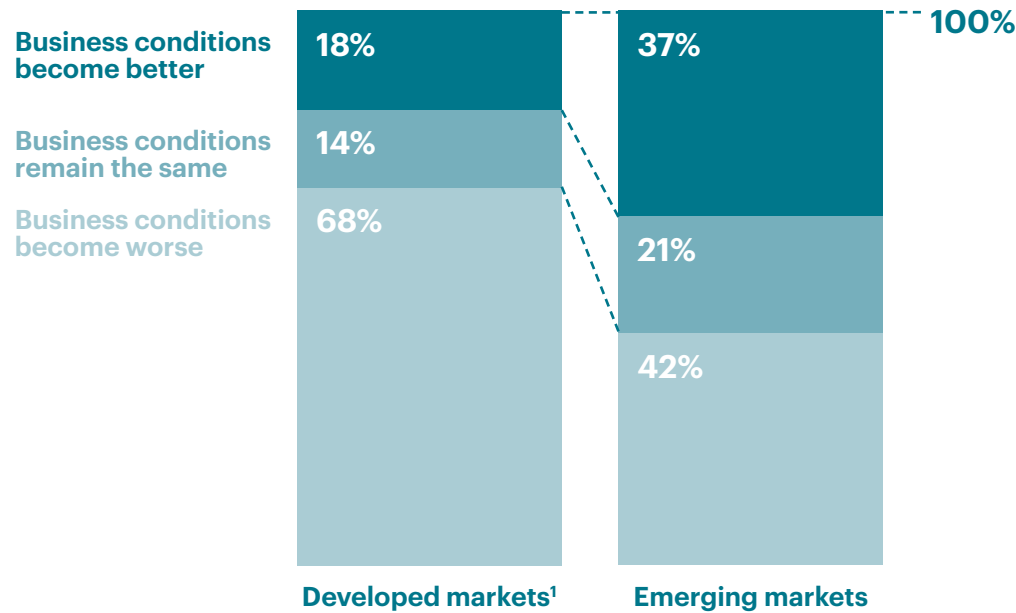


Exhibit 7 Fashion executives in emerging markets are most positive about 2018 business conditions

2018 business sentiment among respondents to Bof-McKinsey Global Fashion Survey 2017, developed vs. emerging markets
% of respondents



¹ Includes North America, Europe mature and APAC mature

Question How do you expect conditions for the fashion industry to develop over the course of 2018?
Source BoF-McKinsey Global Fashion Survey 2017

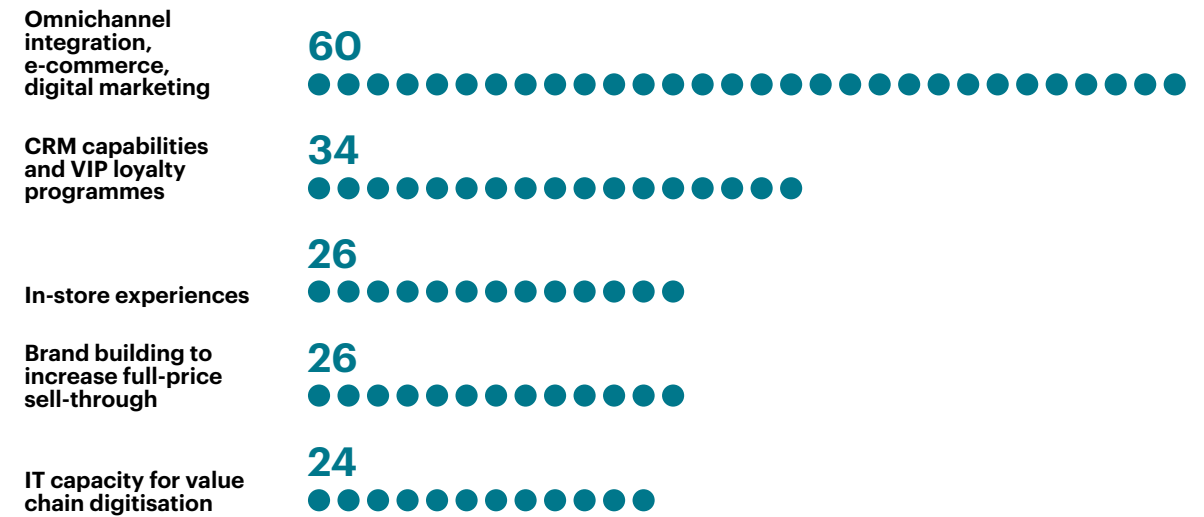
pants say they will focus on improving sales growth in 2018, versus the 16 percent who will focus on cost improvements and 18 percent on sales and cost. Increasing omnichannel integration and investing in e-commerce and digital marketing capabilities are cited as the top priorities (Exhibit 8).

With the insights gleaned from our survey, interviews with fashion industry executives and experts and research throughout the year, we have identified ten major trends that we expect to shape the fashion industry in 2018. These ten trends fall into three main categories: the global economy, consumer shifts, and changes in the fashion system. All in all, 2018 will be another challenging year for fashion players – but, for those willing to help design the new features of the modern fashion system and lead the way through it, 2018 will also offer plenty of excitement.

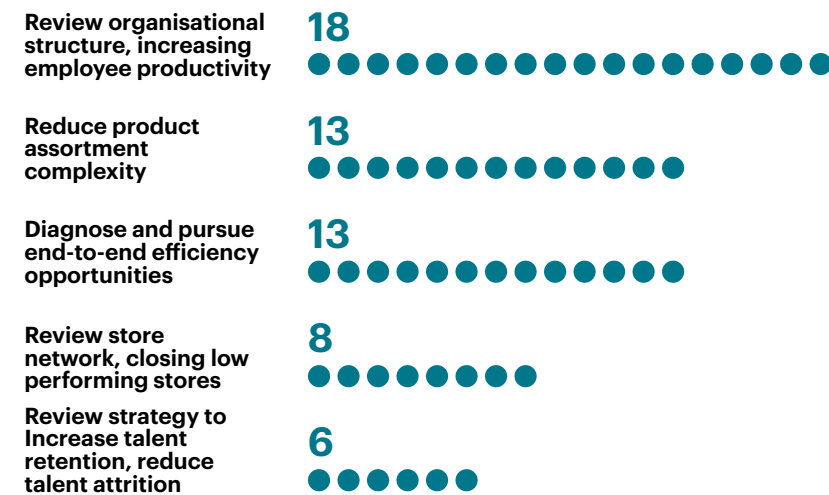
Exhibit 8 Fashion executives will focus more on sales & growth improvements in 2018

Priority areas for 2018
% of respondents

SALES GROWTH AND INVESTMENT



COST IMPROVEMENTS



Question What are the top 3 priority areas for your company in 2018?
Source BoF-McKinsey Global Fashion Survey 2017

THE STATE OF

FASHION 2018

GLOBAL ECONOMY

Predictably unpredictable

01.

Geopolitical turmoil, economic uncertainty and unpredictability are the new normal. Fashion companies and executives must continue to be vigilant and nimble in order to adapt to an ever-changing environment but they will increasingly focus on directing their energies towards what is within their control.

What words would you use to describe your feeling of the fashion industry? % of total respondents who mentioned this word



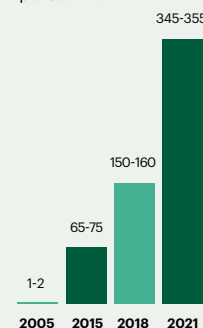
Uncertain as Nr. 1 word in 2016 and 2017 – but optimistic as Nr. 3 in 2017

Globalisation reboot

02.

Despite the rise of nationalism, isolationist rhetoric and reshoring, globalisation will not stall. A new phase of globalisation characterised by the exponential growth of cross-border bandwidth, connectivity and digital data flows will alter the global playing field and give certain players a competitive edge.

Development of cross-border bandwidth in thousands of gigabytes per second



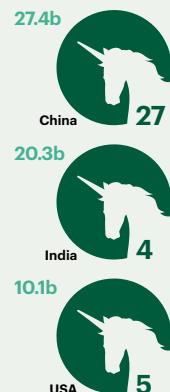
31% annual growth in cross-border bandwidth 2015-2018

Asian trailblazers

03.

With two thirds of the world's e-commerce unicorns, more than half of global online retail sales, and countless digital and tech innovations, Asia is no longer waiting for Western companies to step up. Asian players will assert their power and leadership even more through pioneering innovations and global-scale investment and expansion.

Number of unicorns in e-commerce and valuation in USD



60% of global e-commerce unicorns from China

CONSUMER SHIFTS

Getting personal

04.

Personalisation and curation will become more important to the customer. As consumer values coalesce around authenticity and individuality, brands will value data even more to tailor recommendations, engage influencers and personalise experiences. The fashion companies that flourish will re-focus on their strengths.

Demand for personalisation of the shopping experience



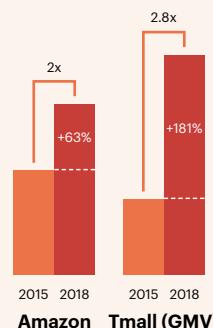
Personalisation as No. 1 trend for 2018

Platforms first

05.

Consumers will increasingly look to online platforms as the first point of search, attracted by their convenience, relevance and breadth of offering. Whether mass, specialist or premium, platforms will continue to grow in scale and reach compelling fashion brands to find ways of engaging more with these powerful sales channels. The question for fashion brands is no longer "if" but "how" to collaborate with big online platforms.

Estimated revenue growth of online platforms, in % and x times



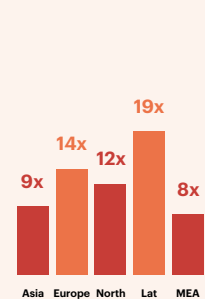
2-3x more revenue on global online platforms in 2018 vs. 2015

Mobile obsessed

06.

As consumers' obsession with mobile grows, the end-to-end transaction will also move to mobile. With an overabundance of mobile payment solutions already available globally, consumers will expect fashion companies to cater for increasingly convenient mobile transactions.

Global mobile payment transaction value, times increase 2015-2018



8-20x more global mobile payment transaction value in 2018 vs. 2015

THE FASHION SYSTEM

AI gets real

07.

Leading innovators will reveal the possibilities of artificial intelligence across all parts of the fashion value chain, exploring new ways of creating value for those employed in the fashion industry. AI enhancements will go beyond the traditional areas of machine tasks into creative and customer interaction processes, blurring the line between technology and creativity.

Online fashion retailer investment in AI in the next 2 years



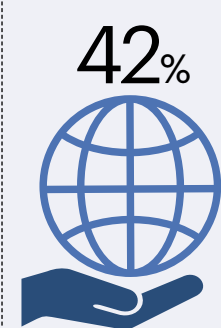
>75% of fashion retailers plan to invest in AI in 2018/2019

Sustainability credibility

08.

Sustainability will evolve from being a menu of market-focused CSR initiatives to an integral part of the planning system where circular economy principles are embedded throughout the value chain. More fashion brands will plan for recyclability from the fibre stage of the supply chain and many will harness sustainability through tech innovation in order to unlock efficiency, transparency, mission orientation and genuine ethical upgrades.

Fashion brands disclosing supplier information, in % out of 100 large fashion brands, 2017



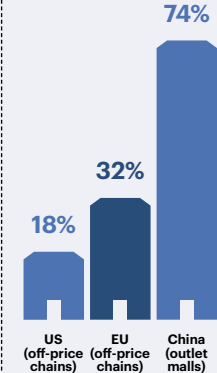
42 out of 100 fashion brands disclose supplier information

Off-price deception

09.

Off-price sector growth continues to be driven by the notion that it provides a solution to challenges like excess stock and slow growth, but the US market serves as a warning about saturation and possible sales cannibalisation. As Europe and Asia get hooked on the myth of an off-price 'panacea', the fashion industry could be put at risk of margin erosion unless companies carefully consider their off-price channel strategies.

Off-price growth from 2015-2018



Off-price growth of 18% in the US; 32% in EU; 74% in China

Startup thinking

10.

Due to an urgent and intense need for innovation across the industry, a growing number of fashion companies will aim to emulate the qualities of startups such as agility, collaboration and openness. Traditional and heritage players will continue to be compelled to open their minds up to new types of talent, new ways of working, new kinds of partnerships and new investment models.

Most important barrier to meeting digital priorities, in % of 2,135 respondents of McKinsey Digital survey 2016

Culture and behavioral changes
Lack of understanding of digital trends
Lack of talent for digital

Culture and behavioral changes as most important barrier to digital

GLOBAL ECONOMY

01. Predictably unpredictable

Geopolitical turmoil, economic uncertainty and unpredictability are the new normal. Fashion companies and executives must continue to be vigilant and nimble in order to adapt to an ever-changing environment but they will increasingly focus on directing their energies towards what is within their control.

The story of the last decade is one of immense economic and political uncertainty. Significant world events grow in frequency, from terrorist attacks to geopolitical turmoil, such as Qatar's stressed diplomatic relations with its neighbours and the growing nuclear threat caused by tensions between North Korea and the United States. In addition, the number of natural disasters worldwide is on the rise. Like terrorist attacks, natural disasters are not only devastating for the people they directly affect but have major consequences for local communities, companies, and infrastructure. It is not surprising that fashion executives continue to use "uncertainty" and "challenging" to describe the industry today.

While the macroeconomic situation in the United States has improved considerably in recent years, it is unclear whether sweeping policy reforms will be implemented, and what consequences they might have. Moody expect the US economy to pick up momentum, while the IMF has downgraded its forecast – citing uncertainty about the timing and nature of US fiscal policy changes as a major factor. Compounding the issue are the dollar devaluation against several major currencies, the potential US withdrawal from major trade agreements and the move to reduce the amount of manufacturing that is offshored.

Meanwhile, the US fashion market is facing ongoing challenges as an overdue market correction continues: by mid-2017, announced store

closures were already more than three times the number of closures in all of 2016.⁴ On top of that, more than 20 percent of malls are expected to close by 2020.⁵ Given the unpredictable nature of future economic development, many US fashion companies will likely have some difficult strategic decisions to make in 2018.

This unpredictability goes far beyond the US. Across Europe, economies are recovering, however concerns over future crises and uncertainties are driving companies to increase their cash reserves.⁶ The potential challenges and impacts of Brexit and the Catalonian independence movement are still unclear. The continued strength of the global equity markets could pose a threat to economic stability, given that it is not fully supported by strong fundamentals.⁷ As the risk of asset bubbles heightens, so does the risk of another global financial crisis. What's more, the global geopolitical mood seems to be increasingly tense.

Asia is not insulated from the uncertainty either. Indeed, the Thomson Reuters/INSEAD Asian Business Sentiment Index showed that despite improving economic performance in most of the region, business confidence among Asian companies fell at the end of 2017. This was attributed to escalating geopolitical tensions in the region, everywhere from the Korean peninsula and Japan to Myanmar.⁸

The frequency of catastrophic events is shaping a new mindset among business leaders,

who have now come to expect the unexpected. Fashion executives are no exception. "We're living in times that are incredibly unpredictable," says Laurent Potdevin, the CEO of Lululemon. "And I don't think it's going to change, I think it's going to continue to be unpredictable".

This mindset change may explain the newfound optimism amongst some of this year's respondents to the BoF-McKinsey Global Fashion Survey. "Optimistic" was the third most cited sentiment respondents used to describe their view of the state of the fashion industry. While domestic political conflicts, policy reforms, and geopolitical instability are identified as common risks to growth, as in last year's survey, fashion businesses globally around the world report that conditions are improving.

In 2018, fashion executives will need to accept the fact that change and instability are fixed features of the current business climate, and to focus their efforts on those aspects of the business that they can control. "You can't control everything," says Levi Strauss's Chip Bergh in an interview for the State of Fashion 2018. "But we can control what our actions are. We can control what we're going to do. We can control where and how we deploy our resources, what areas of our strategy we're going to focus on."

Successful companies will need to become agile in the technical sense: working fast and iteratively, always keeping customer needs at the forefront. Truly agile organisations are paradoxically both more stable and dynamic, as the combination of employee empowerment, short development sprints and bringing solutions rapidly to customers can help a company become more nimble.⁹ "There's so much that is happening all the time that you need to be quite reactive, quite nimble, quite flexible," says Victor Luis of Coach – adding that companies need not to lose "sight of the fact that you can't make a lot of short-term decisions that impact the long-term health of a brand."

Outside the boundaries of an individual company, agility will also require fashion companies to continue to build flexible supply chains and delivery models that can respond quickly when the environment changes. It also means strengthening risk management. When making investments in 2018, fashion executives need to respond to sudden disruptions, but should be wary of making decisions based solely on the anticipated short-term effects of such disruptions and losing sight of their long-term aspirations.



CEO TALK

CHIP BERGH

PRESIDENT & CHIEF EXECUTIVE OFFICER OF LEVI STRAUSS & CO.

The CEO of the iconic American denim and apparel brand speaks to BoF about managing through a time of unprecedented change and navigating the ongoing challenges in the US wholesale sector, while seizing the opportunities presented by new technologies.

by Imran Amed

BoF: What were the defining themes of 2017?

Chip Bergh: The industry is seeing massive amounts of disruption from multiple sides. There is channel disruption with the evolution of these large, powerful pure play e-commerce players, whether that's Amazon in the United States, Zalando in Europe or Tmall in China. With the transparency that now exists online and the ability to shop by price, the consumer is obviously more informed today, has access to more information more quickly than ever before and has much higher expectations and standards than they did even five or six years ago. And finally there is speed and agility: every company is trying to figure out how to do things smarter, faster, quicker to market, so that they can respond to changing consumer signals in a really timely way, without needing to eat a lot of excess inventory.

BoF: What about China?

CB: In China, everything is on steroids. China is embodying all of these trends on a magnified basis because it was coming from behind — now it seems to be almost out in front. Tmall and Alibaba have grown massively. Five or six years ago, most of the e-commerce that was done in China was cash on delivery. It was delivered by a person, they'd come, they'd let you try product on, you would keep what you wanted and pay them. There was no real financial transparency. Credit cards weren't used broadly by consumers in China. AliPay, WeChat Pay — none of that existed. Now consumers don't even carry a wallet in China. Everything's electronic and the speed with which it has happened — WeChat with 600 million users in China alone — is just immense.

BoF: Have the big online e-commerce platforms that you mention become too big and important for a brand like Levi's to ignore?

CB: We've been selling directly to Amazon for a while now; they're a major customer. Amazon in the US is our fastest growing customer — they're a top 10 customer globally. Outside of the US, Tmall and Zalando are big, [also] Flipkart. I think brands really have to consider what their strategy is with each of these big customers first and foremost. Do they want to play or not? You can't disregard the fact that most of these platforms run a third-party marketplace, so, whether you like it or not, they're probably going to have a third-party marketplace for your brand; your brand's likely going to be on that site anyway.

I want to have as much control of the brand as possible on these platforms; it's better for us than a third-party marketplace. So for the most part, we are playing with all these major online platforms and we have a pretty healthy business with most of them.

BoF: What will be the biggest challenge of working with companies like Amazon?

CB: The big challenge now is that Amazon is introducing their own private-label apparel business and they're going to be massive in apparel over time. They're already very big, almost \$20 billion of apparel. They don't have a private-label jeans brand but they're collecting a lot of data on today's consumer and I think their real power, over time, is going to be the data they're able to collect on their consumer. It's just a question of time. You've got to love them, work with

them and partner with them; recognise and respect the size and the scale of the business that they have; and recognise that they could become competitors.

BoF: There are also ongoing challenges in the US wholesale business.

CB: Yes, in our largest market, in our largest channel, some of our largest customers are struggling right now. This is part of the disruption that I was talking about. The US is still one-half of our business; about 70 percent of the US business is wholesale — you can do the maths. About a third of the company's overall results reside in this one channel and it largely comes down to a couple of very key customers.

I think it's going to shake out. It may take another year or two, and we're not accepting that our business is just going to decline in wholesale. There are other wholesale players that are performing reasonably well, including smaller chains. To some extent it's about the distribution, the number of doors that you're in and the strength of your business in those doors. As we face inevitable door closures with some of those big customers, we're looking at: where do we have opportunities to add new doors? Not necessarily our own retail business, but other wholesale customers that represent an opportunity for us.

BoF: To add to that, it's clear that the economic and political situation in the US remains ambiguous, with uncertainty around fiscal policy, trade policy, the dollar and issues with immigration. What is the impact?

CB: There are some pretty gloomy scenarios out there, whether it's border adjusted tax [or] NAFTA falling apart. Any one of these things could have a major impact on the apparel industry here in the US. I made a trip to DC two or three months ago to meet with some of the administration as well as some congressmen and senators about the border adjusted tax. For Levi Strauss & Company, if the border adjusted tax was put into place, this company would make no money, even our profitability would go negative. That's how big of an impact it would have on us. Almost 99 percent of the apparel industry is imported; the way the tax was going to work is we would've had to pay taxes on the full value of the goods that were being imported.

What's going to happen with NAFTA? Nobody really knows. We're in the midst

now of trying to negotiate, but every now and then you hear, "Well we're just going to walk away from it." The hardest thing is the unpredictability of what's going to happen in Washington.

BoF: What's your strategy for managing through this period of uncertainty?

CB: We've been around for [almost] 164 years. We've seen 30-plus presidents and administrations come and go and we've been through it all. We've been through world wars, we've been through the Great Depression. I'm a big believer on focusing on the things that you can control. It is difficult to predict where we are heading in the current political environment in the US. We can try to influence it, but we can't control it. We can [only] control what our actions are. We can control where and how we're going to allocate the critical resources — whether it's money or people or whatever — to deliver the growth that we expect from ourselves and have committed to our shareholders.

BoF: What do you think are the themes to watch out for in 2018?

CB: One is the role of big data and artificial intelligence, and how brands and companies really begin to leverage that to do a better job of connecting with consumers and even formulating what their products and assortments look like. The second big thing is this whole fourth industrial revolution [and] the impact of digital, whether it's 3D printing or graphic printing. Over time these things are going to have an impact on the industry and how brands tap into the digital world. The digitalisation of manufacturing is going to become more of a factor in this industry over the next couple of years.

The last thing is I do think a shakeout is coming. There are going to be winners and losers. There are going to be brands that aren't going to make it. You can probably run down the list almost as easily as I can. There are a lot of brands [weighed down by debt] that are highly dependent on customers that aren't doing very well. I think [only the] strong brands are going to survive and that's why I keep coming back to the strength of the Levi's brand as one of the biggest assets we have. I'm really focused on how do we make it even stronger.

This interview has been edited and condensed.

"It is difficult to predict where we are heading in the current political environment in the US. We can try to influence it — but we can't control it. We can [only] control what our actions are. We can control where and how we're going to allocate the critical resources — whether it's money or people or whatever — to deliver the growth that we expect from ourselves and have committed to our shareholders."

02. Globalisation reboot

Despite the rise of nationalism, isolationist rhetoric and reshoring, globalisation will not stall. A new phase of globalisation characterised by the exponential growth of cross-border bandwidth, connectivity and digital data flows will alter the global playing field and give certain players a competitive edge.

In this new world, globalisation can seem like a dirty word. Across the globe we are seeing increasingly nationalistic rhetoric in public debate, leading to the protectionist stance taken by many countries with initiatives such as “Made in America” and “Made in China 2025”. One practical consequence is a shift in global trade alliances, which are altering trade dynamics. For example, the US withdrawal from the Trans-Pacific Partnership (TPP) is likely to impact both imports and exports of fashion products in the US (with widespread consequences given that the US is currently the largest importer of apparel globally).¹⁰ The ramifications of this move, combined with rising labour costs in many traditional manufacturing hubs and technology improvements, could make re-shoring more commercially viable for fashion companies in the US, as identified in McKinsey’s recent Apparel CPO Survey report. In the same report, more than one-third of surveyed chief purchasing officers said they expect their companies to make increased use of re-shoring. At the same time, consumption has shifted towards the manufacturing centres of the world, local brands and retailers in China and India are growing, and with that the local-for-local production base as well as regional trade networks.

But reports of declining globalisation are much exaggerated. Even with the apparent increase in isolationist behaviour in some countries, globalisation is not stalling. On the contrary, we are entering a new phase of globalisation, driven by digital connectivity and the flow of data, and this will lead to much greater global connectedness, not less. Cross-border bandwidth has risen approximately 80 times since 2005, and over the course of a decade, data flows have raised world GDP by more than 10 percent. Data flows now account for a larger share of the impact on GDP than the global trade in goods. This

trend is expected to continue, with cross-border bandwidth projected to grow by another five times in the next four years. New forms of connectivity will emerge. For example, 40 percent of global devices and connections in 2019 will be machine-to-machine, according to a Cisco estimate.

A significant portion of this global flow of data is intracompany traffic. This includes making transactions, tracking information, and communicating internally and with suppliers and service providers. For many years, large, established companies enjoyed cost savings from building their own systems to deal with these cross-border interactions, which were costly for smaller companies. But the recent exponential rise in connectivity has brought an array of new ways to interact across borders that are inexpensive and open to all kinds of businesses, from operating systems to marketplaces and social networks. Individuals, too, are playing an important role in this new digital globalisation. More than 900 million people have international connections on social media, and consumers are estimated to spend \$1 trillion on cross-border e-commerce by 2020. The largest online ecosystems, such as Facebook, Youtube, WeChat and Whatsapp, have built user bases the size of country populations: between 2013 and 2015 the number of SMEs on Facebook reached about 60 million.¹¹ The emergence of these ecosystems has not only improved the transparency and efficiency of global markets but has also democratised global connectivity by reducing the costs of international communication and transactions.

This growing global connectedness is driving up competitive intensity in the fashion industry. The advantage that established companies enjoyed as a result of their assets – from physical distribution infrastructure to proprietary systems for cross-border communication – is likely to diminish. In 2018, more fashion companies will



take advantage of opportunities to enter new markets, as connectivity allows for access to customers worldwide through own or third-party platforms. Companies enter new markets without establishing a significant physical presence. The ramifications of global connectivity are especially important for younger fashion players, who now have the potential of reaching global scale and becoming “micro-multinationals”: in a recent McKinsey Global Institute survey, 86 percent of startups state they are engaged in at least one cross-border activity. One noteworthy example is Matchesfashion.com, which started as a small chain of local neighbourhood boutiques in London and has since expanded to 190 countries through online channels. Manufacturing companies from Asia develop brands and reach global consumers directly. No longer sheltered by traditional advantages, established fashion players should expect increasing competition from all corners of the world, and from a broader array of companies as startups go head-to-head

with incumbents – all of whom are enabled by virtual connections.

Established companies that operate across markets stand to benefit from growing connectivity as well. They can simplify existing global operations and internal communications through virtual connectivity and improved systems for accessing information in real-time. Incumbents can take advantage of digital ecosystems in the same way as smaller companies, gaining access to customers worldwide – especially those in new segments or in fast-growth markets. New digital collaboration models between fashion companies and their foreign suppliers and service providers can improve transparency and efficiency. Transparency, traceability and trust throughout the value chain can be further enabled by blockchain technology. Companies will be able to tap into global ideas, trends, and talent pools faster and more efficiently, from crowdsourcing innovation ideas online, to virtually connecting with creative or other talent from the other side of the globe.

Next year non-Western markets will account for a greater share of global apparel and footwear sales than Europe and North America. But how will the increasingly important regions of Asia, the Middle East, Latin America and Africa leverage their newfound status to gain even greater impact and influence on the global fashion industry?

IN DEPTH: GLOBALISATION REBOOT

FASHION'S NEW CENTRE OF GRAVITY

by Robb Young

LONDON, United Kingdom — Hindsight really is a wonderful thing. When future historians look back on 2017, they will see several potent symbols of the new world order hiding in plain sight. Obscured by some of the more dramatic events of the year, one discreet milestone that many mistook for a novelty was actually far more telling than it seemed. In October, for the first time since records began, it was revealed that a country in Asia now had the most powerful passport in the world.

According to the Passport Index, a tool developed by residence advisory firm Arton Capital, this year saw Singapore depose Germany in its global ranking. Until then, the best passport to have — based on the number of countries granting visa-free entry or visa on arrival — was from a European or North American nation.

Barrier-free entry matters not only because mobility is an extremely valuable currency in today's globalised business environment but also because it is a measure of a nation's soft power, which in turn bolsters the standing and bargaining power of local companies, brands and entrepreneurs on the international stage.

For Singaporean startups like ViSenze, an AI-powered visual search engine used by the likes of Uniqlo and e-commerce platforms such as Myntra in India and Rakuten in Japan, having executives with a powerful passport represents a subtle but meaningful competitive advantage — especially when the company grew its international footprint by opening new offices in San Francisco, London, New Delhi and Beijing.

Singapore's recent "passport coup" is just one of many signs that point toward the probability that the 21st century will indeed be "Asia's century" and, more broadly, that the West's grip on power is gradually waning. But at a time when the world's axis is tilting east and south in a new and sometimes uncertain era of globalisation, not all industries are adapting fast enough to these monumental shifts.

New power brokers herald end of an era

Although its supply chains and retail networks have perhaps never been more globally expansive, the fashion industry remains disproportionately skewed toward Europe and the US. Even in recent years, the fashion industry has been guilty of seeing the world through a rather patronising prism of "the West and the Rest." For far too long, some insiders claim, the regions of "the rest" — the huge expanse that includes Asia, the Middle East, Latin America and Africa — were treated as an after-

thought. But now, in some ways though not all, the balance of power is shifting in their favour.

"It's crazy but it really wasn't that long ago that the corporate fashion world reduced the whole planet down to three territories. I remember the days when you'd look at a brand's financial report or some strategy document and see that they were literally only thinking about Europe, America and Japan. Everywhere else was lumped together in a footnote called 'ROW' which was basically this miscellaneous 'rest of the world' bucket. That kind of says it all, don't you think?" quips Shaway Yeh, group style editorial director of Modern Media Group in China.

"Now the industry is obsessed with China because they're so dependent on it... but, you know, old habits die hard. Even though most brands now have a presence in most major countries, the way [fashion leaders] in the West approach the rest of the world needs to change. Apart from China, I don't think they give most other emerging markets enough attention or acknowledge their contributions or needs or even their market value for that matter," she adds.

There couldn't be a better moment than now for fashion industry leaders to reflect on this apparent disparity, as 2018 will be a watershed year for purchasing power. According to the McKinsey FashionScope, the collective share of apparel and footwear sales from Europe and North America will fall from 50.4 percent of the global total in 2017 to 49.9 percent in 2018. Meanwhile, the collective share from Asia, Latin America, the Middle East and Africa will rise just above fifty percent and is forecast to continue to increase in the years to come.

"Well, let's see if this sinks in at the next Paris Fashion Week. Just check out their seating plans and see how many [seats] big brands allocate for American and European guests compared to how many for the rest of the world [and] see if it matches the proportion of revenue the brand gets from each region. I bet it's still way off," suggests Yeh, who recently founded a sustainable innovation consultancy Yehyehyeh that partners with global fashion brands for projects in Asia.

"I mean, I get that having the big four fashion capitals and Hollywood and a century of designer fashion heritage will probably always mean that the West has a bigger role in fashion, but that should only go so far."

This legacy has certainly had a lasting impact at the luxury end of the spectrum. It helped some of the more prolific B2B players to root themselves ever deeper into Western markets and it allowed retailers there much

longer to develop, leading to greater market maturity. In the case of Italian showroom L.A. Distribuzione, it means that Europe remains one of its strongest global market regions despite serving a very diverse international retail clientele.

“Back in the ‘90s, Japan was a big player in luxury fashion [but other] Eastern countries were a novelty and Asia was only about a few names like Joyce [boutique in Hong Kong]. The early 2000s were the first picture of the situation we’re witnessing today, where we can see big growth in Asia [and other regions],” says L.A. Distribuzione co-CEO Leonardo Cappannelli. Today, the showroom represents Loewe and Outerknown among others, but in the early years it wholesaled brands like Alexander McQueen and Balenciaga around the world.

Another veteran who has witnessed the meteoric rise of emerging market retail is Maria Lemos, director of Rainbowwave, a wholesale showroom she founded fifteen years ago in London after leading sales teams at Sonia Rykiel and John Galiano in Paris. For Lemos, it is not only a matter of growing sales volume but growing influence in terms of the number of innovative retail concepts and business models coming out of emerging markets.

“There was the Korean wave with Boon the Shop, Space Mue and Rare Market, then waves from Turkey and other countries, but that was just the beginning. Look at

stores like Homme et Femme in the Philippines, which is this incredibly curated boutique in Manila extremely ahead of the curve in a market you wouldn’t necessarily have known to be so advanced,” Lemos says.

Farfetch has been partnering with a growing number of retailers in non-Western markets. The online marketplace now serves customers in 10 languages, shipping designer fashion from over 700 partners to 190 countries worldwide. In recent years, as buyers from its non-European store network became increasingly adventurous and avant-garde, an interesting phenomenon started taking place.

Some European customers using Farfetch have come to rely on its far-flung store partners to buy European designs that are not readily found back in Europe. Instead, they shop online, for example, from a unique selection of Raf Simons from Saudi menswear boutique Le Gray in Riyadh or Simone Rocha via Lebanese boutique Piaff in Beirut, and buy hard-to-find pieces from the likes of J.W. Anderson at South African retailer Maison Mara in Cape Town.

“I think Europe will continue to dominate the creative and craftsmanship sides of the industry, simply because they are impossible to replicate and this [European cluster] is at the heart of the industry. In terms of demand, however, this will definitely be the decade where emerging markets will take the lion’s share of growth,” says Farfetch founder and CEO José Neves.

Asia’s purchasing power needs soft power

“For more than 1,800 of the last 2,000 years, China and India were always the two largest economies in the world,” Kishore Mahbubani told Asia One in 2016. The former diplomat and dean of the Lee Kuan Yew School of Public Policy in Singapore is a great proponent of this being an Asian-led century. “The past 200 years have been a major historical aberration [so] it’s perfectly natural for China [and] India to resume their places... all aberrations come to a natural end.”

The Asia-Pacific region currently accounts for around 38 percent of the world’s apparel and footwear sales, the largest share of any region. Europe is now in second place at around 27 percent. However, global influence is not gained solely by scale or purchasing power. What has been helping to push Asia closer to the fashion industry’s centre of gravity is a combination of supply chain leadership, tech innovation and Asian-led international investments. This is how the region will continue to gain a louder voice.

“In technology, Chinese firms are actually ahead of Western firms in areas such as e-commerce and social media,” says Neves, citing the country’s ubiquitous WeChat platform which has often left fashion

marketers scrambling to keep up with its breakneck pace of development. Interestingly, it was WeChat’s parent company Tencent that swooped in to the rescue of Snapchat when it amassed a reported \$2 billion stake in Snap in November 2017.

Asia’s clout only grows when one of its pioneering firms makes a bold move on international peers. Whether it is Alibaba Group’s recent appointment of a US-based quantum computing scientist to drive exponentially faster machine learning for its e-commerce platforms or the push by Chinese manufacturers like Suzhou Tianyuan Garments, — a supplier for Armani and Adidas — to open a T-shirt factory using advanced robotics in America’s Deep South, the innovation tide is turning eastward.

“Whoever owns the supply chain will eventually be the winner, since there are not many countries left for chasing the cheap needle,” says Gerhard Flatz, managing director of Chinese manufacturer KTC, whose Guangdong factory produces for specialist athletic and performance sportswear brands including Rapha and Mammut.

This sentiment was especially evident in October when supply chain management company Fung Group welcomed a host of venture capitalists and tech entrepreneurs to the launch of its new Explorium incubator lab. With hopes that the lab will help further accelerate the rapid prototyping of omnichannel concepts across fashion retail, the Hong Kong-based giant chose Shanghai for the lab’s location because the city is at the forefront of “new retail” in China, which in turn means it sets digital retail trends across the world.

“We’re connecting innovators who want to create digital supply chains of the future with logistics and retail innovators who want to be the best at serving the digitally-enabled consumer of today and tomorrow,” said Fung Group chairman Dr. Victor K. Fung. Seen in the broader context of China’s colossal One Belt One Road infrastructure project, the impact of this on future trade dynamics for global fashion players could be huge.

East Asian nations like Japan and South Korea now spend more on R&D as a percentage of GDP than many of their Western European counterparts and a culture of entrepreneurship is taking hold across much of the region.

According to the World Intellectual Property Organization, China became the first country to file one million patent applications in a year in 2015. Stringent IP protection and enforcement is a pillar of Singapore’s successful startup scene, contributing to the nation ranking third on the World Economic Forum’s 2017-2018 Global Competitiveness Index. Only the US and Switzerland score higher.

As the global fashion industry becomes more reliant on tech innovation for growth, Asia’s achievements in this realm are a growing advantage. From Japan’s cutting-edge designers using textile nanotechnology to Taiwan’s drive to carve out a niche for itself in eco-friendly high-performance fibres, the region has many things to celebrate.

But as is evident from Asian brands as diverse as Comme des Garçons and Manish Arora, fashion is as much an applied art as it is a creative industry. Most Asian nations have yet to effectively deploy soft power strategies

“For more than 1,800 of the last 2,000 years, China and India were always the two largest economies in the world...the past 200 years have been a major historical aberration.”

to boost their fashion industries as well as their legendary designers naturally do.

“The soft power of my country’s made-by-hand [sector] is underestimated,” concedes Indonesian designer Toton Januar, the 2016 winner of the Woolmark Asia Prize. “The Indonesian government fought for the heritage-craft batik only when the Malaysian government stepped in to patent it.”

Something similar could be said about India’s dizzying array of artisan textiles and ancient techniques — though Prime Minister Modi’s “Make in India” campaign aims to remedy that.

In the same way that India’s vibrant entertainment industry has been underleveraged to promote the country’s fashion sector on the global stage, China has built hundreds of Hanban (or “Confucius Institutes”) to promote Chinese culture around the world yet few of them feature anything like Chengdu street style or the rise of Shanghai Fashion Week. Clearly there are many missed opportunities.

Leveraging Latin America’s cultural capital

Whether it be high culture or pop culture, one way for emerging market fashion players to have greater global impact than pure purchasing power is to leverage their cultural capital.

At the highbrow end of the scale, global fashion brands have been turning to world renowned artists and architects to boost everything from visual merchandising to marketing. A growing number of them have come from Latin America. Giorgio Armani’s collaboration with Colombian artist Marta Luz Gutiérrez for an in-store installation and Louis Vuitton’s ad campaign using a building designed by the late Mexican architect Luis Barragán as a backdrop are just two of many examples.

Beyond the region’s links with Europe and the US, however, there are other opportunities to explore. The rise of south-south trade and cooperation — exchanges between developing nations — is compelling some creative industry leaders to reassess their investment priorities.



The skyline of Chengdu, China featuring West Pearl Tower

With Latin music now topping the international charts from Dubai to Delhi, for example, the social media channels of young Latin American reggaeton musicians represent an increasingly influential marketing vehicle for local fashion brands hoping to tap into new markets on the other side of the world.

Latin America's "telenovelas" (soap operas) could represent another opportunity for mass market players. Mexican multimedia giant Televisa is one of the most prolific telenovela content creators in a region where product placement on TV is commonplace. As early as 2015, the company's international sales rep told Variety that Televisa sells about a dozen telenovelas annually to 37 countries in Sub-Saharan Africa and 24 Middle Eastern and North African territories.

"I wish we, as designers, could influence...fashion as much as the soap opera stars [here] do. Their reach is outstanding," said Dudu Bertholini, a designer who was a wardrobe consultant for Brazilian telenovela Verdades Secretas in 2015.

The formula certainly works elsewhere. Seoul's fashion industry famously benefited from the Hallyu wave of Korean soap operas and music exports to other Asian markets. Success, however, depends on execution. While Japan reigns supreme in the 2017 Soft Power 30 global ranking, the government's "Cool Japan" campaign was criticised by insiders for trivialising Tokyo's globally influential fashion scene by packaging it with sectors that resonate less well abroad like J-pop music.

Building knowledge economies in the Middle East

Unfortunately, top-down initiatives don't always suit the fashion industry. But capturing momentum from grassroots design movements and channelling entrepreneurial flair in an organic way is not easy either.

"Projects that are ignited by the government may start based on a perception of top-down. [But] the soul is created [and] enhanced by the people working on it and experiencing it and these initiatives can come to life in magical ways resulting in repeat business," says Ghizlan Guenez, CEO of The Modist, a Dubai-based e-commerce site that offers contemporary designer brands like Stella Jean and Maison Rabih Kayrouz to women whose religious, cultural or personal tastes lean to a modest style aesthetic.

Pointing to the framework offered by the Dubai Design District and the Dubai Design and Fashion Council, Guenez clearly feels that she has benefited from the top-down approach often used in the United Arab Emirates. The Algerian-born executive has lived in the UAE for 20 years and says that "there's more to be done [but] the entrepreneurial engine is in full force within the UAE."

"What is impressive is the strength and speed of initiatives taking place to enhance [and] develop the influx of talent from all over the world into the Middle East. As entrepreneurialism accelerates in the region, high levels of investment are following opportunities across the fields of art, architecture, technology and education," she adds.

The November opening of the Louvre Abu Dhabi is the latest example. But in neighbouring states like Qatar, there are concerns that some of its megaprojects could end up as white elephants. In Saudi Arabia, Crown Prince Mohammad bin Salman recently announced a plan to build a colossal \$500 billion mega-city on the Red Sea coast near the border with Jordan and Egypt called Neom, to be loosely modelled on the "free zone" concepts in Dubai.

One area where there is a lot of optimism is education. In a bid to diversify away from hydrocarbons, the Gulf states are investing in ways to become knowledge economies. One of several new higher education institutions in the region KAUST, the King Abdullah University of Science and Technology, is a progressive research university where seminars on wearable tech and grafting smart surfaces onto textiles are becoming commonplace.

With a growing number of Western universities present in the region — such as the Paris-Sorbonne University Abu Dhabi, a Dubai campus of London Business School and Georgetown University in Qatar — the fashion education sector is likely to gain more traction too. Currently the region is served by Shenkar in Israel and branches of Esmod in Dubai, Istanbul, Tunis and Beirut. Now, however, several prominent fashion schools from Europe and the US are said to be exploring an opening in the Gulf in the coming years.

In December 2016, the Istituto Marangoni Group's then-managing director Roberto Riccio told a press conference that Dubai had been earmarked as its next opening after Mumbai. More fashion schools are needed to meet demand from the Middle East where the global success of Lebanese designers has inspired a new generation to pursue fashion as a career. Interestingly, one of the drivers Riccio cited for a possible Dubai campus was to attract fashion students from Africa — where there is also growing demand — who could find the visa system in Europe onerous.

Africa's ambition to leapfrog ahead

"The common phrase 'Africa is the future' is a reflection of how the continent is growing on its own terms and not necessarily just as 'new market potential' for the first world to tap into," says Kenyan fashion PR executive Diana Opoti.

Opoti's fashion career arc is a good case in point. After hosting the television show Designing Africa, she created a successful viral campaign called 100 Days of African Fashion that saw her travel the continent and showcase 100 different locally designed outfits on her Instagram account. It was this experimental social marketing venture that eventually led her to launch a multi-brand retail store that will bow in 2018 in Nairobi.

"Technology is one of the most visible ways we've 'leapfrogged ahead' in Africa," she says referring to the way many African consumers skipped the landline and went straight to mobile.

"Kenya specifically is known for its innovation in technology [and] topping this is M-Pesa, the 'SMS mobile wallet' which became the most convenient way of making payments for millions. [It's] so popular, in fact, that it's now



A visitor at an exhibition at the grand opening of the Louvre Abu Dhabi Museum in the United Arab Emirates

challenging global payment systems like Visa who've been forced to adapt by creating their own [rival] system here," Opoti says, referring to the multinational's new mVisa service.

A forerunner of many contemporary mobile payment solutions, the pioneering service was launched in 2007 in Kenya and Tanzania on the Safaricom and Vodacom networks and has since expanded as far as India and Eastern Europe.

Some believe another way African consumers could leapfrog is through cryptocurrency. According to Coin-telegraph fintech expert Olusegun Ogundeji, "decentralised, open and permissionless Blockchain technology may well become the foundation for economic empowerment in Nigeria [offering] peer-to-peer trade, new exchanges and innovative ICOs." Anything that makes online payments easier in the region could eventually help African fashion ecommerce players like Kisua, Jumia and Konga.

On the manufacturing side, countries like Ethiopia where investment has poured in from Asia, have been able to take advantage of the sudden and radical changes happening in the fashion supply chain. Many Chinese and foreign-built factories in Ethiopia are built with the Japanese "kaizen" system in mind to keep standards high.

"We can learn a lot from what happened in Brazil

and Vietnam and other places. We can use automation and leapfrog some of the traditional manufacturing processes into automated processes," said Yared Alemayehu Simegn, manager of Ethiopian shoe factory Walia Leather who produces for several global brands.

The great strides made by fashion players in non-Western markets certainly do not unburden them from the many challenges they can face there. If anything, it points to a steely resilience that helps them deal with everything from poor infrastructure and political instability to trade barriers, bureaucracy and prohibitive tax regimes.

Most insiders concede that fashion will probably always be anchored in cities like New York, Paris, Milan and London but things are evolving fast. Empowered by digital connectivity, upwardly mobile consumers and bold business innovation, emerging market leaders are now helping to find a new centre of gravity for the global fashion industry. With Seoul, Lagos, Bogotá, Kuwait City and many more centres of influence now firmly fixed to the fashion map, power is increasingly shared and decentralised.

As Guenez puts it, this new era is "about seeing a diverse, representative and level playing field, [where] different cultures have influence on the global fashion industry rather than a fully Western bias dominating."

03. Asian trailblazers

With two thirds of the world's e-commerce unicorns, more than half of global online retail sales, and countless digital and tech innovations, Asia is no longer waiting for Western companies to step up. Asian players will assert their power and leadership even more through pioneering innovations, global-scale investment and expansion.

The global fashion market's centre of gravity has long been shifting East. Asian economies have experienced strong economic growth; GDP growth in Asia remains much higher than in Europe and the US. Accompanying this growth is the rise of Asian consumers' fashion expenditures. Asia-Pacific is already established as one of the most important regions for the global fashion business, and according to the McKinsey Fashion-Scope the region is projected to account for almost 40 percent of global apparel and footwear sales by 2018. The Asian online apparel market alone is projected to reach US \$1.4 trillion by 2020.¹²

But Asia's influence is growing not only because of its role as a battleground for sales and new consumers. The region is increasingly the source of technology innovations. Asia now boasts two-thirds of the world's 45 e-commerce unicorns, and China is one of the world's most active digital investment and startup environments. China's unique digital ecosystem continues to spawn giants such as news aggregator Toutiao, which like other online leaders such as Baidu, Alibaba, and Tencent, offers advanced solutions and local innovations. The pace of innovation is spurred by China's uniquely-demanding consumer landscape

where 20 percent of internet users rely on mobile alone to access the internet, compared to just 5 percent in the United States. The phenomenon of digitally-savvy consumers is not limited to China. Ninety-five percent of APAC's 1.5 billion social media users access social media via mobile devices, the highest rate globally.¹³

The innovation leadership fostered by this environment reaches far beyond China's borders. The country's outbound investments amounted to 14 percent of all global venture capital investments outside China in 2016, and the top Chinese internet companies made almost twice the number of overseas deals as US peers.¹⁴ We expect to see Asian companies continue to introduce new technology and business model innovations to the global fashion industry in 2018. A case in point is WeChat, already taking China by storm by employing the Chinese tradition of red envelopes to grow its payments user base. In addition to

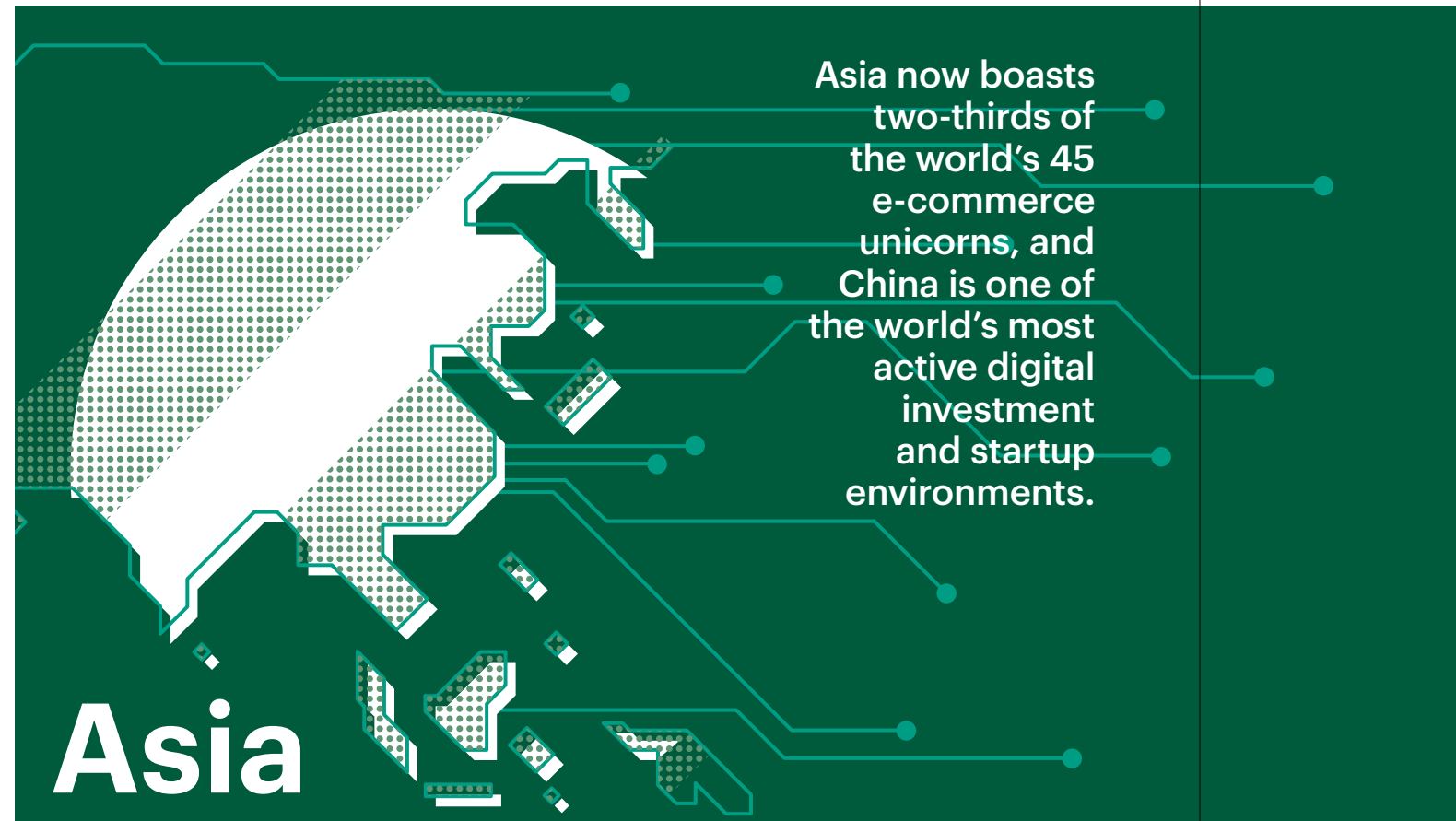
messaging, users can use the app to shop or call a cab, paying for those activities using the app's platform. The app employs both social interaction and gamification that get users to send payments to each other – for fun. Western players like Facebook and PayPal have emulated some of WeChat's many features but have not yet adopted all of them. Asian companies' lead on innovation and digitisation can also be witnessed in the fashion industry, from Chief Purchasing Officers in McKinsey's 2017 Apparel CPO Survey ranking China highest in sourcing digitisation, to Japanese brands such as Issey Miyake, long known for experimenting with technology to drive materials innovation.

In 2018, more Asian brands will leap onto the global fashion scene. Asian fashion players are already

beginning to increase their presence and influence globally. This year, Gentle Monster from Korea attracted investment from LVMH-backed private equity firm L Catterton Asia,¹⁵ and Anita Dongre, the Indian brand that is backed by General Atlantic, opened a store in New York.¹⁶ More designers from Korea, India, China and Japan are displaying their wares at fashion weeks in Europe and the US.

Another way Asian players are expected to assert their power is by reversing the old global expansion pattern of Western companies moving eastward, to Asian companies moving outbound. Some companies will follow the lead of Urban Revivo, a Chinese fast-fashion player making inroads in Europe. Outbound Asian investment is also expected to take the form of increasing ownership stakes in international fashion companies. Recent examples include JD.com's investment in Farfetch, and the acquisition of both Italian Cerruti and Gieves & Hawkes by Hong Kong-based Trinity, which later embarked on an ambitious expansion program in the UK and China. Top positions at the acquired companies will more frequently be filled by Asian leaders.

Asian fashion companies' international ascendancy will go beyond sales and customer engagement, and move into infrastructure and other assets. Many Asian companies are already making large investments in Africa to develop new apparel sourcing hubs to take advantage of lower labour costs and proximity to both raw materials and consumer markets in the West. For example, the recent interest in Ethiopia as a sourcing destination is partly driven by Asian companies, with more than half out of the 124 foreign investors that expressed an interest in Ethiopia's textile and clothing sector during the first quarter of 2017 being Chinese; and many Chinese, South Korean and Indian companies are already making investments in the country.¹⁷ Yuemei Group is one example of a company that has moved significant production to Africa. Such strategic investment to secure access is only likely to grow as Asian companies increasingly look outward and take a more central position on the global fashion stage, with some surpassing their Western peers in terms of innovation, investments and expansion.





CEO TALK

RICHARD LIU

FOUNDER AND CHIEF EXECUTIVE OFFICER OF JD.COM

The JD.com founder and CEO talks to BoF about the rapidly changing tastes and preferences of Chinese fashion and luxury consumers.

by Imran Amed

BoF: What is the biggest challenge facing the fashion industry in 2018?

Richard Liu: In the past, one brand could cover a large number of consumers, like a Zara or a Uniqlo could cover a lot of people easily. Now, people are looking more and more for niche brands, and I think it is a challenge for them. One brand cannot cover most people. You need a lot of brands to cover different groups.

BoF: Does this reflect that the tastes of the Chinese consumer are evolving?

RL: No one wants to take a bag, and put it on a table when a lot of ladies have the same bag with the same style. They want to find something special. Something you cannot find in your circle.

And [in the] lower-tier cities, in the past, some people with less income didn't care about fashion, they just wanted to buy something they need. But if you look at China, there are more and more young people, and their income is relatively very small, but they want to spend time to find fashion, maybe not as expensive as luxury brands, but still very fashionable. Maybe not big brands, [but rather] small brands, or niche brands.

BoF: How does an e-commerce platform like JD.com factor into reaching consumers with their own tastes and preferences?

RL: The most important thing for the brand: they need brand building. So media, including social media, obviously is a very important channel, but if you ask any brand why they spend so many

resources — time, events, fashion shows and marketing dollars — on the brand, it's because they need sales. Commerce platforms for them are the best way to convert their customers to buying. And at the same time, for JD, we are not just a sales platform; we are a brand-building platform. We spend more and more resources to help build the brand — to strengthen the brand is as important as the sales side.

BoF: How do you see that working alongside the brand's own e-commerce or stores?

RL: We don't want to only be a sales platform for brands. We want to create a system that can cover multiple channels, including the [brand's] official website. This is true for JD as well as other platforms and their distributor channels and offline chain stores. We are upgrading our whole platform and CRM system [so brands] can use it to do marketing for different channels. It will all be a single tool, so we call it "Three Ones" — one inventory, one brand, one price.

BoF: One inventory, one brand and one price.

RL: Yes. So online and offline prices are the same, inventory is the same, the brand is the same. In the past different brands online and offline were not the same. And in the past distribution channels — their official website, their offline chain stores and e-commerce platforms — all had different inventory. Even in-store, the same brand might have a different

selection in different stores. We want to use the whole system to strengthen their supply chain.

I'll give you an example: in the past they had to deliver from Beijing or Shanghai to Urumqi, 1,000 km away, but today, we can ship from the offline chain stores in Urumqi, so it's travelling within the same city. The customer experience is better than before; I also think the brands can save some money.

BoF: I'm keen to understand more about the "White Glove Service" that you launched recently and why you think that's an important part of the service offering for JD.com as it also goes after the luxury space.

RL: Over the past 10 years we spent a lot of time on consumer brands including FMCG; we set up a very strong, complete supply-chain service for the brands. But [in] the luxury market, everything is different. So [I thought] we should set up [a] special service for luxury, because luxury is not the same as consumer brands. The service should be different to make sure luxury is special and has a unique experience. It's very important for brand building.

BoF: How is it different, exactly?

RL: First, from the warehouse, we use a very small, special space, only for luxury goods. In this space, we use a lot of technology to protect against even a little bit of dirt. In a huge warehouse you cannot protect against every tiny piece of dirt, but we will use a very small space for luxury products. Second, we use a five-star-rated delivery man, based on customer feedback.

BoF: So you only work with the people that have 5-star ratings?

RL: Yes. We pick them and train them. Today in China most delivery men will ride three-wheeled electric bicycles, which is cheap, fast and convenient. But we ask our white-glove deliverymen to wear a luxury brand suit and drive a luxury car to make sure that we can protect the packages and the experience — they even wear white gloves. Imagine getting this kind of delivery service to your office or home, it's a very different experience. We are even thinking about bringing multiple sizes and colours and letting the consumers choose, just like in a physical store.

BoF: Another big thing that JD was involved with this year was the investment in Farfetch. How does Farfetch fit into your larger fashion strategy?

RL: Farfetch is obviously the most successful and largest platform today for boutiques. On Farfetch you can find many SKUs, even [ones] you cannot find in the official stores. This is just the beginning of people liking niche, special, limited versions, so I'm sure in the future Farfetch will be more popular and more Chinese consumers will love them. We [wanted] to invest in them and introduce them to [our] consumers. Farfetch has a huge space to grow, I know they are talking with a lot of brands and more and more brands will collaborate with them directly.

BoF: Finally, what about your plans for JD outside of China?

RL: In the past several years we have spent a lot of resources bringing foreign brands to China, and to the Chinese consumer, because Chinese consumers increasingly love international brands. So that's our first step. Second step: we also have global sales channels — in the future we will sell more and more China local brands to outside of China.

We will use two different ways to cover the entire globe. The first is our South [East] Asian channel. We will set up [a] subsidiary there and copy the Chinese business model. Build a local team, buyer team, logistics system and last mile delivery team, everything the same as in China. In Indonesia we have been operating for almost two years, and we will go to Thailand very soon.

But for Europe and [the] US we will use a cross-border business model. We have been thinking about this for many years. If you just copy another model or local players do exactly the same thing as them, you cannot find an advantage. So we will cooperate with Chinese local brands and bring them to the US and Europe. They need us, and we also need them, because the brand quality is very good and price is not as high. We will choose them, pick them up and bring [them] to the US and Europe. I think people will love these kinds of Chinese brands.

This interview has been edited and condensed.

"More and more people are looking for niche brands. No one wants to take a bag, and put it on a table when a lot of ladies have the same bag with the same style. They want to find something special. Something you cannot find in your circle."

CONSUMER SHIFTS

04. Getting personal

Personalisation and curation will become more important to the customer. As consumer values coalesce around authenticity and individuality, brands will value data even more to tailor recommendations, engage influencers and personalise experiences. The fashion companies that flourish will re-focus on their strengths.

We expect personalisation to be one of the major themes in the fashion industry next year. Fashion companies will deliver personalisation in many forms – from more-customised products, to curated recommendations, to communications and storytelling that connects to individuals. Indeed, respondents to the BoF-McKinsey Global Fashion survey identified personalisation as the number one trend in 2018. According to a Linkdex survey, more than 70 percent of US consumers expect some sort of personalisation from online businesses.¹⁸ Salesforce.com reports that consumers claim they are happy to hand over data to get a more tailored experience.¹⁹ Executives seem to be listening.

One reason for this development is consumers' growing desire to use their fashion choices to express their own style, self-image, and values. The exploding use of social media plays an important role here. Many consumers – in particular younger generations like millennials and Gen-Zers – share close to everything on social media. In pursuit of “likes” and building their own personal brands they seek one-of-a-kind items. However, other consumers are tiring of the facades people often project on social media, and want to express more honesty and realism in their streams and style choices. In either case, consumers prefer brands that align with their values, and so they seek authenticity from the fashion companies they engage with. “Customers today want businesses with purpose,” believes Tory Burch. “Obviously the product has to be A-plus but it’s also really what you stand for and what you believe in.” For this reason, fashion companies are likely to use more authentic story-

telling and realism in their communications with customers.

Consumers are also becoming more picky. This boosts demand for more unconventional and signature items, and for products with higher quality, better prices, exclusivity and authentic and engaging stories. Consumers know what they want, and are not hesitant to shop around for it – choosing products ideally suited to their needs from a variety of brands and companies. To connect with these empowered consumers, fashion companies should think about how to offer products and experiences that are perceived as unique. “More and more people are looking for niche brands or niche SKUs,” says Richard Liu of JD.com. “No one wants to [put a bag on the table] when a lot of ladies have the same bag with the same style. They want to find something special. Something you cannot find in your circle or in your neighbourhood or in your company.”

Some companies' response has been to broaden the product portfolio and become essentially an umbrella lifestyle brand. In many cases, though, it may be beneficial for companies to refocus on their strengths and value proposition – concentrating on the areas where they can truly distinguish themselves, whether high product quality and signature items, refined price strategies, or more carefully selected product ranges. In other words, rather than taking a scattershot approach, to think carefully about what consumers actually want.

In search of convenient solutions, consumers will look to new sources to help them manage their product selection – and to help process the growing amounts of impressions they face

each day. Increasingly, consumers are trusting others to curate the information for them. Many consumers perceive the lifestyle of the influencers they follow to be more authentic than traditional company branding efforts, as illustrated by the fact that 9 out of 10 consumers trust an influencer more than traditional advertisements or even celebrity endorsements.²⁰ This has led to more influencer endorsements, in addition to product reviews and referrals from peers becoming an important source for curation. In our view, fashion companies will begin to think more about how best to leverage influencer marketing, peer reviews and social media engagement for results that are most relevant to the modern customer. Yet, while influencers are a powerful channel, working with them is not always straightforward. The wrong ambassador can undermine a brand's authenticity.

The year 2018 will also witness more fashion brands that successfully use data to provide personalised curation. One example is Stitch Fix, which serves as a personal stylist, using an algorithm to deliver personalised packages of pre-assorted clothing and accessories to consumers monthly. With this business model, Stitch Fix in 2016 realised revenues estimated at \$730 million. Another example is Affinity, which has a vision of creating a “Pandora for fashion,” recommending styles and looks based on algorithms. But being personal is not enough – personalisation must be experienced as relevant and timely, ideally offering surprising and complementary items, and done in a way that does not feel intrusive.²¹

Consumers will appreciate products that are tailored to their individual needs. Mon Purse, for example, offers customised handbags, partly enabled by new technology such as 3D printing, 3D knitting and laser sensors, as shown by Adidas's “Knit for you” pop-up store that produces bespoke products in just a few hours. Mytheresa.com offers customers the opportunity to personalise Gucci trainers online. Customisation will range from smaller adaptations (like embroidery in store) to pre-designed items such as colour combinations that bring a personal touch, to products designed almost completely by the customer.

The concept of personalisation – from webpages and promotions to customised products – has been around for a while. Yet even though demand for individualised and curated fashion is evident, most fashion companies are not yet providing it at scale. Many seem to struggle with turning customer data into intelligent and actionable insights, and few have managed to implement one-to-one tailoring or deploy the technology effectively. But many fashion brands have recently made big advancements in digital, data analytics, and mass-customisation in production, the prerequisites for delivering personalisation at scale.

We expect 2018 to be the year when leading fashion companies will begin delivering on personalisation in earnest, and when the ability to create individualised products will become a source of differentiation. The leaders of the pack will leverage data and technology like machine learning to provide cutting-edge individualised curation and tailoring for consumers that takes into account purchase journeys and customer feedback; to increase relevance of their storytelling and contextual channels; and to refocus on creating products that are distinctive.

Authenticity

Individuality

05. Platforms first

Consumers will increasingly look to online platforms as the first point of search, attracted by their convenience, relevance and breadth of offering. Whether mass, specialist or premium, platforms will continue to grow in scale and reach, compelling fashion brands to find ways of engaging more with these powerful sales channels. The question for fashion brands is no longer ‘if’ but ‘how’ to collaborate with big online platforms.

Online platforms have been making inroads into the fashion industry for some time and in 2018, we expect to see them further solidify their position. More than one-third of fashion executives participating the BoF-McKinsey Global Fashion Survey believe that the predominance of online platforms in fashion will be among the top three trends in 2018. In many markets, consumers look to online platforms as the first point of search, because they offer a wider variety of products, and often provide superior customer convenience and relevance, from insight-driven marketing to seamless logistics and customer care. The growth of online platforms is a testament to their success in winning over the consumer: Amazon is expected to surpass Macy’s this year to become the largest apparel retailer in the US²², Tmall and JD.com together control more than 80 percent of the Chinese online apparel market, and Alibaba’s Single’s Day is the largest online shopping day on the planet.

While online platforms continue to grow rapidly and to reach unprecedented scale, they are also investing to strengthen their position in the fashion sphere. Many of the platforms, from Amazon to Zalando and Myntra, already push their own private label fashion offerings. They will likely be doubling down on these efforts, expanding their portfolio of in-house brands and products. For example, Amazon reportedly began working recently with some of the largest athletic-apparel providers to develop sportswear. Some online platforms are expected to build their own fashion talent pool, and others will make acquisitions to get hold of such capabilities. Others might focus on building their customer base or obtaining access to new customer segments by means of acquisitions, following Flipkart, which purchased Jabong, or JD.com, which invested in Farfetch.

That’s not all. Online platforms are expected to expand into premium and luxury segments. To provide an attractive value proposition for high-end brands, they are taking steps like developing improved user experiences and services. Take, for example, JD.com’s launch of Toplife, a luxury platform that features a premium delivery service, “JD Luxury Express.” In addition, online platforms have started using acquisitions and collaborations to access premium consumers, exemplified by Tmall’s official partnership with New York Fashion Week. Many platforms will develop and use new partnerships to bring external brands into their offering, through different levels of vertical integration. The depth of the partnership can range from mere order fulfilment to dedicated assortments to fully integrated programmes. For example, Tmall raised its high-end quotient with the launch of an invitation-only “Luxury Pavilion” with brands that included Burberry, Hugo Boss and Maserati, complemented with live-streaming of fashion shows. For fashion brands, collaborating with online platforms can serve as a complement to their own omnichannel offering or as a stepping-stone to expand geographically into new markets.

But the rise of online platforms has put fashion brands in a conundrum, and many fashion companies have remained sceptical about engaging with them. In one sense, the strength of online platforms poses a clear threat as fashion companies are becoming increasingly reliant on platforms to drive business. Selling through online platforms not only means giving up control of one’s own brand and merchandise presentation, but also hands over the collection and control of increasingly important customer data to the platforms. And this in turn means that platforms

are positioned to use this superior sales data and customer insights as well as their own private-label data to build their own-label collections – from merchandise development and planning, to promote online conversion.

Nonetheless, we expect 2018 to be the year when the question for fashion players changes from “if?” to “how?” In other words, the challenge is no longer whether to collaborate with online platforms but rather how to do this in a way that is rewarding for both parties and that positions the fashion brands in the desired way. As online platforms grow in size and market power, the risk of not being present could become higher than the

downside of not having complete control of the online channel.

Brands across segments – from mass to luxury – will likely be compelled to think strategically about and engage more with these powerful channels. Fashion players need to find new ways to collaborate and contract with platforms that will provide clear benefits for both, whether it’s sharing valuable data to better understand consumers or gaining increased control over business levers like brand presentation. “Today we are not just a sales platform, we are a brand building platform” is how JD.com’s Richard Liu puts it.



Powered by artificial intelligence and big data, the world's biggest e-commerce platforms can make an impersonal environment seem highly personal. With tailored products, personalised recommendations, and smarter supply chains, will fashion brands find working with these giants an increasingly persuasive proposition?

IN DEPTH: PLATFORMS FIRST

ONLINE GIANTS GET PERSONAL

by Kati Chitrakorn

LONDON, United Kingdom — The rise of online platforms — Amazon, Alibaba, JD.com and Zalando, among others — has put fashion brands in a conundrum. While many have been sceptical about engaging with these online behemoths, for a growing number of fashion brands, these ubiquitous platforms have become a requisite sales channel now that their reach is so vast. This has only intensified as brands become increasingly aware they are no longer just competing with their peers, but also with social networks and streaming services — anything that engages users online — for attention.

Attracted by convenience and choice, more consumers look to online platforms as their first point of search. For instance, Amazon — which retail analysts predict will be one of the first-ever \$1 trillion companies by the end of 2018 — is an enormous platform with a number of high-margin business operations, including its own site and third-party marketplace, offering a huge selection of brands in one place, making it an incredibly powerful resource.

“If I go on Amazon now and search for running shoes, I’ll get over 1.3 million recommendations from different brands. Retailers are now able to merchandise an astonishing assortment of products online. They’re able to fill that gap of product knowledge that is completely impossible to provide in a physical store environment — and they can transact consumers in one click,” said Doug Stephens, a retail industry futurist and author of “Reengineering Retail: The Future of Selling in a Post-Digital World.”

Yet Amazon’s colossal offering of products can easily become overwhelming. Too many product options can make decision-making difficult, leading to the possibility of fewer sales. This is where personalisation comes in and explains why it has become the holy grail for online platforms across the planet. Amazon knows what

shoppers have bought in the past, are buying now, and are likely to buy in the future — with the insights derived from people’s purchases and searches.

What artificial intelligence (AI) can do is help turn large and diverse data sets into enriched information that can be used to improve the entire supply chain, from design and manufacturing to sales, marketing and customer service. Unrivalled customer data from platforms like Alibaba or Amazon, combined with a suite of powerful tech tools, opens up other powerful new possibilities for fashion brands too.

“Amazon in the US is one of our biggest and fastest-growing customers today. They’re a force and a major customer. Outside of the US, [online retailers like] Tmall, Zalando and Flipkart are big. Brands have to consider what their strategy is with each of these [platforms]. Do they want to play or not?” said Chip Bergh, chief executive of Levi Strauss & Co., for whom these platforms have simply become far too big to ignore.

Levi’s isn’t the only brand to realise the potential of platforms. Calvin Klein was among the first companies to embrace Amazon by selling a selection of products — mainly underwear and denim — through the online retailer. As Amazon has grown, more labels, including Nike and Kate Spade, have overcome concerns about pricing, presentation and the prospect of working with a potential rival.

“Access to consumer data is the holy grail for platform businesses because exclusive ownership of data allows them to exert control over the rest of the ecosystem and makes it attractive for third parties to come onboard the platform,” said Sangeet Paul Choudary, founder and chief executive of C-level advisory firm Platform Thinking Labs and international best-selling author of “Platform Revolution and Platform Scale.”

“It’s important for brands to realise that they can no longer lean on the idea that fashion is something that won’t be consumed by e-commerce. Platforms have the potential to gather tremendous amounts of data and predict what [customers’] wants and needs are going to be,” said Stephens.

Improved Recommendations

This is the key to personalisation. When done right, it can be a major boon for consumer businesses in the era of unlimited choice. Respondents to the BoF-McKinsey Global Fashion Survey identified personalisation as the number one trend in 2018. Another report by McKinsey & Company found that targeted communications, which are relevant and useful, could create lasting customer loyalty and drive revenue growth of 10 to 30 percent. This is understandable given that more than 70 percent of consumers in the US now expect personalisation from online businesses, according to a survey by SEO platform Linkdex.

David Schneider, co-founder and chief executive of European e-commerce giant Zalando, believes that personalisation is even more important for the fashion sector than others. “It is our angle to really create a great consumer experience, be it the offering of unlimited choice [or] being able to personalise [and to] make it really relevant. I think fashion really deserves its very own solutions because...it’s quite different from other products. It’s quite an emotional product, it’s very much trend driven, it’s opinionated, it has a lot of social angles to it,” he said.

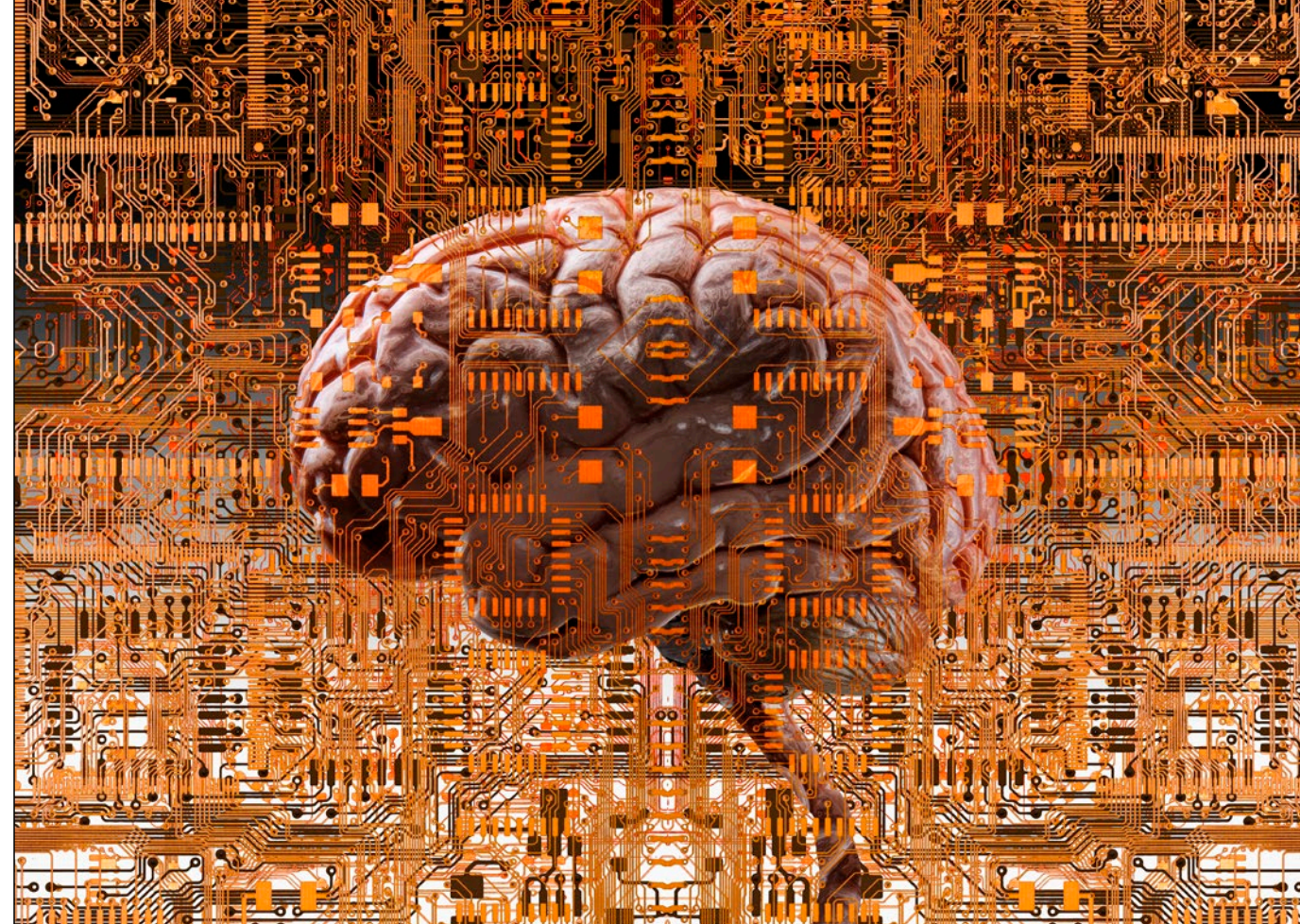
Personalised enhancements offered by platforms could include generating uncannily precise product search results, smart search engines that draw attention to products consumers might not have realised they wanted, or virtual storefronts that display information tailored to individual shoppers based on their unique characteristics and preferences.

Such developments are subtle but effective, said Sébastien Badault, managing director of France at Alibaba Group and the firm’s global business development leader for the luxury brands category. “That’s the first step. It’s great for brands [that work with Alibaba] because it means we can effectively sell your brand. We are not going to show or push your product to somebody who hasn’t expressed an interest in it, or your brand.”

Alibaba has quietly been testing AI technology, which helped drive the success of this year’s Singles’ Day event, where it sold a record 168.2 billion RMB (\$25.3 billion) worth of goods. The new technology — dubbed “FashionAI” — is able to recommend complementary products based on information about a shopper’s previous browsing and purchase habits on its shopping sites, like Tmall and Taobao. The system is also currently installed free of charge at selected stores across China, allowing users to generate outfit matches from hundreds of items, like a personal stylist.

“Over 1,000 brands at this year’s festival converted 100,000 physical locations into ‘smart stores.’ Through

“Access to consumer data is the holy grail for platform businesses because exclusive ownership of data allows them to exert control over the rest of the ecosystem.”



this highly interactive platform, merchants [were] able to better engage with their consumers, generating more revenue,” said Meifang Chen, senior manager at Alibaba Group UK. “[Using AI] recommendations can be incredibly accurate and the beauty of this technology is that it gets smarter and smarter. With every user that it interacts with, the capabilities improve,” added Stephens.

Personalisation strategies differ according to the type of platform — and there are many different business models out there. Farfetch, for example, allows luxury fashion boutiques around the world to sell online without maintaining their own costly digital operations. The site almost acts like operating system for retailers and envisions a future where third parties will build their own applications on it, the way developers build their own apps for iOS or Android.

“There is a distinct difference in that Amazon is both a retailer and a marketplace, whereas Alibaba is just a marketplace,” said Alibaba Group’s Badault. “So if you’re Burberry, you will be selling directly to the consumer, but Saks Fifth Avenue is on our platform [and they are] also selling your products.” What this could mean for Burberry is that “a Burberry trench coat could be \$300, but Saks [might be] selling it for \$250.”

Better Customer Service

Creating a better consumer experience through personalisation can improve customer retention and create a smoother browsing experience, which lets shoppers reach the checkout quickly, spending less time searching for the product they want.

“What these platforms essentially have is a fundamental core loop at their centre. The more data they gather, the more personalised their services become — and that helps to engage consumers even further, allowing them to gather even more data,” said Choudary. This is significant because there is just as much value for platforms to capture what Choudary calls “interest data” as much as “transactional data.”

“Imagine if [platforms] could leverage Google and Facebook’s big data in addition to their own. That’s essentially what JD.com is doing today. We’re co-operating with the leaders in social media and search [in China], giving us an unprecedented amount of data to create better personalised marketing than anyone in the world,” said Xia Ding, president of JD.com’s fashion division, referring perhaps to the firm’s alliances with WeChat parent company Tencent and Baidu, China’s largest search engine.

Under a deal with the latter, users browsing for



JD.com's automated logistics and warehouse complex in Gu'an, China

“Privacy is like currency. Like any other currency, consumers are ultimately going to send that currency to brands and retailers they feel they can trust.”

product information on Baidu's mobile search app can now access a dedicated section to buy items directly from JD.com. By encouraging users to stay within the app and make purchases, JD.com is able to garner valuable data on its customers' preferences.

Personalisation doesn't only benefit the brands and platforms battling for market share; customers too benefit from sophisticated algorithms. AI, for example, can operate chatbots that mimic consumers' interaction with a sales associate or a customer-care assistant. While the quality of these services vary, they can make online assistance available outside of business hours. Amazon Echo, a small device with an embedded microphone that connects the user to Amazon's personal assistant Alexa, is one of the most recent applications of AI by a retailer.

Brands like Tommy Hilfiger, Burberry and Levi's have also deployed AI-powered chatbots in a bid to improve the relationship with their customers. Tommy Hilfiger's chatbot was introduced during New York Fashion Week in September 2016 when the brand announced its partnership with model Gigi Hadid. Developed in collaboration with Msg.ai, the chatbot let

Courtesy

consumers explore pieces from the brand's new collection by asking questions that help identify user's individual tastes and sizes. The goal was to drive traffic to the Tommy Hilfiger website and create a personalised customer experience around their new collection.

Smarter Supply Chain

Platforms can also use AI technologies to make appropriate business decisions and improve the supply chain, going as far back as packaging or R&D. “This is especially important in the case of industries like fast fashion, where user tastes change very quickly and supply chains are usually slower to react. In such scenarios, having a direct link between the actual data being gathered from users about their tastes and what they're interested in – and conveying that back up the supply chain – means that designers and developers in the business can come back with the right products, in much shorter lead times,” Choudary explained.

Amazon, which previously applied for a patent for “anticipatory shipping,” uses AI to predict which products will be popular among customers in certain neighbourhoods and cities, and then stores those products in small warehouses nearby. This enables retailers to maximise the profitability of having the right items in stock before the customer orders them, which results in faster fulfilments and leaner inventory operations.

In some cases, AI can help automate tasks, freeing up time and resources for companies to invest further in personalisation. In March 2017, Coca-Cola teamed up with Salesforce and used its AI platform “Einstein” to automatically keep track of items in stock and replenish them when necessary, eliminating the need to manually monitor and reorder inventory. AI automation also removes human error from the equation.

According to 2017 findings by McKinsey & Company, an AI-based approach could also reduce forecasting errors by up to 50 percent, while overall inventory reductions of 20 to 50 percent are feasible. Stichfix currently uses AI to improve its clothing designs by analysing images and learning about specific styles of clothing. The subscription company generated \$977 million in net revenue in 2017, up from \$730 million in 2016, helping it to edge in on the likes of Asos.

“As the feedback loop between customers, platforms and brands becomes faster and more connected, we're going to see much more agile supply chains [as well as] more alternative supply chains coming up for the first time, where any platform that has access to user data can start connecting directly to contract manufacturers,” said Choudary.

Trade-Offs and the Future

The trade-off for an increasingly personalised and expeditious service on platforms, however, is customer privacy.

“Privacy is like currency. Like any other currency, consumers are ultimately going to send that currency to brands and retailers they feel they can trust. It's going to become a basic business attribute that if you want to be

successful and you want to have close, loyal relationships with customers, you're going to have to prove to them that you respect their information and that you will treat it with care,” said Stephens.

“We're coming to a point where if a customer wants tailored recommendations and customised solutions, they will have to give up some data in order to get to that point,” he added. Indeed, a 2017 report by RichRelevance, a San Francisco-based company that offers personalised shopping experiences for retailers including Macy's and Barneys New York, found that global consumers are willing to share data in return for better customer experience.

“The efficiencies that data can provide, from online marketing to the digital user experience to the physical experience, will be a game changer,” said José Neves, founder and chief executive of Farfetch. “The company with more data receptors and more data intelligence will win.”

Choudary believes that brands looking to scale should focus on the depth of data rather than the breadth of data. “Personalisation only becomes powerful when you have depth. If you want to personalise at scale, it's important to go deep before you start going broad. It might mean focusing on a particular-use case, getting deep data and personalising your services around that case, and then using these services to gather new data.”

“In the long run, there are a few things that will be really important. One is that companies will move away from focusing purely on transactions to focusing on engaging users, because engagement leads to data and once you have data, you can move users towards new transactions,” Choudary explained.

Looking further ahead, personalisation and AI is impacting the industry in more ways than just boosting supply chain processes and omnichannel. Platforms allow for collaboration, which has become essential for companies that want to survive in the digital world. They can create shared value by joining forces to share consumer insights, allowing for a higher degree of personalisation than a brand could ever realise by itself.

Gillette, for example, offers personalised grooming advice for men on its e-commerce website. Using its latest iOS app, customers can take a picture and try different looks. They can also connect with grooming experts and third-party non-competitive producers of grooming products. Men benefit from the personalised experience while platform participants benefit by interacting with a potential pool of buyers.

“[AI] is helping to change the kinds of expectations that users have. Branding is going to change in a big way. Brands are going to become platforms and they will rely less on traditional branding and more on fostering networks that build up the image of a particular brand,” said Choudary.

For Zalando's Schneider, ultimately “it's about learning how to work together and making use of each other's strengths, which I think results in a better consumer proposition.”

06. Mobile obsessed

As consumers' obsession with mobile grows, the end-to-end transaction will also move to mobile. With an overabundance of mobile payment solutions already available globally, consumers will expect fashion companies to cater for increasingly convenient mobile transactions.

Consumers have been mobile-first for a while now: mobile data traffic has surpassed that of desktop, and half of millennials spend more than three hours every day on their devices.²³ Consumers turn to their mobile phones for research, covering everything from inspiration to price comparison, spending an average of six hours per week on researching fashion on their phones.²⁴

Now consumers are also discovering the convenience of using their phones for transactions as mobile payments grow – whether on browser or in apps, through mobile wallets, or by paying through phones in stores – fashion companies will in 2018 begin to realise the opportunities this brings. For example, Tommy Hilfiger and Farfetch have conceived “stores of the future” that allow for deep customer engagement through mobile, taking full advantage of digital wardrobes, pay-by-app and links to social media accounts. We will soon see more fashion companies follow suit.

For a look into the future, consider Asia, which sets the pace for mobile adoption and mobile transactions. In Japan and South Korea, more than 50 percent of e-commerce is done by smartphone or tablet.²⁵ In China, more than 80 percent of online shopping is done on mobile; leading players like Alipay and WeChat are gaining global reach as consumers increasingly use these apps to buy goods in stores abroad.²⁶

So far adoption in Europe and the US has been slow – only about 15 percent of smartphone owners use mobile payment technologies to pay for purchases.²⁷ But mobile adoption is expected to boom, as apps such as Apple Pay are accepted by more and more fashion retailers. In the US, mobile transactions are projected to reach approximately US\$930 billion annually by the end of 2018.²⁸ In Western Europe, they are expected to grow by about 23 percent each year for the next three years, reaching €148 billion by 2021.²⁹

But this clear opportunity has resulted in a crowded landscape of mobile payment solutions. Some 700 fintech solutions are already available globally, and more startups will continue to emerge. How fragmented the landscape will get and who will emerge as winners will depend on the solutions and innovations delivered by different players. One potential disruptor is Bitcoin, a crypto



currency which is becoming more prevalent in Japan and Estonia. A second is solutions for integrating mobile payments into the offline shopping experience. Radio Frequency Identification (RFID) chip technology could help bring about a new stage of mobile transactions, with RFID-enabled scanners facilitating self- or auto-checkout. Mobile transactions in combination with other technologies have the potential to streamline the check-out processes: consider, for example Amazon Go's checkout-free shopping experience, which is facilitated by computer vision, sensor fusion and deep learning.

And since consumers do most of their shopping research on social media, these platforms are developing features that make it easier for users to shop and pay.³⁰ Pinterest has long had a buyable pin option that allows users to make purchases without leaving the site; and Instagram is currently partnering with BigCommerce and Shopify to build m-commerce capabilities. Meanwhile, Chinese social media giant WeChat's payment solution, WeChat Pay, has 600 million active users.

With so many options, fashion companies will be expected to cater to consumers who are using their mobile device as their primary wallet. We will see more examples of retailers embracing mobile transactions to upgrade both online and offline purchase journeys. They will use mobile transactions to deliver experiences that range from frictionless check-outs online, to self-check-outs and the use of mobile wallets in-store. They will use mobile transactions to better integrate social media and call-to-action buttons. To achieve this, fashion companies will not only need to make strategic choices about the solutions they want to cater for, but also how, when and where they will be used. The decisions they face are made increasingly complex by the multiple standards, payment providers, technologies and solutions available, from device-based to cloud-based support, and the choices they make will have big implications on implementation challenges and the resulting customer experience. And regardless of which options they choose, security and privacy continues to be of great concern to consumers and these need to be safeguarded.



CEO TALK

TORY BURCH

CHIEF EXECUTIVE AND DESIGNER, TORY BURCH

The American entrepreneur speaks about rapidly shifting consumer behaviour and preferences, with the backdrop of technological, political and economic upheaval.

by Imran Amed

BoF: It seems everything is changing in the fashion industry – especially the consumer.

Tory Burch: Yes, over the years the customer has changed. Before, it used to be the department stores who were in charge; now the customer is in charge because technology has really given the customer access to so much information. So they're really determining what is relevant. They have high expectations with customer service. They have high expectations with product. They have high expectations with cost and they can go on an app and compare pricing, globally, instantaneously. She has more knowledge and is more savvy than she has ever been.

BoF: What are the most noticeable elements of change in your own customers and the way they interact with the brand, the way they engage with your product?

TB: Today they're coming in and they know what they want. If they're coming into the store, they're coming in with an editorial or with an idea of what they want. They're definitely shopping online. I launched e-commerce 13 years ago; now it's 22 per cent of our business. They're shopping online, at all hours of the day, but they are more purposeful in their shopping. What's interesting is getting a customer into the store, it's really showing them things that they weren't necessarily coming in to buy and I think that's really about some of the interesting clienteling we're doing.

I started the company to start a foundation. Thirteen years ago people told me never to say the two in the same sentence. Customers today want businesses with purpose – this is a huge shift and something that obviously I'm very happy about because I've been talking about it since I started the company. Really our foundation attracts people who want to work. It's great for our employees so it's great for the customer and so it's good for the bottom. That's a big change and certainly, from a Millennial standpoint, that's what they care about. But it's also trickling up as well. There's so much chaos in the world, people want to believe they're buying something that actually has some sort of end result of doing something for other people.

BoF: How has it changed the way you work now, in terms of the way you work with your teams or the way you think about developing product?

TB: It has to have integrity. If my name is on it, we have to protect the logo, the customer experience. So everything that we're designing and putting out in the market, we want to be proud of, and that's always been the case, but even more so now because less product is going in the market. We've edited lines pretty dramatically and it's much more focused. I think customers like that focus. All the promotions and the outlets – that's not something that I'm interested in. We're very long term in the way we look at our business.

BoF: The off-price sector is actually one of the areas of the industry that's continuing to grow, but, as you say, it can have negative long-term implications.

TB: Our biggest focus right now is full-price selling. That's something a lot of brands are not focusing on. We've actually pulled back on the business over the last three years, overturned every rock and invested in the business to actually have growth – but the right long-term, healthy growth. We've always been careful, but it gets away with you at times.

BoF: So if you're not opening tons of stores, you're scaling back product and you're being really cautious about the off-price channel, where are the growth opportunities as you look ahead to 2018?

TB: There's plenty of room for growth within e-commerce and new customer acquisition. Most of our e-commerce business is in the US, so when you think of China, it's a massive market for us. We haven't had to close any stores because we've been really careful about our distribution; we are really set up for tremendous growth there. We also have enormous potential for Europe.

We pulled back ready-to-wear because I wasn't excited about the way it was looking in some of our wholesale partners or just in general. I wanted it to be much more focused. Now our ready-to-wear is on fire; it's super exciting.

BoF: Speaking of wholesale, what's your view of the department store channel?

TB: I get very passionate about the work we've done over the last three years. But being a company in between contemporary and designer, no one from a wholesale channel knew where to put us. Wholesale is now looking for innovation, they need it, right? How do we control the way we look? How do we help build their business? In a way, if I were to make a recommendation to wholesalers, they should become real estate agents and allow the brands to take over, do the concept, "shop in shops," and then create areas for entertainment in their stores.

They need to radically change or it's over for them. They should understand that brands know their brands better than anyone. So when you have a young

team of buyers cherry-picking a line and putting it together, it's not inspiring and it's not inspiring for the customer either. We know what sells the best, so we're really taking ownership in wholesale now, too, and partnering with them in a very different kind of way.

BoF: The last topic that I wanted to explore further with you was around innovation. How are you thinking about that?

TB: Innovation is everything. We've always been interested in innovation, so now it's like: how do we continue the innovation, but in a more fast-paced way. We launched with a retail concept, which was unheard of. We launched with e-commerce, which was unheard of. We started the first concept of an online magazine 10 years ago, which became the idea of a blog. We adapted every kind of social media and PR to help build the brand without advertising. So, how do we continue to innovate but in a way that's addressing what's happening in the macro world now? A lot of people have old mindsets and that just doesn't work here. If people want to [stick with] the classic way of thinking about retail or the classic way of thinking about wholesale, it's just not going to work in this company.

In our company, less is more. Less product with more integrity. We took footwear in-house, so we're in full control of that. How do we expand our reach to the Chinese customer, whether it's through WeChat or bringing Tory Daily in China? That's something we're doing. How do we engage with local people more in each of the places that we are? We're very proud to be an American brand but I think we're a bit atypical for an American brand because we have a much more global outlook. How do we stand for something in messaging, without it becoming political (because that's just a no-win)? We want to have substance – for issues I care about, I can't help myself and that will never change. I think people like that authenticity about me. We are trying to look at the world as a smaller place because it is. How do we synergise the idea of our e-commerce with our stores and with our customer more, in a global way?

This interview has been edited and condensed.

“Before, it used to be the department stores who were in charge, now the customer is in charge because technology has really given the customer access to so much information. They have high expectations and they can go on an app and compare pricing, globally, instantaneously.”

THE FASHION SYSTEM

07. AI gets real

Leading innovators will reveal the possibilities of artificial intelligence across all parts of the fashion value chain, exploring new ways of creating value for those employed in the fashion industry. AI enhancements will go beyond the traditional areas of machine tasks into creative and customer interaction processes, blurring the line between technology and creativity.

In our view, 2018 will be the year leading innovators begin to reveal – and revel in – the possibilities offered by Artificial Intelligence (AI) across all parts of the fashion value chain. Over the past couple of years, the potential of AI – computer systems able to perform tasks normally requiring human intelligence – has expanded considerably as a result of increasingly large and diverse data sets, advancement in key algorithms, and unprecedented levels of mathematical computing power. Although fashion has not thus far been a leader in this sphere, we expect to see fashion companies on the digital frontier demonstrate this potential as they start to deploy breakthrough AI innovations. Pioneers in this field will realise palpable returns from these efforts and demonstrate the potential advantages for companies that successfully marry creativity and AI.

Many fashion executives regard AI as too mechanical to capture the creative core of fashion, and so are uncertain of what exactly it can do for them. But AI's benefits extend across the full fashion value chain. In fact, 20 percent of executives who took part in the BoF-McKinsey Global Fashion Survey believe that the use of AI to reinvent design, merchandising and marketing will be an important trend. AI can deliver significant speed, cost and flexibility improvements across the fashion supply chain. Consumers will enjoy the benefits of such improvements through better product availability and faster, more accurate deliveries. We are likely to see AI innovations ranging from predictive forecasting, capacity

planning, and merchandising to automated production and delivery.

But the potential of AI for the fashion industry goes beyond supply chain processes and automation, as it transcends typical machine tasks and blurs the lines between creativity and technology. Leading fashion companies will use it to enhance the creative process, design and product development; they will, for example, use algorithms to sift vast amounts of data to predict which product features customers are most likely to prefer. Amazon is on the verge of creating the first AI designer, with the development of an algorithm that designs clothes by analysing images, copying popular styles and using them to build completely new designs. Indian designer duo Falguni and Shane Peacock are using IBM's cognitive tool Watson to map the future of Bollywood fashion by combining analyses of over 600,000 images of fashion runway shows and Indian couture. Likewise, fashion startup Stitch Fix deploys algorithms, rather than mood boards, to start creative processes and new designs; it uses algorithms that go through 30 million combinations of, for example blouse attributes, to predict which attributes customers will prefer, and eventually narrows down to just a few suggestions. Such examples highlight AI's potential for identifying unmet customer needs and trends.

In 2018 we expect to see more examples of how companies can deploy AI to redefine interactions and engagement with their customers. Customer relationship management is one of the

next frontiers for AI, with early adopters focusing on improving customer insights through enriched data, opportunity stage recommendations, and dynamic pricing capabilities. In the online world, companies including Burberry and Tommy Hilfiger use chatbots, which enable 24/7 engagement with customers. AI can help improve offline engagement as well. Companies can, for example, use it to evaluate sensor-collected data and improve in-store experiences for target customers.

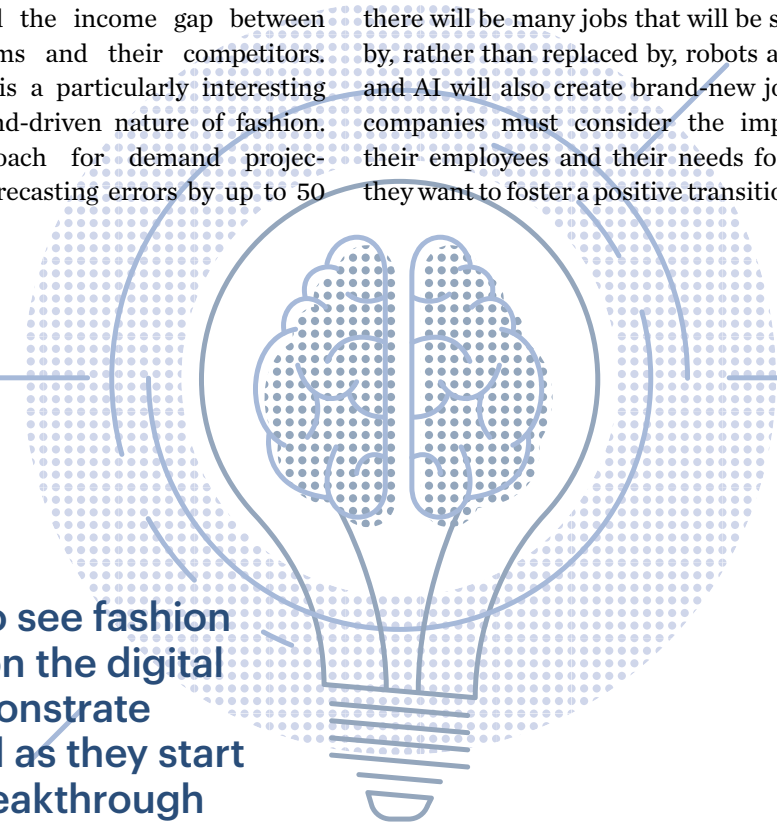
One good example is Farfetch's "Store of the Future." Automatic customer recognition at the store's entrance, RFID-enabled clothing racks and digital mirrors that allow customers to choose sizes, colours and directly check out, all demonstrate how AI can be employed to excite customers in-store while seamlessly integrating the online and offline experiences.

AI can not only deliver competitive advantages to early adopters; it has the potential to disrupt the fashion industry entirely. Research on early adopters suggests that AI-driven innovation will be a new source of productivity and may further expand the income gap between high-performing firms and their competitors. Demand projection is a particularly interesting area due to the trend-driven nature of fashion. An AI-based approach for demand projection could reduce forecasting errors by up to 50

percent, while overall inventory reductions of 20 to 50 percent are feasible.³¹ To turn AI into a source of competitive advantage, fashion players should develop a compelling AI strategy. There is a broad array of possible use cases and technologies, often requiring different capabilities. Fashion companies need to focus on the areas that deliver most value and best support their business strategy.

At the same time, fashion has always been a collaborative industry – where would designers be without their *petites mains*? Similarly, as AI redefines the types of work best performed by humans alone and where AI can support work processes, questions emerge about the outlook for people employed in the fashion industry – where will jobs be lost, and where will they be enhanced? While this is not the first time that there has been anxiety about technology replacing jobs, the speed at which developments are taking place is unprecedented. Research suggests that approximately 20 to 30 percent of current jobs performed by fashion designers could be automated. At the same time, there will be many jobs that will be supplemented by, rather than replaced by, robots and machines, and AI will also create brand-new jobs.³² Fashion companies must consider the implications for their employees and their needs for reskilling if they want to foster a positive transition.

We expect to see fashion companies on the digital frontier demonstrate this potential as they start to deploy breakthrough AI innovations.



AI IN ACTION

Artificial Intelligence (AI) has long held out the promise of transforming the economy and society. With the necessary investments and technology advancements coming into place, we begin to see signs that this future has started to come true – also in the fashion industry.

by McKinsey & Company

For many decades, Artificial Intelligence (AI) – computer systems able to perform tasks normally requiring human intelligence – has held out the tantalising promise of transforming the economy and society; over the past few years we have finally seen sign that this future has started to come true. Ninety percent of all the world's data have been created in the past 24 months.³³ Technology has improved: just to pick one example, GPUs (specialised integrated circuits) can process images 40-80 times faster than the fastest versions in 2013.

In principle, technological advancements mean AI is at the verge of outperforming humans at many tasks. Its ability to unlock unstructured types of data, such as images and natural language (voice or text), makes it possible to analyse data that were previously inaccessible. Its ability to look at a large amount of data simultaneously makes it possible to identify patterns that are impossible for humans to recognise. As a result, AI allows a more comprehensive and improved understanding of the present, and better forecasting of the future. This in turn creates opportunities for automation based on more intimate understanding of operations.

This technological improvement has been coupled with colossal new investment. In 2016, tech giants are estimated to have invested \$20-30 billion in AI; Private Equity and Venture Capital funds have invested an additional \$6-9 billion. From 2013-16, external investment in AI technologies grew at a compound annual rate of almost 40 percent.³⁴ These investments are highly concentrated geographically, dominated by technology hubs in the US and China, with Europe lagging behind; most investors are either big tech players or PE/VC/seed funding.

Nevertheless, while the investments and technology advancements required to accelerate use of AI are coming into place, widespread results have yet to appear. Despite a forecast that by 2020, 85 percent of customer interaction in retail will be managed by AI, there is still some way to travel.³⁵ One indication of this is the wide variance in the current market forecasts of potential economic benefit from AI by 2025: these range from a nugatory \$644 million all the way up to \$126 billion. Today, only 10 percent of startup companies that consider machine learning to be a core business say they generate revenue.³⁶ As an industry, retail is generally not a leader in terms of

AI assets, usage and labour. Retail is expected to increase average spending by 5 percent in the next three years, way behind the level of pace-setting sectors such as financial services, transport and logistics and auto assembly.³⁷

So is the promise of AI in fashion still a mirage? Not quite. Consider a few success cases. Amazon's \$775 million acquisition of Kiva reduced "Click to ship" cycle time from over 60 minutes (human handling) to 15 minutes, and increased inventory capacity by 50 percent – all of which gave Amazon an ROI of close to 40 percent.³⁸ In fashion, Topman works with AI company Granify to help optimise the menswear store's e-commerce conversion rates by serving different messages to shoppers when they are at flight risk. This has given the retailer a 3 to 5 percent uplift in conversions. And flash sales site BrandAlley works with marketing automation company Emarsys for persona-based targeting in its email campaigns: from this, BrandAlley has seen a 16 percent conversion lift.³⁹

Most early adopters in the fashion industry have focused their AI efforts on a few elements of the value chain, the most significant being demand forecasting, operations automation, and customer experience enhancement (in particular in personalisation). US retailer Rue La La collaborated with MIT to experiment with AI technologies to improve demand forecasting. They developed a system that helped them predict the demand for products in their flash sales, and accounted for data sources including brand information, product type, colour, price and a range of other factors. This enabled them to optimise prices and generate a 10 percent increase in revenue without the extra burden of unused inventory or supplier costs.⁴⁰ German e-commerce player Otto uses deep learning to analyse billions of transactions, and is 90



percent accurate in forecasting what it will sell in the next 30 days. This insight allows it to order a couple of hundred thousand items each month from vendors with no human intervention. It has also cut surplus stock by 20 percent and reduced costly returns by 2 million items each year.⁴¹

Image analytics is another extremely active area with the potential to improve customer experience. Examples of partnerships between AI visual search companies and fashion companies include Slyce with Tommy Hilfiger, Flashwell with Zalando, and Pinterest with Target.⁴² Myntra's brand Moda Rapido is powered by AI and works without human intervention to offer computer generated designs, including T-shirts, jeans, kurtas and shoes. The system is fed data from various sources, including customer data, social media, fashion publications etc., and creates thousands of combinations of designs, then hones in on what would sell well. It now has the highest gross margins compared to all other 14 brands under the Myntra portfolio.⁴³ The AI company Sentient Technologies works with Skechers to improve

recommendations based on analysing which images of shoes an individual customer prefers to curate a gallery tailored to a shopper's unique style preferences.⁴⁴ Picalike is another example; it collaborated with BonPrix to make personalised recommendations for out-of-stock items based on visual similarities, reducing the dropout rate on out-of-stock items by 43 percent.⁴⁵

Some startups have managed to embed AI in two or more steps of the fashion value chain. StyleSage, EDITED and BlueYonder are just a few examples of such companies where AI is being used from pricing optimisation, trend forecasting to competitor assortment intelligence gathering.⁴⁶

Looking ahead, further developments in AI have the potential to change the way we shop and disrupt business models. It is a truism that we overestimate the impact of technology in the short run and underestimate it in the long run. Preparing now for the long-run impact of AI is vital for fashion companies that wish to position themselves for the new – and now, the near – future.

08. Sustainability credibility

Sustainability will evolve from being a menu of marketing-focused CSR initiatives to an integral part of the planning system where circular economy principles are embedded throughout the value chain. More fashion brands will plan for recyclability from the fibre stage of the supply chain and many will harness sustainability through tech innovation in order to unlock efficiency, transparency, mission orientation and genuine ethical upgrades.

Sustainability will be at the centre of innovation in the fashion industry in 2018, with front-runners harnessing the circular economy to unlock technical innovations, efficiencies, and mission orientation. Fashion companies have started to embrace the importance of sustainability, with 42 out of 100 fashion brands in 2017 disclosing supplier information.⁴⁷ Leading companies will go further, moving to close the loop of the entire product lifecycle by means of recycling and regeneration. As focus shifts to a circular economy, sustainability will evolve from being a menu of fragmented initiatives to being an integral and defining part of the entire fashion value chain.

An important force behind the growing sustainability movement is the realisation that sustainability leadership can serve as a real

source of differentiation, as has been observed with Patagonia, which has earned a large and loyal customer base through its relentless focus on sustainability from product development to innovative campaigns and involvement in sustainability initiatives. Millennials in particular are interested in more-sustainable solutions; 66 percent of global millennials are willing to spend more on brands that are sustainable.⁴⁸ “Sustainability, interestingly, it’s really important with the young generation,” says Levi Strauss’s Chip Bergh. “In China ... the value they place on how brands do business, what brands stand for is off-the-charts compared to any prior generation.”

As consumer attention on sustainability issues increases, sustainability leaders can use their advantage to promote revenue growth. Sustainability will also be accelerated by advancements in technology across materials, products and processes. A next-level focus on sustainability has the potential to drive technical and process innovation, strengthen the bottom line by means of radical process reengineering, and improve transparency and risk management.

The industry’s growing focus on sustainability is also being driven by passionate industry pioneers. For example, the Ellen MacArthur Foundation has created the Circular Fibres Initiative, bringing together industry stakeholders to move from the “take-make-dispose” approach to a circular economy for textiles. Building on the success of the New Plastics Economy initiative,

the Circular Fibres Initiative’s vision is to develop a new system for textile building on circular economy principles of restoration and regeneration. Another player in this movement is the Danish Fashion Institute, whose Global Fashion Agenda raises awareness on sustainability in the fashion industry.

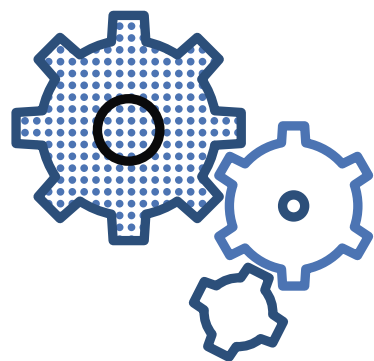
Fashion companies can find potential opportunities across the entire value chain. Some fashion players experiment with innovation in materials, like sustainable fibres. Radically innovative products already exist; after years of development, C&A introduced a “Cradle-to-cradle certified” T-shirt at a mass-market price, demonstrating one possible future model of circular fashion production. We expect the commercialisation of sustainable prototypes – something which has so far often been missing – to ramp up in 2018, as is the case with recycled polyester, which is increasingly being used by mass-market players. We also expect to see alternative business models and new concepts centred around sustainability. A recent example is Arket, H&M’s new brand of clothing. In addition to incorporating sustainability into the end-to-end processes and product lifecycle, H&M has defined the brand concept around longevity, with an emphasis on enduring design and quality.

Another important topic will be the issue of waste. Zara, for example, is installing collection bins across all stores in China, H&M invested in Re:Newcell and Eileen Fisher’s Renew program

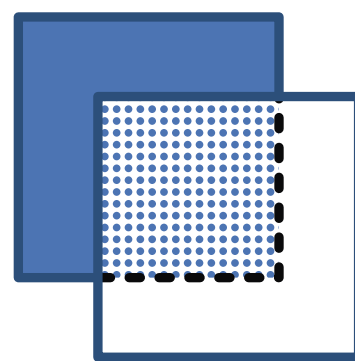
mends or resews clothes for reuse. Areas like on-demand manufacturing and supply chain process reengineering are worth exploring; Adidas’ 3D printed sneakers are a case in point.

We believe more fashion startups and initiatives built around the business idea of sustainable fashion will break new ground in 2018. Examples range from Ambercycle, which uses microbes to break down polyester for re-use in new textiles and Modern Meadow, which grows leather in a lab, to efforts like the Indian Restart Fashion initiative, which brings together designers who make clothes from post-consumer products. In addition, we may see more progressive incumbents take advantage of startups’ innovations to drive their own sustainability efforts. Take, for example, North Face, which collaborated with Spiber to develop a parka made of faux spider silk. Fashion for Good is promoting startups in this area. It is collaborating with incubators and other apparel companies to provide funding and operational expertise for developing innovations that promote sustainable practices.

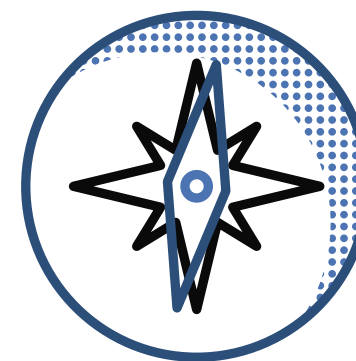
In sum, 2018 will bring to fruition the “next level” of sustainability and offer the potential of a competitive advantage for fashion companies who embrace it fully. As the commercial advantages become apparent, a dedicated group of sustainability champions will lead the way, showing the fashion industry how to drive innovation and value by integrating sustainability across the entire value chain.



Efficiency



Transparency



Mission
Orientation



Ethical
Upgrades



Q&A

DAME ELLEN MACARTHUR

FOUNDER OF THE ELLEN MACARTHUR FOUNDATION

One of the world's leading thinkers on the circular economy speaks to BoF about the growing momentum among fashion companies to commit to the principles of this restorative and regenerative movement.

by BoF Team

BoF: Could 2018 be a watershed year for the fashion industry, in terms of a greater commitment to sustainability and circular-economy principles?

Dame Ellen MacArthur: Since we launched the Circular Fibres Initiative in May 2017 we have seen that leading brands are increasingly committed to tackling some of the drawbacks of our current "take-make-dispose" model.

Today's textiles economy is so wasteful that in a business-as-usual scenario, by 2050 we will have released over 20 million tonnes of plastic microfibre into the ocean. While existing mitigation efforts are essential to reduce the negative impacts of today's system in the near term, we need to start the transition to a fundamentally different and better system – a new textiles economy. We need to raise the level of ambition and aspiration by working towards a common vision and setting clear targets. There are already efforts underway to get commitments to some of the ambitions of a new textiles economy. For example, the Global Fashion

Agenda is gathering commitments towards building a circular economy for textiles, to be achieved by 2020.

BoF: What learnings have you drawn from this work that you can apply to build momentum for improving sustainability in the fashion industry?

EM: Every sector is of course unique – and fashion is very different from plastic packaging in many ways. Yet five learnings stand out as prerequisites for successful systems-level change.

1. Alignment on the case for change. Transforming a system requires a great deal of effort and therefore a compelling rationale.
2. A positive vision. By its very definition, system change entails moving from an existing system to a new one. This requires a clear vision of the target state to move towards: "If we can imagine it, we can achieve it."
3. Broad stakeholder buy-in and time-bound commitments. To achieve system change, the vision must be backed by all actors, including industry, government

and cities, civil society and the broader public. None of them can do it alone.

4. Proof that the vision is possible. Demonstrator projects, conducted collaboratively by various stakeholders along the value chain, are required to test new models at scale and provide evidence for their success. This is particularly important, as no single actor can achieve system change alone.
5. Need for unprecedented levels of collaboration and alignment in areas of action.

BoF: How have you worked to raise fashion players' interest in a circular economy? In your experience, what has been the biggest obstacle to getting fashion companies to give real attention to this and other sustainability topics?

EM: The vision of a new textiles economy offers a chance to set the fashion industry on a new trajectory. Instead of just trying to "do less bad," we need to change the way we make and use clothes so that their production and use builds economic, societal and natural capital rather than depleting it. It's an invitation for the industry to explore new materials, pioneer new business models, harness design and put technology to work. Many players now understand that if they want to make the most of the new possibilities, collaboration at unprecedented levels is needed. And it'll be worth it: it's a \$500 billion opportunity. Now we need the industry and all concerned stakeholders to rally behind it.

BoF: What do you see as the most important challenges for fashion players as they continue to deliver on improving their sustainability record?

EM: Worldwide, clothing utilisation – the average number of times a garment is worn before it ceases to be used – has decreased by 36 percent compared to 15 years ago. After use, less than 1 percent of material used to produce clothing is recycled into new clothing. This take-make-dispose model not only leads to an economic value loss of over \$500 billion per year, but also has numerous negative environmental and societal impacts. For instance, total greenhouse gas emissions from textiles production, at 1.2 billion tonnes annually, are more than those of all international flights and maritime shipping combined. It is therefore critical that fashion players complement existing efforts to reduce the negative impacts of the current system with a radical, longer-

term, systemic transformation that moves towards a positive vision of a system that works: a circular economy.

BoF: What is your advice to fashion companies that have begun the journey of transitioning towards a more sustainable and circular model, but feel overwhelmed by the scale of change they need to make or worry that it requires too much investment to see any real progress?

EM: There are practical steps an individual company can take in the short term to start transitioning towards a circular model. Gradually introducing leasing models to customers or increasing the use of recycled content are just two examples of actions that can significantly help drive circularity. Yet no single company can drive a full transformation towards a circular economy by itself. If on a current trajectory, by 2050 the fashion industry will be responsible for a quarter of the world's carbon budget. We need a radically new approach. This includes unprecedented levels of collaboration across brands and retailers, their supply chains, cities and governments, and collecting, sorting and reprocessing actors. Jointly developed open-source tools, for example design guides for circularity, are also an essential enabler for the transition.

This interview has been edited and condensed.

"After use, less than 1 percent of material used to produce clothing is recycled into new clothing. This take-make-dispose model not only leads to an economic value loss of over \$500 billion per year, but also has numerous negative environmental and societal impacts."

09. Off-price deception

Off-price sector growth continues to be driven by the notion that it provides a solution to challenges like excess stock and slow growth, but the US market serves as a warning about saturation and possible sales cannibalisation. As Europe and Asia get hooked on the myth of an off-price 'panacea,' the fashion industry could be put at risk of margin erosion unless companies carefully consider their off-price channel strategies.

From mono-label outlet stores to multi-brand off-price concepts and outlet malls, off-price formats have become an important part of the fashion retail landscape, and the off-price sector will continue to grow in 2018. Today's shoppers continue to demand lower prices and desire a treasure-hunt experience. At the same time, off-price offers brands and retailers a channel for clearing excess inventory quickly. This is an important consideration because of the difficulty of forecasting consumer preferences accurately. Excess inventory constituted \$472 billion of total lost retail revenue globally in 2015, an increase from \$362 billion in 2012.⁴⁹ Overstocks have been further exacerbated by the increase in online shopping, where return rates average more than 20 percentage points above offline shopping.⁵⁰ Off-price is an apparent solution to these challenges, and in the coming year, brands and retailers continue to appreciate these aspects of the off-price channel.

The United States was quick to adopt off-price formats, much to the chagrin of conventional department stores; in 2016, two-thirds of shoppers in the United States shopped at an off-price retail store.⁵¹ Off-price specific chains such as those under TJX (whose portfolio of chains include T.J. Maxx and Homegoods) were for a long time the most prominent and continue to exhibit impressive sales growth. Traditional department stores responded by launching their own off-price versions – including Neiman Marcus Last Call, Nordstrom Rack and Saks Off Fifth. Nordstrom also acquired the off-price retail site Hautelook. In addition, factory outlet centres have expanded, exemplified by Tanger Factory Outlets' growth of approximately 10 percent annually since 2010. And online players like Bluefly, The Outnet and Yoox have continued to expand, creating an even greater number of off-price alternatives.

More importantly though, following a period of aggressive footprint expansion, slowing sales and tight competition amongst off-price concepts and cannibalisation. There are signs that the US off-price market may have reached a tipping point and could prove a less viable source of growth going forward, something fashion players in the US should be wary of as they look towards 2018.

Meanwhile, other regions have discovered the potential of off-price. Between 2003 and 2017, the number of off-price stores in Europe has more than doubled.⁵² This growth rate is expected to continue in 2018. As was the case with the early US market, today's European market is dominated by factory outlet centres and off-price chain T.J. Maxx. Furthermore, online players like Yoox are gaining ground. Asia is experiencing early expansion: the total outlet market in Korea has grown about 5 percent over the last year; the premium outlet market has grown the most, approximately 12 percent. In China the market for outlet factories is estimated to reach \$12.2 billion in 2018.⁵³

Yet as the off-price market is expected to expand in the coming year, particularly in Europe and Asia, companies need to take into account the potential pitfalls of this channel. In the US, some brands that leveraged off-price stores to grow sales volumes saw their brand image or margins suffer when off-price options started cannibalising sales of full-priced, high-end items. Michael Kors and Ralph

Lauren have been cited in the press as examples of companies that implemented an off-price strategy which ended up backfiring.⁵⁴ Conversely, Coach has achieved financial improvement partly from reducing its exposure to outlet stores.⁵⁵ The sentiment that there can be too much movement away from full-price is slowly catching on more broadly. In this year's BoF-McKinsey Global Fashion Survey, 25 percent of fashion executives said that investing in brand building to increase full-price sell-through is one of their top five focus areas for sales and growth.

In 2018, as the off-price channel continues to grow in Europe and Asia, fashion executives

should carefully consider their strategy for this channel and determine how to reap its benefits while avoiding the potential downward spiral seen in some cases. They need to take into consideration the trade-off between short-term sales growth and brand image. For example, differentiating factors such as merchandise, location and customer service can help ensure that full-price and off-price co-exist as complementary and mutually beneficial channels. In addition, fashion companies should consider alternative strategies for dealing with excess inventory and online returns and avoid pursuing off-price channel strategies for the wrong reasons.

25 percent of fashion executives said that investing in brand building to increase full-price sell-through is one of their top five focus areas for sales and growth.





CEO TALK

VICTOR LUIS

CHIEF EXECUTIVE OFFICER OF TAPESTRY INC.

The chief executive of the newly formed ‘modern luxury’ group speaks to BoF about competing in an uncertain world, the enduring power of brands and the challenges of managing off-price channels.

by Imran Amed

BoF: The state of fashion is uncertain and challenging right now — how are you managing through it?

Victor Luis: In an increasingly fast and transparent world, there is a need for continuous innovation — but there’s so much that is happening all the time that you absolutely need to be reactive, nimble, flexible without losing sight of the long-term. So the idea of being consistent, of remaining true to the brand, of remaining true in your communications with consumers is absolutely vital through those periods.

If you listened to our last three or four earnings calls you’ll hear the word “unpredictable.” We’re not in the “let’s do a financial flip tomorrow” or “let’s create a new idea and then go and move on to the next one” game. We’re in the brand-building business. For me product is everything; everything starts there and then it’s [about] how you actually build emotion in storytelling around that, because, if it’s just about the function, you literally don’t win. At the end of the day that takes time. It takes consistency. Build a relationship between a brand and a consumer. The short-term stuff will come and go.

BoF: While brand remains very important, of course, there are all of these new businesses that become very popular, very quickly on the basis of a single product. They aren’t at the scale of Coach of course, but if people latch on to a product, a company can grow really quickly.

VL: Successful brands start with great

product. We started as a manufacturer on 34th Street. It started with six guys making product, making belts and wallets, really designing them one at a time as craftsmen. That’s a different culture than say, “Okay we’re a design-led company.” That starts with someone who has an idea and then goes off and searches for others to help them make or develop product. Handbags come naturally to us, leather comes naturally to us. As we get into footwear — which is one of the reasons we acquired Stuart Weitzman — as we get into outerwear and into other categories, it takes time. These are not things we can just do overnight. The challenge of going from handbags to other categories, or from apparel to handbags, is not easy. We know that incredibly well. You’ve seen that with many other brands in our space and others. I think the internet allows for ideas to reach consumers much more quickly and flexibly. That I would certainly agree with. I think that allows entrepreneurs to come up with very singular, focused products that allow them to break through a little bit.

BoF: So in a product-led world where brand remains important, what do you see happening to lifestyle brands? Do you still see that as being a compelling proposition?

VL: I do, as long as you don’t try to create a monotone world where you try to fill a consumer’s life with everything that’s one expression. It’s been part of what we’ve discussed relative to the Kate Spade world. We’ve decided we’re not going to invest in the Jack Spade business and men’s. Kate Spade has quite a few licenses in home and

other categories and we’re going to review those. I’m not a believer that you can have someone from head to toe and then go to their home and expect their life to be Kate Spade [too]. I do believe that within each category, Kate Spade has an opportunity [in] the main fashion categories, to create some of the ideas of “the best of”.

BoF: As a vendor who is operating in some of the troubled department stores, what do you do?

VL: I believe that there’s going to be some more continued dislocation because, at the end of the day, we have great partnerships — with Nordstrom, with Macy’s, with Neiman Marcus, with European department stores, [and] we’re especially strong in Asia. I think that in each one of those markets, the role of wholesale is quite different. In the luxury space, wholesale practically does not exist in Asia. Even if department stores exist, we manage our businesses directly within that channel because they’re all concessions. Those Asian department stores have been able to build a loyal base of vendors where valuation [and] consumers’ perception of products is not destroyed because of promotions and everything else. That business model, I believe, is more sustainable.

Europe has less dependence on overall department stores because there are high street locations combined with some department stores, but also you have a very healthy and fragmented select shop or speciality store world. But I don’t think it’s easy for those people to scale. The idea that Colette is successful in Paris and [therefore] can open 30 stores across Europe is very challenging. Those concepts are unique because they have special meaning in the cities in which they are in. They’re unique events. So how they scale is through something like a Farfetch or through online and through other players.

Then you have the US where, quite frankly, the department store channel has played a very significant role both in distribution at scale but, of course, because it’s mostly wholesale relationships, they have not believed in the concession game as much. They have some branded business, but they also have some daily business, a more commoditised business where price and convenience plays more of an important factor, that’s where dislocation comes from, right? You can’t go on Amazon and find the Gucci offer, but you can go on

Amazon and find the sock, the underwear, the T-shirt and maybe five or six other items that are daily items that you would’ve typically gone to department store X for. That shrinks their base and so the added-on sale becomes more difficult. As a result, I think we’re going to see a need for differentiation. How many malls is that? How many department stores is that? It probably points to some form of continued shrinkage where it will find its natural place.

BoF: Another big industry theme to watch next year is the continued growth of discount channels — even in Europe and Asia.

VL: Right. But remember Europe is protected through a couple of things; one is fragmentation. Italians are not necessarily shopping in the UK on Department-Store-UK.com nor Germany nor others. And then two, you actually have regulations that manage when you can and can’t go on sale. So we’re protected from ourselves by the government. In the US, you have wholesale relationships where they own the inventory, you cannot tell anyone what they should or shouldn’t price it at. That leads to very tough decisions on whether you can trust that your brand’s going to be treated well because you’re impacted not by your performance, but by the performance of the broader chain. Those are tough, tough decisions.

BoF: Looking towards 2018, how do you think things are shaping up?

VL: My confidence is in the long-term health of our industry in the sense of a very strong belief that consumers will continue to look for fashion as a way to express themselves, and within the fashion categories I especially have a lot of confidence in leather goods. I have a lot of confidence in footwear because of the role that it plays from above — that wonderful unique combination of fit and comfort combined with branding. There’s obviously going to be continuing numbers of consumers who come up into the premium space, but there will be some commoditisation of apparel because of fast fashion and what’s happening online. I especially like more branded apparel, outerwear and a few other places where, again, brand and logo can create value for us and give value to consumers.

This interview has been edited and condensed.

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10. Startup thinking

Due to an urgent and intense need for innovation across the industry, a growing number of fashion companies will aim to emulate the qualities of startups such as agility, collaboration and openness. Traditional players will continue to be compelled to open their minds up to new types of talent, new ways of working, new kinds of partnerships and new investment models.

Some leading thinkers believe that within the next decade, 40 percent of Fortune 500 companies will cease to exist. As a growing number of retailers file for bankruptcy and fashion brands continue to disappear, more fashion companies are realising that survival requires constant innovation. The mantra “innovate or die” has never felt more relevant. That’s why we expect fashion players in 2018 to be keenly focused on delivering innovation from design to after-sale. We will see more companies looking outside the industry for inspiration on how to infuse innovation into their entire ecosystem. Learning from the operating models of startups and digital native companies, fashion companies will be compelled to open up to new types of talent, new ways of working, new kinds of partnerships and new investment models.

One way to promote innovation is to acquire innovative startups. We expect that in 2018 the venture capital investment in the fashion ecosystem will grow and investor competition for the most attractive startups will intensify as the fashion industry’s significant market size makes it ripe for further technological and digital disruption. Some of the venture capital infusion will be driven by fashion entrepreneurs. These include Miroslava Duma, who set up the hybrid venture FTL to invest in and commercialise new technologies in fashion; Net-a-Porter founder Natalie Massenet, who is setting up a fashion and lifestyle venture capital fund; and designer Rebecca Minkoff who launched a fashion tech venture capital fund in partnership with Quotidian Ventures. Large heritage players will be involved too, establishing their own venture capital arms to invest in innovative startups. Examples include LVMH Luxury Ventures, which

is using its starting capital of €50 million to invest in small, promising fashion firms, and H&M’s venture capital operation which invests in young technology companies like Ivyrevel or Worn Again. Additionally, traditional VC firms will be focusing more on fashion – further fuelling the competition for the most innovative startups as they look to spot the next Stich Fix or Farfetch.

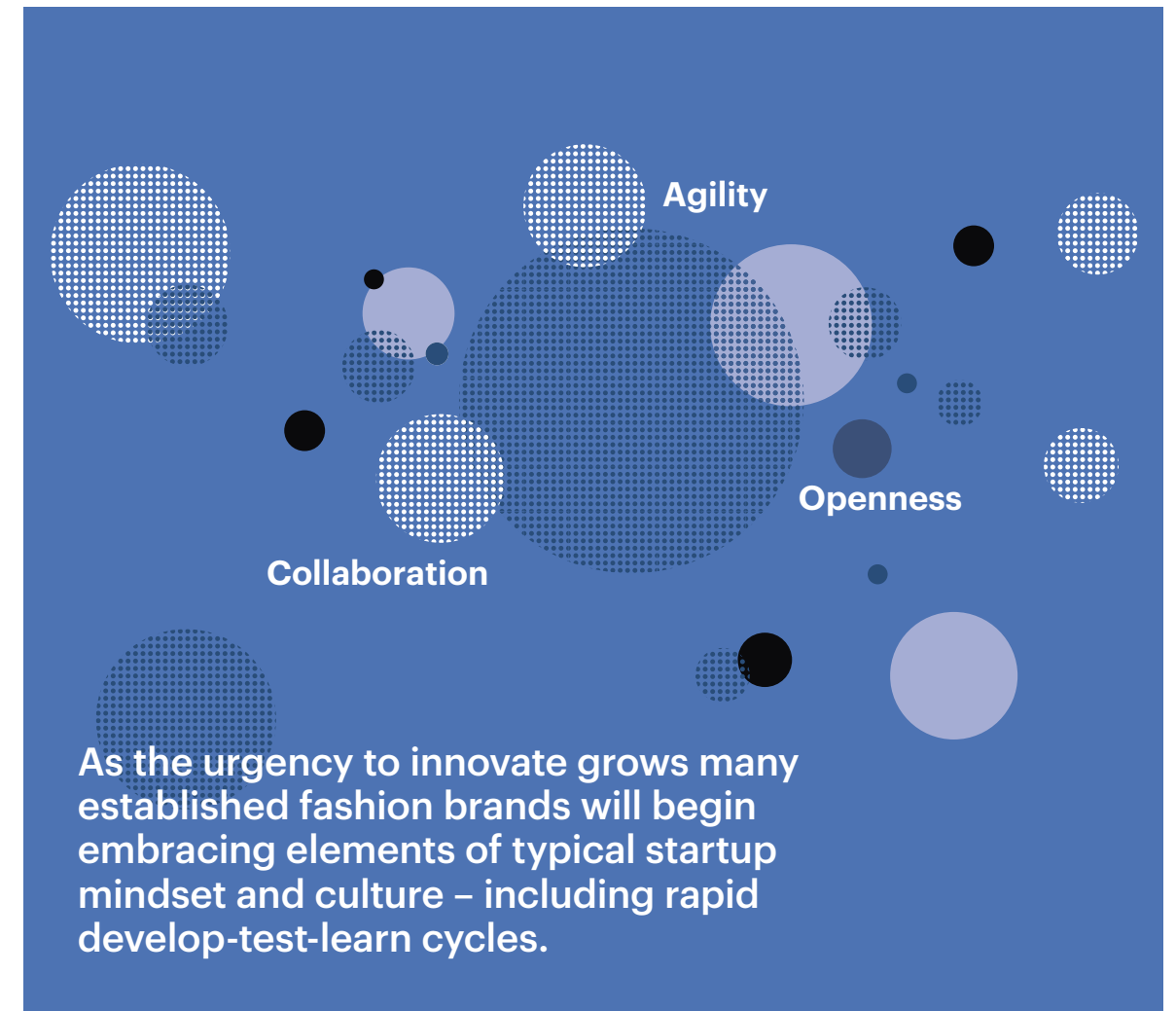
The drive to innovate will intensify the war for talent amongst key players. To accelerate innovation efforts, fashion companies will need people with new skill sets, combining distinctive data analytics and technology skills with entrepreneurial mindsets. Given the dearth of such skills in the industry, fashion companies will increasingly try to hire people from the outside. Barneys New York recruited a former Facebook executive as chief information officer and Under Armour appointed General Motors’ former head of Global Advanced Design as chief innovation officer. Given that demand for individuals with those same skills is rising across all industries, fashion companies will be competing against a broad range of other companies. This raises the question for many traditional fashion companies; what is required to attract this type of talent?

Fashion players will be exploring how new collaboration models can increase the speed of innovation. There is a range of options, from cooperating with technology companies, like H&M’s collaboration with Google to leverage data insights for customised design, to partnering with academia to introduce technology and digital capabilities into fashion curriculums. We will see more traditional fashion companies adopting new approaches to boost innovation and stay successful in an increasingly competitive landscape.

The fashion industry has not historically been known for rapidly adopting new working models. As David Schneider of Zalando puts it, “right now, many are a bit too closed down. A bit too centred around internal systems rather than really thinking about opening up and actually seeing, how can I collaborate with others.”

As the urgency to innovate grows we believe many established fashion brands will begin embracing elements of typical startup mindset and culture – including rapid develop-test-learn cycles. The agile working model has recently emerged as a highly-effective way to spur innovation. Many large traditional companies across industries have adapted their organisational structures and practices to self-organising teams

and interactive networks to improve speed, flexibility, and innovation. 24 Sèvres, the global e-commerce site of French conglomerate LVMH, runs like a startup, working in spurts according to the “release early, release often” model. The e-retailer Boohoo successfully deploys another typical startup method, “test and learn,” using data analytics test to demand for small product batches, and quickly recognising which items are selling before scaling up production. In 2018 we expect fashion companies will increasingly embrace new types of talent and investment models, and experiment with building agility and other startup working models into their organisations to drive innovation.





CEO TALK

MARCO BIZZARRI

PRESIDENT & CHIEF EXECUTIVE, GUCCI

The Gucci chief executive talks to BoF about how a culture of purpose and new ways of working underpin the brand's impressive turnaround.

by BoF Team

BoF: How has your culture-change programme played a role in Gucci's turnaround?

Marco Bizzarri: The most important thing, after identifying the positioning of the brand, is attracting the right people. People are at the centre of everything in the fashion industry, not just in terms of product, but in terms of creativity and business. What I try to do is make sure that people foster a culture of respect that includes everybody. They are placed for more talents. They are placed to work together. They are placed to be transparent.

You can have the best strategy ever, but you will lose it if the culture does not sustain the strategy. The culture is the most difficult thing to create, because you are talking about people; human beings who change every day in their behaviour, attitude and perceptions. You need to make it an ongoing activity and that means leading by example. You need to show that you believe in that and that you [remove] all the people who do not follow this kind of respect you want to create in the company.

If I can create this kind of culture in the company — and I think we are doing it — then the talent will come. Our industry is very small, everybody talks; so the best talents now send their CVs to Gucci all the time. They know that, despite the success of the brand, the way that we work is a good way to work. I am always there so do not [always] realise, but if you stand back and look at it, all these people, young people, proudly dressed in Gucci, are all smiling. Being able to create this sort of energy and creativity, both in terms of product and business, is fostering [success]. Other

companies can do the right product for the season, but they can not copy our [people]. That is the difference.

BoF: How do you personally get involved and role model this culture?

MB: I try to push everybody to take risks and make mistakes — and not kill them if they make mistakes. Of course, if they make the same mistake twice it is a problem. That is something that comes from your past, your experience as a person. It is not something you can write in an email. You need to show on a daily basis that you really believe in these values.

BoF: You have done what you set out to achieve. Is that what you mean when you talk about completing the puzzle?

MB: Yes. What I mean is that it is like writing a book. You have a lot of chapters; they are linked together, but they are different. Gucci is writing different chapters. Alessandro is writing different chapters at every single show and we are writing different chapters in the business. We are writing different chapters to try to change an organisation and culture on a daily basis — and we are not finished.

There is a place in Hvar where they found startups that are linked to Singularity University, created by scientists like Ray Kurzweil and Peter Diamandis, who foresee a different way of education. They say that the way that universities and schools are educating kids is outdated, because the pace of change in technology is so high today that you cannot rely on what you learn. Sometimes your experience is the worst prison for you.

I went there two weeks ago as a student for seven days to be bombarded by these new ideas. Tomorrow, we are going to this off-site in Treviso with the company, because we want to be sure that the organisation we have in Gucci is going to change. You need to work in a completely different way, where the most senior person is not necessarily the one deciding, but the one with more knowledge is deciding — maybe that's a kid who is 25 years old!

BoF: Engaging with young people seems to be a big part of your strategy — and more than half of your customers are now Millennials.

MB: We have this executive committee called Comex; I have created this one called "Shadow Comex," which is made up of people around 30 years old who I ask to discuss the same topics that I discuss with my other colleagues, to see what feedback we can get. It is just a matter of creating a way [to ask] questions [and get] a different perspective.

The most intelligent people are not working for you, especially in technology or data science, etcetera, so where are they? You need to find them. Maybe not with the normal employment contract, but [you need to] try to source creativity from outside in an interesting way. It is very good to realise that, instead of just hiring people. You can go and scout these people through the internet, in India or wherever, and [host contests] on certain projects; the one that wins, gets the position. For example, I could deploy 10 teams around the world to find the best way to display products in the shops, and I offer \$10,000 to the one who finds the best way to display the products in the shops.

The idea is to find different ways to use the organisation. I have people at corporate [headquarters] who are trying like crazy [to source talent] and we do not find people — especially in the shops. Finding [retail] staff is a big issue. You need to see things in different ways, because the industry and the world are changing too fast. I think that the old way of managing a company is finished, especially for CEOs who are used to working in the same way. We are human beings, we tend not to innovate. We tend to protect what we were doing in the past.

This interview has been edited and condensed.

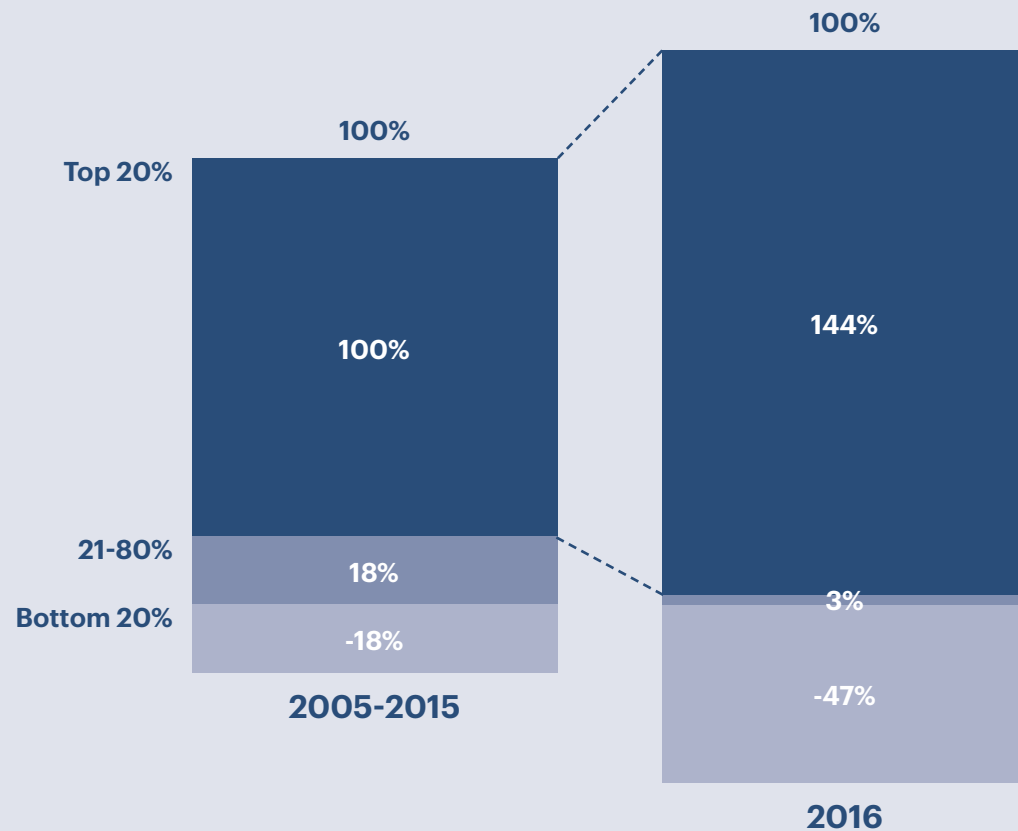
“We are writing different chapters to try to change an organisation and culture on a daily basis — and we are not finished. You need to see things in different ways, because the industry and the world are changing too fast. I think that the old way of managing a company is finished, especially for CEOs who are used to working in the same way.”

McKinsey Global Fashion Index

The McKinsey Global Fashion Index (MGFI) is composed of almost 500 public and private companies spanning different geographies, segments and product categories. It was created to track the industry's performance through three key variables – sales, operating profit, and economic profit – providing a holistic benchmark for the global industry.

Exhibit 9 In 2016, the top 20 percent of fashion companies generated 144 percent of industry economic profit

Fashion companies' contribution to industry economic profit in 2005-2015 vs. 2016)
%



Source McKinsey Global Fashion Index 2017

The MGFI was first introduced in the State of Fashion 2017, to fill a gap in the coverage and understanding of the global fashion industry. While fragments of the fashion industry – such as particular segments or categories – have been tracked before, the MGFI provided the first holistic overview of the entire global fashion industry.

The MGFI tracks financial development across six price segments (see glossary): 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. New of this year is the breakdown by geographies: Europe Mature, Europe Emerging, North America, Asia Pacific (APAC) Mature, APAC Emerging, Middle East & Africa (MEA) and Latin America.

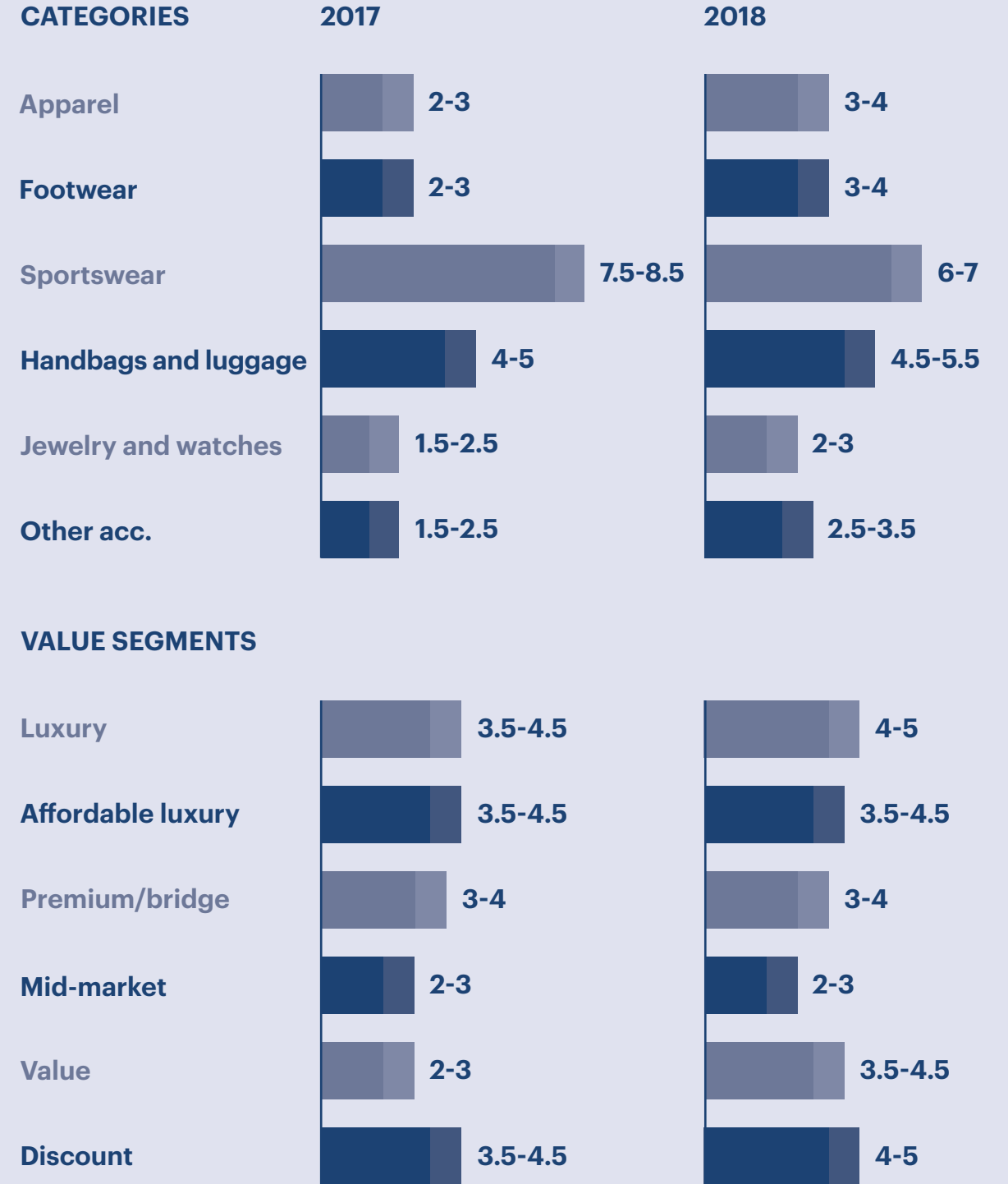
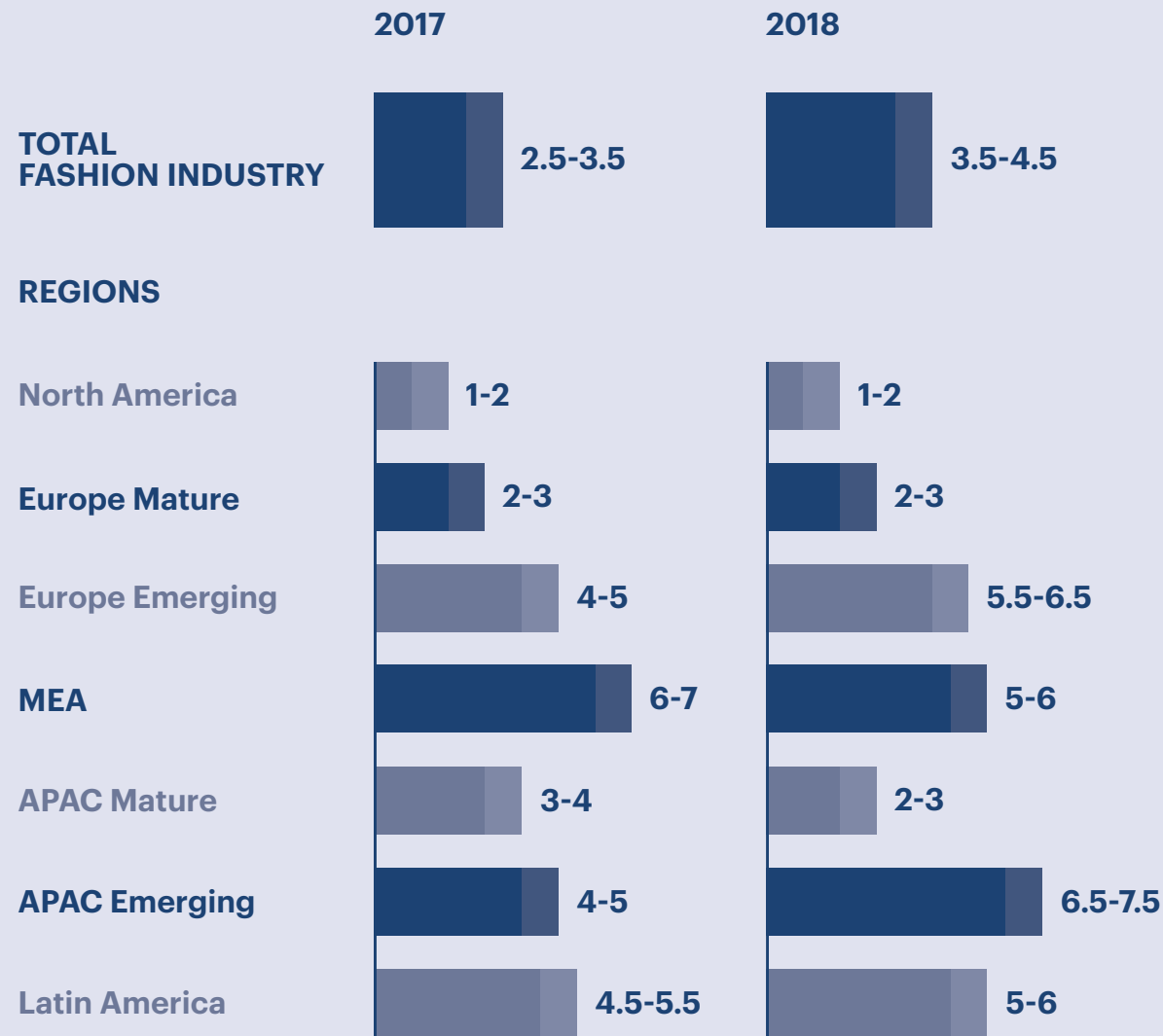
The MGFI tracks the historic development of three key performance variables: sales, operating profit and economic profit – a measure of value creation to determine how much each company had to invest to generate its performance (see glossary). Additionally, the MGFI forecasts sales growth for the year ahead.

We pointed out in the State of Fashion 2017 that fashion is a “winner-takes-it-all” industry, and a review of the economic profit in the fashion industry in 2016 indicates that the gap between leaders and laggards of the industry is widening. While between 2005 and 2015 the top 20 percent of the fashion companies generated 100 percent of the economic profit, in 2016 the top 20 percent of companies generated a staggering 144 percent of economic profit (Exhibit 9). These top 20 percent of companies include Richemont, Nike, LVMH, TJX, Hermes, Gap, H&M, Ross stores, Gitanjali Gems and Michael Kors.

Exhibit 10 Fashion industry sales growth¹

FASHION INDUSTRY SALES GROWTH 2016-2018

%

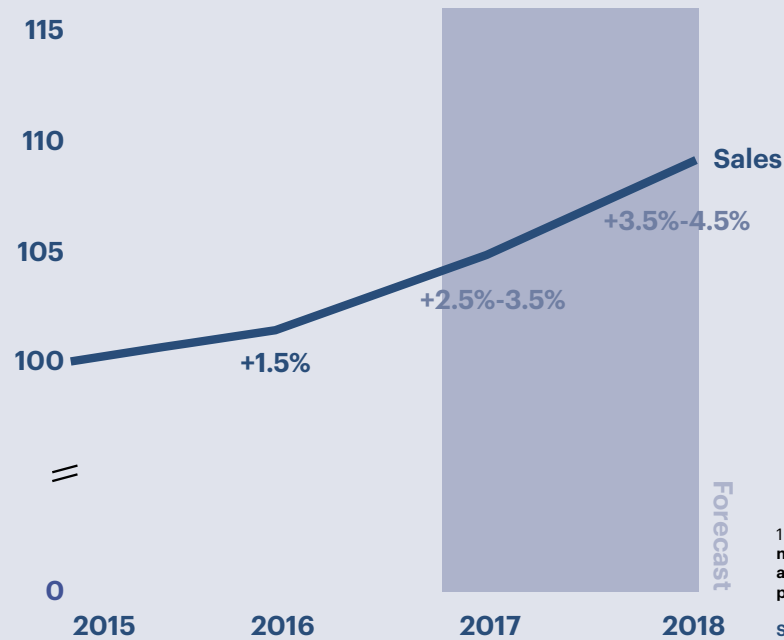


¹ At fixed 2016 exchange rates. Sample of 349 public companies and 146 private companies

Source McKinsey Global Fashion Index 2017

Exhibit 11 Global fashion industry sales growth¹

Reported sales (nominal, net of excise duty)¹; 2015 = index 100



¹ 2015-2016 at real year-on-year exchange rates and nominal net of excise duty. 2017 and 2018 forecasted assuming fixed 2016 exchange rates. Sample of 349 public companies and 146 private companies

Source McKinsey Global Fashion Index 2017

Industry and regional performance

After a sluggish 2016 with total fashion industry sales growth of only 1.5 percent, in 2017 the fashion industry is following the uptick in the broader global economic environment.⁵⁶ In line with the forecast made in the State of Fashion 2017, by the end of this year the MGFI expects industry sales growth to reach 2.5 to 3.5 percent globally in 2017. Looking towards 2018, we expect a continued uptick in global fashion industry sales growth, while not yet reaching the sales growth level of 2015 (5 percent). We project industry sales growth of 3.5 to 4.5 percent in 2018 (Exhibit 11).

However, the growth is primarily driven by emerging markets in the East and South. Emerging countries across APAC, Europe and Latin America are forecasted as particularly strong growth markets in 2018, with growth rates estimated to range between 5 and 7.5 percent. Meanwhile, the economic outlook in Europe

Mature is stable, and the fashion industry sales growth is likewise expected to remain at a modest but steady 2 to 3 percent. The outlook for the North American fashion sector is less clear; while overall consumer confidence is strong, the impact of fiscal and trade policy changes is uncertain, and markdown pressures, market corrections and store closures continue. With this in mind, we expect a modest growth of 1 to 2 percent.

Market segment performance

In 2017 we saw consumers continuing to trade away from the mid-price segments, towards companies at the higher and lower ends of the industry. In 2018 we expect this development to continue across all regions. The luxury segment enjoyed the strongest improvement in 2017, driven partly by the return of luxury consumption in Asia, and in 2018 we forecast luxury to further accelerate to 4 to 5 percent growth. We

expect affordable luxury to continue at strong 3.5 to 4.5 percent growth. Similarly, we expect the move away from the middle to benefit players in the value and discount segments. This is driven by increased consumer demand for these segments and new players entering the stage in markets like India, Europe Emerging and Latin America. The off-price channel is expected to grow across European and Asian markets. We forecast particularly strong growth of 4 to 5 percent in the discount segment for 2018, continuing its strong trajectory from 2017.

Product category performance

The general improvement of fashion industry sales is reflected in stronger sales growth forecasts across almost all categories, including apparel and footwear. Handbags and luggage, and to some extent watches and jewellery, continue a

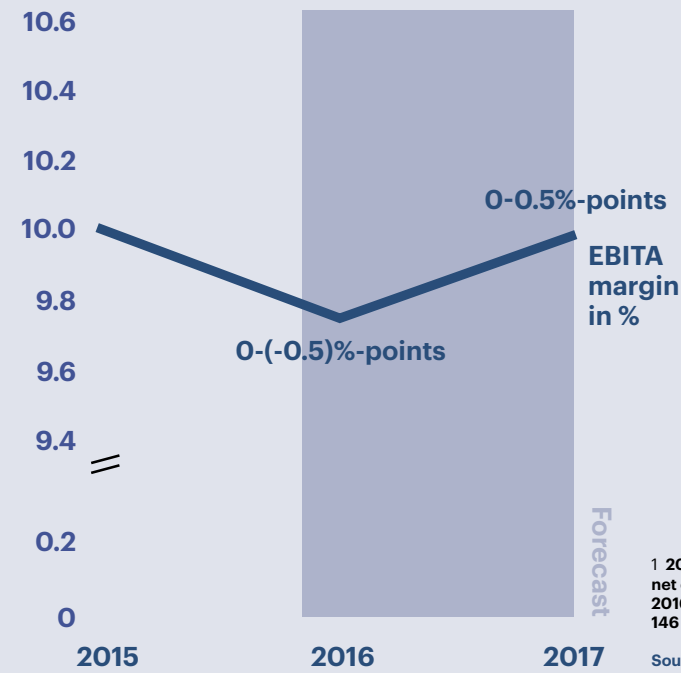
slow-paced return towards their historic highs, driven in particular by demand in APAC. Sportswear is the only category where we forecast the record growth rates to slow down in 2017 and 2018 after its height in 2016, as the “athleisure trend” has reached its peak in some mature markets. However, it is still expected to be the fastest growing category, with continued strong demand in many markets.

Operating profit and economic profit

Just as the fashion industry topline is improving from its 2016 low, the bottom line is on its way to recovery from the negative development experienced in 2016 when overall industry operating margins contracted by (-0.5) to 0 percentage points. For 2017 we expect a mild improvement in fashion industry operating profits of 0 to 0.5 percentage points (Exhibit 12).

Exhibit 12 Global fashion industry operating profit development¹

Operating profit measure: EBITA (Earnings Before Interest, Taxes, and Amortization), EBITA margin in percent



¹ 2015-2016 at real year-on-year exchange rates and nominal net of excise duty. 2017 and 2018 forecasted assuming fixed 2016 exchange rates. Sample of 349 public companies and 146 private companies

Source McKinsey Global Fashion Index 2017

GLOSSARY

Agile

A delivery approach using incremental, time-boxed “sprints” from the start to the end of a project, instead of trying to deliver it all at once near the end. Is often used as a description of a working model or organisation with the ability to quickly reconfigure strategy, structure, processes, people, and technology toward value-creating and value-protecting opportunities.

Artificial Intelligence (AI)

The theory and development of computer systems able to perform tasks that normally require human intelligence, such as visual perception, speech recognition, decision-making, and translation between languages.

Athleisure

Athletic-inspired way of dressing rooted in joggers, leggings, tank tops, and sneakers – designed to be worn for exercising, streetwear, and daywear.

Circular economy

A system that is restorative and regenerative by design, relying on system-wide innovation to minimise resource input, waste, emission and energy leakage by slowing, closing, and narrowing material and energy loops.

Customer relationship management (CRM)

The strategy and processes for managing the company’s relationships and interactions with existing and potential customers.

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 utilised 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.

Generation Z

Demographic cohort born circa 1995–2014, following the Millennial generation.

Gross Domestic Product (GDP)

Macroeconomic measure of the market value of all final goods and services produced in a country within a defined period.

M-commerce

Mobile commerce; the use of wireless handheld devices such as cellular phones and laptops to conduct commercial transactions online.

Mature markets

A market is considered to be mature when in a state of equilibrium with absence of significant growth, or a lack of innovation.

Millennials

Demographic cohort born circa 1982–99. Are also commonly referred to as Generation Y (this name is based on Generation X, the generation that preceded them).

Off-price

Off-price stores sell products at a discount from full-price; typically overstocked goods or goods that are at the low end of a demand cycle such as seasonal goods, in order to sustain lower average prices. Various off-price concepts include brands’ mono-label outlets, retailers’ outlet stores, multi-label off-price concepts, and outlet malls.

Omnichannel

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

Post-consumer products

A product or material that has served its intended use, and has diverted or recovered from waste for recycling or re-use.

Price segments in MGFI

As definitions of market segments often vary across sources, all companies in the MGFI are categorised based on a Sales Price Index, providing a range of prices for a standard basket of products within each segment and home market – thereby relying only on a quantitative measure, whereby companies in each segment price their items similarly.

Radio-frequency identification (RFID)

RFID uses electromagnetic fields to automatically identify and track tags attached to object.

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.

See-Now, Buy-Now

Shoppable runway shows that allow consumers to buy their collections immediately after they debut on the catwalk.

SME

Small and Medium-sized enterprises.

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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