

Apparel, Fashion & Luxury Group

Fashion's new must-have: sustainable sourcing at scale

McKinsey Apparel CPO Survey 2019



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Introduction

McKinsey's 2019 Chief Purchasing Officer (CPO) survey, the fifth in the series since 2011, focuses on sustainable sourcing at scale—fashion's new must-have. The survey finds that social and environmental sustainability has become a burning priority for apparel companies, just as it is becoming an increasingly important issue for consumers and governments.

A skeptic might ask: does this spotlight on sustainability represent a move towards long-term transformation of the industry or is it simply the fashion of the season? The clear majority of survey respondents expect the industry to transition to a much more sustainable model by 2025. They foresee wider use of sustainable materials, an improved ecological footprint, increased transparency, and strengthened supplier relationships and purchasing practices. But most apparel companies will need to shift current practices dramatically if they are to deliver on such bold expectations.

Our survey reflects the perspectives of 64 participating sourcing executives, who are responsible for a total sourcing value of over USD 100 billion. These respondents cover the full spectrum of the market, including vertical apparel retailers, hybrid wholesalers, and sportswear companies. We supplemented the survey findings with proprietary analyses of sustainable apparel offerings, powered by EDITED; street interviews with young consumers in four European cities; and background interviews with sourcing executives and industry experts. Highlights of four of those interviews are included in this report.

This report presents respondents' and interviewees' outlooks on the future of apparel sourcing, interwoven with our own interpretation and experience from our client work. McKinsey is deeply committed to supporting greater sustainability in the fashion industry.

This report makes it clear that it will be challenging to deliver true progress in the complex arena of sustainability. Indeed, the industry lacks a common language on sustainable sourcing, let alone a shared set of standards. But our findings leave no doubt that sustainable sourcing at scale is a must for apparel companies over the next five years—and that consumer demand for sustainable fashion is growing rapidly. At the same time, margin pressure is making it even more important for companies to improve the efficiency of end-to-end product development and sourcing processes. As our survey shows, executives see no conflict between this imperative and the drive for sustainability.

We also point out that companies need to make progress on sustainability while navigating a volatile, fast-changing environment. Our survey underlines the impact of "Trade 2.0"—increasing trade tensions exemplified by the US- China trade war, which is amplifying country shifts in apparel sourcing. That, combined with ongoing demand volatility, is pushing companies towards a more flexible, demand-driven sourcing model.

In the years ahead, apparel companies must shape a robust sustainability agenda that addresses both social and environmental imperatives. And they must deliver it at speed and scale, harnessing innovations in technology, standards, processes, materials, and communication. Our survey sheds light on companies' preparedness, plans, and progress in four key areas of that sustainable-sourcing transformation:

- **Embracing sustainable materials.** The share of products containing sustainable material remains low today, but CPOs envisage a major scale-up in the next few years. The majority of those surveyed aspire to source at least half of their products with sustainable materials by 2025. That won't be easy: CPOs cite several obstacles to implementation, including availability, cost, and quality of materials.
- **Driving transparency and traceability.** Apparel companies are under increasing pressure to create transparency on their supply chains and to share that information with consumers—but few companies have yet achieved that transparency. Eight in ten CPOs surveyed have ambitious plans to step up transparency by 2025. Six in ten plan to go further and share information about their suppliers at the point of purchase. Again, the change required will be dramatic.
- **Turning supplier relationships into strategic partnerships.** In supplier relationships, social and environmental sustainability is taking on much greater importance: two-thirds of CPOs surveyed said it would likely become a top factor in their supplier ratings. This is encouraging garment manufacturers to invest proactively in environmental sustainability, worker well-being, and fair wages. CPOs recognize that more is needed: collaboration across the value chain is key to achieving an industry-wide transformation in sustainability.
- **Reinventing purchasing practices.** Our survey underlines the fact that sustainable and responsible sourcing has significant implications for purchasing practices, from planning to negotiation to order placement. Two-thirds of CPOs expect sustainable sourcing to add between 1 and 5 percent to their costs, with most agreeing that this is an investment in building competitive advantage. That said, there are important opportunities to improve the efficiency of internal product-development processes.



Apparel sourcing in a time of trade tensions: the macrostate at play

Ongoing demand volatility is pushing companies towards a more flexible, demand-driven sourcing model. At the same time, it is increasingly important that companies improve the efficiency and sustainability of their end-to-end product development and sourcing processes—both because margins are under pressure and the search for cheaper sourcing locations is running out of steam. Added to these challenges is Trade 2.0: increasing trade tensions, exemplified by the United States-China trade war, are accelerating the shift out of China as a sourcing country.

Process improvements are top of mind for sourcing executives

Trade 2.0 and the associated shift away from China might have made headlines, but these are, in fact, not the biggest concern of sourcing executives. In our 2019 apparel-sourcing survey, the priorities CPOs cited most often when addressing macro trends were internal process improvements. More than 40 percent of respondents named digitization of sourcing processes, consolidation of supplier base, and end-to-end process efficiency as the top three priorities in which action was needed in their companies. More than 50 percent of respondents put sustainability and transparency in the top three (Exhibit 1).¹

The focus on internal process improvements is a reminder that there are diminishing returns from the old model of moving continually from one low-cost sourcing country to the next, as cost gaps between countries are narrowing. Indeed, shifting sourcing countries was near the bottom of the list of priorities identified in our survey, with only 20 percent of respondents naming it a top three priority. That was a steep decline from the 2017 CPO survey,² when it was ranked third among key focus areas.

At the same time, there are several trends driving greater focus on process improvements. For one thing, technological innovation offers new solutions and, at the same time, customer

demand for sustainable sourcing is rising. In addition, increased volatility and resulting gross margin losses from markdowns are pushing apparel companies to shift from a focus on minimizing the price of supply to a focus on customer-centric, agile product development to meet customer demand.

Our discussions with sourcing executives make it clear that there has been too little focus on process improvement to date. There is, therefore, considerable room to improve the cost, speed, flexibility, and sustainability of end-to-end product development and sourcing processes in the apparel industry. In particular, there are three key focus areas for process improvement.

First, companies need to digitize processes to drive efficiencies and effectiveness. Digitization is the core enabler today for the improvement of end-to-end process efficiency and is a must-have for sourcing executives. Since our 2017 CPO survey on digitization, some companies have set out on a broader digital transformation journey, but most have picked individual solutions, such as upgrading their product lifecycle management systems or introducing virtual sampling to support more streamlined processes. Advanced analytics is still in its early stages in the industry, as is the move towards supporting multimodal sourcing models—both key elements of “intelligent sourcing.” There is also increasing focus on achieving greater agility and flexibility.

“There are diminishing returns from the old model of moving continually from one low-cost sourcing country to the next.”

Apparel sourcing executive

¹ It is possible that the number-one ranking of sustainability and transparency was influenced by the fact that our overall survey topic was sustainable sourcing.

² Digitization: The next stop for the apparel-sourcing caravan, McKinsey & Company, September 2017.

To support the transformation, CPOs are looking to attract future talent, shift mindsets, and develop capabilities in sourcing departments. That points to a second key area of focus: strengthening and simplifying cross-functional collaboration within the sourcing organization and beyond. Internal handover and decision-making processes throughout the merchandising and product-development process are still a key hurdle in cutting down lead times. To enable closer cross-functional collaboration, companies need to achieve greater clarity of roles, responsibilities, and

decision points, joint KPIs, and integrated data systems as a “single source of truth.”

Last but not least, apparel companies need to embark on ambitious supplier-partnership programs. Greater collaboration and connectivity with fewer suppliers will be needed to deliver greater speed and flexibility, improve sustainability, and improve cost and efficiency across the value chain. More sophisticated suppliers are already benefitting from stronger partnerships and are innovating more effectively.

Trade 2.0: increasing trade tensions are accelerating the shift from Chinese sourcing

Since our 2017 survey, a new trend has emerged in apparel sourcing: Trade 2.0. Many companies, especially those based in North America, face an environment of increasing trade tensions.³ In our 2019 survey, CPOs from these companies said they expected the more challenging trade environment to have a strong impact on sourcing cost development over the next year, adding to the margin pressure coming from consumers.

The increasing impact of Trade 2.0 is reflected in McKinsey’s Economic Conditions Snapshot, which surveys global executives each quarter across industries. In June 2019, 75 percent of respondents cited increased trade conflict as a key risk to economic growth over the next 12 months—up from 63 percent in March 2019.⁴

Such trade tensions are likely to affect apparel more than most other industries. In the US, for example, the fashion industry accounts for 6 percent of imports but pays 51 percent of tariff receipts.⁵ Indeed, Trade 2.0 was one of the top ten trends identified in

The State of Fashion 2019, published by The Business of Fashion and McKinsey.⁶ The report showed that fashion companies face a shake-up of global value chains—bringing both new barriers and new opportunities—as trade agreements are disputed or renegotiated. As the report noted:

“A sharp rise in trade tensions between the US and other large economies seems set to increase costs for some companies and increase the risk of disruption. At the same time, new trade agreements promise better trading conditions in certain instances.”

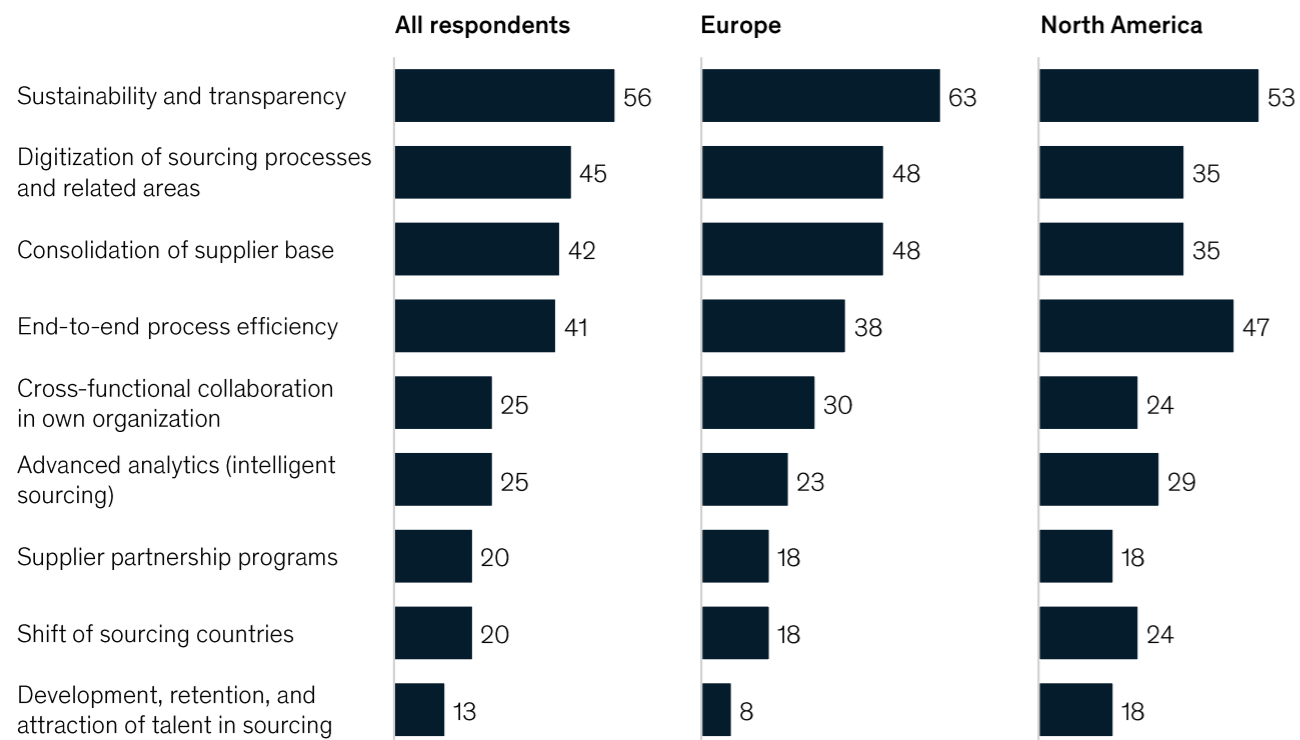
It is not surprising, then, that our 2019 apparel-sourcing survey found that many CPOs expected sourcing costs to increase significantly in the years ahead. Two-thirds of surveyed companies expect prices to increase (Exhibit 2). CPOs in the premium and sportswear categories and those with sourcing value of more than USD 1 billion, expected above-average price increases. For North American respondents, shifting trade agreements are the number-one driver for the cost increase, whereas European CPOs see exchange rates as the key factor.

Exhibit 1

Overall, sourcing executives now focus on process improvements and no longer on searching for the next sourcing country

“What are the top 3 areas to adjust apparel sourcing within your company to cope with overall macrotrends?”

Percentage of respondents, n = 64



SOURCE: McKinsey Apparel CPO Survey 2019

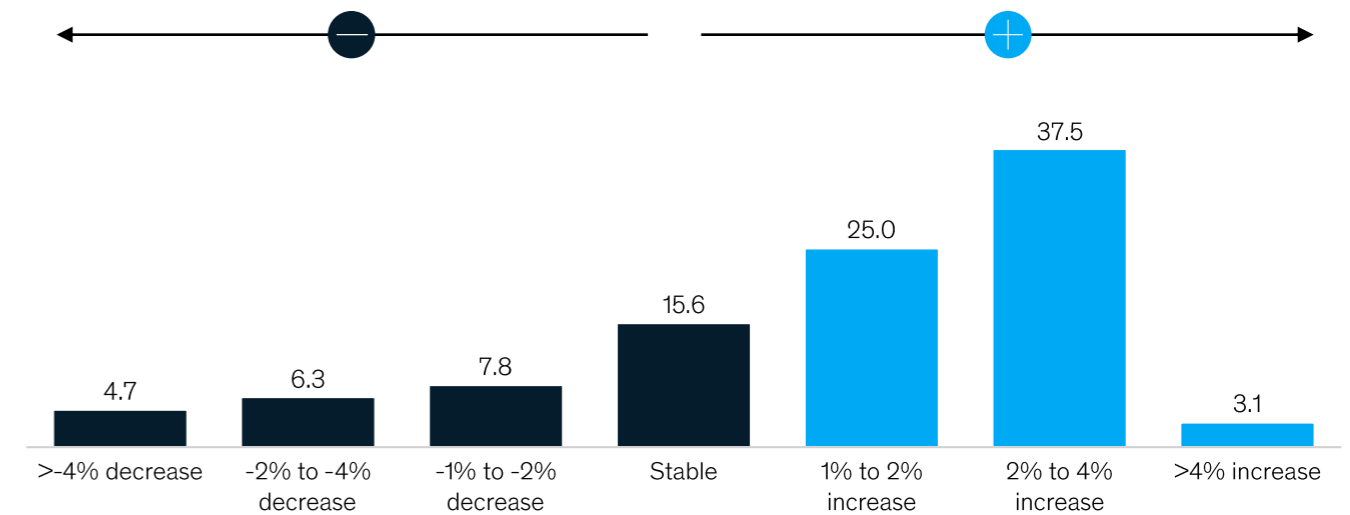
³ Use of the term “trade war” in the industry publication Sourcing Journal increased 2.4 times in January to July 2019 versus prior year (January to July 2018: 74; January to July 2019: 175) mostly focusing on the trade dispute between the US and China.

Exhibit 2

Two-thirds of surveyed companies expect price increases

“What is the overall trend in sourcing costs (price per piece, FOB), independent of sourcing country?”

Percentage of respondents, n = 64



SOURCE: McKinsey Apparel CPO Survey 2019

⁴ McKinsey Economic Conditions Snapshot, June 2019.

⁵ Russell, Michelle, “AAFA again calls for swift resolution to tariff dispute”, Just-Style, August 22, 2018, https://www.just-style.com/news/aafa-again-calls-for-swift-resolution-to-tariffdispute_id134314.aspx.

⁶ The State of Fashion 2019, The Business of Fashion and McKinsey & Company, November 2018.

Shifts in sourcing countries are therefore a core concern for North American apparel firms, with a focus on finding alternatives to China; today, the label inside the typical garment sold in the US reads “Made in China.” On average, respondents’ companies sourced 36 percent of their sourcing value from China—double the value of the next-largest sourcing country, Bangladesh. The countries with the next-largest shares of sourcing value were Vietnam at 14 percent and India at 10 percent.

“The challenge with near-shoring is not higher wages—it’s the fabric production.”

Apparel sourcing executive

But that picture is already changing: China’s and Hong Kong’s share of total garments exported globally has declined continuously since 2013. Even in terms of absolute value, there has been a pronounced shift away from China. The value of China’s exports of woven garments fell from USD 30 billion in the first half of 2016 to USD 26 billion in the first half of 2019, while its exports of knitted garments fell from USD 29 billion to USD 27 billion over the same period.⁷

A further acceleration of sourcing shifts away from China by US companies is on the horizon. In our 2019 survey, more than half of the executives from North America were planning to reduce their sourcing value from China by more than 10 percentage points over the coming year. When we last surveyed sourcing executives in 2017, only 27 percent of US respondents planned to reduce sourcing from China on a similar scale.

Among European companies, however, the shift away from Chinese sourcing is much less pronounced: only 15 percent of European CPOs surveyed planned a reduction of more than 10 percentage points. To some extent, European companies are benefitting from the exodus of their US counterparts from China and are taking advantage of the capacity becoming available as competition between Chinese suppliers heats up. That is unlikely to be more than a blip, however, as Chinese manufacturers already have high levels of efficiency and will not be able to finance price-driven competition for long.

Which countries will be the beneficiaries of the shift out of China? Bangladesh is still seen as a highly attractive country, but Vietnam is following close behind and narrowing the gap, according to our 2019 survey (Exhibit 3). More than half

of the companies surveyed said they planned to increase the value of sourcing from Bangladesh by more than 10 percentage points over the coming year, while four in ten said the same about Vietnam.⁸ In fact, the growth of these two countries is so rapid that some buyers are starting to face capacity issues.

It is worth noting that excitement about Ethiopia seems to be abating somewhat. In our 2017 CPO survey, Ethiopia was the second most highly rated country in terms of its growth prospects; it is now ranked fourth. That is a reminder that building up Ethiopia’s garment industry is a long-term undertaking.

All in all, the continued attractiveness of these countries as sourcing destinations is a reminder that lower-cost labor is still a priority for apparel sourcing.

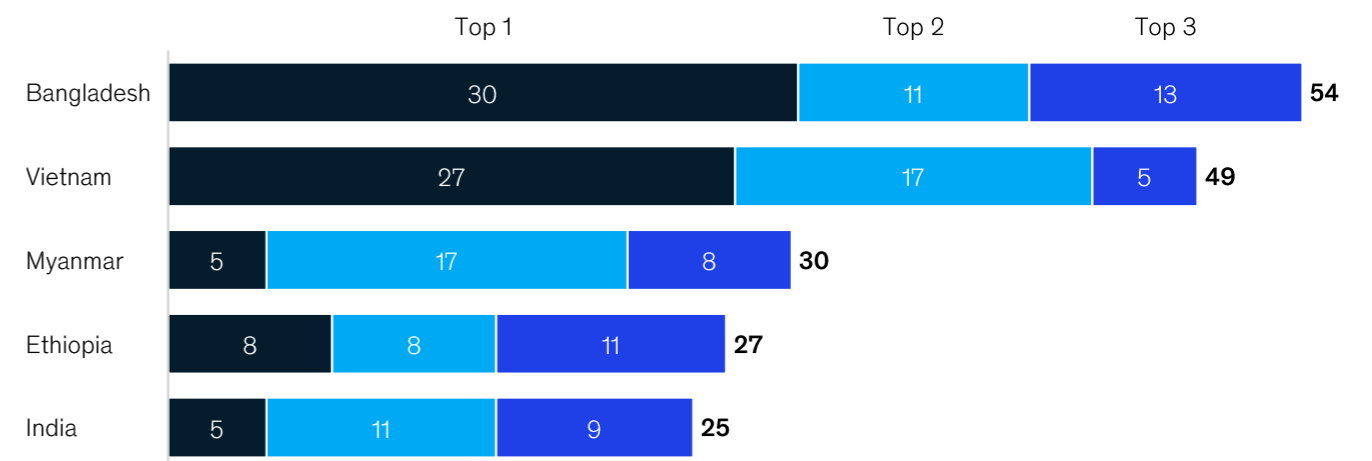
What about near- and reshoring? There is evidence that the combination of Trade 2.0 and increased demand volatility is catalyzing the development of a more flexible, demand-driven sourcing model that is multimodal and smartly uses nearshoring among its levers. With the cost gap between proximity sourcing and key Asian sourcing countries closing, more companies are considering shifting volumes closer to home. Among respondents in our 2019 CPO survey, almost half expected to increase proximity sourcing by more than three percentage points, and a small minority expected an increase of more than ten percentage points over the coming year. On the other hand, reshoring values are expected to remain largely stable. In the US, for example, the “buy local” movement has had limited impact, despite US-China trade tensions, in part because of a lack of capacity in US apparel manufacturing.⁹

Exhibit 3

Bangladesh still seen as most interesting destination, but gap to Vietnam is closing

“What do you see as the top 3 country hot spots up to 2025?”

Percentage of respondents, n = 64



SOURCE: McKinsey Apparel CPO Survey 2019

⁷ China Customs Statistics, HKTDC Research, http://china-trade-research.hktdc.com/resources/MI_Portal/Article/ff/2012/05/450059/1564112975328_GarmentsExportJun2019.pdf.

⁸ There are differences between North American executives, who prefer Vietnam, and their European counterparts, more of whom rate Bangladesh highly.

⁹ For further discussion on this topic, see *Is apparel manufacturing coming home?* McKinsey & Company, October 2018.



Spotlight on sustainable sourcing

Consumer demand for sustainability is increasing, as are societal expectations of the fashion industry. But it is no easy matter to drive progress in this complex arena: to begin with, there is no common, objective industry standard on sustainable sourcing. Apparel companies must shape a robust sustainability agenda addressing social and environmental issues—and deliver it at speed and scale.

5x

increase in number of sustainable fashion products launched over the past two years*

Why sustainable apparel sourcing is a must

The question is no longer whether but how to scale social and environmental sustainability in apparel sourcing. Sustainable fashion is picking up rapidly among consumers, is starting to become a real driver of purchasing decisions, and is likely to be critical for competitive success in the near future. As an indicator of growing public concern about the topic, internet searches for “sustainable fashion” tripled between 2016 and 2019. Hits on the Instagram hashtag #sustainablefashion quintupled between 2016 and 2019 in both the US and Europe.¹⁰ That is an indicator that sustainable fashion is becoming part of a broader movement, driven, in part, by the concern, activism, and rising spending power of Generation Z consumers.

At the same time, political action has changed the framework within which apparel companies operate, and regulations have become stricter. The UN Sustainable Development Goals adopted in 2015, is now the core framework guiding the implementation of sustainability strategies. The 2015 G7 Leaders Declaration agreed to “promulgate industry-wide due diligence standards in the textile and ready-made garment sector,” which drove the 2017 OECD Due Diligence Guidance for Responsible Supply Chains in the Garment and Footwear Sector. Most recently, the 2019 G7 summit ushered in the Fashion Pact, with 32 major apparel companies agreeing to a set of shared environmental-sustainability objectives.

Multilateral action on sustainable apparel has been matched by action by national governments in the main production countries and consumer markets. For example, China continues to tighten its environmental policies as part of the 13th Five Year Plan 2016–2020. In France, a circular-economy law is expected to come into force as early as 2021; it will prohibit clothing companies from destroying overstock. And in Turkey, the Zero Waste Campaign was extended to textile products in 2019. There are similar initiatives underway in many other countries.

A McKinsey analysis powered by EDITED shows that apparel companies still have a long way to go to meet the demand for sustainability. The analysis scanned fashion products launched at 235 online shops of brands and retailers in France, Germany, the United Kingdom, and the US in the first half of 2019. It found that, among mass-market apparel brands and retailers, only 1 percent of new products launched during this period were tagged “sustainable” in online shops. But that offer has increased fivefold since 2017. At the same time, specialized sustainability players, such as Allbirds and Everlane, have shown rapid growth.

“The willingness and ability to change is what’s going to be the distinguishing characteristic of the winners and the losers in the next ten years.”

Edwin Keh, CEO of the Hong Kong Research Institute of Textiles and Apparel

¹⁰ Chua, Jasmin Malik, “Use of #SustainableFashion hashtag spiking on Instagram,” Sourcing Journal, July 18, 2019, <https://sourcingjournal.com/topics/sustainability/instagram-sustainable-fashion-heuritech-160617/>.

* Powered by EDITED

No common language for sustainable fashion

Sustainability is likely to be one of the predominant themes of the fashion industry in the years ahead, but the topic is complex and multifaceted. To begin with, there is no common language to define sustainable fashion. Although initiatives such as the Sustainable Apparel Coalition's Higg Index have made a start in this regard, it is still difficult for industry practitioners to talk about sustainability with a shared vocabulary, let alone forge a joint understanding.

“Sustainability issues are complex... and they are hard to simplify.”

David Savman, General Manager Global Production, H&M Group

Moreover, sustainability encompasses a vast breadth of topics. Claims of sustainability can relate to anything from individual lighthouse projects or capsule collections to fully-fledged, integrated sustainability strategies.

It is no surprise, then, that consumers lack a clear picture of what sustainable fashion is all about. We conducted street interviews with 16- to 25-year-olds in four major cities in Europe—Cologne, London, Madrid, and Paris—which showed that young consumers are unsure what sustainability means or how to identify which brands or retailers are more sustainable than others. This is despite the fact that fashion magazines have been trying to educate the consumer with initiatives to increase visibility and understanding of sustainability. The consumers we interviewed want more and better communication on sustainability from fashion companies themselves.

56%

of CPOs agree that responsible and sustainable sourcing is considered a key strategic part of doing business, as is apparent from its position as top 10 priority on the CEO agenda today

Frequently, articles titled “What is sustainable fashion?” are published in general-interest magazines. However, these typically focus on sustainable-materials options, without providing measures of sustainability or covering the broader issues involved. The breadth and complexity of sustainability cannot be communicated to the consumer in terms of the garment's price, size, or material—simpler ways must be found to signal a garment's degree of sustainability.

This speaks to a broader issue: a lack of standardization of sustainability in apparel sourcing across the industry. Standardization and objective criteria for measuring sustainability are needed—for example, in the mix of sustainable materials. Our conversations with apparel-sourcing executives point to an increasing recognition that greater standardization is needed to align the industry and inform the consumer. One example is David Savman, General Manager Global Production at the H&M Group, who said the following (see page 32 for the full interview):

“Sustainability issues are complex ... and they are hard to simplify. As an industry, we have work to do in understanding all the elements and collaborating with many different stakeholders across different paradigms to meaningfully engage with these issues.”

The sourcing function: driver or doer?
Given growing consumer and regulatory focus on the topic, sustainability is increasingly seen as a competitive advantage in the apparel industry. This places sustainability at the heart of the C-suite agenda: more than half the sourcing executives in our 2019 survey agreed that sustainable sourcing is on their companies' CEO agenda. This finding differed markedly by region, however. In Europe, 70 percent of companies fully agreed that responsible and sustainable sourcing was on the CEO agenda—compared to just 35 percent of North American companies.

Our survey respondents reported that the influence of the sourcing function in company-wide sustainability strategy is mixed. Just under half the CPOs surveyed said they had the responsibility to deliver on sustainability targets but lacked decision-making power. But just over half the CPOs saw themselves as shapers of the broader sustainability agenda. The tension between the operational and strategic role of the sourcing function is tangible.

“We don't yet have the vocabulary or language to explain what we are doing at the consumer level.”

Edwin Keh, CEO of the Hong Kong Research Institute of Textiles and Apparel

Environmental sustainability is the top focus

In our 2019 survey, we asked sourcing executives to identify their top three sustainable-sourcing initiatives for the next five years. While the key initiatives mentioned spanned a broad field, environmental-sustainability initiatives were mentioned two to three times more often than social-sustainability initiatives. The most frequently mentioned topics were resource efficiency (particularly for water), transparency, and sustainable materials (Exhibit 4).

Almost one-third of the sourcing executives mentioned initiatives to improve resource efficiency, and nearly one-quarter mentioned transparency as one of the top three initiatives they are working on. This was followed by sustainable materials, identified by 21 percent of respondents.

The most frequently mentioned social-sustainability initiatives focused on fair or living wages (11 percent of respondents), social responsibility more broadly (8 percent), and decent work (8 percent). Our survey makes it clear that industry-level collective bargaining relating to living wages is not yet widely popular. One-third of respondents reject such initiatives and say they are not planning on future participation.

It seems that two factors are influencing the increased focus on environmental issues. First, sustainability is often used by the broader public as synonymous with environmental sustainability only. Second, as one sourcing executive told us, environmental sustainability initiatives are easier to implement.

Besides these targeted initiatives, two themes of overarching organizational

transformation are also at the top of the agenda for some sourcing executives. One in five respondents said their companies were working on a sustainable transformation, in which they aimed to integrate end to end sustainability throughout the organization and drive cultural change. Fourteen percent of respondents said they were working on digital transformation across their supply chains, starting with a reduction in physical samples, including analytics-driven buying decisions and Industry 4.0.

The future of sustainable apparel sourcing

Our 2019 CPO survey suggests that sustainable apparel sourcing has the potential to disrupt the industry significantly, driven by innovations in technology, standards, processes, materials, and communication.

Four innovation-led disruptions

The executives we surveyed believed that the following four innovation-led disruptions would become prevalent throughout the apparel industry by 2025 (Exhibit 5):

- **Virtual sampling.** A staggering 83 percent of respondents believed that physical samples would be used less often than virtual samples by 2025. This reflects the high interest virtual sampling is attracting in the industry today. However, the full value of virtual samples can be achieved only when processes are

transformed at the same time. It remains to be proved that companies can achieve the change management needed to shift mindsets, embed new ways of working across functions and with suppliers, and upskill staff—all by 2025.

- **Social auditing.** Respondents were equally optimistic about globally harmonized standards for social auditing. The launch of the Converged Assessment Framework of the Social & Labor Convergence Project and its integration in the Higg.org platform opens the way for reducing audit fatigue. However, some sourcing executives are still cautious about the speed of implementation, waiting to see what moves auditing companies make.
- **Transparency at the point of sale.** A major push will be needed to achieve the target of product-specific communication at the

point of sale, to give consumers transparency on suppliers, the situation of workers, and raw materials. To date, many mass-market companies have not shared any product-specific supplier information beyond publishing supplier lists, and they typically focus on basic information about materials (see next section).

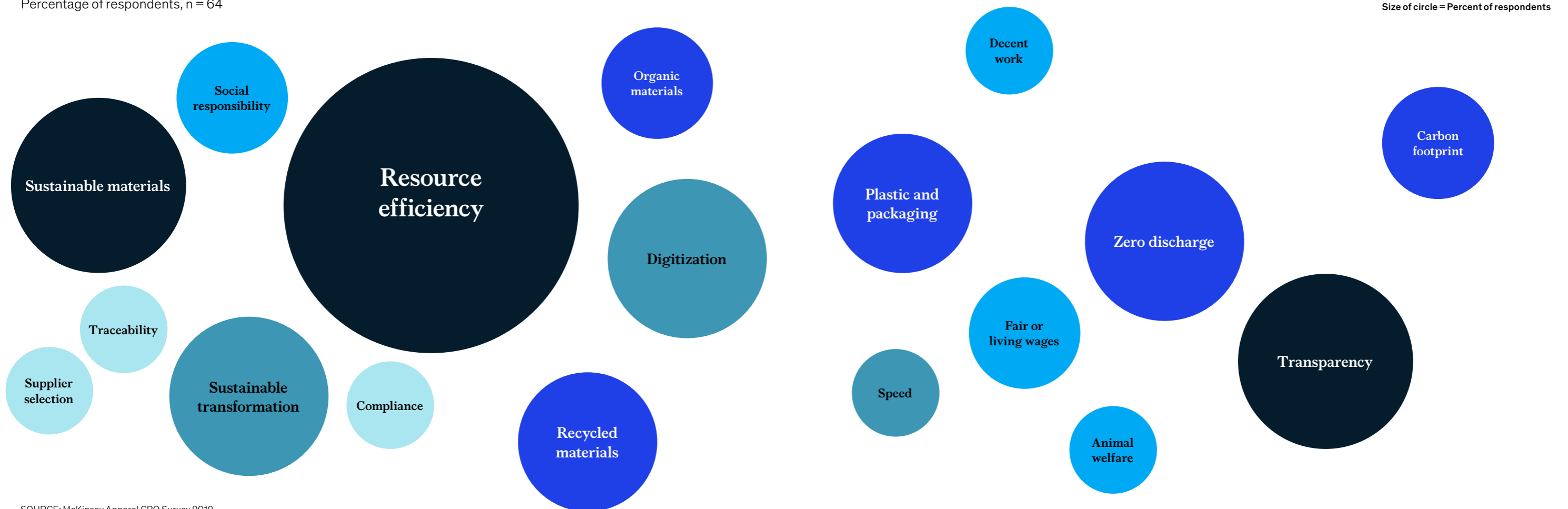
- **Recycled fiber content.** Sourcing executives are highly optimistic about the industry transforming to use at least 30 percent recycled fiber content in every new garment. They are less bullish about expanded use of innovative materials, such as low-carbon synthetics, however. We discuss company plans on the sustainable-materials transformation in the next section.

Exhibit 4

Sourcing executives work on a broad set of sustainability-related topics

“What are the key sustainable apparel sourcing topics at the top of your agenda for the next 5 years?”

Percentage of respondents, n = 64

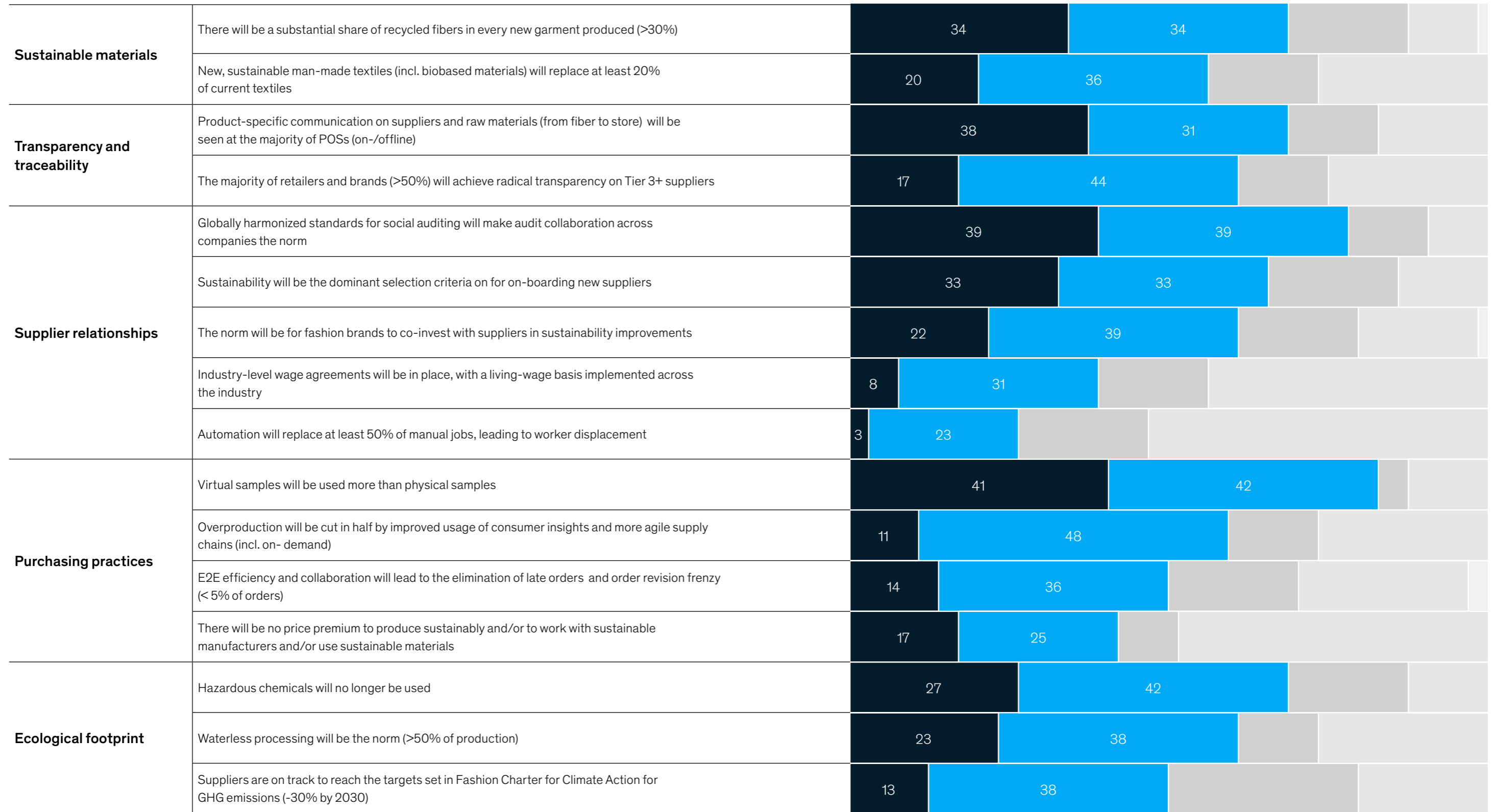
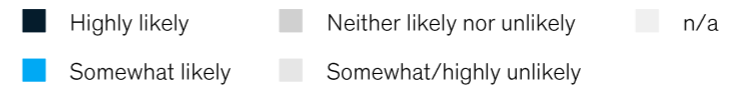


SOURCE: McKinsey Apparel CPO Survey 2019

The future of sustainable apparel sourcing by 2025

“Please indicate the likelihood that the following industry-wide sustainability disruption will occur by 2025.”

Percentage of respondents, n = 64



What impact will all these sustainability-related innovations have on sourcing costs? The jury is out on this question, and our survey findings and interviews show there are two opposing views on the answer. One sourcing executive who believes that sustainability will not increase costs told us, “a lot depends on having the right partners.” Other sourcing executives, however, associate additional cost with sustainability. In the next section, we set out findings on actual cost mark-up levels and on the price increase that sourcing executives are willing to accept for sustainable materials. We discuss sustainability-related costs more broadly in the final section of this report.

agile supply chains.¹¹ For the sourcing function, it will be crucial to build a multimodal sourcing model and change from a pure focus on FOB price to integrating final product margins and sustainability impact into intelligent sourcing decisions.

Companies also need to consider how to advance their purchasing practices in areas such as industry-level living-wage agreements, eliminate late orders and frequent order revisions, and achieve climate change targets together with suppliers.

“A lot depends on having the right partners.”

Apparel sourcing executive

Look before you leap: the basics must be in place

Alongside the high-profile innovations discussed above, there are areas that received less attention from apparel-sourcing professionals in our survey. But we believe that these are nonetheless important enablers of sustainable sourcing—as our interviews with sourcing executives confirmed.

One key enabler will be to embrace a more flexible, demand-led model—which can help to rein in the wastefulness of overproduction. That wastefulness has been amplified by shorter fashion cycles, consumer demand for novelty, and the volatility of demand.

Though only 11 percent of survey respondents see the transformation to a flexible, demand-led model as highly likely, almost 60 percent believe in it to some degree. To bring this change to life, companies will need to transform the go-to-market process, embrace digitization and analytics, leverage consumer insights, and shape

Shaping and delivering a robust agenda for sustainable sourcing

In our 2019 CPO survey, we asked respondents to identify the three key sustainable-apparel-sourcing topics at the top of their agendas for the next five years. The top ranked topic by far was sustainable materials (Exhibit 6). Other key priorities were transparency and traceability, supplier relationships, and purchasing practices.

We should note that, although initiatives on improving ecological footprint were mentioned by two-thirds of executives among their top three initiatives, most mentioned them in second or third place.

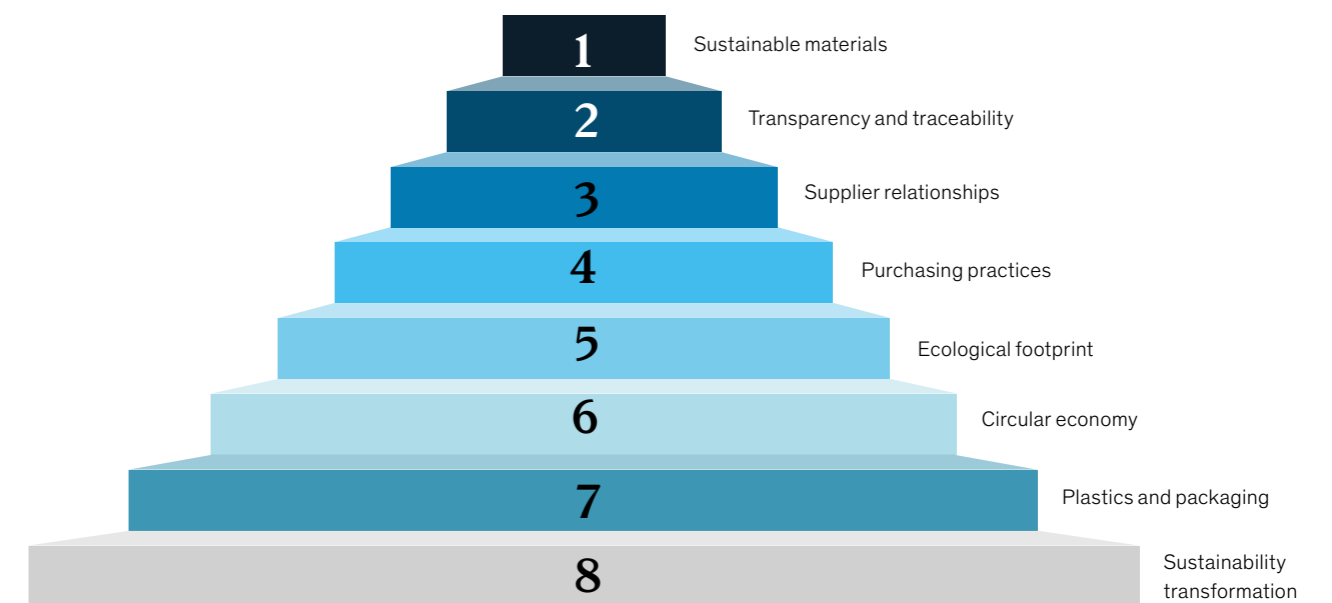
Our report sheds light on companies’ preparedness, plans, and progress in these four key areas of sustainable-sourcing transformation. Each is the focus of a subsequent chapter of this report. Together, action on these priorities will contribute to a robust sustainability agenda that addresses both social and environmental issues. In the years ahead, apparel companies will need to deliver that agenda at speed and scale—harnessing innovations in technology, standards, processes, materials, and communication.

Exhibit 6

Key areas sourcing executives plan to work on

“What are the 3 key sustainable apparel sourcing topics at the top of your agenda for the next 5 years?”

Top 8 topics aggregated, n = 64



¹¹ Measuring the fashion world, McKinsey & Company, October 2018.



“Brands will be challenged to become more radical in how they behave and what type of materials they use.”

Edwin Keh, CEO of the Hong Kong Research Institute of Textiles and Apparel

Embracing sustainable materials

Among the apparel companies we surveyed, the share of products containing sustainable materials remains low today—but CPOs envisage a major scale-up in the next few years. That won't be easy: CPOs cite several obstacles to implementation, including availability, cost, and quality of materials. An even greater challenge will be to foster cross-functional implementation of efforts to increase the share of sustainable material. Companies will also need to invest in new manufacturing capacity and technological innovation—but most sourcing executives surveyed remain cautious about making such investments.

55%

of companies aim to source at least half of their products with sustainable materials by 2025

Broadening the sustainable-product offering: the scale-up ahead

Though the share of products with sustainable material is still low, mass-market apparel companies have broadened their product offering made with more sustainable material options. In recent years, the two largest global apparel retailers—Inditex and H&M—have both made bold public pledges on sustainable materials. Many other companies have done the same, committing to a significant share of sustainable materials in their sustainability pledges. And retailers and brands, as well as portals such as Asos or Zalando, have started to make it easier for consumers to find these products on their websites.

Both organic cotton and products made from recycled materials are being used more widely. An EDITED analysis of 235 online shops conducted exclusively for this report found that, in the mass market, 2.6 times more products were being tagged as made with organic cotton than in 2017. Over the same period, 3.3 times more products were tagged as made with some recycled materials. Nonetheless, absolute volumes are still low. Products made with some organic cotton account for 3 percent of all products made from cotton. Only 2.3 percent of t-shirts offered on online shops are made with organic cotton and only 0.7 percent of jeans are made with recycled fibers.

Our survey suggests that, in the coming years, there will be a significant scale-up in offerings that use sustainable materials. Among participating executives, 55 percent said their companies wanted at least half of their products to be made with sustainable materials by 2025.

These plans for use of more sustainable options show that the industry is starting to move away from sustainable capsule collections or sublines to broad use of sustainable materials. Only a few of the companies surveyed have the minimal goal of less than a ten-percent share of products sourced with sustainable materials.

Larger companies with at least USD 1 billion in sourcing value will drive the industry shift. Four out of five of these companies plan to source at least half of their assortment from products made with sustainable materials, while two out of five plan to source more than 75 percent of their assortment from such products.

Several of the executives we interviewed underlined the fact that companies have a long way to go if they are to realize these ambitions. For example, Edwin Keh, CEO of the Hong Kong Research Institute of Textiles and Apparel, made the following remarks (see full interview on page 26):

“Many companies say they are moving to sustainable materials, but that is quite a loose term at present. And we don't yet have the vocabulary or language to explain what we are doing at the consumer level. Brands will be challenged to become more radical in how they behave and what type of materials they use. Moving away from petroleum-based raw materials will certainly be a major step. Moving away from very water-intensive, chemical-intensive materials or traditional cotton is also a big opportunity. And there will be much more recycled content: there is so much useful material that we are either landfilling or incinerating that provides areas for opportunity.”

Our survey findings spotlight the recycling opportunity. Three-quarters of companies are planning to include recycled polyester from plastic waste, whereas two-thirds are aiming to include recycled polyester from post-consumer garment waste. The latter seems an ambitious target given the current status and the additional hurdles to overcome in closed-loop processes, such as availability of the right post-consumer waste, return logistics hurdles, scale-up, and cost-competitiveness of chemical recycling technologies.

Given the current level of true closed-loop recycling, the high focus on recycled polyester from closed loops and recycled cotton warrants a closer look at what will be needed to reach these targets—as we discuss in detail on page 27.

In cotton, however, survey respondents expressed a preference for responsible cotton over virgin organic cotton or recycled cotton. In the more recent sustainability pledges, preferred cotton fibers, rather than organic cotton, are the go-to solution for the broader commitments.

Finally, 45 percent of companies surveyed are looking to integrate more innovative bio-based materials, on par with recycled nylon or responsible or recycled wool. Considerable innovation is taking place in this area, much of it partnership-driven. Examples include the most recent Adidas and Stella McCartney dress and Bestseller's joint venture with biotech company Pond.¹² In 2019, a number of outdoor companies started to develop products integrating PrimaLoft biodegradable insulations.¹³ Meanwhile, the leading sourcing and production trade shows are adapting to the increased demand for sustainable-materials innovation with new concepts or focus areas.

Availability, cost, and quality are the biggest bottlenecks

Our survey shows that availability, cost, and quality of materials are seen as the biggest bottlenecks for the scale-up of sustainable materials. Additionally, the question of cross-functional implementation of sustainability arises as a “moment of truth” for scaling up sustainable materials. Reaching the declared targets for sustainable materials will require significant scaling up. However, availability of material is a major bottleneck: 46 percent of companies surveyed rank this as the top hurdle. Only when looking at the top three topics together is it overtaken by the cost of materials.

Companies with more than USD 1 billion in sourcing value see the availability of materials as even more critical, as

95 percent of them rank it among the top three topics and three-quarters see it as the number-one hurdle (Exhibit 7). While almost 90 percent of these companies see cost as second within the top three, only 21 percent rate cost as the number-one issue. The quality of materials available currently is a less pronounced issue for these companies.

This differs from companies with less than USD 1 billion in sourcing value, as they rate costs as a more decisive limiting factor that they will need to overcome to scale up sustainable-materials usage. As a third topic within the top three, 44 percent of the companies within the group with less than USD 1 billion in sourcing value identify their current supplier base, followed only by quality of material. Compared to the larger companies,

more of these companies see the need for upskilling in their design departments and the sourcing organization.

Internal knowledge of the sourcing organization and design are mentioned by a more limited number of sourcing executives. The scale-up plan certainly raises questions of capability and shared incentives across design/product development, merchandising, and sourcing. The level of integration of sustainability across functions and all processes will be a moment of truth for the shift towards sustainable materials at scale.

“There is no silver bullet; rather, there will be a combination of a lot of small innovations and a few radical changes.”

Edwin Keh, CEO of the Hong Kong Research Institute of Textiles and Apparel

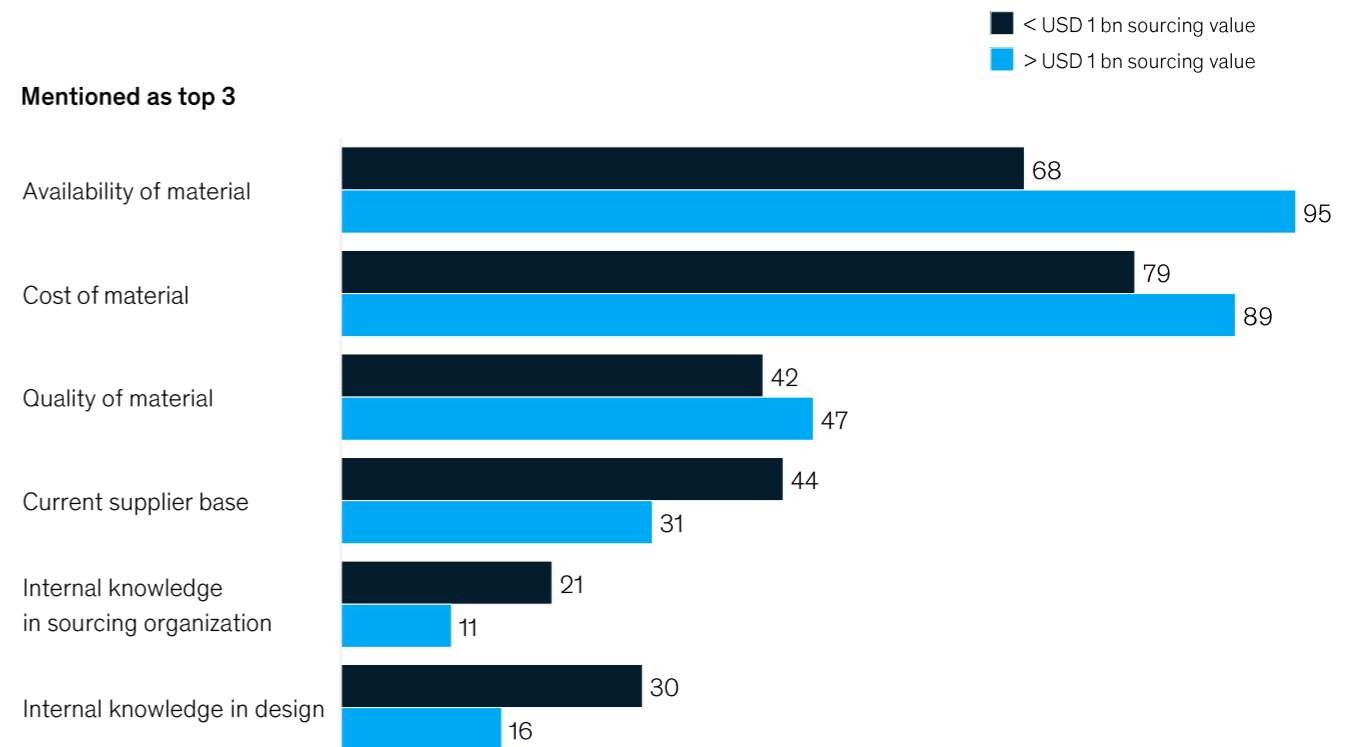
¹² “Visionary partnership with biotech pioneer,” Bestseller, May 7, 2018, <https://about.bestseller.com/news/visionary-partnership-with-biotech-pioneer/>; “Adidas by Stella McCartney debuts performance apparel prototypes in continued push to create a more sustainable future for sport,” Adidas, July 5, 2019, <https://news.adidas.com/tennis/adidas-by-stella-mccartney-debuts-performance-apparel-prototypes-in-continued-push-to-create-a-more-/987619ca-079c-48de-85c2-6958f77349fd>.
¹³ PrimaLoft Bio, <http://primaloft.com/primaloftbio>; Henkel, Regina, “PrimaLoft Bio: With micro-organisms against microplastic,” Ispo.com, January 29, 2019, <https://www.ispo.com/en/trends/fighting-microplastics-primaloft-develops-first-biodegradable-synthetic-fiber>.

Exhibit 7

Availability and cost of material are considered the main hurdles for sourcing sustainable material at scale

“What do you see as the main hurdles for moving to sourcing sustainable material at scale?”

Percentage of respondents per segment, n = 64



SOURCE: McKinsey Apparel CPO Survey 2019

Given the widespread concern about cost, it is worth highlighting the divided view among survey respondents on the acceptability of price premiums for sustainability and sustainable materials. Some of this divide is visible in the price premium that sourcing executives are willing to pay for sustainable materials. Almost half the respondents would accept a price premium of 3 to 5 percent, almost one-third would accept only increases of 1 to 3 percent, while about one-fifth are not willing to pay even up to 1 percent more.

Benchmarking prices of sustainable against conventional options in stores shows that, on average, consumers do not have to pay more for sustainable options. Any cost increase on the sourcing side therefore has to be mitigated. Consumer price strategy varies significantly between companies, however. When comparing the average price of cotton t-shirts and jeans of ten UK mass-market brands and retailers based on EDITED data, on average organic cotton t-shirts are 10 percent cheaper than non-organic (Exhibit 8).

At some of those brands the average price of organic options is half that of non-organic ones. On the other hand, recycled jeans are on average 1 percent more expensive than non-recycled. The price variation differs widely across retailers and brands, however—some offer organic options at an average price premium of up to 60 percent and recycled options at a premium of up to 70 percent.

Closed loop: big gaps remain

Looking at the share of companies planning to focus on recycled materials from used and discarded garments, the question of availability of materials is even more pronounced. The industry has much work to do to solve the logistics involved in consumers returning clothes for recycling. Likewise, greater effort and innovation is needed to design circularity into products. And expediting technological innovation in recycling will be paramount to fulfill new demand.

In particular, the solutions to support high-volume conversion of post-consumer waste into raw materials are currently underdeveloped—which makes that conversion overly costly. It would therefore be a smart move for manufacturers to invest in the development of according technology ahead of increased demand for recycled materials. Despite this need, however, our survey found that the majority of sourcing executives are not yet willing to make capex investments or co-investments and collaborate with new types of partners (Exhibit 9).

The high share of companies aiming to focus their sustainable-materials strategy on recycled polyester or cotton from post-consumer waste warrants a closer look into potential hurdles for sourcing closed-loop materials. Sourcing executives believe that investments into building manufacturing capacity would be required to boost the availability of material.

As investments are seen as the biggest hurdle for implementation and only 26 percent of companies are likely to invest, this issue seems unlikely to be solved within the next five years. We should note, however, that large companies are more likely to invest to gain a competitive advantage from circular-economy leadership. In addition, partnerships are evolving between brands/retailers or their foundations and manufacturers, fiber firms, and start-ups.

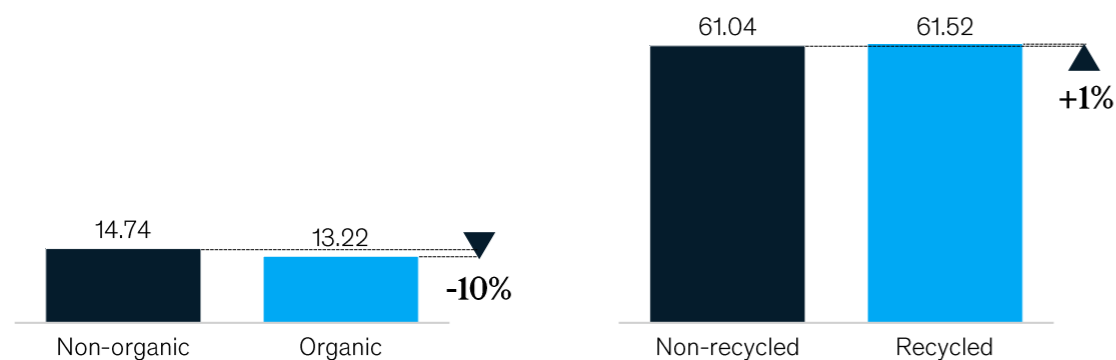
Exhibit 8

Consumers don't have to pay more for sustainable options

Average price of cotton t-shirts and jeans at UK apparel players¹, GBP

On average, organic cotton t-shirts are 10% cheaper

On average, recycled jeans are 1% more expensive



¹ 10 UK brands and retailers with largest offer of organic cotton t-shirts, or recycled jeans respectively.

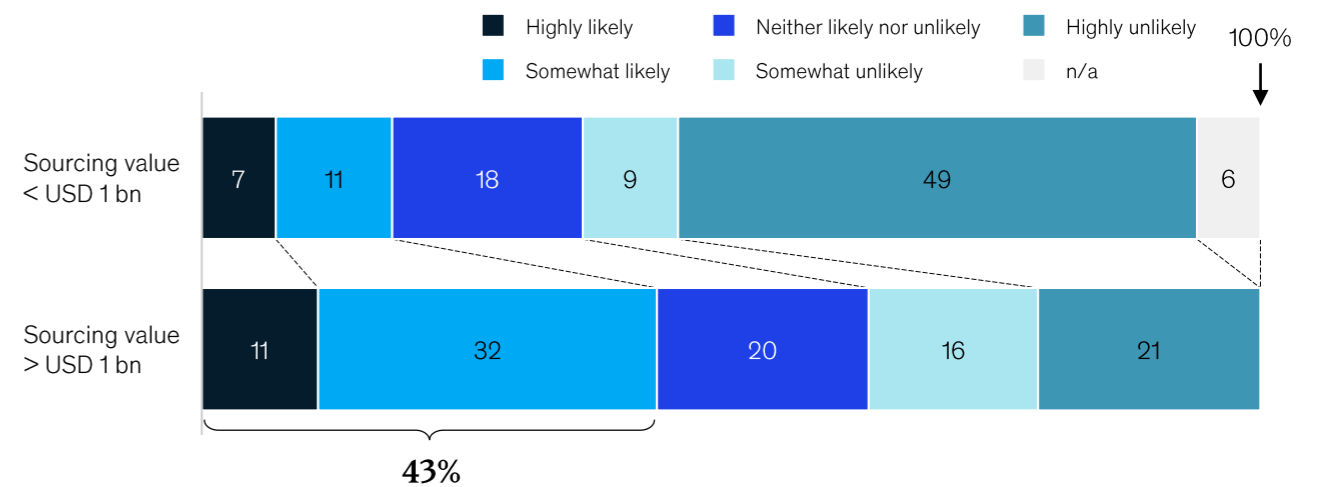
SOURCE: McKinsey Apparel CPO Survey 2019

Exhibit 9

Divide in investment strategies, with 43% of the companies with sourcing value > USD 1 bn likely to invest or co-invest in the next 5 years in closed-loop assets

“Do you expect your organization to (co-)invest in / develop own assets to create closed loop systems (post-consumer) in the next 5 years?”

Percentage of respondents per segment, n = 64



SOURCE: McKinsey Apparel CPO Survey 2019

Edwin Keh
CEO, Hong Kong
Research Institute
of Textiles and
Apparel (HKRITA)



The good guys will win

There has been progress in the sustainability of apparel supply chains over the past few years. Companies have made commitments and there is a lot more accountability about meeting targets and timelines—companies are moving from vague long-term promises to actually operationalizing sourcing strategies.

I am hopeful that in three to five years we will be talking about the positive things that the supply chain can do—such as contributing to improving social benefits, improving societies and the environment, and driving positive change. In the future, supply chains will take on more of a competitive advantage and will no longer be based on the old model of risk. Already, suppliers realize that they have to move away from a labor-intensive to a more capital-intensive business. The only way to retain their customers is to become a source of innovation and to have intellectual property that keeps the customer with them.

I think it is apparent to everybody right now that we have too much of everything—too many brands, and too many manufacturers consuming too much material and producing too much waste. There will be a zero-sum game where the good brands and the good manufacturers will win at the expense of the ones that are not as prepared and have not moved along the track as fast. Consumers will start picking sides—and the good guys will win.

At HKRITA, we have three themes which guide our research agenda—sustainability, Industry 4.0, and social good. The traditional research methodology is an eight to ten-year timeline but, for sustainability, that pace is too slow. We are looking to disrupt this and move to a faster cycle in which we do a lot of things in parallel—comparable to software development in how it flows very quickly from an idea to industry scale.

The new working model involves collaborative platforms where we engage with multistakeholders and multidomain experts. Once we have proof of concept, then the appetite to do more is there. For example, we recently proved the business case

for recycling: we opened a recycling mill in Hong Kong last September to process post-consumer waste, turning it back into usable yarn for manufacturing. In fact, this yarn is now selling at a discount to comparable virgin yarn. If a recycling mill can operate in the most expensive economy in the world, there is no city in the world that has a reason not to recycle.

There is a lot of creative thinking in sustainability. But there is no silver bullet; rather, there will be a combination of a lot of small innovations and a few radical changes. Moving away from petroleum-based raw materials will certainly be a major step. Moving away from very water-intensive, chemical-intensive materials or traditional cotton is also a big opportunity, as is moving into processing—using more benign, less resource-intensive materials. And there will be much more recycled content: there is so much useful material that we are either landfilling or incinerating that provides areas for opportunity.

Many companies say they are moving to sustainable materials, but that is quite a loose term at present. And we don't yet have the vocabulary or language to explain what we are doing at the consumer level. But certainly, brands will be challenged to become more radical in how they behave and what type of materials they use.

Also, there's the problem of scaling up the use of recycled materials. This is no longer a science challenge—it is a reverse-logistics challenge. Our entire global supply chain is optimized to produce in the East and consume in the West. But most of the recyclable material exists in the consumption economy, not in the manufacturing economy. There are several possible solutions to this, the first being onshore manufacturing in the West. The other possibility is to process waste back into raw material to be transported offshore for manufacturing.

Finally, tackling mental hurdles and changing mindsets is a major challenge to sustainability. We have to overcome the focus on short-term goals. We need to change how targets are set and how targets are integrated into the business. Aspirational goals are good, but we need clear working plans on how we are going to get there and smarter ways to integrate these decisions. Also, we need to look at who is missing from the room when decisions are made—notably the people who have to implement sustainability issues in manufacturing and in the supply chain. Engaging suppliers and integrating them into the whole ecosystem is going to be more and more critical.

Essentially, what made us successful in the past could be the thing that kills us in the future. The willingness and ability to change is what's going to be the distinguishing characteristic of the winners and the losers in the next ten years.



“Reaching internal alignment on the need to be more transparent is much easier than obtaining the information required...”

Cameron Bailey, EVP Global Supply Chain, VF Corporation

Driving transparency and traceability

Apparel companies are under increasing pressure to create transparency on their social and environmental sustainability performance internally, and to share that information with consumers. Few companies have achieved that transparency today, but eight out of ten CPOs surveyed have plans to step up transparency by 2025 in the form of supplier lists on their corporate social responsibility websites. Six in ten plan to go further and increase the level of product-specific information on their suppliers at the point of purchase. Again, the change required will be dramatic. For example, only one in ten companies today share details on the properties, origin, and value chain of their sustainable fibers.

59%

of sourcing executives expect to see an increase in the level of information on suppliers at the point of sale

The urgency of greater transparency

The apparel industry is under increasingly urgent pressure to create transparency internally and share the information with consumers. Transparency, of course, is not an end in itself. It allows consumers to make more informed decisions at the point of purchase, helps to identify social or environmental issues and risks in the supply chain, holds all stakeholders accountable, and is a starting point for improvement. Authentic and provable information will require investments in traceability. Almost one-quarter of sourcing executives plan to focus on transparency as a core sustainability initiative within the next five years.

The Rana Plaza disaster in 2013, in which over 1,100 people died when a multistory apparel factory collapsed in Bangladesh, triggered a new drive for transparency in the industry. Fashion Revolution, which was founded after the disaster, published its fifth transparency report in 2019, which focused on transparency of business practices of apparel brands and retailers more broadly—going beyond supplier mapping.

Over the last decade, increasing numbers of apparel companies have started to publish their supplier lists on their websites; most often these are focused on tier 1 suppliers, though some have also started to include tier 2 suppliers.

Broader country-wide supplier-mapping initiatives are underway in Bangladesh and China:

- **Bangladesh.** Between 2013 and 2018, factory mapping was undertaken, auditing and tracking the remediation status by Accord on Fire and Building Safety in Bangladesh and the Alliance for Bangladesh worker safety. In addition, a four-year research project, Mapping in Bangladesh, was launched in April 2017 to provide a digital map with accurate and credible information on factories in Bangladesh.¹⁴
- **China.** The IPE Green Supply Chain Map, linking supplier information to environmental data, was launched in 2018—mapping suppliers of 6 apparel retailers and brands, which had been extended to 11 at the time of writing.¹⁵

Supply-chain transparency has garnered additional business interest with the change from the “sourcing caravan” model to end-to-end efficiency improvements to manage sell-through and product margins, rather than intake cost only. More recently, the trend towards transparency and traceability has been further fueled by consumers’ demand for “radical transparency.”¹⁶ A mere supplier list on the sustainability section of the website is not enough to answer consumers’ questions. This is a reminder that transparency is not an end in itself: consumers are asking for more information at the point of sale to make informed decisions and they are asking for authentic information to be able to hold apparel brands and retailers accountable.

¹⁴ Mapped in Bangladesh, <https://mappedinbangladesh.org/>.

¹⁵ Green Supply Chain Map, <http://www.ipe.org.cn/MapBrand/Brand.aspx?q=6>

¹⁶ See description of the radical transparency trend in The State of Fashion 2019, The Business of Fashion and McKinsey & Company, November 2018.

Limited transparency today, but ambitious plans for the future

In this report, we focus on the aspect of supplier and material transparency mapping by apparel companies—in other words, the tracing from raw material or fiber to store and the communication of this information to consumers. Key findings from our 2019 CPO survey include the following.

First, only half the companies surveyed have transparency beyond tier 1 suppliers. However, eight out of ten sourcing executives have plans to publish their companies' level of transparency on at least tier 2 level by 2025 in the form of supplier lists. In fact, the sourcing executives we surveyed believe that publishing information on tier 2 suppliers will become the norm. Of course, it remains to be seen whether companies will deliver on this very ambitious target.

However, even the publishing of supplier lists would not fulfill the demand for radical transparency from consumers who ask for information at the point of purchase; currently, the norm in product-specific supplier information is simply to share the country of origin. There is some progress in meeting this demand.

A number of companies, even in the mass market, have started to share more specific supplier information, and 59 percent of companies we surveyed plan to increase the level of information on their suppliers at the point of purchase by 2025. Among mass-market companies, H&M was an early mover in this area, first with Arket in 2016 and then in 2019 with their main format. The company shares detailed information on production country, supplier name, and factory names and addresses, as well as the number of workers in the factories.¹⁷

High product-specific transparency levels on suppliers, materials used, and the ecological footprint of products is mostly reserved to specialist sustainable-fashion concepts. Two-thirds of companies surveyed use hang tags for ingredient branding for sustainable materials. Roughly 70 percent of them show the basic material mix on the sewn-in label and just over half give an indication of sustainable fiber—such as organic cotton or recycled polyester. On the broader industry level, only 11 percent of companies share details on properties, origin, and the value chain of the sustainable fibers.

65%

of surveyed sourcing executives expect to achieve full traceability from fiber to store by 2025

The promise of technology: how transparent can you get?

Our CPO survey also sheds light on the technologies that will enable greater transparency. Radio-frequency identification (RFID) is the technology with the highest levels of usage today (by 13 percent of respondents) and the highest expected adoption rate (58 percent). The blockchain, which is currently hardly implemented (by only 2 percent of respondents), is also seen as a viable option (50 percent). Meanwhile, only 30 percent of respondents see DNA tagging of natural materials as likely to be used in five years (Exhibit 10).

While RFID has the highest future adoption rates across the board, blockchain implementation seems to be a more likely strategy for larger companies. Taking current usage and expectations of likely implementation

into account, four out of five companies with a sourcing value exceeding USD 3 billion would be using blockchain in five years, as would 62 percent of companies with sourcing value between USD 1 billion and USD 3 billion.

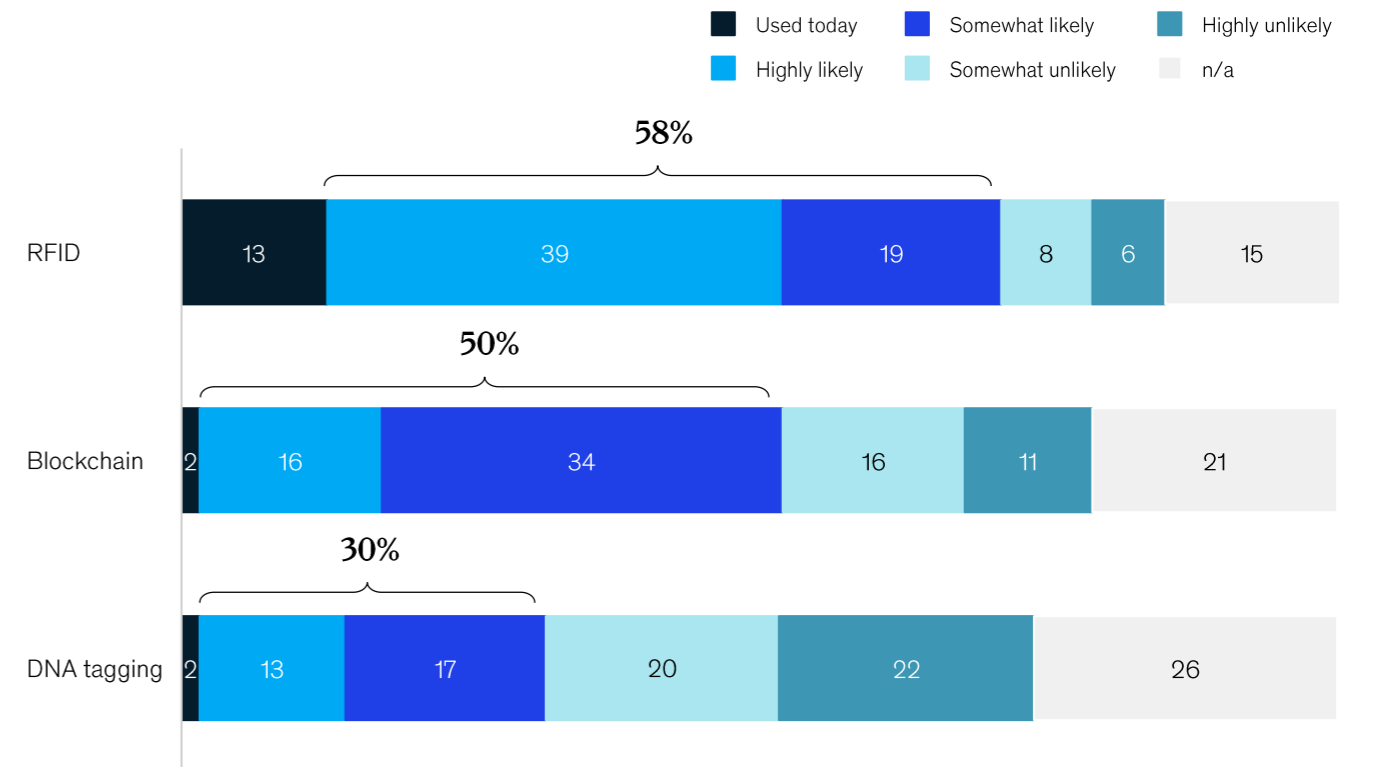
Assuming all companies that rate traceability technology as likely over the next five years actually implement the relevant technologies, we would see RFID used by 71 percent of companies, blockchain by 52 percent, and DNA tagging by 32 percent. That would require very rapid growth in adoption rates, however.

We should note that in technology-implementation some suppliers are already far advanced and are working on increasing their manufacturing efficiency with Industry 4.0. A significant part of the adoption of transparency-enabling technologies might therefore be driven from the back end.

Exhibit 10

RFID is the technology with highest levels of usage today and the highest expected adoption rate

“Which technology for traceability do you use/expect to implement within the next 5 years?”
Percentage of respondents, n = 64



SOURCE: McKinsey Apparel CPO Survey 2019

¹⁷ “H&M first major fashion retailer to bring product transparency to scale,” H&M Group, April 23, 2019, <https://hmgroupp.com/media/news/financial-reports/2019/4/3275581.html>.

David Savman
General Manager
Global Production,
H&M Group



A race to the top

Sourcing is facing a major change—possibly the largest change the industry has seen in 50 years. This rests on two factors. First, digital disruption has changed consumer behavior to require different sourcing, new service levels, and increased collaboration with suppliers. Simply put, we're not selling the same way, so we can't keep buying the same way. Second, sourcing itself is changing. For decades it's been about moving further away from home and finding areas with large workforces. Now it's not a race to the bottom, it's a race to the top—you need the most efficient suppliers, and you need the most mature and developed suppliers. Those two parameters put enormous, and different, demands on the sourcing industry. The successful companies are going to be the ones that can link the new sourcing landscape to the new retail landscape.

Within that, sustainable sourcing poses a huge opportunity, as it makes the industry itself sustainable. And it brings customer value. Customers and organizations care about sustainability, whether that be resources or environmental issues. H&M has more than 170,000 colleagues and they want to work for a company aspiring to be at the forefront of doing good. It's one of the biggest areas in attracting and retaining talent. Today, you don't get good people if you don't have a serious sustainability agenda.

But sustainability issues are complex. The challenge is that they are hard to simplify. As an industry we have work to do in understanding all the elements and collaborating with many different stakeholders across different paradigms to meaningfully engage with these issues. The challenge is simplifying, engaging, and communicating—and still making a difference.

For the last 20 years, H&M has had a very integrated sustainability agenda and it's played an integral role for every merchandiser or buyer in the company: it's what they are measured on. We have examined how we do business and how it

affects quality, processes, and purchasing practices. This is how we make sure we work with all parameters in our business idea—price, quality, fashion, and sustainability—by enabling our business partners to run their businesses in the best way.

There is a misperception that incentivizing sustainability and focusing on cost is a balancing act. A supplier that is a high performer in sustainability will often be the one who offers better control of their cost, as they are efficient—they run a good business and don't waste resources. We are constantly improving and revising our purchasing practices to create value in all areas. But it needs to be approached as a profitable model over time, with a long-term advantage. It potentially creates a short-term disadvantage if you don't get effective implementation, collaboration, and transparency right. Purchasing practice is the sum of all parts, not the accumulated score. It's not necessarily about changing organizational processes, but rather questioning what the organization chooses to focus on for long-term positive effect.

Right now, for H&M, this means better collaboration with our suppliers. Currently, there are no operational industry-wide purchasing-practice parameters. There are good initiatives, such as the ACT initiative, as well as the SAC efforts to find a standard audit format and scoring, but we haven't seen major industry-wide standardization yet. To communicate something that is comparable to others is a great idea; once this happens, we will be able to engage better with our customers. Being customer-facing on purchasing practices needs a clear agenda. The industry is becoming more self-controlling, but I do think more brands should have bigger responsibility and accountability in making sure what they pay covers the cost of what they are buying—and to invest in transparency around that.

Transparency is super important and our ambition is to be as transparent as possible. We have been brave in communicating what we have done thus far, and it's created credibility and opportunities for us to develop further. Technology plays an important part in this, for example, our customers can go online to see where every product is made. Our Standard Minute App will show how long garments take to make and enabling us to both ring fence labour cost as well as being sharper in capacity planning. I also think both RFID and blockchain are going to play a huge role in transparency going forward.

Ultimately, there is no downside to transparency. It leads to better engagement with critical consumers on complex issues and serves as a driver for development. It's easy for brands to hide behind complexity—we need to simplify this as much as possible through transparency.

We've just seen the start of this. People do want to work for a company that has an ambition to be in the forefront of doing good in the world, and people do want to be customers of such a company. I'm 100 percent sure that sustainability is becoming a real competitive advantage and if it doesn't, we will do it anyway.



Turning supplier relationships into strategic partnerships

In supplier relationships, sustainability is taking on much greater importance—two out of three CPOs surveyed said it would likely become a top factor in their supplier ratings. This is encouraging garment manufacturers to invest proactively in sustainability as part of broader efforts to drive efficiency and cost-improvement, strengthen their brands, and fulfill their social purpose. CPOs recognize that more is needed: collaboration across the value chain is key to achieving an industry-wide transformation in sustainability. To date, however, the reality has not matched the aspiration, and many apparel retailers and brands are still shying away from making longer-term commitments or sharing strategic plans with suppliers.

Close collaboration needed across the value chain—but still a far-off dream

Collaboration across the value chain is essential for achieving an industry-wide, sustainable transformation. For years, apparel companies have signaled their intent to move to closer partnerships with suppliers—including by emphasizing that the role of sourcing managers is changing from that of negotiators to relationship managers. So far, however, the reality has not caught up with the aspiration: apparel retailers and brands are still shying away from making longer-term commitments or sharing strategic plans.

Our CPO survey confirmed that there is a long way to go before arm's-length relationships give way to a closer embrace. Although long-term relationships with suppliers are the most frequently used collaboration model today, these are mostly relationships without binding commitments by buyers (Exhibit 11). Suppliers therefore take risks and invest in innovation and sustainability on the basis of a tenuous agreement about the future of the relationship.

Many supplier relationships remain transactional, with a season-by-season timeframe. Our survey found that the transaction-based model is still used by four out of five apparel companies—and for one out of six companies this remains the preferred model, which they use with more than half of their suppliers. For some respondents, these low-commitment relationships are the only way of working. In part that is due to remaining high levels of inefficiency in the end-to-end product-development process, lack of planning capabilities, and siloed ways of working across the process.

All in all, about two-thirds of companies surveyed have neither long-term volume commitments nor shared strategic plans with their suppliers. Only one-third of companies share strategic plans, and only 16 percent of companies no longer work in transactional models with their suppliers.

What about the suppliers' perspective? Just as apparel companies are seeking greater sustainability performance from their suppliers, many of the leading garment manufacturers are investing proactively in sustainability. One example is Esquel, whose Vice Chairman, Teresa Yang, said the following (see full interview on page 38):

“We actively respond to the environmental challenges in relation to energy, water, air quality, chemicals, and waste by optimizing our process management. Through better forecast and resource planning, we reduce waste along our supply chain with a focus on minimizing defects and overproduction, which in turn reduce inventory and extra processing. We also look for innovative ways to weave available technology into our operations to reduce environmental impact from resource consumption and wastewater.”

Such companies are driving sustainability as part of efficiency and cost improvements, as part of their sales and marketing strategy to leverage sustainability as a competitive advantage. They also see sustainability as a strength in attracting and retaining talent, and from the vantage point of the social purpose of business.

“It’s not a race to the bottom, it’s a race to the top—you need the most efficient suppliers, and you need the most mature and developed suppliers.”

David Savman, General Manager Global Production, H&M Group

A shift to collaborative audits

Today, progress against sustainability targets is mainly audited by third parties. However, one-third of companies in our 2019 CPO survey have empowered their suppliers for self-auditing with tools like the Higg Index—where self-auditing by suppliers is supplemented by less-frequent own-factory audits. It is worth highlighting that value companies typically rely on their own staff much more than companies in other segments, while premium companies strongly leverage third-party auditing.

Overall, the shift to collaborative social audits and collaborative environmental audits is accepted today, as roughly half of all survey respondents already participate in these initiatives. Auditing fatigue and lack of standardization, however, continue to be major issues in the industry. Further standardization in social

audits is a more recent development, with the launch of the Converged Assessment Framework by the Social & Labor Convergence Program and the integration of the suite of Higg Index tools.

The move towards greater standardization is laudable, but many of the current initiatives are facing criticism as standards are self-defined and often self-assessed. As yet, there are no objective measurements of environmental or social sustainability, and no objective rating on sustainability performance. This makes communication to consumers on sustainability difficult.

73%

of sourcing executives plan to consolidate their supplier base by at least 5%

Supplier consolidation will accelerate

Supplier consolidation is likely to accelerate over the next few years—and, as this happens, environmental and social sustainability performance will become a clear point of differentiation for suppliers. In our CPO survey, almost three-quarters of sourcing executives said they planned to consolidate their supplier base by at least 5 percent. That trend was particularly pronounced among larger companies: most firms with more than USD 10 billion in sourcing value planned to consolidate their supplier base by more than 10 percent. It is clear that apparel companies are reducing the number of suppliers they work with in order to improve sustainability, efficiency, digitization, and speed.

Sustainability will play an increasingly important role in how apparel companies select their suppliers. Three out of five survey respondents said sustainability would be a very important factor in their supplier ratings by 2025—up from only one in five who say it is today.

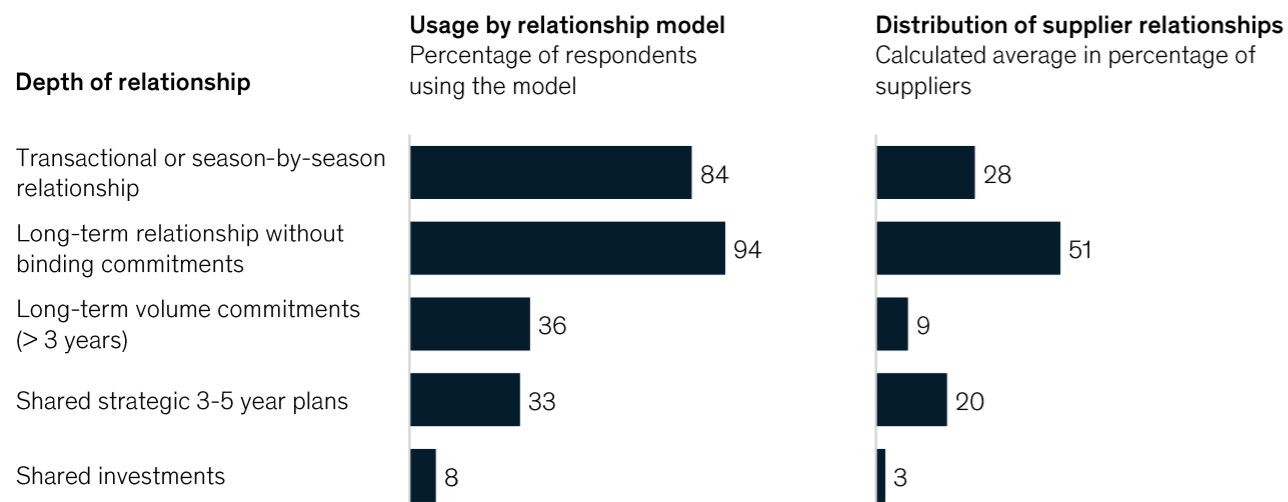
That points to a significant shift in the overall sourcing equation, as many companies have begun to implement more sophisticated supplier scorecards. A number of apparel brands and retailers have upgraded their supplier ratings over the last couple of years. As they have done so, they have moved away from viewing sustainability as a compliance-based hygiene factor and embraced more sophisticated models that assign different weights to a range of social and environmental sustainability criteria. At the same time, increasing numbers of manufacturers are proactively improving their own sustainability performance.

Our CPO survey shows that today's supplier-scorecard ratings mostly lead to non-binding volume increases when suppliers perform well—or punitive volume reduction when they underperform. It is less common for companies to reward well-performing suppliers with multiseasonal volume commitments, and even rarer for them to enter into strategic partnerships and co-invest with such suppliers (Exhibit 12).

Exhibit 11

Despite years of discussion on closer supplier relationships, the dominant way of working with suppliers is still without binding commitments

“In your supplier relationships, how are the collaboration modes distributed?”



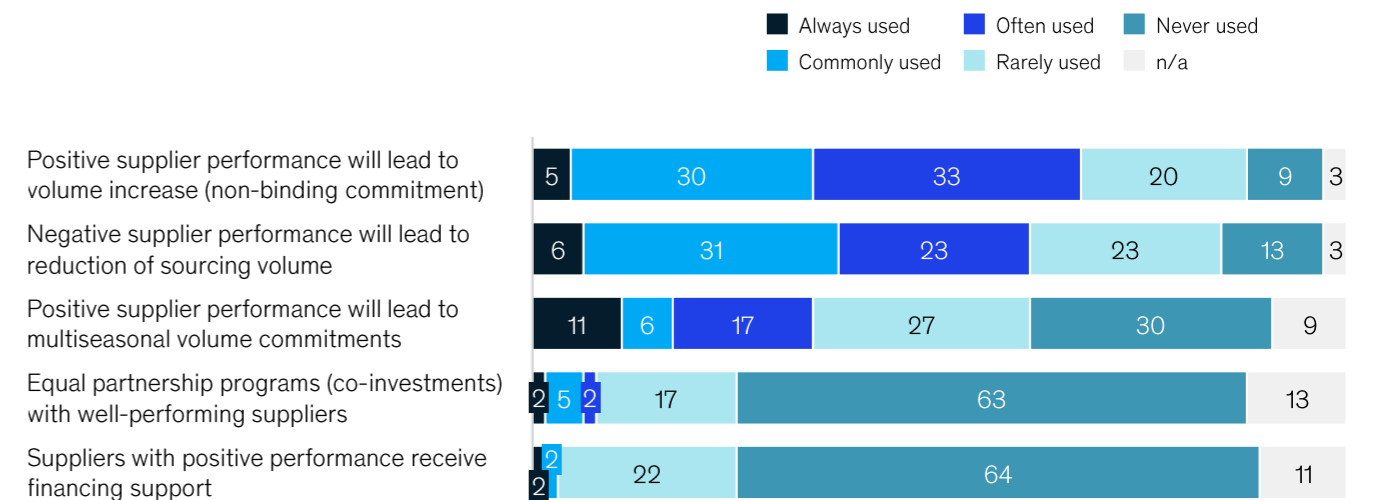
SOURCE: McKinsey Apparel CPO Survey 2019

Exhibit 12

Incentives are usually on volume-commitment side; financial support or partnerships are very rarely applied

“How do you typically incentivize your suppliers to increase their levels of social and environmental sustainability?”

Percentage of respondents, n = 64



SOURCE: McKinsey Apparel CPO Survey 2019

Teresa Yang
Vice Chairman,
Esquel Group



Investing in sustainability for our future generations

Esquel Group is a global textile and apparel company distinguished for its vertically integrated supply chain that straddles from seed to shirt. Founded in 1978, my father Mr. Y.L. Yang planted the seed for a new kind of company—one that would redefine the way in which apparel companies operated. We started out just making shirts, but over the years we realized we could be much more than a shirt maker.

My father taught me the importance of thinking long-term in running a business. To us, sustainability is not about compliance nor for promotional purposes. Instead, it reflects our vision and commitment, while at the same time it acts to enhance our competitive advantages. We become a true agent of change, providing quality employment, contributing to the livelihood of the communities in which we operate, and achieving a sustainable development model within the company, which currently employs more than 55,000 people across 8 countries.

Esquel's vision of Making a Difference is reflected in the way we tackle two of the biggest challenges of our age—climate change and wealth gap. Today, the impacts of climate change are undeniably felt by all. Our colleagues across our global operations in China, Malaysia, Sri Lanka, Mauritius, and Vietnam have experienced firsthand the consequences of typhoons, floods, and droughts in increasing frequency and magnitude.

In this regard, I like to think of ourselves as pioneers, having the ability to demonstrate how to manufacture with a minimal impact on the environment. Our vertically integrated supply chain enables us to take a holistic approach to identify, prioritize, and manage cross-supply-chain consequences. We actively respond to the environmental challenges in relation to energy, water, air quality, chemicals, and waste by optimizing our process management. Through better forecast and resource planning, we design out waste along our supply chain with a focus on minimizing defects and over-production, which in turn reduces inventory and extra processing.

We also look for innovative ways to weave available technology into our operations to reduce environmental impact from resource consumption and wastewater. Our investment in the water-recycling facilities in Gaoming, China, currently treats 38,000 tons of wastewater and recirculates 2,000–3,000 tons of treated water daily back to our manufacturing operations, substantially surpassing regulatory standards. Since 2005, we have reduced per-unit output consumption of water by 67 percent, and electricity by 49 percent.

On the other imperative to close the divide, the philosophy originates from our business decision of not chasing cheaper labor locations as wages rise, but improving the competencies and, in turn, productivity of our people in countries where we have an established presence. We choose this different path in the face of the rapidly changing worker demographics and social expectations: more and more educated young talents are seeking a higher quality of life and more knowledge-based work in organizations whose values they believe in, instead of tedious and repetitive back-breaking jobs that provide little satisfaction. For this generation, environmental and social issues are critical to their way of living.

To attract and retain talent for a sustainable workforce, we invest in automation to free up manpower from the most mind-numbing work. As of today, up to 77 percent of our production processes for a basic shirt can be fully or partially automated.

But I must stress that machines are not there to replace jobs. By empowering our people with the appropriate skills, tools, and knowledge, they are more inclined to stay with us, as they can see a career path and the promise of upward mobility. Their increased productivity, and in turn, their take-home pay, goes on to benefit the well-being of their families and the local communities.

And of course, sustainability matters to our clients. We earn our reputation as a trusted business partner by focusing on providing high quality products and services to all of our clients. They may have different sustainability agendas on their own, but our vertically integrated supply chain gives us the opportunities to collaborate with them and meet their needs. One example on the recycling front that shows the power of vertical integration is that we are working on exciting projects with clients about reclaiming and recycling cotton waste during our production processes. With spinning, weaving, and knitting experts working in close collaboration, we are able to create recycled blended yarn of high quality and strength. In recycling, there is still a lot of work needed around the whole supply chain because the collection process and logistics cost of recycling discarded garments are still major challenges.

To ensure lasting changes for our future generations, it is important for every one of us to understand and believe in sustainability. Our senior management, for example, must make much longer-term projections rather than just looking at the immediate future. Investing in sustainability almost never guarantees immediate returns. There is no shortcut to sustainability. Getting the basics right is critical. While sustainability has already become part of Esquel's DNA, we cannot achieve our goals alone. Only if we continue to work in collaboration with clients, governments, suppliers, and partners, can we look back years from now and say that the world we live in has improved—and that it could only get better.



Reinventing purchasing practices

Responsible purchasing practices seek to minimize the social and environmental impact not just of apparel companies' direct suppliers but also of their broader value chains. Our survey underlines the fact that sustainability has significant implications on end to end processes—including planning, negotiation, and order placement. Two out of three CPOs expect sustainable sourcing to add between 1 and 5 percent to their costs, with most agreeing that this is a necessary investment to meet consumers' expectations. But survey respondents report limited use of incentives to improve the efficiency of internal product-development processes across functions, which have a high impact on social and environmental sustainability in the supply chain.

As one sourcing executive put it: "I'm shocked by how little the business knows about the supply chain and how their decisions impact factories and production." There are important opportunities to address these fundamentals and drive improvement, however. Moreover, new technologies such as virtual sampling could unlock a step-change in sustainability as well as in speed, agility, and cost.

A price worth paying: additional costs expected for sustainable sourcing

Almost two in three respondents in our 2019 CPO survey expect sustainable sourcing to increase costs by between 1 and 5 percent by 2025. That is not trivial, as many sourcing executives find themselves under increasing pressure to deliver "more for less." Moreover, current incentives in apparel sourcing are based largely on cost price and intake margin—which makes the cost of sustainable sourcing a topic of keen awareness for sourcing executives. We should note, however, that some executives we interviewed reported that sustainability was adding no cost for their companies. As one said: "You just have to have the right partners."

Nonetheless, the majority of survey respondents see investment in sustainable sourcing as a necessary investment to strengthen competitive advantage—and close to half mitigate the additional costs from sustainable sourcing through resource savings and efficiency programs.

Limited use of incentives to improve efficiency of internal product-development processes

Our CPO survey finds that there is currently limited use of incentives to improve the efficiency of internal product-development processes, which have a high impact on social and environmental sustainability in the supply chain. Issues of concern include the impact of inefficient go-to-market processes, working in functional silos, and a lack of knowledge of sustainability in sourcing and at suppliers.

The result is overproduction and large amounts of unsold merchandise. Those problems are increasingly in the spotlight: in recent years, consumers have become much more aware of the wastefulness of the current fashion system. Many apparel companies are therefore making concerted efforts to increase agility and flexibility in the supply chain, improve demand-focused merchandise planning using integrated artificial intelligence, and use digital technologies to enhance their overall go-to-market processes.

Frequent order revisions and resulting late confirmations of final orders are among the key issues contributing to high sample inefficiency, overtime in factories, and unplanned airfreighting of finished products. These issues are often caused by a vicious circle starting in merchandise planning and product development, caused by go-to-market calendars that are too long or insufficiently segmented, and a failure to integrate consumer insights.

58%

of respondents see additional costs for sustainable sourcing between 1% and 5%.

“There is no shortcut to sustainability. Getting the basics right is critical.”

Teresa Yang, Vice Chairman, Esquel Group

Our survey also highlighted the fact that frequency of late orders is the indicator that is most widely used, with 90 percent of respondents tracking it. The frequency of order revision is the least-tracked indicator, tracked by 69 percent of respondents. Frequency of late orders and sample efficiency appear to be priorities for respondents: 48 percent and 45 percent, respectively, are incentivized as KPIs (Exhibit 13).

Another issue is current negotiation practices. Some brands and retailers have moved to a clear should-cost negotiation model with fair manufacturers' margins, and shared strategic plans for joint efficiency improvements—but these are not yet common practices across the industry. Outmoded negotiation models are still incentivized by cursory annual targets for percentage-based price reductions.

The responsibility of the supply chain is to align the commercial view with our purpose-led vision of protecting the planet and improving the lives of people.”

Cameron Bailey, EVP Global Supply Chain, VF Corporation

To fix these fundamentals, key actions that apparel companies can take include integration of shared sustainability and process-efficiency KPIs, improvement of cross-functional and supplier collaboration, improved planning accuracy, and overall end-to-end efficiency improvements.

Cameron Bailey, the EVP of Global Supply Chain at VF Corporation, said the following regarding alignment across functions (see full interview on page 44):

“Our science-based targets are another factor contributing to scaling and operationalizing our purpose-led supply chain vision. These targets span our entire company and are broken down across all functions—which then are responsible for activating specific plans to ensure success in hitting our overall objectives. This way, our environmental targets are integrated into our product strategy and innovation road map.”

High potential for sustainability to unlock value

Our survey and our related research find that there is high potential for sustainability to unlock value for apparel companies. One of the issues resulting from the process inefficiencies described above is the high number of samples along the product development process, which negatively impacts lead time, cost, and environmental sustainability. It is clear that sustainability, speed, agility, and cost are not mutually exclusive—as is highlighted by the shift to virtual sampling.

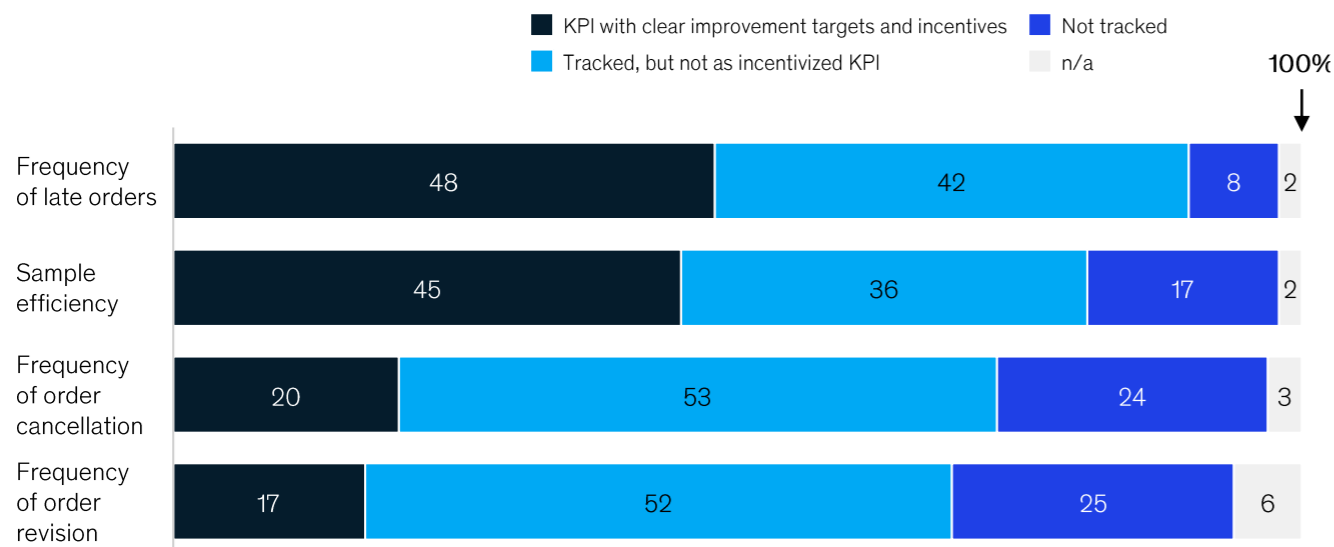
Virtual sampling, discussed earlier in this report, is not yet broadly used by the companies we surveyed—but they have high ambitions for its adoption by 2025. On average, companies surveyed use virtual sampling for 11 percent of their products today, but they expect to increase that to an average of 46 percent by 2025. True to its transformational nature across functions, effective implementation of virtual sampling will require upskilling, reskilling, change-management excellence, and consistent focus (Exhibit 14).

Exhibit 13

In many cases, incentives to improve internal product-development processes, which have a high impact on social and environmental sustainability in the supply chain, do not exist

“How do you track indicators for product development and purchasing process efficiency?”

Percentage of respondents, n = 64



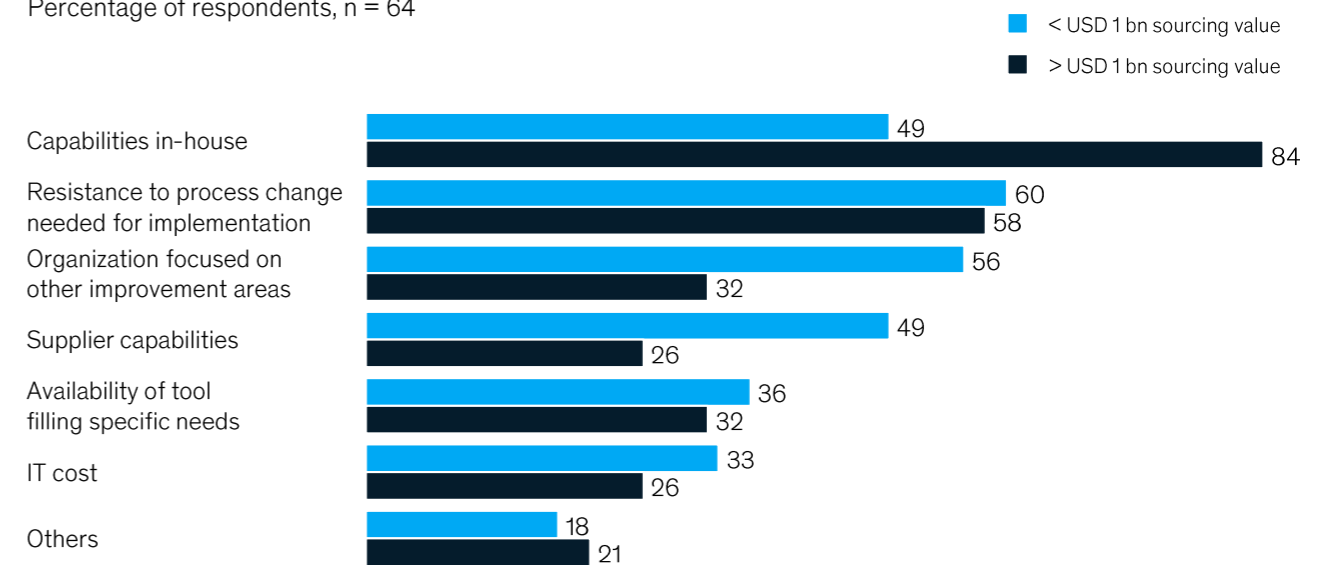
SOURCE: McKinsey Apparel CPO Survey 2019

Exhibit 14

Change management excellence to implement virtual sampling entails several factors

“Which hurdles are hindering implementation of virtual sampling?”

Percentage of respondents, n = 64



SOURCE: McKinsey Apparel CPO Survey 2019

Cameron Bailey
EVP Global
Supply Chain,
VF Corporation



Establishing a purpose-led supply chain

Across VF Corporation, we've embarked on a journey to become a truly purpose-led organization. We know consumers are increasingly interested in knowing exactly where their products come from, how they are made, and the potential impact—positive or negative—they have on people and the planet.

Social and environmental responsibility have risen higher on the list of factors influencing purchasing decisions. And conscious consumers are using their wallets to vote companies and brands up or down based on their actions and levels of transparency throughout their business operations.

In the not-so-distant past, “sustainability” was used primarily as a tool to mitigate reputational risk and ensure compliance. Our world changed quickly and companies, including VF, have come to clearly understand that transparency and traceability are critical to the future. To that end, our Global Supply Chain organization has set a goal to trace all products through our entire supply chain and share as much information with our consumers as possible. This may come in the form of “ingredient” labels for our products, or pictures or videos direct from the farm or factory floor with testimonials from the workers themselves.

However, like most things within a global supply chain, it's complicated. Reaching internal alignment on the need to be more transparent is much easier than obtaining the information required. Consider the example from our Vans® brand: through our traceability efforts, we found there are as many as 56 different suppliers involved in the end-to-end value chain to make one pair of shoes. While this work is tedious, it's vital to fulfilling our purpose-led commitments. We expect to achieve similar transparency for another 150 products by the end of 2021.

The impact of these actions is meaningful. We believe our traceability efforts will positively impact 60 percent of our suppliers and more than 500,000 workers worldwide. What's more, when we assessed our end-to-end value chain, we found that our supply chain touches the lives of about 6 million people. When you're operating at this scale, even the seemingly small improvements can have a transformational effect on our industry and the people it employs.

At VF, we have the advantage of operating one global supply chain organization that we leverage for the benefit of our entire brand portfolio. Enterprise-wide collaboration ensures that we employ a One VF approach to our supply chain, aligning sustainability capabilities and breaking down silos. Our central Global Responsible Sourcing team ensures alignment of strategies and activities across brands. An example is the global material hubs that enable us to share innovative, sustainable materials across multiple VF brands.

Our science-based targets are another factor contributing to scaling and operationalizing our purpose-led supply chain vision. These targets span our entire company and are broken down across all functions—which then are responsible for activating specific plans to ensure success in hitting our overall objectives. This way, our environmental targets are integrated into our product strategy and innovation road map.

The responsibility of the supply chain is to align the commercial view with our purpose-led vision of protecting the planet and improving the lives of people. To achieve this balance, we work with suppliers to enable them to achieve sustainability within the same cost structure. We have projects and processes in place to mitigate cost, and we work with suppliers on shifting to more efficient operations such as augmented workplaces and auto-cutting. And, we strive to always put the operator first when making these changes: people come before cost. All in all, if we are to deliver sustainability in sourcing on a net-net basis, the old ways of doing business won't work.

VF's owned manufacturing operations employ 12,300 people and play a significant role in incubating these new solutions in sustainability, efficiency, and automation. The standard methods we develop internally for cost-to-product, and efficient and effective manufacturing processes are critical in helping our suppliers transform their operations.

The overall industry transformation cannot be achieved by the actions of a few committed companies; it requires everyone to work together to create systemic change. Industry-wide collaboration with other large apparel companies, suppliers, NGOs, and other cross-functional stakeholder groups is key to making real progress. For us, our purpose-led supply chain is about doing business in the right way while also delivering on our value-creating expectations.

Apparel companies in the early stages of sustainable and responsible sourcing should start by setting a clear vision from the top and then putting a dedicated team in place to build the strategy. An essential and foundational first step is to establish a clear baseline of data; you can't know the best path forward if you don't know your starting point. And companies must make sustainability a full-time job for their people and integrate it across their operations.

Conclusion

Apparel executives increasingly believe that sustainable sourcing at scale is a must-have for their companies and for the industry. But true commitment, and a tremendous amount of work, will be needed to turn that aspiration into reality. Apparel brands and retailers will need to embrace social purpose as core to their missions and business models, and set ambitious targets on environmental and social sustainability across their organizations. They will need to make sustainable sourcing an integral part of the business fabric—including by rethinking corporate culture, creating clear accountability for achieving sustainability metrics, and fostering cross-functional collaboration. Those initiatives will have to come on top of a drive to fix the basics in end-to-end product-development and sourcing processes. And they will need to be underpinned by significant investment, for example in scaling up new technology to support sustainable sourcing.

The effort to deliver on the promise of sustainable sourcing at scale will have to extend far beyond individual companies, however. Apparel brands and retailers will need to build true collaboration with suppliers, encompassing real co-investment and long-term planning along with robust measurement and management of performance. They will need to drive accountability by measuring and incentivizing sustainable behavior across their end-to-end supply chains. Apparel players will also need to build on existing commitments to develop global industry-level standards that foster systemic change. Last but not least, they will need to work harder to engage the broader public in the sustainable-fashion transformation, including finding ways to speak to consumers about sustainability in a way that is clear, simple, and standardized.

The fashion industry has always been about daring, challenging, imagining, and leading. It is time to apply those qualities to the imperative of sustainability.

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