EXECUTIVE SUMMARY

Global Gains Mask Recovery Pains

With much of the world under Covid-19-related restrictions through 2020 and 2021, the global fashion industry has faced exceptionally challenging conditions. But after nearly two years of disruption, the industry is beginning to find its feet again.

Despite ongoing headwinds, there were signs by mid-2021 that things were taking a turn for the better, particularly in markets where vaccination rates were high. In the US, the release of pent-up demand created spikes of so-called “revenge buying,” leading to a growth spurt that echoed an earlier phenomenon in China. Return-to-work and occasion styles topped consumer shopping lists.

But the pandemic has only served to exacerbate inequalities in performance that have become a persistent theme over recent years. A small group of leading brands are equalling, and in some cases already surpassing, their pre-pandemic performance. This should not, however, be confused with a universal return to form. Large numbers of companies will continue to struggle to create value — and, in some cases, to survive — as the bruises of the crisis linger on.

The few brands that outperformed either played into the needs of the moment — comfort, outdoor activities and online shopping — or appealed to wealthier cohorts who were able to better weather the impacts of the crisis. Companies that couldn’t align with these market features tended to struggle, and the list of casualties grew longer as the pandemic continued through 2021. Indeed, the fashion C-suite has been an uncomfortable place to inhabit for much of the past year, illustrated by the rising numbers of takeovers and bankruptcies.

After a hiatus in last year’s edition of The State of Fashion, we return to our roster of fashion “Super Winners” — the top 20 listed companies by economic profit. The proportion of value destroyers (companies generating negative economic profit) in 2021 was higher than ever. Moreover, the losses of the bottom 80 percent in terms of value creation more than offset the profits of the top 20 percent.

This year’s Super Winners group is dominated by sportswear brands, luxury players and Chinese home-grown companies, all of which outperformed the wider market. From a geographic perspective, China recovered to 2019 levels of economic activity much faster than the rest of the world. Chinese demand was fuelled by appetite for local shopping, particularly in the luxury segment, as consumers who faced travel restrictions shifted to domestic alternatives.

Looking ahead to 2022, in aggregate, McKinsey Fashion Scenarios suggest global fashion sales will reach 96 to 101 percent of 2019 levels in 2021 and 103 to 108 percent in 2022. Still, while overall sales are expected to make a full recovery next year, performance will vary across geographies, with growth likely driven by the US and China, as

Europe lags. In addition, as international tourism remains in the doldrums, the shape of consumption will continue to evolve, sparking a growing focus on domestic spending. In response, many companies will recalibrate their retail footprints, even amid uncertainty as to whether these pandemic-induced behaviour shifts will stick.

In the year ahead, discount and luxury fashion will continue to outperform, as recovery will be uneven across value segments, and the mid-market will be squeezed. Still, with economic growth and consumer sentiment improving in some markets, and many shoppers looking to refresh their pandemic-era wardrobes, growth will be top of the agenda for many brands.

The market environment, however, will remain complex with new challenges to address, amid logistical bottlenecks, manufacturing delays, high shipping costs and materials shortages. These will further inflate input costs and strain imbalances between supply and demand. The likely result will be higher prices for customers.

Despite widespread operational disruptions, the pandemic has done little to slow down the megatrends reshaping the industry. In fact, these have accelerated over the past year, with industry leaders making bold moves in digital, taking action on environmental and social priorities and focusing more sharply on diversity, equity and inclusion in response. However, concerns around slow progress in these areas, coupled with all-time high job vacancies, mean brands will need to work hard to attract and retain talent in the year ahead.

In a similar vein, fashion companies will need to ensure they are acting in the interests of all stakeholders — including customers, employees, contractors, investors and wider society. Many brands will push harder on circular business models, greener materials and more sustainable technologies. One breakthrough to support these initiatives is blockchain, which is the underlying technology for digital "product passports." These contain coded information that can add value, support supply chain transparency and ensure authentication — a significant advantage tackling counterfeiting.

Online business models were a standout success story of the pandemic. We expect that companies will continue to invest in digital innovation and experiment with fresh approaches to creativity and commerce in 2022. Digital assets such as non-fungible tokens (NFTs), gaming "skins" and virtual fashion will edge closer to the mainstream, with some brands expanding into the digital "metaverse." In-app social commerce will play an increasingly important role in sales and marketing. On the flipside, these opportunities will bring increasing threats of cyber crime and data loss, meaning companies will need to work hard on resilience in an increasingly risky digital landscape.

While overall fashion sales are expected to make a full recovery next year, performance will vary across geographies. The market environment will remain complex and inconsistent.

Most fashion players will proceed on an uneven footing in 2022, as an inconsistent and uncertain recovery requires them to either raise their games or face the threat of consolidation or bankruptcy. Indeed, many of the gains expected next year are likely to be offset by recovery pains and disruptions to the global economy, which will compel decision-makers to take measures to keep businesses steady.

As fashion leaders consider their options, they will need to reflect on the many lessons they have learned during the pandemic, keeping their companies aligned with an ever-shifting playing field, enhancing their strategies for managing turbulence and balancing the needs of various stakeholders to create value for their customers, their shareholders and society at large.

INDUSTRY OUTLOOK

Regaining Lost Ground Whilst Bracing for Aftershocks

Executives in the global fashion industry are cautiously optimistic about the year ahead, though new and ongoing disruptions are beginning to erode that mood in some quarters. While some global markets are starting to recover after 18 to 20 months of pandemic-related turbulence, propelled by surging e-commerce adoption and domestic spending, challenges relating to supply chain bottlenecks and uneven consumer demand continue to hang over the fashion industry, undermining growth prospects.

Overall, global fashion sales are on track to pick up momentum in 2022, as increasingly hopeful consumers unleash pent-up buying power, refreshing their wardrobes as social life begins to resume in many key markets around the world. While the luxury sector is expected to achieve a full recovery by the end of 2021, the wider fashion industry is not set to return to pre-pandemic performance levels until early 2022.[1] This is a much quicker recovery than was expected six months ago.

The industry's recent emergence from a sustained period of turbulence is still weighing heavily on the minds of industry executives, as shown by their choice of the top three words to describe business conditions in the year ahead in our BoF-McKinsey State of Fashion 2022 Survey: "recovery" (cited by 59 percent of fashion executives), "challenging" (50 percent) and "changing" (42 percent). However, executives are leaving behind the all-consuming preoccupation with "uncertain" market conditions that they expressed in 2021 and turning their attention to driving growth in an altered market landscape — even though a degree of uncertainty around crisis recovery and inconsistency nonetheless persists in the year ahead.

In 2022, fashion is poised to benefit from fundamental macroeconomic drivers. Consumer sentiment is on a positive trajectory, especially in markets where vaccination and saving rates are high. In the US, savings in the first quarter of 2021 were estimated to be 3.1 times higher than in the first quarter of 2019.[2] Alongside this, 43 percent of US consumers said they would increase their fashion spend in 2021,[3] with clothing for work and special occasions top of their shopping lists. While pent-up demand has already played out as so-called "revenge shopping" in the luxury segment in China, similar behaviour is expected to pick up steam in the broader fashion market in the US in early 2022. In Europe, consumer confidence in economic recovery is more cautious, with approximately one quarter of respondents in a September 2021 survey optimistic that the economy would rebound to pre-pandemic levels by the end of 2021, while over half expected recovery only in 2022 or later.[4]

As fashion inches towards rosier conditions in some regions, industry leaders have a more hopeful outlook than last year. Some 75 percent of luxury executives, 61 percent of mid-market executives and 50 percent of value executives expect better trading conditions in 2022 than 2021.[5] This reflects a different distribution of mood compared to our last survey, which was conducted in 2020 to capture sentiment about 2021, in which mid-market executives were the least hopeful group, with only 22 percent expecting better trading conditions, whereas value executives were the most hopeful at 36 percent followed by luxury at 31 percent. While there are most likely a variety of reasons why mid-market executives are feeling more positive about 2022 than they were about 2021, one may be that the surviving and restructured players in that segment of the market are expecting a rebound after it fared poorly for several years.

From a demand perspective, younger cohorts such as Gen-Z and wealthier consumers from middle-income groups and upwards are predicted to demonstrate the strongest appetite for leisure spend (including fashion, dining out, travel, entertainment, electronics, etc.) in the US through 2021 and beyond. Fashion is one of the top three categories on which they seek to splurge or treat themselves.[6] In China, there are strong prospects for growth in consumer spending power, where rising incomes will contribute to an anticipated increase of $10 trillion in consumption growth between 2021 and 2030.[7]

While the global fashion market will continue to grow overall, performance will be uneven across geographies, depending on their ability to recover from pandemic-induced health and economic shocks. The Chinese fashion market — including both luxury and non-luxury segments — is already back to pre-Covid sales levels. The non-luxury segment reached +2 percent over 2019 H1 sales in H1 2021.[8] However, for a full-year comparison, macroeconomic disruptions through the latter half of 2021 will likely temper this growth to -3 to +2 percent for 2021 versus 2019 sales overall. On the other hand, the luxury sector shows strong signs of growth in China amid ongoing travel restrictions and increased domestic spend; the luxury segment is set to reach +70 to +90 percent over 2019 sales by the end of 2021.

The US is not far behind — US non-luxury segment fashion sales will have recovered to +5 to +10 percent over 2019 levels by the end of 2021, according to McKinsey Fashion Scenarios analysis.[9] A similar picture will emerge in the US luxury segment, which is expected to return to -5 to +5 percent of 2019 levels in 2021, slightly below non-luxury due to ongoing luxury spend repatriation in China muting sales recovery in the US. In Europe, there will be a slightly slower trajectory for recovery of non-luxury fashion sales, reaching just -15 to -10 percent of 2019 sales by the end of 2021, and taking until 2022 to recover fully. Meanwhile, the European luxury segment will remain below 2019 levels until beyond 2022, as vast amounts of spend from Chinese nationals travelling abroad is redirected to Mainland China.[10] Given this diverse set of dynamics and with the global fashion industry fully recovering only in 2022, growth will be front of mind in the year ahead: 87 percent of fashion executives plan to pursue sales growth in 2022.[11]

Despite the slower projected return to pre-pandemic sales levels in Europe, executives in that region are the most optimistic about the year ahead, likely owing to factors such as the comparatively strong presence of European luxury brands across global markets. Indeed, 67 percent of Europe-based executives expect better trading conditions in 2022 than 2021. This compares with 57 percent of executives in North America (where the release of pent-up buying spiked in 2021) and 52 percent in Asia, where most key markets have already returned to pre-pandemic sales levels. None of the executives in Asia anticipate worse trading conditions in 2022, while some scepticism remains among executives in Europe and North America, where 8 percent and 9 percent expect worse conditions respectively.[12] Collectively, these sentiments likely reflect a relaxation of stimulus packages and the release of pent-up buying, and point to the caution required next year in the face of supply chain stresses and the challenges of maintaining stable growth.

INDUSTRY OUTLOOK

Several forces are at work to create both opportunities and risks in 2022, including new growth channels, consumer behaviour patterns and complications in the global economy. Executives predict that supply chain pressures, the rise of domestic luxury spend amid muted international travel and the continuing evolution of digital channels will have the biggest impact on their business in 2022. To be sure, the disruption of global supply chains ranked at the top of the agenda for 84 percent of executives in the BoF-McKinsey survey, as the turmoil experienced over the last two years — amid material shortages, transportation bottlenecks and soaring shipping costs, exacerbated by surging consumer demand in some markets — is expected to remain in the year ahead.[13] As the logistics industry continues to shift and challenges mount, executives need to pay close attention to the transparency and control measures in their supply chains to meet consumer demand.

Invariably, supply chain stresses will impact margins. As a result of these cost inflation pressures, 67 percent of fashion executives expect to increase retail prices in 2022, with an average uplift of 3.2 percent, while 14 percent of executives even expect to increase prices by more than 10 percent. Since many players will be focusing on sales growth, price increases will be used to offset narrowing margins. Still, 17 percent of executives expect to lower prices, with the most expectation for price decreases coming from the mid-market, perhaps due to the segment's ongoing squeeze throughout the pandemic.[14]

Following supply chain disruptions, the second most prominent challenge on executives' minds is the sustainability gap, cited by 15 percent of executives as one of their top three concerns for 2022 in the BoF-McKinsey survey. However, 12 percent of executives also rate sustainability as an opportunity in the year ahead, suggesting that any costs or challenges they encounter relating to sustainability may be outweighed by business benefits associated with improving their company's impact on the environment and society. Compared with 45 percent of executives who cited Covid-19 as a top challenge in last year's survey, the health crisis was highlighted by just 10 percent of respondents as a top challenge for 2022, suggesting that measures to curb the impact of the pandemic on business are proving their mettle in some markets.[15] Looking ahead, fashion companies will need to address these interconnected challenges by taking an active and vigilant approach to supply chain management while establishing priorities for an ambitious and revitalised sustainability agenda.

Alongside sustainability, executives are also looking to "digital" and "consumer engagement" as opportunities for 2022, cited by 32 percent and 11 percent of fashion executives respectively. While both digital and sustainability opportunities are longer-term themes that are highlighted by executives year on year, consumer engagement is a new opportunity cited by executives for 2022, reflecting the view that customer experiences with brands across online and offline channels are becoming even more important for brand differentiation in a highly competitive marketplace. Fashion players will therefore need to accelerate their use of data and analytics across business functions to develop customer insights and adjust their strategies accordingly.[16]

The year ahead will present a welcome shift for some fashion players, having regained much of the ground lost to the pandemic after nearly two years of turmoil. Still, worrying signs, supply chain stresses and a degree of uncertainty across some geographies and parts of the industry point to a need for prudence as an increasingly inconsistent overall picture emerges. At the same time, as overall industry sales recover, fashion players will likely continue to suffer business disruptions through 2022, with some fighting for survival as both pandemic-related and global economy aftershocks are likely to emerge in the year ahead. All told, the state of the global fashion industry in 2022, defined by the 10 themes in this report, will be characterised by new and persisting challenges tempered by fresh opportunities to grow and evolve at a crucial time for most businesses.

Industry Outlook as of the beginning of November 2021.

01. UNEVEN RECOVERY

Recovery from Covid-19-related economic shocks will be uneven across consumer markets and sourcing regions, as countries with strong healthcare systems and economic resilience outperform. In this patchy environment, fashion players with international footprints will need to look at investment decisions with precision, reassessing local conditions regularly while mitigating for market-specific risks.

In the global effort to vaccinate people against Covid-19 and recover from the economic shocks related to the pandemic, some countries are better positioned than others. The key parameters that will shape recovery patterns in the year ahead include levels of health resilience — a function of both Covid-related measures and domestic healthcare systems —and economic resilience. Gaps will also be impacted by varying levels of government fiscal support and the maturity of their digital economies. In response, fashion companies operating international businesses will likely need to tailor strategies to local conditions, as well as take steps to mitigate risks and boost their supply chain resilience.

A significant differentiator is access to vaccines, which varies substantially between low- and high-income countries. Of the approximately 5.5 billion vaccine doses that were administered globally by September 2021, some 80 percent were in high- or upper-middle-income countries, according to the World Health Organization.[17] Looking ahead, many low-income countries may not receive enough doses to vaccinate all adults until well into 2022 or 2023.[18] With the ongoing threat of new variants, these countries could stand to be the most exposed to further humanitarian crises and deeper economic shocks.

"The pandemic is reversing hard-won development gains, adding to the problems facing the most vulnerable. The post-Covid recovery must not leave anyone, or any country, behind," World Trade Organization director-general Ngozi Okonjo-Iweala declared in a 2021 plenary session, calling for equitable access to vaccines and greater trade cooperation. "Keeping global markets open is essential for a strong and sustained recovery."[19]

Countries that lack the digital infrastructures for remote working, or whose economies rely heavily on manual labour, are particularly susceptible to further shocks. The fashion industry has seen workers in manufacturing hubs impacted by ongoing Covid-19 outbreaks and associated shutdowns that have punctured production output. Throughout 2021, outbreaks in Vietnam led to the closure of numerous factories affecting supply for companies such as Adidas and Swiss shoe brand On.[20] Meanwhile, Ethiopia, Honduras and India also saw increased uncertainty around job security and working conditions, while China's zero-Covid policy continues to result in factory shutdowns.[21]

Coupled with the slow distribution of vaccines in some markets, these ongoing disruptions will have both upstream and downstream consequences on fashion.

The global fiscal response to the pandemic has been three times higher than the response to the 2008 global financial crisis, exceeding $10 trillion in the G20 alone.[22] However, many countries struggling under high debt burdens have lacked the firepower to drive recovery. For fashion, this meant some companies used the financial support available to them to maintain labour and budget balances, while others have faced prolonged difficulties. With many existing fiscal support schemes set to come to an end in the year ahead — while others have already ended — companies will need to consider alternative strategies to support a return to growth.[23]

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Looking ahead to the medium term, McKinsey in partnership with Oxford Economics has developed a range of scenarios[24] for how the virus will likely influence the recovery of individual economies, based on the varying levels of effectiveness of their healthcare systems and fiscal responses. While some countries are likely to see their GDP growth return rapidly to pre-pandemic levels, others will likely face recurring health shocks and therefore weaker short-term growth or even prolonged downturns.

In the scenarios analysed across fashion's largest consumer markets, 2022 is broadly expected to be a year of growth. However, there will be variations across countries, reflecting the unpredictable nature of viral outbreaks and differences in fiscal and healthcare responses. In the US, year-on-year GDP growth of 3 to 3.2 percent is likely in 2022, according to McKinsey analysis.[25] While the economy in China had regained GDP levels from the third quarter of 2019 by as early as the end of the first quarter of 2020, further year-on-year growth of between 6.3 and 8.2 percent is expected in 2022.[26] Across the Eurozone, the year-on-year GDP growth rate is predicted to be approximately 5.3 percent. For example, in Germany, the forecast is 5 to 5.3 percent GDP growth, following rising infections and accelerating inflation through mid-2021.[27] Despite record numbers of Covid-related deaths and one of the most severe economic slowdowns, the UK outlook is brighter, with a forecast of 7.2 to 7.4 percent in 2022.[28]

Adjacent to fiscal and healthcare responses, consumer sentiment will play a large part in determining the speed of return to pre-pandemic social and working lives. Spending restrictions by consumers during Covid-19 lockdowns combined with stimulus payments boosted savings across key consumer markets such as the US, where saving rates in 2020 were double that of 2019. This will translate into increased optimism next year, particularly among younger and wealthier customers who will continue to drive spending in fashion categories, particularly in the luxury segment.[29] The spikes in spending that emerged in China during so-called "revenge shopping" periods in 2020, when lockdowns ended and consumer confidence returned, are expected to play out in some other fashion markets as they recover.[30] In the US and UK, these spending spikes will likely occur after the start of 2022, according to McKinsey analysis.[31]

As a result of these and other factors, McKinsey Fashion Scenarios project an almost complete recovery to pre-pandemic sales levels in 2022 in Europe, the US and China, with the latter's incremental growth in domestic luxury spend outperforming.[32] Globally, these scenarios suggest that total fashion industry sales could surpass 2019 levels by 3 to 8 percent in 2022, with the luxury segment surging by 15 to 25 percent over 2019 levels.

However, lower- or middle-income countries that have lower vaccination rates face the risk that Covid-19 could become endemic, causing cyclical waves of the virus and subsequent slowdowns in economic growth.[33] On top of this, the highly transmissible Delta variant has accelerated the spread of Covid-19 in some countries, with its high levels of vaccine resistance disrupting the recovery trajectory. For example, in India, the variant's proliferation in the first half of 2021 pushed consumer sentiment to a record low and disrupted fashion industry suppliers.[34] While spending has rebounded in urban areas especially, with the country's GDP predicted to expand by around 8 percent in 2022 according to McKinsey, supply chains remain impacted amid ongoing factory closures. [35]

Across other regions, growth projections remain uneven and subject to rapid change. In Latin America, McKinsey projects between 2 to 5 percent GDP growth in Mexico in 2022, which is linked to growth in the US economy, while Brazil is set to experience slower growth of 1.5 to 3 percent.[36] In the Middle East, growth is expected to pick up overall, driven by the loosening of travel restrictions and increased oil output. Meanwhile in Africa, the outlook is mixed and will depend on vaccine dissemination and the severity of potential new waves of Covid-19. In Nigeria for example, the outlook is increasingly muted for 2022, with growth expected to be 2 to 4.5 percent following another wave of the Delta variant in 2021.[37]

Given such a mixed global picture, there will likely be significant variation in recovery profiles across consumer markets and sourcing countries that play a critical role in fashion's supply chains. Moreover, the outlook remains volatile as Covid-19 continues to send shockwaves across the global economy. This, combined with the inflationary impact of additional supply chain disruptions — including shipping industry consolidations, global labour shortages, longer-term regulatory changes and a burgeoning energy crunch — and other macroeconomic and geopolitical risks, means significant and unpredictable challenges will remain in the year ahead.

"We are living in very uncertain and uncharted times," declared the International Monetary Fund's chief economist Gita Gopinath at an October 2021 press briefing for the organisation's world economic outlook. "We have never seen a recovery of this kind... and we have to be particularly vigilant."[38]

As fashion leaders consider potential scenarios for the markets in which they operate in the year ahead, they will need to plan for accelerating growth in some and delayed recoveries in others. As a result, they should adopt market-specific strategies that reflect conditions in their key centres of commerce. Those who navigate this uneven outlook by better anticipating granular demand trends across specific income groups, cities and demographics within each market will likely fare better (see "How the Global Wealth Gap Is Impacting Fashion" on page 26).

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Furthermore, given the supply chain uncertainty embedded in this outlook, fashion brands should reassess the risks of relying on each manufacturing hub in their sourcing footprint while weighing up the need for supply chain resilience with the increased cost of sourcing

How the Global Wealth Gap Is Impacting Fashion

Widening inequality between income groups and other demographics could exacerbate the already uneven economic recovery from the pandemic which is expected across countries in 2022. How fashion companies respond to these disparities will depend on the local context of each consumer market, operating hub and sourcing region that make up their global footprints.

by Casey Hall

The neighbourhood of Boa Viagem in Recife, Brazil. Diego Herculano / NurPhoto / Getty Images.

When the president of the World Bank appeared at a virtual press conference in October 2021 for the organisation's annual meeting, his account of the growing inequality gap was unambiguous. "As you know, the world is suffering from a dramatically uneven recovery. Inequality is worsening across country groups," said David Malpass, referring to the different recovery speeds and trajectories of higher-income and lower-income countries from the impacts of the Covid-19 pandemic.[39]

Since countries with stronger healthcare systems and economic resilience are likely to outperform others in 2022, business performance will vary across many of the consumer markets, operating hubs and sourcing regions that underpin the global fashion industry. But fashion companies will need to do more than just take these differences into account as uneven recoveries across countries will be exacerbated by uneven recoveries within countries.

Indeed, the recovery picture is far more diverse, complex and nuanced at the sub-national level, complicated by disparities in each domestic context. Within countries, some provinces, states, regions and cities were impacted unevenly by the pandemic or saw economic gaps between them widen as a result.

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In the UK, for example, the pandemic has made the country's "North-South divide even worse," according to a report by the Centre for Cities, a London-based think tank. The health and economic impact of the crisis has made it "four times harder" to narrow the divergence between people's living standards in the North and Midlands regions and those in the South, with cities like Birmingham and Hull therefore predicted to face greater challenges than others.[40]

Fashion companies considering their expansion priorities in a given market or refining their assortment mix across an existing retail footprint would be wise to keep such shifts in mind.

A similarly uneven picture has emerged across cities and regions in many other countries. In Brazil, longstanding economic disparities between certain states have heightened since the onset of the pandemic,[41] such as significantly higher poverty levels in the states that make up the North and Northeast regions compared to wealthier states in the South and Southeast.

According to Carlos Jereissati Filho, outgoing chief executive of Iguatemi Empresa de Shopping Centers, a retail group which owns malls across Brazil, international brand partners that have noted these shifting patterns are now doubling down on certain states and cities.

"The luxury brands that have been in the market for a long time... are now seeing that Brazil is bigger than just states like São Paolo and Rio de Janeiro [in the Southeast region]. They're seeing opportunities in the South region [where we have malls and outlets in Rio Grande do Sul and Santa Catarina states] and in the Central-West region of the country like Brasilia [where we have a mall in the Distrito Federal] and places where the cultural industries have been booming [in spite of the pandemic] and a lot of money is flowing into like Goiânia [in Goiás state]," he said.[42]

Different demographic groups within countries were also unevenly affected by the pandemic, with the nature of impacts influenced by factors such as socioeconomic group, occupation type, educational attainment, race, ethnicity, gender and others.[43] Due to the intersectional nature of some of these characteristics, pre-existing inequalities between cohorts are often reinforced or exacerbated by a widening wealth gap, which can lead to more severe outcomes for affected groups.

In some countries, early discussions of "V-shaped" or "U-shaped" economic recoveries from the pandemic have largely given way to a "K-shaped" model, in which the wealthiest people saw a quicker economic recovery, and those at the lower end of the income spectrum saw their economic opportunities dwindle or stagnate. This has happened in both developing and advanced economies.

In the US, for example, poverty increased after some of the benefits that were part of a government relief package ended in 2020, according to data published in a joint report by researchers at three universities in December of that year.[44] The authors noted a disproportionate impact on some groups and communities: "The increase in poverty in recent months was more noticeable for Blacks, children and those with a high school education or less," reads the report. A disproportionate impact between different demographic groups has been observed around the world, in countries as diverse as Japan,[45] Russia[46] and Argentina.[47]

"The most marginalised groups always get hit the hardest," Wendy Edelberg, director of the Hamilton Project, an economic policy arm of the Washington DC-based Brookings Institution, told a US media outlet in 2021.[48] "But what is so unusual is, for a lot of other groups, it's not that they're being hit less — it's that they're seeing no pain at all [or] they're doing well," she added. "For a lot of people, the crisis is over. It's invisible to them."

This is certainly not the case for the 97 million people around the world who were pushed into extreme poverty in 2020 by the pandemic, now living on less than $1.90 per day.[49] Among the working poor are many who are employed by manufacturers and raw materials producers in the developing world that supply global fashion brands. Many have been at the sharp end of the Covid-19 crisis, increasingly vulnerable to factory closures and exploitation.[50] According to analysis in the "BoF Sustainability Index," a significant proportion of fashion companies' commitments to pay workers living wages are not backed by concrete action.[51]

Meanwhile, the number of people accruing extreme wealth during the pandemic period has risen precipitously. A record 493 people joined *Forbes'* World's Billionaires list in the year spanning March 2020 to 2021,[52] amounting to the creation of a new billionaire every 17 hours on average. The growing number of people who are either very rich or very poor has meant that the global middle class, which had been an expanding demographic for many years, shrank by 54 million people in 2020.[53]

These shifting dynamics clearly point to numerous moral imperatives for governments, societies and businesses in the years ahead. Yet, in addition to their collective and individual responsibilities to help tackle inequality across the countries where they operate, fashion companies must also prepare for the many potentially profound business implications that such disparities present. As they decide where and how to invest, leading fashion players will determine how unequal recovery speeds and trajectories affect them (see "Uneven Recovery" on page 21) in more granular terms.

Indeed, however useful a bird's-eye view on the wealth gap may be for identifying living wage levels or distributing merchandise by value segment across countries, it obscures important detail about sub-national disparities. Decision-makers must weigh up risks and opportunities by studying subtly different and sometimes rapidly changing local market conditions across different subsets of society and different expanses of each country, which are influenced by a unique context of political, cultural, economic and historical factors.

Consider the following four snapshots which illustrate how uneven recoveries within countries could impact the global fashion industry in 2022.

The widening wealth gap could trigger policy changes that impact specific segments, such as the luxury sector in key markets like China.

Even in China, where comparatively effective early management of the Covid-19 pandemic allowed it to be one of the only major economies to experience growth in 2020,[54] recovery has been uneven across different demographics.

Chinese President Xi Jinping's calls to rein in "excessive incomes" can be seen as a direct result of widening inequality in the country, which has become more pronounced since the arrival of the pandemic. Like in many other countries, poor workers and small businesses bore the brunt of China's Covid-related economic impact, with Gavekal Research estimating that the bottom 60 percent of Chinese households lost about $200 billion in income during the first half of 2020.[55]

Meanwhile, the Hurun Research Institute reported that the collective wealth of the members of its 2020 China rich list — made up of 2,398 people with individual wealth of over 2 billion yuan (approximately $312 million) — increased more that year than in any other during the 22-year period the organisation has been compiling the list.[56]

In China and other countries, growing inequality undermines the social contract between the government and its people, whose satisfaction rests partly on the belief that they will collectively continue to grow more prosperous.

Though some luxury analysts are concerned that new policy interventions to curb income inequality could be implemented which may hit the luxury market (an October 2021 China International Capital Corp report predicted, for example, that China would expand its consumption tax to cover more luxury consumer goods),[57] others suggest that any impact on the bottom line is likely to be muted for most luxury brands.

The luxury sector's ultra-wealthy VIP consumers, the likeliest target of any overt moves to curb perceived excesses, are defined by investment bank Jefferies as those who spend more than €100,000 ($117,000) a year on luxury goods. This cohort is estimated to comprise around 110,000 individuals, accounting for a quarter of total Chinese spending.[58]

Though this is a significant proportion of the luxury market, it is not the main driver of luxury spend in China. Rather, that is the middle and upper-middle class, a cohort which expanded by 350 percent between 2009 and 2020.[59] A push to lift more of China's population into this group by promoting a so-called "olive shaped" economy (shrinking economic extremes at each end and growing the centre) could actually be positive for luxury sales in the long term, some analysts contend.

Still, as future policymaking plays out, analysts see 2022 as a pivotal year for luxury brands. Some may consider opportunities to shift marketing, distribution and product development in ways that align to consumers who are either less inclined to exhibit their wealth or prefer a more discreet experience.

Events in South Africa highlight how intersectional inequality can create a destabilising force for future high-growth retail markets.

Even before the pandemic, South Africa had one of the highest, persistent economic inequality rates in the world, with a consumption expenditure Gini coefficient, which measures the deviation from equal income distribution, of 0.63 in 2015 (0 represents perfect equality and 1 represents maximum inequality).[60] According to Vuyokazi Futshane, author of a May 2021 report prepared for the United Nations about the intersection of inequality and recovery, "upward mobility [in South Africa] is greatly influenced by gender, race and class," and "all of these dimensions of poverty and inequality have been heightened by the Covid-19 pandemic."[61]

South Africa has a "heavily racialised" labour market, according to a report by the country's department of statistics, in which Black South Africans are not only the most likely to be unemployed, but also earn the lowest wages. Whites earn substantially higher wages than all other population groups.[62]

Manifestations of this longstanding inequality have been felt in both direct, as well as a multitude of indirect, ways by fashion retailers. One recent example was the attack on shopping malls and other retail centres as part of looting and protests that began in July 2021. The unrest was nominally triggered by the jailing of former President Jacob Zuma, but it also signified the release of longstanding pent-up grievances felt by Black South Africans who have been hit hard by job losses and rising living costs as a result of the pandemic.

Despite a slowdown in GDP growth in recent years and a contraction of per capita income since 2014, international fashion retailers have continued to enter the South African market and, in some cases, have succeeded in taking market share from local chains. The middle class and lower-income groups in South Africa have been squeezed throughout the pandemic period, denting business at shopping centres, but hopes are high for a relatively fast recovery among some high-end mall executives.

According to Preston Gaddy, general manager of Sandton City and Nelson Mandela Square in Johannesburg — both of which emerged unscathed from the unrest, though Sandton City did close its doors for a period as a precautionary measure after consultation with police — the number of weekend shoppers between 2021 lockdowns bodes well for 2022. In an echo of other markets, repatriated spending on luxury goods has helped soften the blow during the pandemic.

"'Mrs Sandton' cannot go to the Champs-Élysées to buy her LV bag, so she's been buying locally," he said, referring to an archetypal customer at the shopping centre seeking brands like Louis Vuitton. "Global luxury brands are saying, 'It might be a small dot on the edge of the African continent, but the numbers being posted by luxury retailers in South Africa [are] notable and we need to pay attention.'"

Gaddy said that brands from Adidas to Alexander McQueen have continued opening, expanding or investing in Sandton City. He believes more luxury entrants are eyeing South Africa as a gateway to the continent, a region which is increasingly on their radar. Others, however, are less certain that those who can afford to drive South Africa's consumer comeback in 2022 and beyond can necessarily be counted on to do so.

"I think we are going to see a huge dent to confidence… and maybe [we'll also see] another wave of emigrations," explained Sasfin Bank senior equity analyst, Alec Abraham. "Where we could have had an uneven but something of a recovery in more discretionary categories in retail, the fear that many people experienced during those riots will certainly impact that recovery in 2022."

A local approach to controlling India's Covid-19 outbreak has led to uneven retail recovery speeds across different regions of the country.

In late 2021, the recovery of the Indian retail sector from the country's devastating second wave of Covid-19 infections was still underway. According to Retailers Association of India (RAI) chief executive, Kumar Rajagopalan, recovery has been uneven, not only across income groups — income inequality has broadly been widening over the last 20 years in India[63] —but also geographically.

Unlike in 2020, when India's pandemic plan included a lengthy nationwide lockdown, lockdowns in 2021 were mostly rolled out and lifted on a state-by-state basis. With different durations and severities of restrictions, retailers across the country naturally experienced different economic impacts.

According to Rajagopalan, the South region of India, and most of the country's North region, where malls and retailers were open for business "almost all the way through [the pandemic]" in some states, have seen a faster retail recovery in the wake of India's second wave. By August 2020, an RAI survey showed the North had recovered 98 percent of retail sales (versus the same month in 2019) and the South had reached 97 percent.

However, in the country's East region, "there have been some ups and downs," he said, especially in the Northeast region, where persistently high Covid-19 case numbers resulted in more restrictions.

As one of the first states that went into lockdown and one of the last to emerge from Covid-19 restrictions, Maharashtra in India's West region, which boasts one of India's largest economies[64] and is home to the city of Mumbai, initially lagged other regions in its recovery.

It is not yet clear how these divergent recoveries will play out in the year ahead. This is in part due to the dynamic and complex nature of income inequality and other disparities between people living in India's regions, states and cities. However, there will almost certainly be perceptible differences which require diverse responses from global fashion companies as they decide how to invest across the country.

Overall, Rajagopalan says the "India story" is as compelling as ever for the broader retail sector: "India has a young population; its middle class is growing; per capita income is growing above the $2,000 level; all these stories are still there. If you consider [all that alongside the return of] government spending and employment… the market for retail should return to its full might in 2022."

According to RAI's September 2021 business survey, nationwide retail sales had already reached 96 percent of comparable levels in 2019, boosted by the beginning of India's festive season, which runs through to December, and the return of weddings, many of which were postponed due to restrictions on people gathering.

Women's employment-to-population ratios declined more than men's during the pandemic but the impact of the gender gap on economic recovery will depend partly on local local market conditions like those in Saudi Arabia.[65]

"Social and economic inequalities have been exacerbated, undermining women's economic security and resilience against shocks," said Michelle Bachelet, UN High Commissioner for Human Rights, explaining the reasons for a growing gender gap over the pandemic period in a 2021 address. "[Yet] the majority of socioeconomic Covid-19 responses adopted by states are surprisingly gender-blind, often failing to address the specific needs of women."[66]

The need to work from home and to home-school children has prompted many women to drop out of the labour force since the beginning of the pandemic. According to estimates by the International Labour Organization (ILO), women's employment worldwide declined by 54 million in 2020.[67]

There have been some anomalies, though. In Saudi Arabia, despite fears the pandemic would set back recent progress in labour force participation, the number of women in the country's workforce actually grew 64 percent in the two years from late 2018 to the end of 2020, according to World Bank data.[68] Though part of that timespan covers a period prior to the pandemic, economists at the international organisation have specifically noted evidence of a continued rise since the onset of Covid-19.[69]

Though years of gender inequality and laws limiting Saudi women's participation in society prior to reforms that started in 2016 mean the country is coming from a very low baseline in terms of female labour force participation, the recent lift in employment rates bodes well for the country, assuming it is accompanied by a more comprehensive female empowerment agenda. More working women is also good news for the fashion and retail industries.

Both industries have been beneficiaries of Saudi Arabia's Vision 2030 master plan for economically diversifying the kingdom away from reliance on oil, spearheaded by Crown Prince Mohammed bin Salman Al Saud. Growth of the Saudi service sectors is a key pillar, particularly those that also boost domestic consumption and tourism. By 2020, 26 percent of Saudi women were working in the wholesale and retail sector, according to figures from the Brookings Institution.

An exodus of foreign workers during the pandemic and a relatively early retail reopening after the lifting of restrictions unlocked even more opportunities for women in the country. Saudi women are more likely to replace expatriate workers than Saudi men in some settings, according to Brookings, and they are also more likely to work in service sectors like fashion and retail. Though this is partly driven by their comparative willingness to work for lower wages, both Saudi women and men are paid significantly more than foreign workers.[70]

While there are questions around how permanent the shift to local employees will be for blue collar and manual labour sectors, white collar jobs and those in the fashion and retail sectors are more likely to remain open to local women. The country's overt "Saudisation" policy, which compels companies to allocate a certain proportion of jobs to native Saudis, should help encourage that.

"For the first time, brands [are employing Saudi women and therefore] have direct access to their female consumers via their teams... and the result is [that brands are] having more insight into the consumer behaviour of their target market," explained Marriam Mossalli, founding partner and senior consultant of Jeddah-based luxury communications and marketing consultancy Niche Arabia.

Members of this new female workforce are also looking for new work-appropriate items for their wardrobes, a change she suggests more global fashion brands should note. "It's not just attire [for women who] lunch anymore."

The author of this article focuses on global markets in Asia-Pacific and other regions at The Business of Fashion.


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02. LOGISTICS GRIDLOCK

The fashion industry is reliant on an intricate web of global supply chains that are seeing unprecedented levels of pressure and disruption. With logistical logjams, rising shipping costs and shortages of many kinds adding new layers of complexity, companies must rethink their sourcing strategies while implementing cutting-edge supply chain management, and building in greater flexibility to keep products flowing with customer demand in the year ahead.

The ship that blocked the Suez Canal undergoes maintenance. Tang Ke / Costfoto / Barcroft Media via Getty Images

Around half of global businesses suffered supply chain disruptions in 2021, with one in eight severely affected.[71] This was the fallout from a combination of global and local factors, including material and component shortages, transportation bottlenecks, staff unavailability and rising shipping costs.[72] Many of these challenges show no signs of abating, and the majority of business leaders expect logistical roadblocks to persist through 2022 and beyond. Indeed, 87 percent of fashion executives in our BoF-McKinsey State of Fashion 2022 Survey expect supply chain disruptions to negatively impact margins next year.[73]

It is likely that logistics challenges will only intensify in 2022, with global surges in demand clashing with unpredictable pressures on freight services, ports and terminals. There are growing concerns that increased levels of disruption and price hikes could last longer term, or even represent a new logistical normal for the global fashion industry.

"The supply chain assets are running at full capacity. It's bursting at the seams. So my opinion is that these frustrations will continue until at least the second half of [2022 or]… even extend into 2023," said Joseph Phi, group chief executive of supply chain management company Li & Fung, which counts fashion brands among its clients.[74]

Three structural factors are at play in creating these conditions, which add to the impact of the Covid-19 pandemic: operational challenges (caused in part by soaring demand), shifting industry dynamics and new waves of trade agreements and regulation.

After months of lockdowns, consumer demand is surging in markets such as the US and UK. However, some brands have struggled to obtain products on time, with manufacturing and transport delays — on sea, in the air and on land — leading to chronically depleted inventories in some cases. Brands with manufacturing operations in regions severely impacted by the pandemic have faced staff shortages and factory closures. In August 2021, Adidas said that pandemic-related supply chain disruptions could cost the company up to €500 million ($586 million) in sales.[75]

Outbreaks of Covid-19 have also worsened port congestion and restricted ship availability. In July 2021, container ship supply was 11 percent lower than the previous September. The situation was exacerbated by the limited availability of steel container boxes, as surging demand to restock inventories amid shipping disruptions left thousands of boxes at sea, in freight hubs or in ports.[76] The dislocation contributed to skyrocketing costs and undermined brands' efforts to keep pace with demand. In response, some turned to air freight and trans-continental rail alternatives, leading to new capacity jams, longer waiting times and rising costs in air and rail freight, too.[77]

Alongside logistical challenges, fashion and shipping companies are facing a range of new regulatory and trade hurdles. Among incoming regulations is the EU's proposal for a world-first carbon border tax and new restrictions on emissions from ship engines. Companies must manage these alongside challenges such as import bans from China's Xinjiang region.[78] For companies shipping between the EU and the UK, Brexit adds new layers of paperwork and customs delays. Equally, ongoing trade tensions between the US and China threaten to exacerbate supply chain disruptions.[79]

In 2021, the vulnerability of maritime chokepoints was highlighted by the Suez Canal blockage, when a container ship became wedged in the canal, preventing shipping in both directions. The six-day event delayed the transport of billions of dollars' worth of goods.[80] Though such events are rare, they demonstrate the industry's reliance on a limited number of supply routes. "[With] the Panama Canal, there's always a threat of closure, either by accident, or maybe intervention by government and other factors too [but]… what happened in the Suez Canal… is a call to action that we need to identify and build contingencies. Given what's going on, overland freight [via train between China and Europe] is definitely a viable alternative," said Phi of Li & Fung.[81]

Today, it costs up to six times more to ship a container from China to Europe than it did at the start of 2019, and up to 10 times more from China to the US West Coast.[82] In real terms, shipping a 40-foot container from Asia to the US West Coast cost between $1,600 and $2,100 in July 2019; now it will set companies back between $21,000 and $23,000.[83] Looking ahead to 2022, shipping prices will likely continue to climb and remain above their pre-pandemic levels in the longer term, as shipping companies continue to consolidate and new capacity only slowly emerges.[84]

"What happened in the Suez Canal… is a call to action that we need to identify and build contingencies."

In response, fashion brands may need to abandon the idea that cost increases are hiccups, instead planning for a permanently more expensive logistical future.[85] Still, some fashion players will be more exposed to these factors than others. There may be opportunities for luxury brands to pass on higher costs to customers by raising prices.[86]

Globally, pressure on containers and shipping will continue to require logistics players to deprioritise some shipments, while a lack of road-transport drivers, both domestically and internationally, will exacerbate operational costs and delays. In holding back the delivery of products to stores and homes, these conditions will continue to make it difficult for brands to respond to booming consumer demand. To further complicate matters, customers have become accustomed to super-fast delivery, both online and in store, with delivery delays putting a strain on customer satisfaction,[87] while adjacent trends such as accelerating demand for sustainable materials are putting additional pressure on supply.[88]

In the longer term, brands will need to balance the desire to enhance speed to market with the need to alleviate supply chain pressure. That may mean streamlining production, logistics planning and booking capabilities, as well as putting in place contingency plans and alternative suppliers, while remaining as agile and flexible as possible. To do this, some companies are bringing shipping in-house: in late 2021, companies such as Walmart and American Eagle invested in dedicated container services to avoid third-party shipping congestion.[89] In the last mile of delivery, dynamic rerouting and drone delivery could present alternative solutions to short-staffed last-mile distribution in some circumstances.

At the same time, brands need to work with their suppliers to scale up nearshoring and reshoring activities to build production capacity and safeguard access to raw materials. Indeed, a number of European companies doubled down on nearshoring efforts through the pandemic, moving textile manufacturing from China to Turkey to minimise delays.[90] Over 70 percent of companies plan to increase the share of nearshoring close to company headquarters, and roughly 25 percent intend to reshore sourcing to their headquarters' country, according to McKinsey's Apparel CPO Survey 2021.[91]

"As an industry, we still have too long lead times," said chief executive of PVH Corporation Stefan Larsson. "There is a big opportunity to better match planning and buying to demand, and that's something that we learned when Covid hit. The second-biggest learning is to build resilience into the supply chain now."[92]

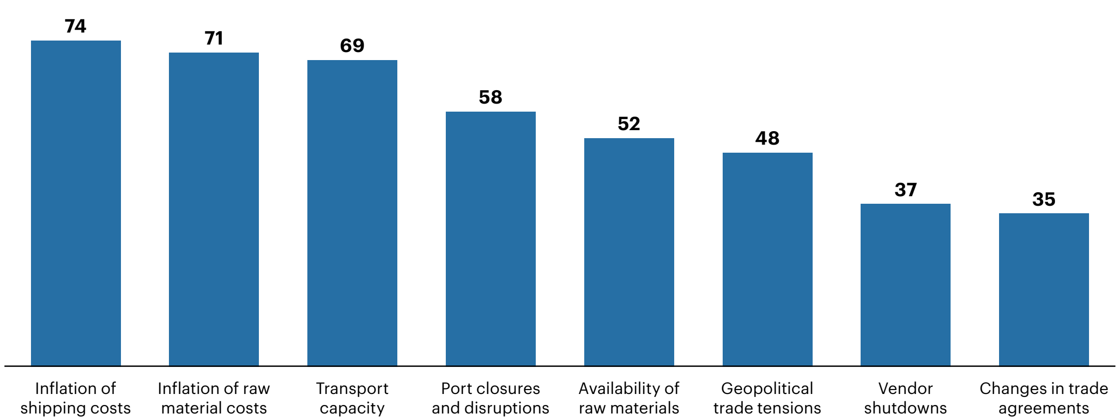
Brands need to work with their suppliers to scale up nearshoring and reshoring activities to build production capacity and safeguard access to raw materials.

Of course, adapting operations and adjusting to rising demand will come at a cost to a company's profitability. Shoe brand Steve Madden

Exhibit 6:

Multiple factors will negatively impact supply chains in 2022, with higher shipping and materials costs as the main concerns

OPERATIONAL TRENDS EXPECTED TO IMPACT[1] SUPPLY CHAINS IN 2022, % OF RESPONDENTS



1 Responded "very high impact" or "high impact"

SOURCE: BOF-MCKINSEY STATE OF FASHION 2022 SURVEY reported that supply chain disruptions were behind a $30-million cut in its first-quarter sales expectations in 2021, while Asos has warned that supply chain pressures and consumers returning to pre-pandemic behaviour could reduce 2022 profit by over 40 percent.[93] There will likely be more profit warnings attributed to supply chain issues in the year ahead.

"It has been difficult to plan inventory flow with much precision… We do not expect those conditions to change any time soon."

Given the hefty bottom-line implications of logistical gridlocks, many fashion executives are working hard to find solutions. "It has been difficult to plan inventory flow with much precision," said Erik Nordstrom, chief executive at Nordstrom. "We do not expect those conditions to change any time soon."[94] Common practical measures have included introducing agile ways of working to improve efficiency, upgraded inventory management, reimagined supply chain organisations (incorporating visibility-enhancing solutions) and technologies such as sophisticated dashboards known as digital supply chain control towers.[95]

As leaders innovate to create efficiencies, there is an imperative for slower-moving brands to expand their focus from efficiency initiatives to digital and operational enhancements which help to better plan and track logistics. In addition, expectations for prolonged logistical turmoil will encourage larger brands and retailers to consider more fundamental solutions. It is likely some will explore cross-functional or even vertical integration, such as bringing distribution or production in-house.[96]

Fashion executives have pointed to further digitisation of supply chain operations as the way forward. VF Corporation chairman, president and chief executive Steve Rendle said that he sees "significant opportunities in creating a hyper-digital supply chain."[97] Meanwhile, H&M Group chief executive Helena Helmersson suggested that a lot of the firm's supply chain development is focused on technology and that it is a priority to find "competitive advantages in a supply chain context when it comes to speed, agility, cost efficiency and price."[98]

With logistics caught in the industry's crosshairs like never before, decision-makers should think carefully about how to adapt. In 2022, brands will aim to regain control of supply chains while communicating potential delays with customers at each step. It will pay to consider control towers, in-house distribution, nearshoring of manufacturing and cutting-edge inventory management, all while securing early access to raw material supplies.

Leading brands will collaborate closely with logistics providers, communicating frequently and expecting that providers will hold more cards in negotiations. To keep a watchful eye on finances at a time of rising supply chain costs, they may also consider using a zero-based budgeting system, requiring all costs to be re-justified at each budget review. In short, as the pressure intensifies, careful planning and a deeper integration of supply chain considerations into decision-making will become table stakes in the year ahead.