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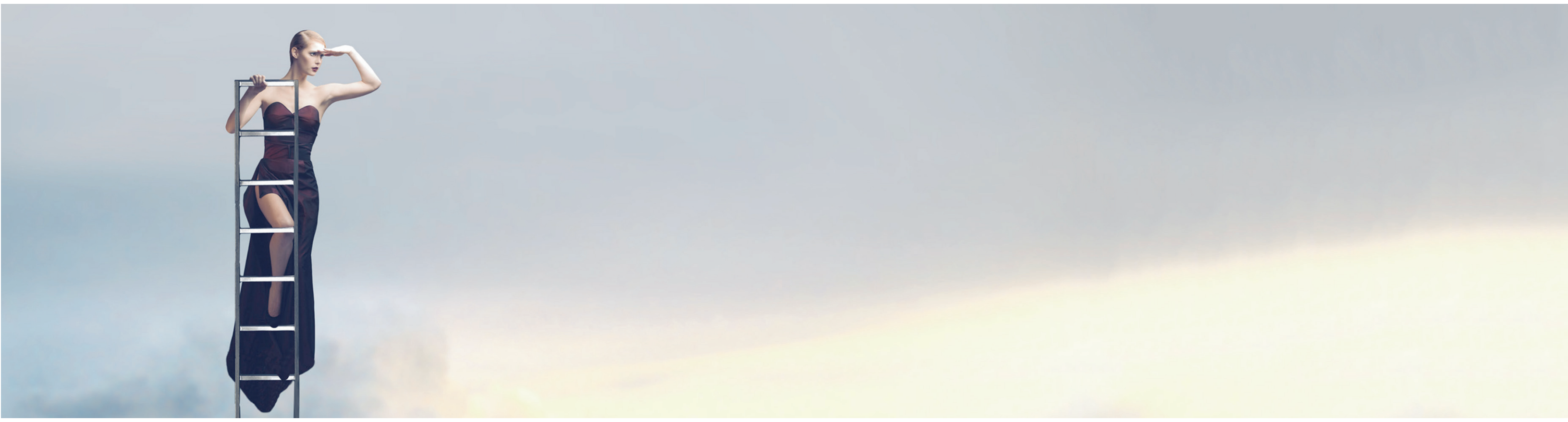

McKinsey's "FashionScope"

Unleashing fashion Growth city by city

The global economy is experiencing an unprecedented shift in power toward emerging-market cities. How will this trend shape the apparel industry in the next decade? How should apparel companies capture the next wave of growth in those markets, which may not be on their radar screen today?

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Key facts

- The women's apparel market growth will accelerate driven by the increasing weight of emerging markets, which by 2025, will account for 55% of apparel sales and 60% of growth
- Top 600 growth cities will account for 62% of women's apparel market's growth by 2025; and 16 out of top 20 growth cities are from the emerging markets
- Mature markets are still important: half of the 20 largest women's apparel markets will remain in the mature markets

Understanding the West-to-East global economic rebalancing

A rebalancing of great scale and speed is happening from West to East and the global economic balance is shifting to emerging markets. In fact, we are observing the most significant economic transformation the world has seen. Twenty-first century China is urbanizing on a scale 100 times that seen in nineteenth century Britain, and at10 times the speed. This means that the shift making Asia the world's economic center of gravity is 1,000 times larger than the Industrial Revolution.

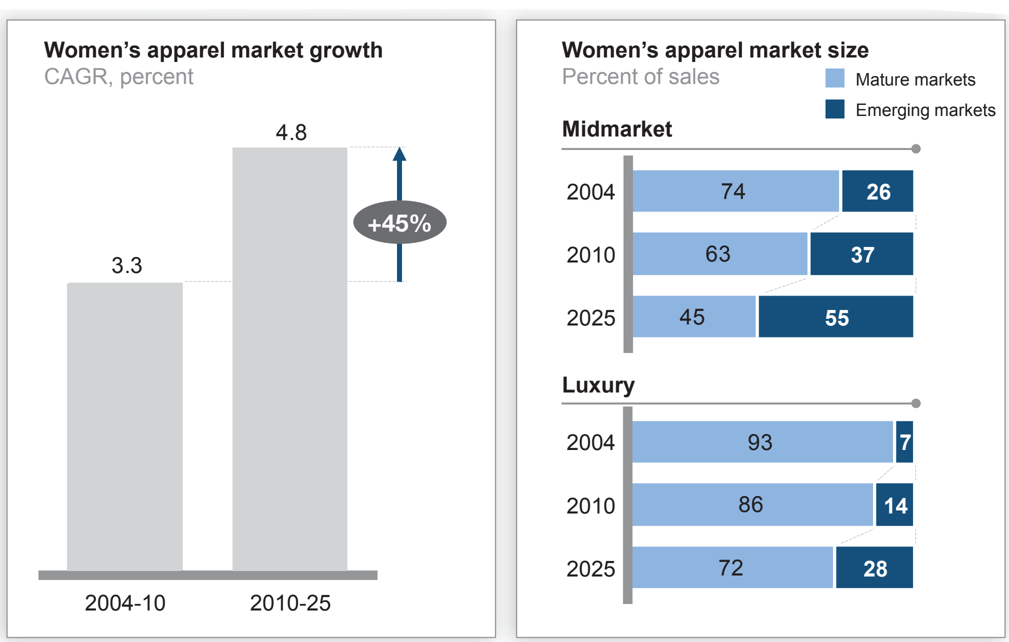
Apparel market growth reflects this great shift

The women's apparel markets reflects this great shift as we observe the same move towards fast-growing markets. For apparel brands and retailers the rebalancing is excellent news as the global women's apparel market growth rate will increase by 50 percent over the next 12 years. Historically the market has grown at just over 3 percent per year; by 2025 the growth rate is expected to approach 5 percent per year. Yet, in most markets the growth rate will slow down and the acceleration is driven by the increasing weight of emerging markets in the total. Emerging markets account for 37 percent of women's mid-market apparel today, but by 2025 their share is expected to rise to over 50 percent. During this time these markets will have grown three times faster than mature markets.

This trend is occurring for mid-market and luxury apparel. In 2004, emerging countries had a share of only about 7 percent in the luxury apparel market; today they account for 14 percent of the market, and by 2025 they will have approximately 25 percent of it. It is worth pointing out that for countries like China and Russia, the local number may underrepresent the importance of the Chinese and Russian consumers due to their intense shopping when travelling nternationally. With the important exceptions of China and Russia, the women's luxury apparel market is and will remain a mature markets game for the next decade. But it is safe to say that the shift eastward has begun **[Exhibit 1].**

Exhibit 1

The growth of the global women's apparel market will accelerate, driven by a shift to the faster growing, emerging markets



Cities are the nexus of growth

Not much attention is being given to one of the most dramatic aspects of the ongoing emerging markets revolution: the growing power of cities and the extreme growth concentration in a limited number of mega cities. The world's top 600 cities (in terms of absolute GDP growth) are expected to drive almost two-thirds of the global economic growth by 2025. Massive urbanization will continue across emerging markets, which will envelope three-quarters of these large cities. In 2025, there will be 60 mega cities — more than double today's number of urban behemoths where GDP will exceed $250 billion, accounting for fully one-quarter of global GDP.

Hundreds of medium-sized cities are experiencing unprecedented growth- especially in emerging markets

Despite the scale of mega-cities like Shanghai, Sao Paulo, and Moscow, we should not miss noticing the importance of the many cities that are not as large, yet very significant. Emerging-market countries have more than 400 of these middle-weight cities and these are expected to account for 50 percent of global GDP growth by 2025. Puene, Harbin, Luanda, Puebla, and many others will be among the top 100 fastest growing cities. Together, those 400 middle-weight cities will within 15 years be generating wealth equivalent to the entire U.S. economy today.

McKinsey's unique tools for understanding the new urban growth paradigm

An important aspect of the growth of these cities is conditioned by very specific factors from city to city. Variables like birth rate, wealth distribution, and level of working women correspondingly affect growth in markets like baby food, luxury products and women's fashion. Companies need to identify the biggest and fastest-growing cities for their particular products and services. To help them do this, McKinsey has developed a proprietary methodology called Cityscope. This methodology builds on broad sets of economic and demographic data for more than 2,600 cities around the world combined with deep market understanding to forecast growth at city level.

FashionScope: analyzing fashion growth at city level

Using the Cityscope methodology, McKinsey has developed an apparel-specific view called "FashionScope," which organizes granular data and statistical forecasting across midmarket and luxury price points.

- **Emerging-market cities are capturing most of the growth:** 70 percent of top growth cities for women's apparel sales by 2025 are emerging market cities. Together these cities will add an additional $100 billion to the global women's apparel market **[Exhibit 2].**

- **Mature and emerging cities will be equally important in terms of absolute size:** Of course there will be some changes in the next decade, with 7 new cities in the top list, including Beijing, Hong Kong, Tianjin, Rio de Janeiro, Guangzhou, Chongqing, and Shenzhen. But the fast growth of the emerging cities does not mean that mature markets are becoming irrelevant. Far from it. When we look at total size, mature-market cities will still have half the women's apparel market worldwide.

- **Market growth has different levels of concentration across segments.** We intuitively know that the luxury market is more concentrated than midmarket across product categories, but thanks to FashionScope the levels of this concentration can be quantified. The top 600 cities will account for 85 percent of the growth in the luxury women's apparel market, versus a 60 percent share in midmarket women's apparel. These figures are in line with overall consumption growth, and more concentrated than FMCG growth, which is estimated to be approximately 40 percent **[Exhibit 3].**

- **Growth is granular and varies by category.** Driven by different factors, midmarket and luxury women's apparel will not grow in the same way across cities. Midmarket women's apparel will grow more dramatically in some cities, like Sao Paulo, while luxury women's apparel will see significant growth in others, like Singapore and Milan. Growth in the luxury markets is still heavily dependent on the mature market, where 70 percent of top-growth cities are located **[Exhibit 4].**

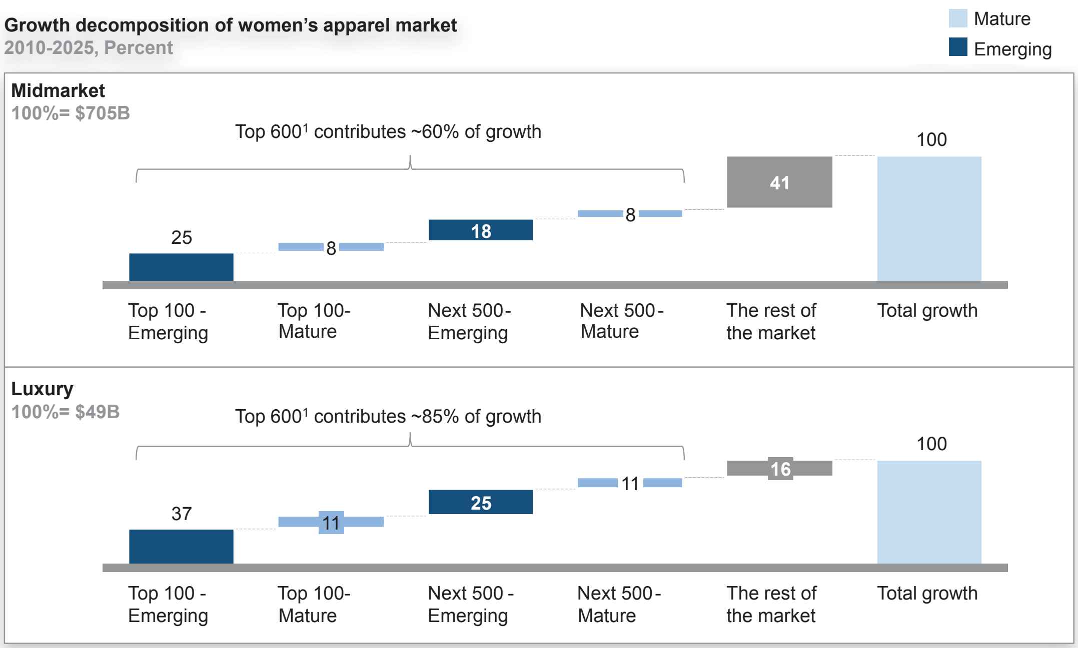
Exhibit 2

14 out of top 20 growth cities are from the emerging markets

1 Ranked by absolute growth in women's apparel sales from 2010 to 2025

Exhibit 3

Growth in the luxury apparel market is more concentrated than midmarket



1 Ranked by absoulte growth from 2010-2025

Exhibit 4

Top 101 fastest growing fashion cities by category

1 Ranked by absolute growth from 2010 to 2025

This extreme growth concentration is great news for apparel brands and retailers. It will enable companies to focus efforts more easily and completely on higher growth areas. Analysis of growth concentration by city reveals extensive remaining growth in the U.S. and Europe, in cities as large as Los Angeles, Paris, or London. Perhaps more importantly, the city approach to growth can be a compass for navigating the great ocean of emerging markets, helping players to prioritize cities and focus resources in targeted market entry plans, whether in Belo Horizonte, Brazil, or Wuhan, China.

Using FashionScope to grow city by city

The city-by-city approach can help apparel companies revamp their growth strategy and bring new insights to their business development models, resource allocation, and organization structures. How can these new business insights on city-level potential be fully leveraged to accelerate your company's growth?

The right plan

We all know that having the right strategic plan is the essential starting point. To build your plan, questions about where to go and when need precise answers. FashionScope can help companies get the right answers in a number of important ways. It identifies growth at the city level, enabling insights on where to concentrate resources to achieve the greatest impact. FashionScope also encourages the development of forwardlooking market intelligence, which a key enabler for keeping strategic decisions ahead of the competition.

FashionScope can thus orient apparel companies towards footprint expansion strategies that take account of the growing importance of city-level growth. Rather than discussing Europe or Asia as alternative destinations, or even the U.K. versus France, companies can now ask themselves, "in what 10 key cities should we next establish a strong presence?"

Outstanding execution to achieve impact

Beyond the plan, outstanding execution is a must to achieve impact. When we help our clients on their international expansion, we collaborate on developing the right answers to a number of crucial questions.

- How should resources be deployed or redeployed? Will assortment and pricing need to be adjusted? How can the brand be quickly built?
- What is right go-to-market model for each location?
- Will organization changes be needed in the long term?
- What is the best approach to acquiring top talent for the new locations?
- How can support from key local stakeholders be optimally locked in?

While these levers are all critical, let us focus on a few that are potentially mostly impacted when considering a city level approach.

Resource allocation — Resource allocation is probably the biggest growth bottleneck for companies seeking to expand their footprint. Financial resource allocation is key and capital and talent need to be invested in the places where your strategy can unfold. Unfortunately we often observe a strong stickiness to existing strategies in Western organizations that want to be on the go. The challenge is even greater for companies that attempt to focus on cities without city-level budgeting, as resources always tend to become diffused. In terms of human resources, it is vital that the best talent is deployed where it will really make a difference. One question we often ask our clients: are you ready to reassign one of your top leaders, who may today be a country head, to become district manager of Shanghai or Sao Paulo? That is the kind of resource allocation that wins in the new world of city-level growth.

The right go-to-market model — When going international, apparel brands and retailers need to design an expansion model that will best suit their needs and the realities of their new footprint. In a world without constraints most would prefer a 100-percent-owned retail store expansion; however, in new geographies, an optimally balanced model needs to be developed, accounting for all pertinent legal, financial and operational constraints, while measuring short-term speed with long-term strategic interests. Smart companies may find it most efficacious to start planting their flags right away with a local partner to benefit from their market knowledge, reduce risk and relieve short-term financial constraints - but they will design in a buy-back option from the start to secure long-term brand control.

Organizational implications — We have many discussions with fashion players about how to organize their “international” divisions. Historically most companies have structured their teams around regions, countries, and then areas within the country where relevant. Obviously, if a new destination is Shanghai, then this logic breaks down, because Shanghai is larger than many countries in which international companies operate. In the new urban paradigm, organizations must account for the fact that managers of operations in megacities are as important or more important than most country heads.

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The global paradigm shift driven by emerging-markets cities is posing similar questions for Western companies for many different industries. For fashion players, cities are mattering more than any other product category. The problems and opportunities facing their strategies are well suited for the application of McKinsey’s new urban analysis tool, FashionScope.

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