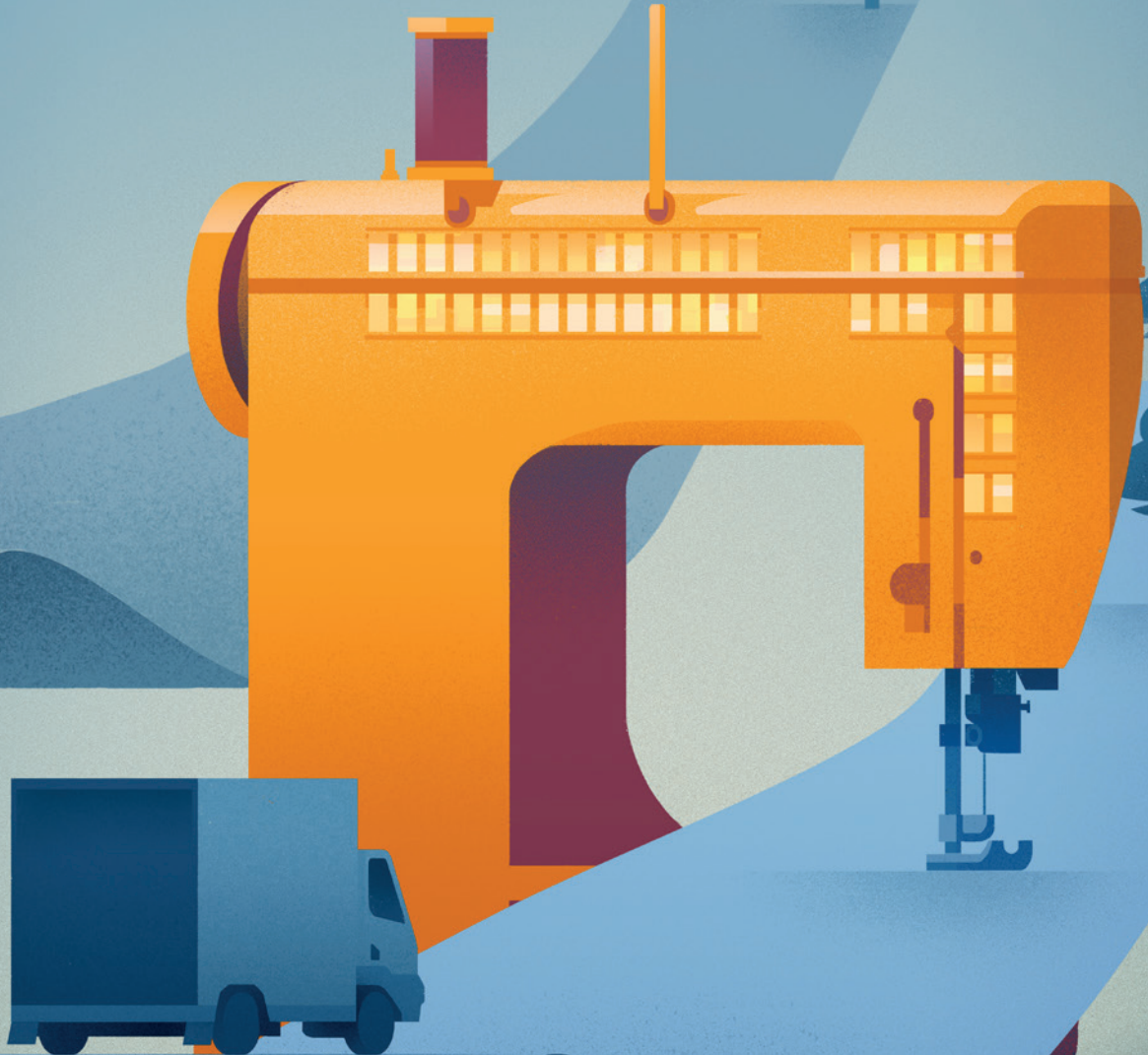


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UNIT

Re-threading supply chains in the lifestyle industry



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Contents

- 3** Executive summary
- 5** Introduction: Hitting the heartland
- 6** Part I. The single source issue
- 9** Part II. Collaboration: walking the talk?
- 11** Part III. Agility, flexibility and resilience
- 14** Part IV. The traceability imperative
- 16** Part V. Sustainable production: greening the lifestyle industry
- 18** Conclusion: Re-calibrating supply chains for the long term

Executive summary

Supply chains in the lifestyle sector (which includes clothing, footwear, textiles, luxury and toys) were already under pressure prior to the 2019 coronavirus pandemic. Environmental sustainability, labour standards and technology adoption were among the internal challenges facing companies, but external headwinds were also complicating factors. Globalisation has been under threat, facing challenges in the form of the US-China trade war, Brexit, rising economic nationalism, and the crisis of the multilateral trade regime and the World Trade Organisation (WTO) itself.

While the pandemic has hit the lifestyle industry especially hard, mapping on to critical production and consumer markets like China and Italy, it should also be a spur for much-needed reforms. The Economist Intelligence Unit, sponsored by Maersk, surveyed 450 supply-chain executives and interviewed a range of experts to garner their views and opinions on the future of supply chains in their industries. Our key findings include:

- **The pandemic exposed existing supply-chain risks.** After decades of focus on “just-in-time” delivery and lowest landed cost, the lifestyle sector, especially the clothing, garments and footwear industries, has quickly realised its supply-chain rigidities. Nearly 40% of respondents source from just one country (outside their own), the survey found; in comparison, just 9% of fast-moving consumer goods companies do the same. This single-country reliance is prompting a

shift towards “multi-sourcing” and greater flexibility.

- **Supply-chain executives are focusing on resilience—and they are using the latest technology to help.** Lifestyle sector respondents were the least likely of the three sectors surveyed to rate their supply chain as “flexible”, and introducing new technology is a resilience-building measure for 39%, the largest grouping. They are betting on new tools from blockchain and satellite technology to cloud computing and collaborative digital platforms to foster resilience-building flexibility. Software start-ups are helping the industry to leverage e-commerce, 3D printing and advanced supply chain analytics.
- **Brands need to collaborate more effectively with supply-chain partners.** Upholding labour standards, ensuring product traceability and managing environmental impact all require high levels of communication and engagement throughout the supply chain. Our survey shows that improving collaboration with supply-chain partners was the second most frequently cited strategic objective, voted for by 26% of respondents, compared with a survey average of 20%. However, the pandemic has seen many brands enact *force majeure* contract cancellations with negative impacts on suppliers. Such moves, combined with ongoing supply-chain governance breakdowns, indicate a gap between objectives and hard realities.

- **Slow fashion, “re-commerce”, fewer seasonal cycles and more use of digital communication are creating a more sustainable status quo.** Fashion, garments and footwear producers have long faced criticism for their negative environmental impact and poor labour standards, but evidence shows that progress is at hand. The pandemic has driven the rise of the

second-hand and the so-called shift to thrift. Brands have reflected on the desirability of constantly refreshing seasonal ranges. Chief sustainability officers have more influence on supply-chain strategies compared with those working in other industries in our survey; however, with a mere 3% of respondents describing them as having a “strong influence”, there is clearly further to go.

About this report:

To find out the main challenges affecting global supply chains, and what this might mean for the future of industries, The Economist Intelligence Unit, commissioned by Maersk, surveyed 450 supply-chain executives across three sector verticals (lifestyle, retail and fast-moving consumer goods) in seven countries—Australia, China, France, Germany, Japan, the UK and the US—spanning four continents. This report focuses on the lifestyle industry, which spans clothing, footwear, textiles, luxury and toys. We would like to thank the following experts for their time and insight:

- Raoul Leering, head of international trade analysis, ING
- Thomas O’Connor, senior director of supply chains, Gartner
- Isabelle Chaboud, associate professor, Grenoble School of Management, France
- Luis Teixeira, chief operating officer, Farfetch

This report was written by Adam Green and edited by Candice de Monts-Petit.

Introduction: Hitting the heartland

Prior to the 2019 coronavirus outbreak, the lifestyle industry was growing at a healthy clip, expected to reach US\$3.3trn in 2030, up from US\$1.9trn in 2019, with the garments and apparel sectors driving job creation in emerging markets across several mass-producing countries, including Bangladesh, Pakistan, China, Vietnam and Indonesia.¹ Luxury goods sales had boomed, owing to expanding affluence in high-growth economies (largely in Asia).² Meanwhile, the sports apparel and footwear sectors benefited from the rising popularity of casual/sportswear hybrid “athleisure” gear, in addition to the growing popularity of sporting events and the brand development opportunities that these bring through sponsorships.

But these industries also faced deep structural challenges in areas ranging from labour standards and environmental impact to evolving sales channels, notably the rise of e-commerce. They were also battling the headwinds to globalisation evidenced in the US-China trade war, the UK's planned departure from the EU and the ongoing struggle of the WTO to define its purpose and direction.³ In addition, foreign direct investment in emerging economies, where a sizeable number of lifestyle suppliers are located, had been in steady decline since the 2008 financial crisis, hindering diversification efforts in these countries, explains Raoul Leering, head of international trade analysis at ING, a Netherlands based bank. He believes that the uncertainty of the current economic crisis is acting as an additional brake on investment in emerging markets.

¹ <https://www.weforum.org/agenda/2020/08/how-the-textile-industry-can-help-countries-recover-from-covid-19/>

² https://www.bain.com/contentassets/8df501b9f8d6442eba00040246c6b4f9/bain_digest__luxury_goods_worldwide_market_study_fall_winter_2018.pdf

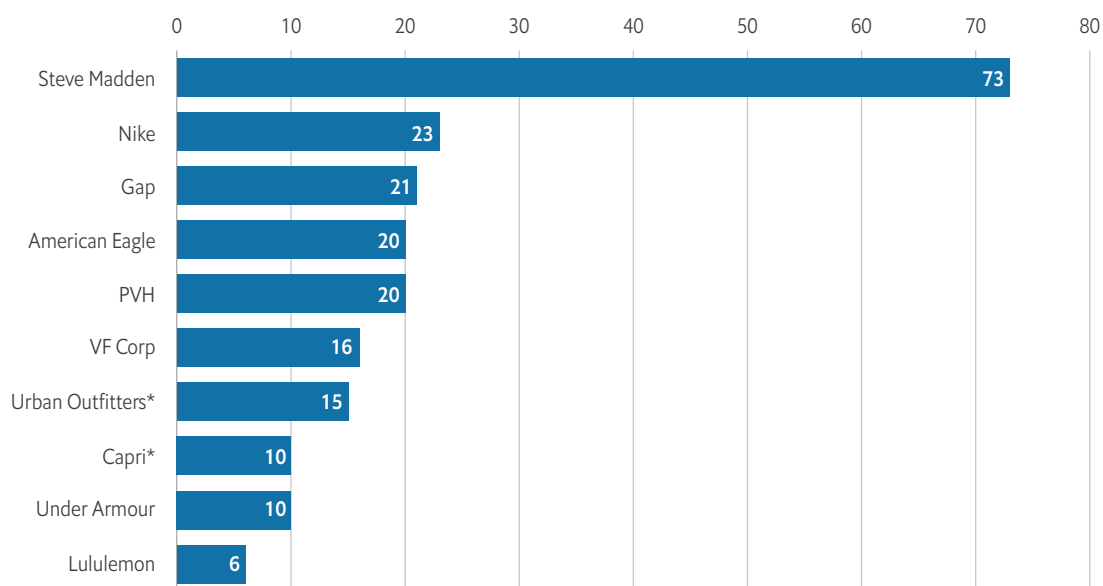
³ <https://www.swp-berlin.org/10.18449/2019C46/>

Part I. The single source issue

The Covid-19 pandemic has revealed further underlying health conditions in the industry, such as a reliance on geographically limited providers and “hidden” risks, such as single-source producers from which multiple supply-chain participants have relied on. Regionally, the huge role of China in global supply dynamics has become clear. In 2003, when SARS emerged, China played a minimal role in global supply chains (it had only joined the WTO two years previously), and during the global financial crisis it was wealthy Chinese consumers who helped to buoy up spending to offset declines in Western markets.⁴

Today, China is a powerhouse producer for lifestyle brands around the world. According to WTO data, China accounted for 39.2% of world textile exports and 30.8% of world apparel exports in 2019.⁵ The country is a major supply source for several US clothing brands, including Nike (23%) and Gap (21%).⁶ In addition, around 85% of toy products worldwide are produced in China.⁷ Since the pandemic began, toy manufacturers in the country have had to radically reduce output due to worker shortages and difficulties sourcing inputs.⁸

Chart I. Sourcing from China
(%)



Source: CNBC/Coresight Research.⁹

* Maximum figures

⁴ <https://www.bain.com/insights/luxury-after-coronavirus/>

⁵ https://www.wto.org/english/thewto_e/minist_e/min05_e/brief_e/brief23_e.htm

⁶ <https://www.cnbc.com/2020/03/16/coronavirus-wreaks-havoc-on-retail-supply-chains-globally.html>

⁷ <https://www.theguardian.com/world/2020/feb/29/coronavirus-chinese-vendors-supply-chains-toy-manufacturers>

⁸ <https://www.wsj.com/articles/coronavirus-upends-global-toy-industry-11582809430>

⁹ <https://www.cnbc.com/2020/03/16/coronavirus-wreaks-havoc-on-retail-supply-chains-globally.html>

As more and more countries entered lockdown in the early months of 2020, other sourcing risks quickly became evident, even for those not relying on the Chinese market. Our survey found that 39% of respondents from lifestyle-sector companies were sourcing from one country (outside their own), compared with a survey average of 28% and an average of just 9% in the fast-moving consumer goods sector. The necessity to move towards selecting suppliers who are based closer to home was also noted, with 25% planning to make major changes to their sourcing footprint. However, trade experts caution against a knee-jerk reshoring response.

“The business community has been too quick to conclude that we should be “reshoring” because we are too dependent on global supply chains,” says Mr Leering. Disasters can happen at home too, he says, citing floods that struck the Netherlands in 1995 and the Ebola outbreak in Africa, a region touted as a new manufacturing base closer to Europe.

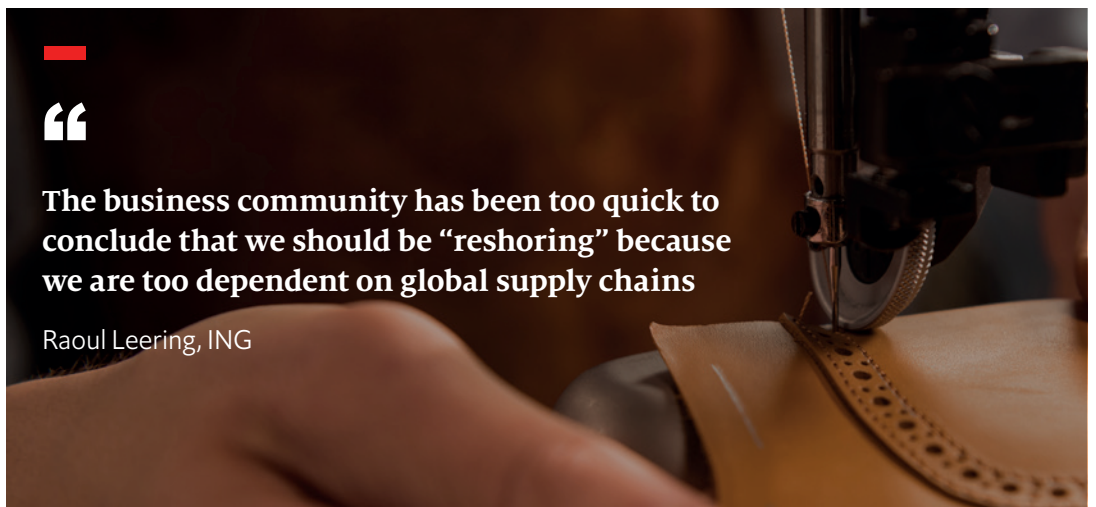
“In the end, we’re talking about businesses maximising profit, so this will come down to a cost-benefit analysis, and the benefits are uncertain. We don’t know when or where the next disaster is going to hit us.”

Sourcing strategies, be it multi-sourcing or “near-sourcing”, will ultimately depend on the economics of the particular case. One shift that Mr Leering foresees is improved competitiveness in the garment and textiles market in both Europe, and North and East Africa, where workers are often less closely packed together. “If there is a 1.5-metre distance rule, this will be a larger cost disadvantage for companies in parts of Asia, like Bangladesh, and could be an impetus for near-shoring,” he says. But other factors could work against certain regions emerging to take a greater share of production, such as traceability. “If you have complex global value chains you need to be able to monitor every step of the production company, so communication technology is very important.



The business community has been too quick to conclude that we should be “reshoring” because we are too dependent on global supply chains

Raoul Leering, ING



In some African countries that is still not developed enough to be sure that you get your supplies on time.”

Geopolitical risk will also shape supply-chain diversification decisions. In December 2019

Hasbro, a US toy-maker that manufactures the majority of its products in China, was already reporting to shareholders a desire to further diversify its supply chains owing to US-China tensions and tariff uncertainties.¹⁰



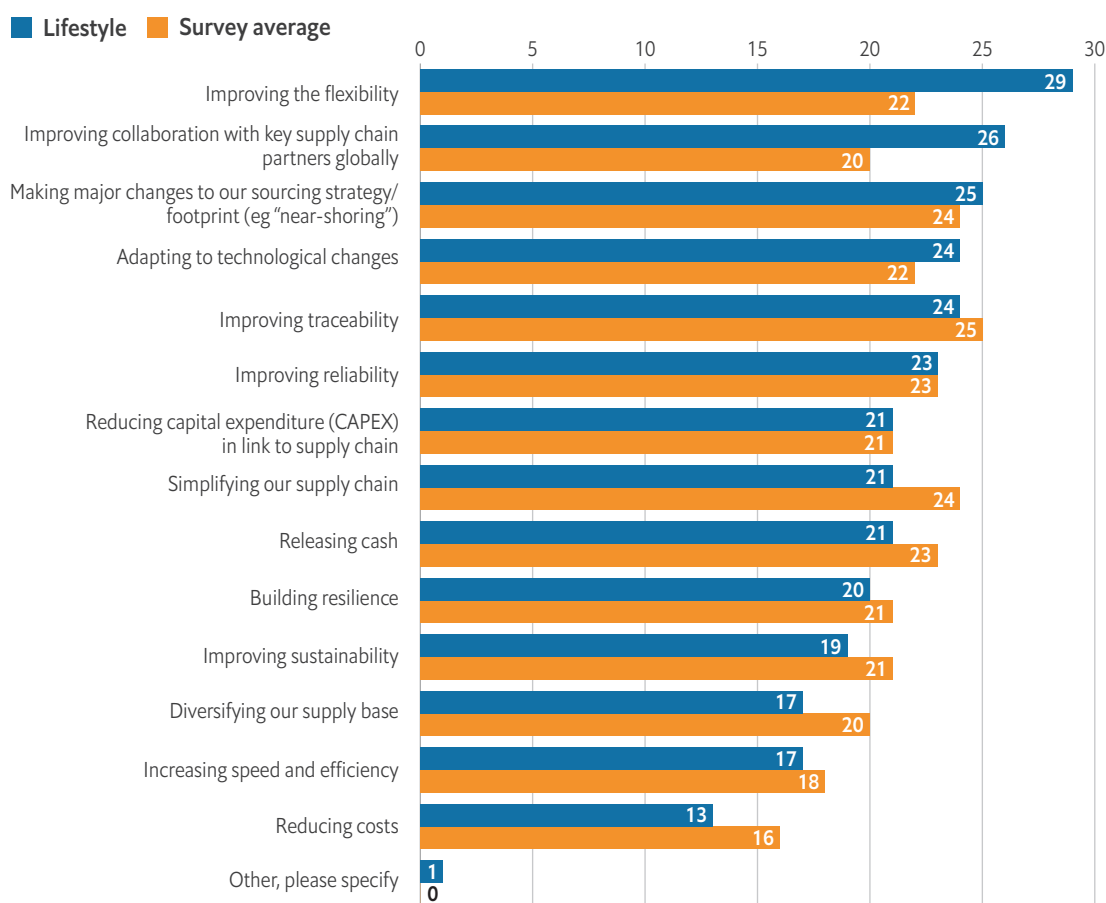
¹⁰ <https://investor.hasbro.com/node/31781/html>

Part II. Collaboration: walking the talk?

Our survey found supply-chain partner collaboration to be a priority for executives: it was selected as the second most important

strategic objective by 26% of lifestyle respondents, compared with a 20% survey average.

Chart II. Strategic objectives of lifestyle supply chain executives (%)



Source: The Economist Intelligence Unit.

The collaboration imperative can be seen as a result of poor governance in parts of the fashion sector. The 2013 Rana Plaza factory collapse in Bangladesh triggered a wave of social media campaigns under hashtags such

as #whomademyclothes. Issues still weigh on the sector, as evidenced in the recent "dark factory" controversy involving a fast-fashion supplier in the UK city of Leicester.¹¹

¹¹ <https://www.bbc.co.uk/news/business-53305006>

The Covid-19 pandemic has seen communication breakdowns that have resulted in some European and American brand retailers invoking force majeure clauses to cancel orders. A March 2020 survey of suppliers in Bangladesh, a key sourcing country, found that more than half had the bulk of their orders cancelled, with 72% of buyers refusing to pay for raw materials and 91.3% of buyers refusing to pay for production costs.¹² As a result, more than 1m garment workers were fired or furloughed, with 98% of buyers refusing to pay for the partial wages of furloughed workers, despite legal requirements. By June 2020, 1931 brands had delayed, put on hold or otherwise cancelled US\$3.7bn worth of orders in Bangladesh.¹³ Industry associations across Asia issued a joint statement calling for contracts to be honoured and for brands to work together with suppliers to find a way through the crisis.^{14, 15}

The initial pandemic-driven shockwave having abated, there has been good dialogue and partnership, with some major brands,

including Nike, Adidas, H&M, Primark and UNIQLO committing to pay in full for orders completed and in production.¹⁶ Paul Marchant, Primark's CEO, said publicly that order cancellation was essential to short-term survival but that, as a reopening timetable emerged, the company was able to prioritise dedicating more funds to support the supply chain, including establishing a wages fund and a commitment to taking an additional £370m (US\$486m) of orders in April. Once trading restarted, the company was able to place orders worth £1.2bn (US\$1.6bn) with its suppliers.¹⁷

The extent to which this is backed by action depends in part on the financial health of companies going into the crisis. "You've been able to see the difference between businesses that were in a strong financial position compared to those that were not," says Thomas O'Connor, senior director of supply chains at Gartner, a research and advisory firm. "Those in a stronger financial position have been able to more effectively invest in those suppliers they see as critical to their restart operations."



¹² <https://www.workersrights.org/wp-content/uploads/2020/03/Abandoned-Penn-State-WRC-Report-March-27-2020.pdf>

¹³ <https://www.business-humanrights.org/en/latest-news/bangladesh-1931-brands-have-delayed-cancelled-37bn-worth-of-orders-from-garment-factories-during-covid-19/>

¹⁴ <https://unctad.org/en/pages/newsdetails.aspx?OriginalVersionID=2380>

¹⁵ <http://www.asiatex.org/ennewss/393.html>

¹⁶ <https://www.workersrights.org/issues/covid-19/tracker/>

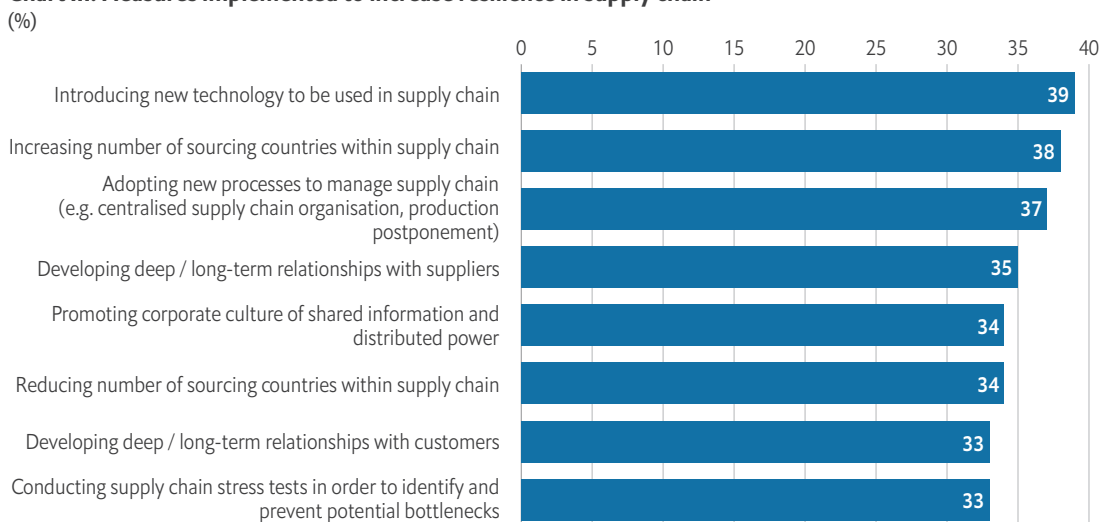
¹⁷ <https://www.primark.com/en/primark-cares/newsroom/primark-commits-to-pay-for-outstanding-finished-goods-and-suppliers-fabric-liabilities/a/e1f1caa6-a434-4aba-9463-2e12d251fb2d>

Part III. Agility, flexibility and resilience

Our survey shows strong interest among lifestyle executives in more flexible and technology-driven supply chains. Although respondents from the lifestyle sector were the least likely of those in the three sectors surveyed to rate the flexibility of their supply chain highly, nearly two-thirds (65%) agree

or strongly agree with the statement that flexibility is a key differentiator in building supply-chain resilience. Thirty-nine percent of respondents cited introducing new technology into supply chains as a resilience-building measure in recent years, making it the most widely employed measure.

Chart III. Measures implemented to increase resilience in supply chain



Source: The Economist Intelligence Unit.

The Covid-19 crisis has shown that some brands are capable of more flexibility when under pressure. For example, certain firms quickly rebalanced global inventory to focus on stronger markets and move away from countries hitting a trough, in terms of infections and lockdowns. Although the growth of e-commerce is a major challenge for more than a third of respondents to our survey, the industry has moved online at an unprecedented speed this year. Once stores were forced closed and physical retail became

impossible, brands had to find ways to sell inventory—in some cases by moving online for the first time. These firms were aided in doing so by the presence of e-commerce platforms that gave them the means to reach consumers. The experience mirrors the SARS crisis, which was a turning point for Asian e-commerce that led to platforms like Taobao and JD.com going mainstream.

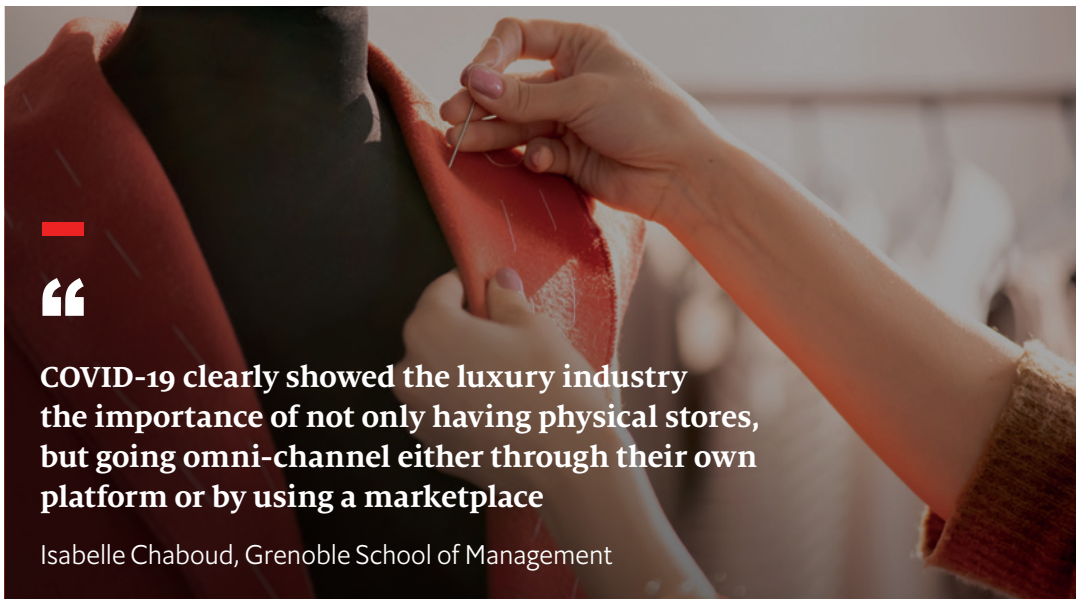
Farfetch, a British-Portuguese fashion e-retail platform, was already an industry darling

before the crisis, offering luxury brands an e-commerce channel while maintaining product authenticity. In the second quarter of 2020, it posted a 48% year-on-year increase in gross merchandise value to reach US\$721, says its chief operating officer, Luis Teixeira. “The investments we made to build the global platform for the luxury fashion industry have been paying off, with features such as global logistics capabilities, geo-diversified supply network and localised services enabling continuity,” he says.

“COVID-19 clearly showed the luxury industry the importance of not only having physical stores, but going omni-channel either through their own platform, if they can create their own, or by using a marketplace,” says Isabelle Chaboud, associate professor at the Grenoble School of Management in France. “The problem of authenticity was extremely

important, but [firms] are seeing this as a way to increase sales. In the future, I think more and more luxury brands are going to develop their own platforms, so they can authenticate products”.

New technologies such as 3D printing and cloud software have also enabled supply-chain flexibility. Software start-ups are connecting brands and partner factories by providing tools for design, sourcing, trim selection, order management and delivery, along with real-time status dashboards. Supply Compass, a UK-based start-up, provides a software-as-a-service platform allowing brands to design collections and find trusted manufacturers.^{18, 19} The company also launched a new initiative allowing factories to sell fabric from previously cancelled orders, reducing waste and economic losses.²⁰ Another platform, Unmade, lets



¹⁸ <https://techround.co.uk/news/supply-compass-launches-full-service-platform/>

¹⁹ <https://www.forbes.com/sites/brookeroberthislam/2020/04/13/designer-and-supply-chain-digital-revolution-how-covid-19-is-changing-the-fashion-industry/#408853aa7ccc>

²⁰ <https://supplycompass.com/blog/fashion-supply-chains-emerging-out-of-covid-19/>

manufacturers shift production sites; shoe brands including US-based New Balance have used it to facilitate moving from one factory to another digitally.

Such start-ups are pitching their wares at a high-demand market. Our survey found that inefficient supplier selection and evaluation—which was selected as the most important internal risk factor by 10% of lifestyle respondents, compared with a survey average of 7.8%—was the most likely internal risk factor to impact supply chains in the coming one to three years. Further findings showed a broad interest in a range of other resilience-boosting technologies, with 82% believing that blockchain can build supply-chain resilience, while 81% thought the same about collaborative platforms and advanced analytics, 80% about AI, 77% about

cloud applications, and 73% about satellite technology.

Flexibility is part of the resilience imperative. For decades, many segments within the lifestyle industry built their supply chain strategy on “lowest landed cost”, which means calculating the geography and production route that amounts to the lowest total price of a product once it arrives at a buyer’s doorstep. Although this made sense from an economic perspective, it sparked a “race to the bottom” and the rise of low labour standards in parts of the industry. Mr O’Connor believes that the pandemic has revealed risk across these areas that companies may not have realised they had. “Covid has shown that a company might buy materials from several businesses, but the final source is a single supplier. It has focused attention on single failure points that [firms] might not have noticed in the past.”

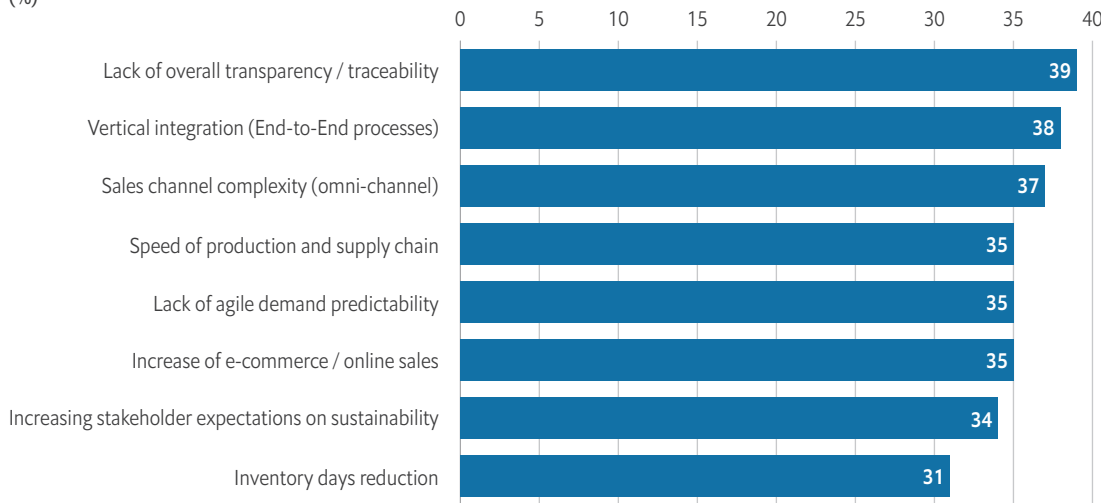
Part IV. The traceability imperative

Resilience depends on visibility of risks, yet lack of transparency and traceability was the most commonly cited challenge facing lifestyle supply-chain executives in our research.

This is despite noticeable progress in recent years. Initiatives such as the 2016 Transparency Pledge, intended to demonstrate the commitment of apparel and footwear companies to manufacturing supply-chain transparency through a common

minimum disclosure standard, has aligned companies including Benetton, C&A, Levi Strauss, New Balance, New Look, Next, Nike, PVH Corporation and VF Corporation. The 2020 Fashion Transparency Index found that 40% of the 250 companies surveyed publish supplier lists (up from 35% in 2019) and 24% publish lists of processing facilities (up from 19% in 2019); only 7% publish suppliers of raw materials (up from 5% in 2019).²¹

Chart IV. Main challenges that lifestyle supply chains are facing
(%)



Source: The Economist Intelligence Unit.

Companies are looking to technology such as blockchain to boost transparency and traceability. Fashion designer Martine Jarlgaard, for instance, collaborated with Provenance, a blockchain technology company, using its app to track sustainable alpaca fleece from shearing to finishing,

creating a “digital history of the garment”.²² Babyghost, a US fashion brand, partnered with BitSe, a Blockchain-as-a-Service company, during Shanghai Fashion Week in 2017, embedding garments with scannable chips, each of which delivered interactive information about the piece and its journey.²³

²¹ <https://www.fashionrevolution.org/about/transparency/>

²² <https://www.provenance.org/case-studies/martine-jarlgaard>

²³ Perez et al. (2020) ‘Traceability of Ready-to-Wear Clothing through Blockchain Technology.’



The 2020 Fashion Transparency Index found that 40% of the 250 companies surveyed publish supplier lists

Others are strengthening traceability by taking ownership of materials supply directly, as evidenced in Chanel's purchase of a tannery to secure its access to leather.²⁴ "The supplier had been working with Chanel for ten years. They realised they needed a solid partner to have long-term sustainability, and Chanel needed to secure their supply of quality leather," says Ms Chaboud. "Italian leather is among the best in the world and the quality of raw materials is important, especially since Chanel stopped using precious leather and crocodile in recent years".

Companies have looked to re-shore manufacturing, as with LVMH opening a new factory in Texas to shorten its supply chain to the American market.²⁵ Ms Chaboud predicts a further shift towards "near-shoring" in luxury. This is reflected in our survey, with 37% of respondents planning to move towards a near-sourcing model, citing increased flexibility (55%) and stronger relationships with suppliers (49%) as top advantages.

²⁴ <https://excellencemagazine.luxury/2020/08/chanel-strengthens-its-supply-chain-in-leather-with-the-purchase-of-conceria-gaiera-giovanni/>

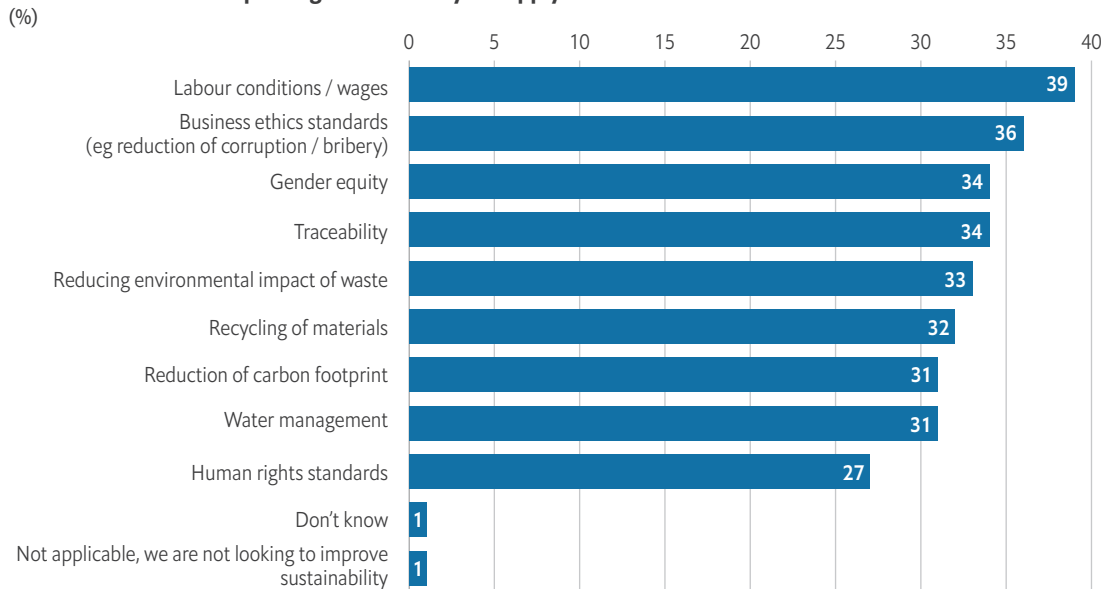
²⁵ <https://www.thecut.com/2019/10/why-is-louis-vuitton-opening-a-factory-in-texas.html>

Part V. Sustainable production: greening the lifestyle industry

The fashion industry has faced particular criticism for labour conditions and gender inequality, as well as environmental damage, from accelerating “fast fashion” cycles to causing pollution and product waste. This is

reflected in companies’ priorities in terms of improving the sustainability of their supply chain, with labour conditions, wages and business ethics viewed as prime concerns.

Chart V. Priorities in improving sustainability of supply chains



Source: The Economist Intelligence Unit.

Consumer interest in environmental impact is surging, along with stakeholder pressure : internet searches for “sustainable fashion” tripled between 2016 and 2019, and hits on the Instagram hashtag #sustainablefashion quintupled between 2016 and 2019 in the US and Europe.²⁶ There is also evidence of growing board-level concern. According to a 2019 Accenture survey, 38% of CEOs in the fashion sector implemented sustainability

measures within their operations in 2019.²⁷ Brands are also setting quantitative targets; for example, VF Corporation, which owns multiple brands in the outdoor and work sector, aims to reduce greenhouse gas emissions from its operations by 55% between 2017 and 2030.

However, despite some positive steps, our survey found that chief sustainability

²⁶ https://www.mckinsey.com/~/_media/mckinsey/industries/retail/our%20insights/fashions%20new%20must%20have%20sustainable%20sourcing%20at%20scale/fashions-new-must-have-sustainable-sourcing-at-scale-vf.ashx

²⁷ https://www.accenture.com/_acnmedia/PDF-115/Accenture-Threads-That-Bind.pdf



officers are not yet sufficiently influential in setting supply-chain strategies. A mere 3% of respondents described chief sustainability officers as having a strong influence, compared to a global survey average of 4%. The Covid-19 pandemic might quicken progress, with a noticeable “shift to thrift” as shoppers look to bargain-hunt from home, notably for second-hand goods. Even as purse-strings tightened, thredUP, an online platform for second-hand sales, recorded 20% year-on-year growth in transactions between

mid-March and May 31st 2020; an aggregate list of online competitors saw an average contraction of 24%.²⁸ According to a joint report produced by GlobalData and thredUP, the global resale market is predicted to double in size over the next five years, from US\$28bn to US\$64bn.²⁹ This prospective growth has seen new capital directed to the sub-sector: in April 2020 Vestiaire Collective, a global platform for fashion resale, secured US\$64m in investment to expand its global shipping network, highlighting growing investor interest in circular supply chains.³⁰

²⁸ <https://www.thredup.com/resale/#resale-growth>

²⁹ *ibid.*

³⁰ <https://www.crunchbase.com/organization/vestiairedecopines>

Conclusion: Re-calibrating supply chains for the long term

After the hardest year in its modern history, the lifestyle sector is beginning to emerge from the pandemic, with forward-looking companies taking the opportunity to make long-needed changes, from achieving more resilient, multi-sourced and technology-enabled supply chains to improving sustainability. Although clouds still hang over the industry, especially as new lockdowns are introduced and new waves of Covid-19 threaten to reignite the outbreak, some of the changes now being made are addressing longstanding problems, from traceability and flexibility to the need for more collaboration with supply-chain partners. The last six months have also shown what is possible when there is will and a break from status-quo thinking, says Mr O'Connor: "We've seen huge levels of agility in supply chains, which companies probably didn't realise was there pre-COVID".

While every effort has been taken to verify the accuracy of this information, The Economist Intelligence Unit Ltd. cannot accept any responsibility or liability for reliance by any person on this report or any of the information, opinions or conclusions set out in this report. The findings and views expressed in the report do not necessarily reflect the views of the sponsor.

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