Next Generation Operating Model

How to shift from surviving to thriving

April 2023

OC&C
Strategy consultants
Traditional operating models are under pressure from many directions – cost inflation, rising complexity across consumer touchpoints, skills shortages and rising consumer expectations – which is leading to margin pressure.

Increasing consumption, and therefore volumes, has provided some relief to the industry, however as ESG becomes more critical volumes are likely to stagnate or decline, increasing the pressure on existing models.

In this new context, it is essential for brands to start on a journey of evolving their operating model to be more fit for future.

We see 7 key themes to future winning operating models –

- Diversified revenue streams
- Purpose-led
- Close to Customer
- Strong Employee Brand
- Circular Economy
- Collaboration
- Technology Enabled

The journey and speed will look different for different brands but having a clear view on the evolution required is critical.
Traditional retail & fashion operating models are under pressure from all directions

- Cost inflation is still at record levels; c.9% in January 2023
- The number of consumer touchpoints has doubled in the last 5 years
- 80% of businesses are unable to meet customer demands due to too few staff
- 63% of customers seek companies that prioritise things that they care about
These challenges will be compounded as volume growth slows and stagnates; there won’t be anywhere to hide.

What does the future look like?

- *Expected US & UK apparel market real decline of c.0-1%pt pa 22-27*
- *50% reduction in items bought to meet UN emissions targets*
- *Global secondhand clothing market worth c.$218bn by 2026, growing at c.18%pa*
The winning model blueprint is not yet clear; there are a number of key themes that will be critical for future successful operating models:

- **Purpose Led**: Ever-rising consumer expectations are driving a need for a strong brand that resonates and stands for more.

- **Strong Employee Brand**: Being an attractive employee brand with flexible working models and strong values is increasingly important to potential employees, in the context of a skills shortage.

- **Technology Enabled**: With the ever-changing complex environment and rising costs, technology will be key to simplify and drive efficiency.

- **Collaboration**: Given complexity of the fashion & home environment, it is impossible to do it all yourself. Using partnerships to fill capability gaps will be key.

- **Circular Economy**: The fashion industry has a significant impact on all aspects of ESG, transforming all or part of the operations to be circular is key.

- **Close to the Customer**: Data-led understanding of what customers want and matching content, product and production to this is key to engagement, maximising margins and reducing waste.

- **Diversified Revenue**: Retailers can no longer rely on growing volumes to grow revenues, and must diversify.

See Appendix for more details.
Practically, there are an evolved set of processes underpinned by these themes that address some of the major challenges in the model today.

Processes that are **circular** and underpin a business that **stands for something**

**Resilient and adaptable supply chain** that is flexible to pressure and withstands changes

Products that are **made (almost) to order** and in real time based on true customer demand to reduce waste

Underpinned by **robust, automated and data-driven systems** that enable and support staff and brand performance

A collaborative culture throughout the business, within **teams**, with **suppliers** and with **partners** to fill gaps
A number of brands are already bringing this to life

**BAUKJEN**

**Designed for Good**

“Champions of slow fashion” — the brand is a top 5% B Corp and aims to balance profit and purpose. They aim to be circular and zero-waste, using sustainable fabrics, plastic free packaging, and with second hand and rental clothing.

They support small facilities, and work in partnership with family run suppliers.

Ensure all facilities are well-vetted and adhere to codes of conduct.

Baukjen has diverse revenue streams including first hand sale, clothing rental model and second hand lines that contribute towards a more circular footprint and insure against future volume declines.

**MAIDEN HOME**

Products are made to order, ensuring no waste and zero excess inventory.

Additional revenue streams include design services, partnerships with trade professionals and project management services.

Affiliates are used for marketing, promoting the brand on socials in exchange for commission of sales.

Handcrafted to order

Trusted Design Advice

Premier Benefits

Best for the World 2021

PRE-LOVED

RENTAL
Although this is a longer term strategic journey, there are a set of key questions to start to build a view on now:

- Are we clear on the shape of our future operating model that will set us up for success?
- How will we win in a context of stagnant / declining volume?
- Where do we need / want to move faster, vs where can the evolution be at a slower pace?
- Where will technology enhance our ways of working and create efficiencies and the greatest ROI?
- How are we working with our supply chain to limit our resource consumption and produce more responsibly? How does this flow through our operations?
- Where do we want to partner to enhance our capabilities vs deliver ourselves?
- Do we have the hard and soft skills in the organisation to take us on this change journey? How do we
Practically there are some key steps to developing the right approach…

- Decide where you want to play on the scale of fast adopter to follower
- Map your operating model & identify pain points
- Understand cost to serve, ROI and areas of greatest need & financial benefit
- Define strategic options and prioritise
Appendix: Data & Examples
Some brands are already offering integrated reselling platforms for second hand clothing in good condition.

Multiple brands are partnering with rental platforms for additional, more circular revenue streams.

Driving new revenue streams will likely insulate businesses from contractions in industry volumes.

Rental & Resale

Repair services are an increasingly common add-on service, either offered through partnerships with repair apps.

Additional services such as styling and food.

Brands can also offer their technology / platform as a service to other brands, listing their products on their website.

Services

Orders paid on account, and interest paid on payments not paid off at the end of each month.

Allows users to delay payment up to a year, paying interest on cash payments not made before end of delayed payment period.

Credit Options

Brands are starting to launch virtual fashion shows, where virtual models exhibit new clothes and technologies. Virtual allows brands to interact in more detailed ways and to showcase products in ways that are impossible to replicate in reality.

Brands are also expanding into NFT sales.

Virtual Realm

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GANNI
SOJO
FARM GIRL
DUCK&DRY
FARFETCH
NEXT

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Staying close to the customer through data and flexible supply chains is essential for ensuring reduced waste, better margins and customer relevance.

In order to produce only products that customers want...

- **c.20% of excess stock was written off altogether by apparel sellers in 2022, with dangerous ramifications for cashflow.**

- **Improving buying processes can lead to +1-3% contribution margin, and 5-15% reduction in overproduction.**

- **Improving planning, buying and sourcing can cut CO₂ emissions by c.3%.**

... Brands must be demand led, and reconfigure the planning, buying and sourcing model

- **Boohoo and Fashion Nova use test and repeat model, creating small ranges to test customer demand before ordering large batches.**

- **Shein has grown to c.40% market share in the US using small batches on c.1 week lead times, combined with analytics scraping socials / shopping websites.**

- **Zara operate a fully integrated end to end planning platform, which enables automated store level range planning with lead times of c.2-3 weeks.**

- **New ranges are created monthly with short lead times and each merchandiser is responsible for overseeing c.60 stores.**

- **At the extreme end of the spectrum, Stòffa luxury menswear produces c.90% of its clothing to order.**

- **Requires relationships with manufacturers who are willing to work in this way, which is different to majority of current supply chains.**

- **Growth has been 25-70% YoY.**

Source: OC&C & WDSN, OC&C analysis
Traditional fashion brands and retailers are starting to test circular customer proposition across the full model, or on specific elements eg hangers.

H&M offers a third party service with collection bins for customers to recycle apparel; Nike customers can drop off apparel and trainers from any brand to recycle.

Vivaia uses plastic bottles to create sustainable shoes and handbags, so far recycling over 1.8m plastic bottles.

Re-sale platform called Circularity allows customers to buy overstock and used items at reduced prices.

Clothing engineered in 50 sizes to ensure customers find perfect fit, quality is high and styles are designed in capsule style to reduce the number of items needed.

Created “infinite tee” out of 100% Infinna, a textile made from 100% textile waste, broken down to a molecular level and then re-used.

Gives clothing and accessories a new lease of life, e.g. repairing holes, cleaning and restructuring products to reduce need to replace.
Enhanced technology, data and systems is at the heart of transformation and enabling more efficient management of the rising complexity.
Blockchain could also provide an exciting avenue for using technology to protect intellectual property, and allow customers to see product lifecycles.

**Supply Chain Transparency**
- Fashion brands could use blockchain to track the movements of raw materials to finished products, allowing them to verify the origin and authenticity of materials.
- Records are collected in a blockchain with a unique cryptographic code, linked to the previous block in the chain.

**Anti-Counterfeiting**
- Blockchain can create digital certificates of authenticity tied to each unique product, that cannot be duplicated or altered.
- This allows customers to verify authenticity, and prevent counterfeiting of e.g. luxury goods.

**Loyalty Programmes**
- Blockchain technology can increase the security of a loyalty programme, ensuring that rewards are earnt and redeemed in a transparent manner, with no need for banks or credit card intermediaries.

**Examples**
- H&M and Givenchy have partnered with VeChain to prevent counterfeiting.
- LVMH have formed a blockchain based platform called Aura.
- Louis Erard have a blockchain based loyalty scheme with Qiibee that allows fans to track transactions, and pick rewards.
- Partnered with Bolt Threads to create a dress made from sustainable, lab growth fabric, that allows customers to trace through to source.

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Consumers of today care more than ever about a brand’s values…

Abandoned Fashion Purchase as Brand Did Not Reflect Values, % Respondents

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<thead>
<tr>
<th></th>
<th>2021</th>
<th>2022</th>
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<tbody>
<tr>
<td>GenZ</td>
<td>40%</td>
<td>47%</td>
</tr>
<tr>
<td>Millenials</td>
<td>34%</td>
<td>33%</td>
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…so brands must stand for something more, and create a community for customers

**Gymshark**

- Strong social media use (brand and user generated content) and community focussed on exercise (e.g. Gymshark app & World Tour)
- Now reaches c.10 million customers, and is valued at c.$1.4bn

**Charlotte Tilbury**

- Brand focussed on inclusivity and the founder’s vision / story on the “transformative power of make-up” on self-confidence

**Allbirds**

- Footwear brand focused on sustainability of materials (provenance, recyclable) without compromise on performance or style

**Glossier**

- Strong use of user-generated content (brand reps), co-creation of products with most engaged fans, marketing focussed on community
- 70% of online sales come from peer-to-peer referrals

Source: Desk research, Allure, Drapers, OC&C analysis
It is more important than ever to have a purpose and more flexible models that appeal to potential employees; the best talent is key to success.

Hiring and retaining staff is increasingly challenging…

- Retail vacancies have increased by >70% from Feb 2020 – Aug 2022
- Retail pay in the UK has risen at double the national average in 2022 (5.5% vs 2.7%)
- LVMH is looking to fill 30,000 positions by 2024 driven by specialised personnel leaving the fashion sector

… as employees demand more from a flexible model of work

<table>
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<tr>
<th>Flexible Working</th>
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| Patagonia offers your own working hours, every other Friday off, and childcare facilities on site (and nannies on company trips) are all offered by Patagonia to support parents.

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<th>M&amp;S (EST. 1884)</th>
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| Retail managers can work their hours over 5 days, over a 4 day week, or a 9 day fortnight to allow increased flexibility. Job Share finder to improve access to shares.

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<th>Additional Benefits</th>
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| Farfetch offered flexible working since 2013, 32 days of holiday, adoption leave and enhanced parental leave, share options. Currently 66/100 top flexible companies.

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<th>Standing for Something</th>
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| Zalando provided assessment of employees is based on overall potential, not experience, and thus teams are motivated and fluid, providing broader opportunities for talent to thrive.

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<th>Demellier London</th>
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| Founded to support all women to look and feel their best while working out, no matter their size. Donate c.$5m pa to charities that focus on lifting up women.

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<th>Fabletics</th>
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| Launched “7 Women, 7 Causes” line of 7 tote bags, each supporting a different cause, e.g. mental health, children affected by war, and women’s education.

Retail pay in the UK has risen at double the national average in 2022 (5.5% vs 2.7%). LVMH is looking to fill 30,000 positions by 2024 driven by specialised personnel leaving the fashion sector.
The most complex challenges will be difficult for brands to solve by themselves; moving quickly to establish partnerships will be key.

Brands will need to decide where it makes sense to partner vs. going alone…

<table>
<thead>
<tr>
<th>Could you easily achieve it by yourself?</th>
<th>Partner for success</th>
<th>Could it be a potential source of differentiation?</th>
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<tbody>
<tr>
<td>YES</td>
<td>Compare relative merits of partnership vs. DIY</td>
<td>Do it yourself</td>
</tr>
<tr>
<td>NO</td>
<td>Enter exclusive / strategic partnerships if possible</td>
<td>And look to build or buy capability over time</td>
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… and the type of partnership that will help them achieve their ambitions

<table>
<thead>
<tr>
<th>Challenge</th>
<th>Partner type</th>
<th>Example</th>
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<tr>
<td>Controlling complex value chain</td>
<td>Suppliers</td>
<td>Training and support to drive compliance with both environmental and social standards in the supply chain</td>
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<td>Drive sales and acquire customers in stagnant volume market</td>
<td>Peers</td>
<td>Designers such as Victoria’s Secret and Reiss launched on Next Label to grow brand awareness, access a new customer group &amp; grow sales</td>
</tr>
<tr>
<td>Enter exclusive / strategic partnerships if possible</td>
<td>Different Industry Players</td>
<td>Fashion brands partner with other brands such as food retailers to drive awareness sales in new audiences to counteract stagnant volumes</td>
</tr>
<tr>
<td>Specialist capability / resource</td>
<td>3rd Party Service Providers</td>
<td>Support services to drive towards circular models, including waterless washing, reverse logistics, recommerce</td>
</tr>
<tr>
<td>R&amp;D and Technology</td>
<td>3rd Party Tech Providers</td>
<td>Walmart has partnered with Zeekit to allow customers to upload pictures of themselves and virtually try on clothing items in different sizes</td>
</tr>
</tbody>
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Source: Desk research, OC&C analysis