Baker Ing

Fashion & Apparel Europe

January 2022

Foreword by Tokio Marine HCC

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FOREWORD: TOKIO MARINE HCC

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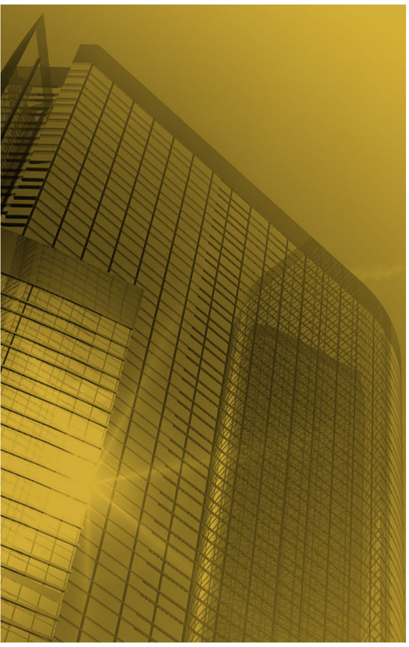
The world of UK retail continues to move at a break-neck pace. 2020 and into 2021 saw unprecedented challenges for the sector. A perfect storm of disruptive forces came together as the industry traversed through huge structural changes, particularly with the accelerated shift to online.

2022 has reported a slow start, with footfall numbers down significantly on pre-pandemic levels and retailers hit by the biggest increase in prices charged in many years. Although sales have been recovering somewhat in recent months, retailers have been forced to contend with global shipping delays and rising costs. The continuing supply chain disruptions – impacted heavily by both Brexit and the pandemic – are posing major problems for the sector and we are already seeing the fallout from the stress on working capital. Container prices have significantly increased too which will be eroding margins, rendering retailers reluctant or unable to pass on these price increases. In addition, to tariffs and other increased costs to consider, delays due to increased administration and paperwork is not helping either. There is also a shortage of workers throughout the supply chain. All of this means that retailers will need to be agile and build resilient supply chains in order to ride out the disruption.

A surge of inflation in essential goods and services has hit retailers and consumers hard, with households cautious about discretionary spend as they contend with the increases in their cost of living. This poses further demand uncertainty. However, we have seen some buoyancy over the last 12 months due to pent-up demand and increased consumer savings and so we should be seeing some of this reverse over the course of 2022. Consumer spend will be spread more widely as the travel, leisure, and hospitality sector recovers, and this will perhaps depress the demand for discretionary goods. That said, discretionary spend could be further impacted by the increases in National Insurance and mortgage rates.



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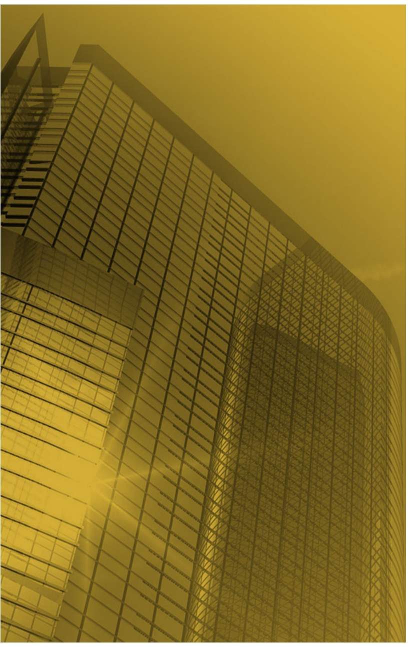

Many suppliers in the retail sector depend on Trade Credit insurance to protect their debtor book and to promote safe revenue growth. The Trade Credit market is maintaining a close eye on financial performance across the retail sector. Whilst it may be a sector facing many headwinds, there is also much to be positive about. Over 2020 and 2021, we saw retailers bolstering their balance sheets and liquidity and looking to preserve cash. All this cost cutting underlines a strong focus on balance sheets that ensures retailers do not burn through cash too quickly. Therefore, as pressure on working capital remains tough, we are focusing on cash, liquidity and facility headroom when considering retail risk.

The claims environment has been relatively benign over 2020 and 2021, with businesses protected from insolvency action. Unfortunately, however, the fallout in the form of administrations is inevitable, and already this year, we are beginning to see failures. Since the courts reopened, we are seeing an increase in County Court Judgements (CCJs) being lodged and insolvencies returning to the more "normal" levels of 2019. All-in-all, the sector is clearly heading towards normality despite insolvencies set to rise as creditors go back to the courts.

When considering the expected rise in retail insolvencies, it is important to consider the commercial rent moratorium. This is a government support initiative that protects tenants from eviction by landlords over unpaid rent. The moratorium was extended to March 2022 and has been a real saviour for many retailers who had feared a wave of legal action by landlords. It allows more time for negotiation and to trade their way out of debt. In order to provide an orderly exit from this support initiative, the government will be introducing legislation for a new arbitration system to solve disputes between landlords and commercial tenants affected by the pandemic.

Summary

Despite adversity, the retail sector remains resilient, and although we may start to see an uptick in insolvencies, 2022 will be a year of investment and perhaps new partnerships. Retailers will reposition their business model, strategy, marketing, stores, and operations to flourish in a post-pandemic world. Successful retailers of the future will be very different to today's and will offer customers something unique. Their stores will provide experiences rather than simply focusing on selling stock.

The UK sector does continue to face challenges from the economic, political, and social uncertainties, and there are likely to be failures. However, despite all these challenges, there are opportunities for retailers. Gaps will form in the market, and we may see increased M&A activity. Businesses will have a chance to change, adapt and streamline their processes resulting in greater efficiencies, and new partnerships will enhance their propositions and capabilities.

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As consumers begin to return to pre-pandemic behaviours, the sector should move from survival to recovery. Those who have managed to navigate through the challenges posed and remain relevant and agile, will hopefully emerge as stronger businesses. With the successful rollout of the vaccine, consumer sentiment will also improve as their lifestyles begin to return to normal.

Retail may not have had a chance to fully recover in 2021, but in 2022, it should be showing clear and widespread signs of a recovery. Therefore, our underwriting approach is reflective of this, we look at individual businesses within their particular sub-sector and the opportunities that are presenting themselves after a very difficult period.

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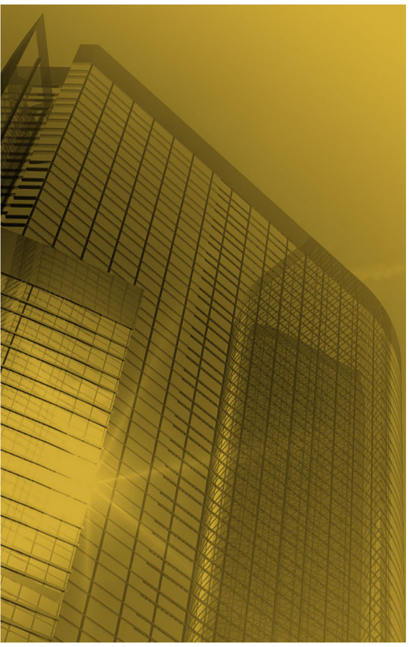

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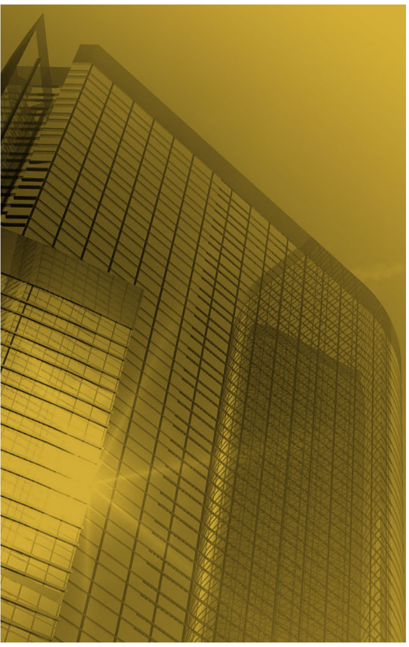

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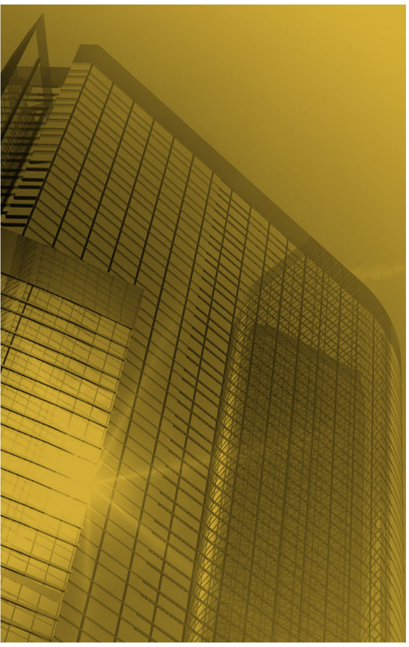
EXECUTIVE SUMMARY



With more than half a million companies generating more than EUR 320bn, Europe's Fashion and Apparel (F&A) is one of the most innovative and dynamic sectors in the world. Many local brands have for decades flourished to become international leaders. H&M and Zara in casualwear, Adidas and Puma in sportswear, Chanel, Louis Vuitton or Gucci in luxury, are only but a few names who have shaped the way the sector works across all continents. This unquestionable success was made possible through the support of two pillars: On the one hand, the environment in which these companies operate -affluent societies who adopted clothing as a sign of social status, rapid globalization of fashion and trends, and great infrastructure to support complex operations-; on the other, the capacity of companies to innovate and adapt to a sector in transformation and to the changing demands of customers, constantly re-shaping or creating new supply chain systems, inventory management processes, marketing and branding outputs, collection designs, retail and even real-estate strategies.

Production on one side, and retail or the other, are the two key steps on the value chain, which is further broken down in a large number of operations. Companies may have followed different strategies within them (in-house production, outsourcing, location of manufacturing, size and organization of retail space, etc.), however all of them have developed key assets for success. For production, the management of complex and global supply chains has become essential in order to offer products at mass-consumption scale within increasingly tight delivery deadlines, while responding rapidly to any supply chain disruption. The importance of controlling the supply chain has been further increased by negative press that has tarnished the reputation of some brands and brought a growing number of consumers to ask for their clothes to be made in a more ethical way. For retail, the mastering of marketing and brand positioning have become a key factor for success. In F&A perhaps more than in any other sector, consumers are purchasing more than just a clothing item. They are also buying an aspiration, a social status, a visible sign of belonging to a chosen group. Clothes are items that define who we are, and who we project ourself to be.

Today, the sector is facing huge challenges. Changes in patterns of consumption, ethical and environmental concerns, brand reputation, the increased complexity in international operations and digital disruption are some of the new risks that companies need to learn to address. The new e-commerce paradigm is also forcing the retail market to bring rapid structural changes. The capacity of the players -both brands and marketplaces- to bring these changes is key for their future success as the market is evolving very rapidly, and previous leaders who are not adapting fast enough are left behind, while new entrants -whether their value proposition is based on e-commerce, ethical clothing, second-hand recycling or low price points- are changing the game.

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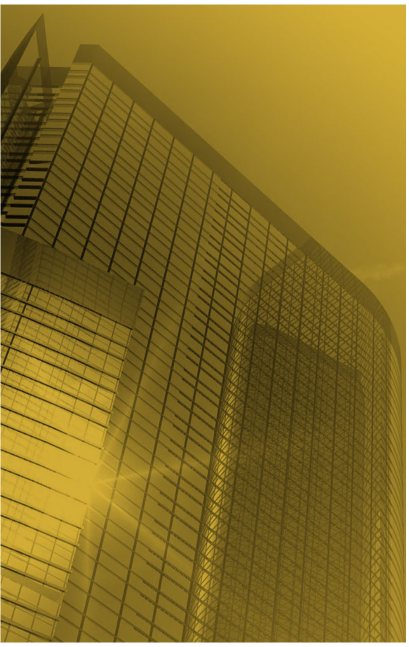

With tight lockdowns and various restrictions across the world due to the COVID sanitary crisis, 2020 was particularly difficult for the sector at all levels, as retail sales performance dropped year on year by more than 20%. Production was halted in some countries, transport was disrupted, stores were closed, then re-opened with extremely tight restrictions, the type of products purchased changed as public events were cancelled and remote work was encouraged, prompting people to use casual clothes more than outfits fit for work, etc. The EU and local governments helped maintain companies afloat through fiscal stimuli and rescue packages for many affected sectors, including F&A. As the vaccine campaign progressed in the region, activities resumed to a more normal level in 2021 and retail performance improved by roughly 20%. Companies however still had to face various interruptions across the value chain. The COVID crisis -like most crisis- accelerated the sector's deeper transformations, the most obvious being the transition to online sales. Consumers' lifestyles have also changed -some have moved away from the big cities, and some keep working from home- and as the COVID crisis is hoped to fade with the high vaccination campaign and measures in place, these trends are now likely to continue in 2022.

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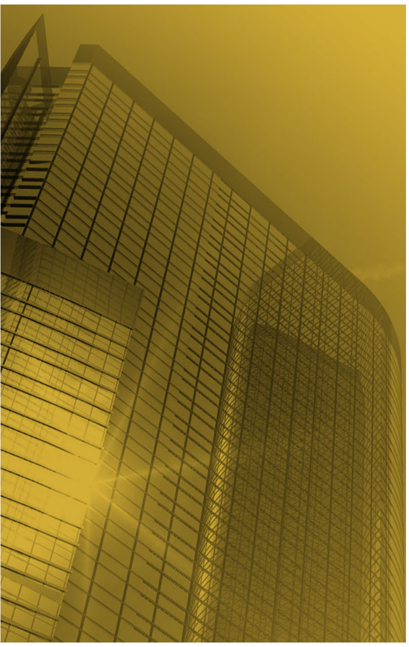
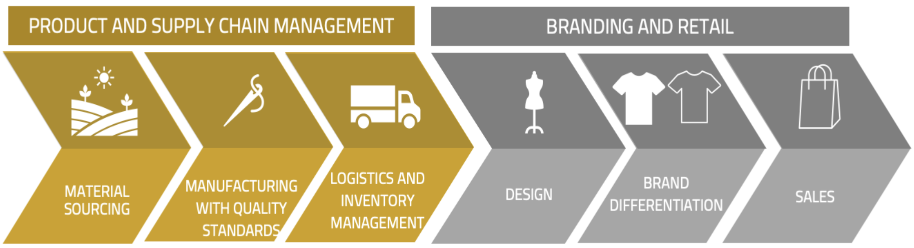


1. OVERVIEW

With a production worth EUR 160bn, retail sales of more than EUR 270bn and some of the biggest retail brands of the world, the F&A sector in Europe is extremely dynamic and competitive. Companies like Zara, Adidas, Louis Vuitton or ASOS that have pushed the boundaries in retail, marketing and complex supply chain management have grown to become global leaders, in a market where brand differentiation and go-to-market strategies have a huge impact on reputation, perceived value and sales. In today's paradigm, two main stages of the value chain can be identified: on one side, the optimization of the process of production in a global manufacturing context, combined with a rigorous system to check quality and standards among other production requirements in the supply chain management ; on the other, branding and retail activities, which are the heart of any F&A business -from collection design to promotional campaigns or retail location, design and service, the positioning of the brand is a key element for commercial success.

Chart 1.1- F&A value chain



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The sector has been evolving very fast in the past decades, from technology or production location to retail tactics or branding. Major disruptions such as digital transformation -which impacts all steps of the value chain, e.g., consumer habits or production methods-, a shift in consumer demands for more conscious choices of products that are more respectful of the environment and of labour conditions, or the use of new technologies -in the making of fabrics for example- are forcing players of the sector to react quickly at the risk of rapidly becoming obsolete. The COVID crisis, which particularly hit the sector, has been acting as an accelerator of these trends, and precipitated the rise, and fall, of many companies in F&A.

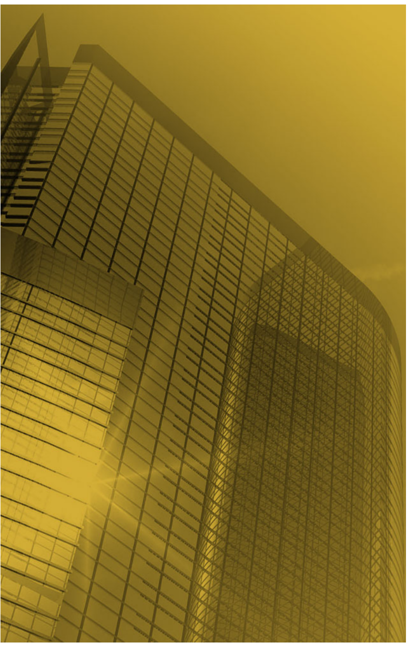
In **2. Economic Drivers**, we will look at the macro-economic context in which the sector evolves. A stable economic backdrop and a large population with a high purchase power contribute among other factors to making Europe a highly developed and competitive market. A clear openness to the world economy allowed many companies to scale up both their operations and retail activities globally. Governments, EU institutions, talent, supporting activities such as logistics or harmonized banking / payment systems or an environment encouraging innovation has also created the base from which many companies have managed to thrive, as we will see in **3. The F&A Ecosystem**. Active and efficient interventions of governments in the region have helped restore this environment relatively rapidly after the COVID crisis.

The manufacturing of F&A is done through an extremely sophisticated, dense and global supply chain, which often involves sourcing and production in several countries in order to maximize the value of production. Amid the globalization, European companies, in order to dominate specific segments of the market, have gone through radical innovation in both manufacturing and branding and retail. Today, European companies that still produce in the region are specialized in highly skilled or technology-intensive production. A number of large companies outsource however their production outside Europe. For them, the supply chain has become more complex and key assets are needed to ensure good delivery of the products, from traceability or inventory management to quality control or efficient logistics. These topics will be explored in **4. The F&A Supply Chain**.

One of the most important characteristics in the F&A retail is the importance of branding for commercial success. Successful brands have managed to be associated with reputation, creating a relationship with customers that goes far beyond the item sold itself -Louis Vuitton created a foundation for art in Paris for example-. The creation of a valued brand and an efficient retail machine requires a clear strategy, sophisticated skills and capacity of implementation. Brands need to be proficient in the use of resources (communications, press contacts, sponsorship contracts, store locations, delivery timing, etc) to become leaders. Adidas' famous three stripes, Burberry's innovative adoption of digital marketing tools and endorsement by celebrities are only but a few examples of brands selling aspirations, status, sense of belonging, more than just an item to wear. In **5. Branding and Retail Performance**, we will look into this branding strategy and the retail performance of the main players in the region.

Many profound changes have been affecting the sector in the past years. Digital transformation, changes in consuming habits, production complexity and of course COVID in 2020-2021 are a source of great opportunities for businesses in F&A, but also of heightened risks as the landscape is moving fast and as costs, in terms of retail space, logistics and R&D are high. In this challenging context, businesses need to make decisions to adapt to the new paradigm, gain the trust of consumers as new generations are looking for different values from brands. In **6. F&A Trends and Risks**, we will explore the trends, opportunities and the main risks faced by F&A companies in Europe.

Finally, Europe is a heterogeneous region, with countries that have demonstrated strengths in areas more than others. In **7. Country Perspective**, we will be able to provide a more granular image of the sector, where each country profile differs greatly from the other, from manufacturing patterns to retail dynamism.



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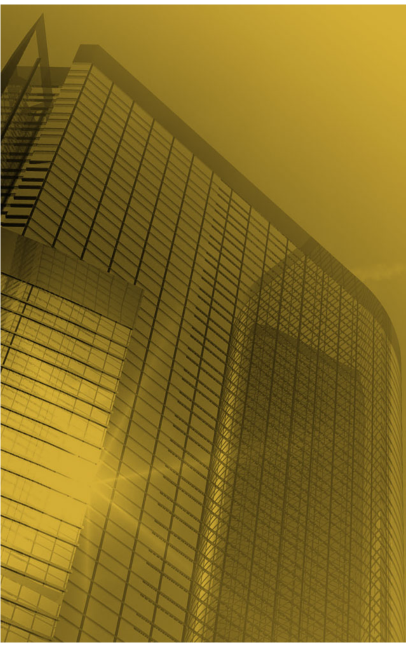
2. ECONOMIC DRIVERS



With 510 million inhabitants, and an average GDP per capita of around EUR 26,000, Europe (defined as the EU and the UK) is one of the biggest economic areas of the world. Extremely open to trade and movement of capital, Europe has followed a process of economic liberalisation in the past decades that has enormously contributed to define its productive specialisation in high-tech, high added-value and knowledge-intensive goods and services. The combination of high levels of investment, a sophisticated system of R&D and relatively efficient action of the public sector in the provision of both transversal and sectorial public goods has led to the consolidation of a dynamic area where the convergence of quality standards is one of the main policy goals. The coexistence of efficient regulatory frameworks in place with the presence of big companies (in some cases the world leaders) with a massive number of competitive, flexible and innovative SMEs has helped the economy to cope relatively well with both structural transformations of recent decades -including the transformation of the EU, the emergence of China as a key economic power and the new demands from consumers such as sustainability and workers protection– and short-term shocks such as the financial crisis of 2008, the Brexit or the COVID.

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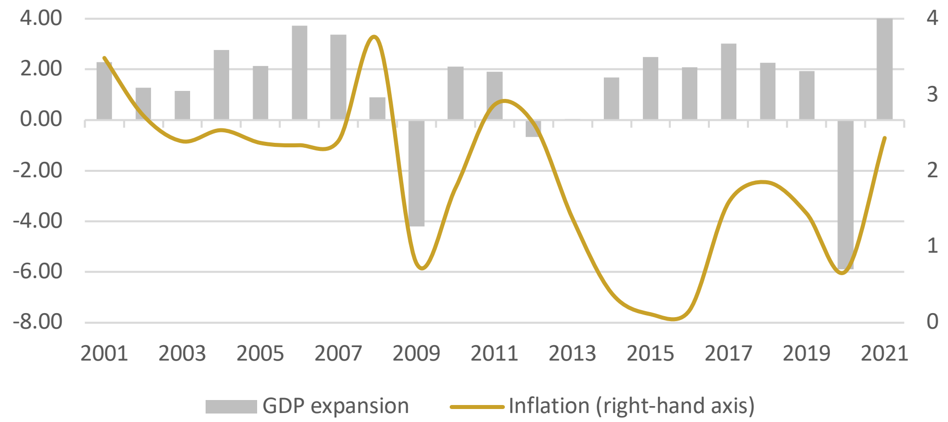
Chart 2.1- GDP and inflation in the European Union



Source: Baker Ing International with data from IMF

The European Union has expanded at an average rate of 1.6% year on year between 2001 and 2019, with drops in 2008 and 2012 only. The expansion of the economy occurred in a context of low inflation, which averaged 2.0% in the same period. The combination of fiscal rules and the anti-inflationary monetary policy (mainly in the Euro Area) has led to relatively low budget deficits and manageable levels of debt. Low levels of interest rates -yields of 10-year maturity bonds of the Euro area's central governments average 2.6%- have helped to boost private consumption and investment, which in the past 20 years averaged 21.8% of GDP. The COVID crisis changed the dynamics of GDP growth in two ways. Firstly, the economy collapsed dramatically in 2020. The 5.9% drop was higher than the two previous contractions. Secondly, the economy started suffering from higher

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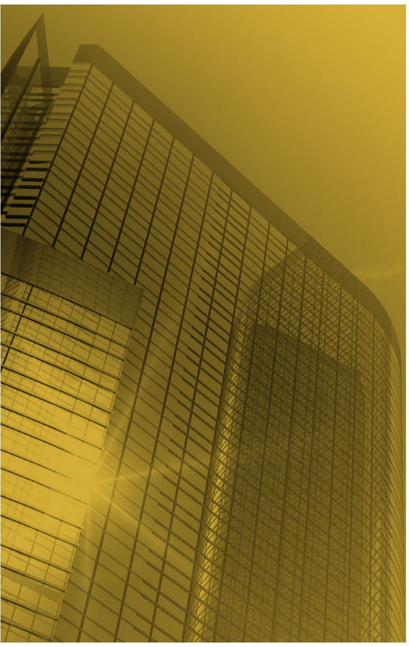

inflation -in 2021 CPI average 2.4%, the higher since 2012- due to both international factors such as the increase in energy prices and monetary stimuli. The consolidation of the European Union has led to a huge harmonisation in the functioning and regulation of markets, consumer rights and quality standards for production. In addition to that, the free transit of goods and workers have created significant economies of scales for companies that managed to expand in the common market, through the opening of subsidiaries or exporting. The development of the common market has encouraged the expansion of European companies with huge footprint in Europe and beyond in a number of economic sectors such as Telefonica/O2 in telecommunications, Santander Bank, AXA, Allianz and HSBC in Finance, L'Oréal and Beiersdorf in cosmetics, Inditex and H&M in fashion, Danone, Buitoni and Nutella in food, Ikea in interior design, Carrefour or Aldi in retail, and Iberdrola or EDF in energy. The economies of scales given by the common market have underpinned key assets of the big companies such as innovation policies (both in product and process), quality in production that allow them to differentiate, brand and marketing knowledge, human-resources schemes and, among others, logistics and supply-chain management. The development of the common market has not however benefited just the big companies. The structure of companies of Europe shows a huge concentration of SMEs: out of almost 23 million companies, around 93% employ less than 10 people. Most SMEs have managed to benefit from the efficient ecosystem to expand, invest, increase productivity and access new markets, and around 1.7 million European companies have exported in recent years.

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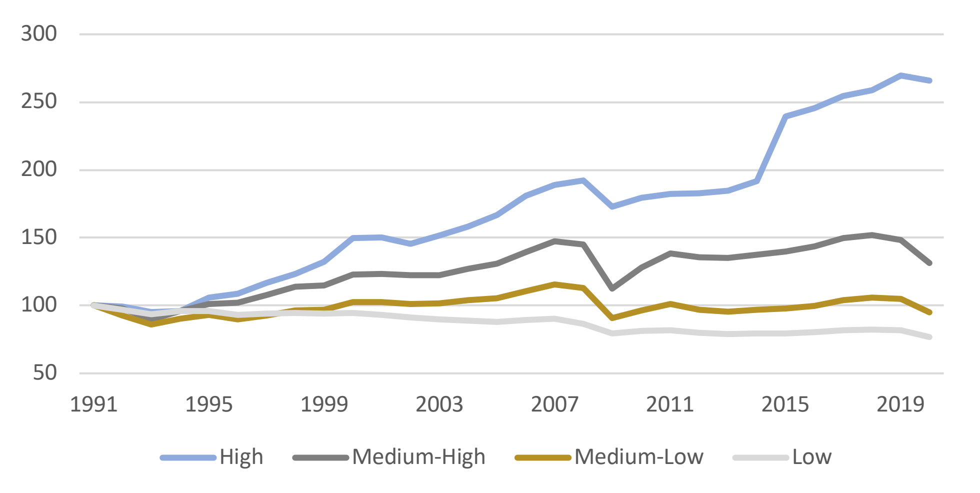
Chart 2.2- Expansion of manufacturing by technological level



Source: Baker Ing International with data from Eurostat

In recent decades, the European economy has radically transformed its productive structure. The relevance of manufacturing, which used to be the leading component in the added value, has been decreasing systematically. For example, manufacturing represents now only 10% of GDP in France and 19.7% in Germany, vs 16% and 23% of GDP respectively in 1995. The drop in manufacturing was replaced by the rise of other sectors such as information and telecommunications, or professional and scientific activities. Importantly, although manufacturing continues to play a strategic role in the European economy, its nature has changed. As can be seen in the chart 2.2, Europe has specialised in high-tech to the detriment of low technology-embedded manufacturing. Sectors with high-tech manufacturing such as pharmaceutical, computers, electronics, optical products and aerospace-related products have expanded by 165% in the past 30 years.

Box 2.1- Heterogeneity in economic functioning

The functioning of the European economy is heterogeneous and three main regions can be identified. The first region is the Northern and Central area, mainly formed by Germany, France, Netherlands, the UK and Nordic countries. The countries in this category are the richest of the continent, have dynamic labour markets, high salaries and better government results. The second category is formed by the 'Southern Europe' area. Italy, Spain, Portugal and Greece are the main countries of this group. These countries have a lower GDP per capita than the previous group. In general. They tend to have less flexible labour markets and governments tend to have a less satisfactory performance in terms of fiscal discipline. Finally, the third category is formed by Eastern European countries, who, despite the convergence process that their economies have experienced, are smaller and whose companies are not in the forefront of global productivity.

Table 2.1- Key indicators by region

Area	Population (in millions)	GDP per capita in PPS (EU 28=100)	Unemployment rate	Government result (as % of GDP)	Government debt (as % of GDP)
Northern	285.1	115.0	5.8	-0.7	74.6
Southern	129.1	90.4	12.5	-1.7	122.2
Eastern	102.5	73.4	4.6	-1.2	43.0

Source: Baker Ing International with data from Eurostat

The heterogeneity is not just at country level but within the countries as well. As can be seen Map 2.1, areas of higher income tend to be concentrated in Northern countries, as well as in metropolitan areas such as Paris, Helsinki, Stockholm or the north of Italy and the south of Germany. In addition, some divergence in income can be seen within the Southern countries. In Spain, for example, the north formed by Catalonia, the Basque Country and Madrid have a higher income than the rest of the country. In Italy something similar happens with the already mentioned northern area. Among the Eastern countries, the heterogeneity is not so marked, although there are some pockets of affluence such as around Bucharest, Warsaw, Budapest or Vilnius.

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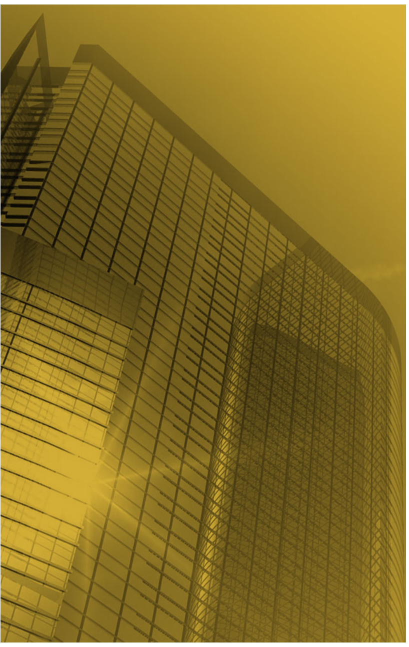
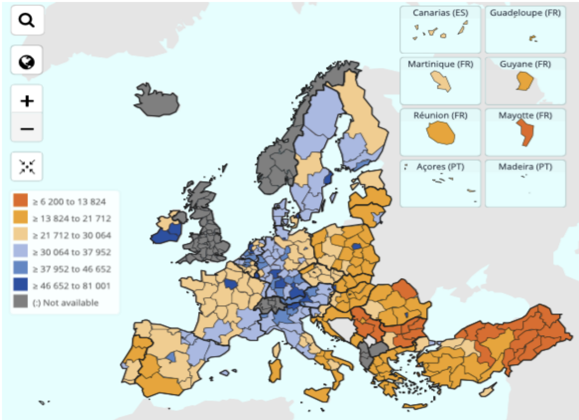


Map 2.1- GDP per capita and economic expansion - selected countries



Source: Eurostat

Effects of COVID on the macro and political spheres

The COVID has shaped the functioning of good part of the world economy, both directly and indirectly. Concerning the direct impact, majority of countries of the world imposed severe restrictions to the economy in the first half of 2020, affecting growth and disposable income. Although at different paces, these measures have been lifted in late 2020 and in 2021 as the vaccination rollout progressed all around the world. In terms of the indirect impact, the COVID has both forced entire sectors to change the way they work and affected patterns of consumption. Although in 2022 the economies will behave under the "new normality" -essentially with COVID becoming a less severe disease with low lethality rate-, a number of sectors and companies will need to implement deep reforms to adapt to the new scenario. In some cases, the changes to be introduced are responses to challenges that appeared with the pandemic -for example the way that airlines operate-. In other cases, these changes can be responses to trends that have been present for years and were deepened or accelerated by the COVID crisis, for example the push towards a less environmentally damaging consumption.

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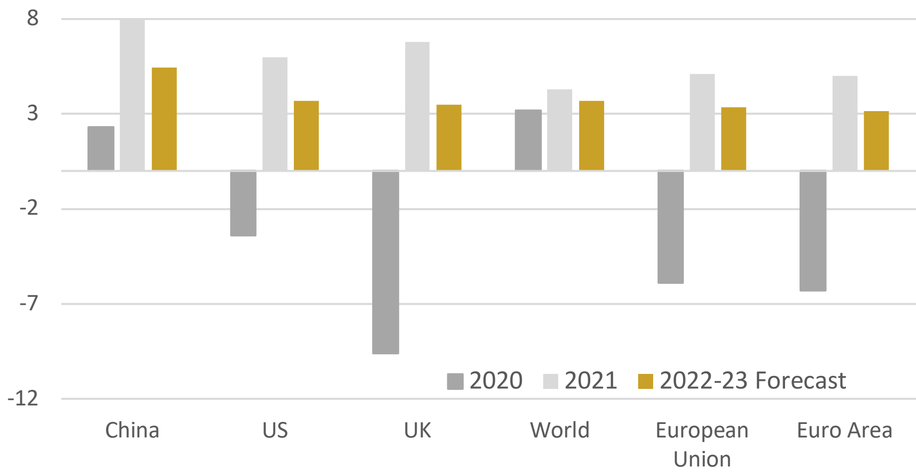
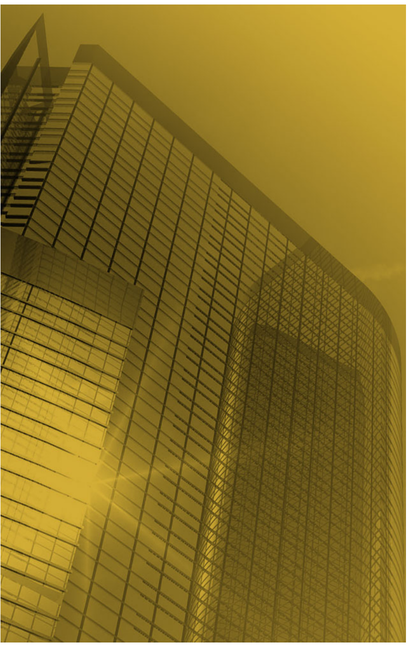
Chart 2.3- GDP growth of selected regions and countries



Source: Baker Ing International with data from IMF

The collapse of the global economy is estimated at around 3.5% in 2020. Europe, just like the rest of the world, was hit heavily by the COVID crisis. Early spring lockdowns, voluntary social distancing, disruptions in supply chains and lower demand led to a record drop of economic activity. The European Union went down by 5.8%, whilst the UK experienced one of the most dramatic collapses by dropping by 9.9%. The year 2021 was marked by a 5.9% global growth as activities resumed, albeit still with interruptions, a figure expected to be more moderated in 2022, to 4.9% according to the IMF.

Governments of the region responded with unprecedented policy support packages, especially in the first year of the pandemic. The fiscal policy was designed to address both the health challenge and the economic effects of the waves of lockdowns -the first one in spring 2020 and the second in autumn 2020. Fiscal policy (through automatic stabilizers or discretionary policies) provided support of about 7.5 and 6 percentage points of GDP in advanced and emerging European economies respectively. According to the IMF, fiscal policies included a) job retention schemes, deployed by about 40 European countries, that protected 68 million jobs at their peak, b) corporate sector policies (including guaranteed credit to companies, debt moratoria, and job retention schemes) which provided lifelines to companies -the number of corporate bankruptcies declining in 2020 despite the downturn- and c) financial policy measures which, together with support to households and companies, helped shield banks from the shock. Non-performing loans have remained largely contained, common equity Tier 1 capital ratios showed resilience, and credit has continued to flow. Central banks embarked on substantial monetary easing through both conventional and unconventional means. Macroprudential measures were also eased to cushion the impact of the crisis on both banks and borrowers. Importantly, the European Union relaxed existing rules to allow countries to incur higher deficits in order to boost emergency packages.



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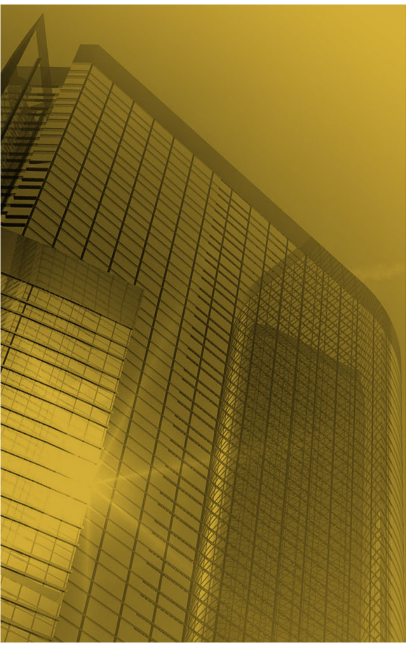

Table 2.2- Economic performance

	GDP			Inflation			Unemployment		
	2020	2021	2022	2020	2020	2021	2020	2021	2022
Germany	-4.6	3.1	4.6	0.4	2.9	1.5	3.8	3.7	3.6
France	-8.0	6.3	3.4	0.5	2.0	1.6	8.0	8.1	8.3
Italy	-8.9	5.8	4.2	-0.1	1.7	1.8	9.3	10.3	11.6
Spain	-10.8	5.7	6.4	-0.3	2.2	1.6	15.5	15.4	14.8
UK	-9.6	6.8	5.0	1.2	4.3	3.5	8.1	5.4	3.5

Source: Baker Ing International with data from IMF

Despite the emergence of new waves, the year 2021 saw a slow return to a new normality. In the first half of 2021, many countries in Western Europe went through a renewed surge in infections. This 'third wave' was triggered by the emergence of more infectious variants of the virus, a shortage of vaccines, and public lockdown fatigue – which arguably led to the premature easing of the social restrictions associated with the second wave. The third wave of the pandemic led to the setup of renewed lockdowns and other restrictions across many countries in the region, which, although generally lighter than in 2020 - most factories in the region were able to stay open under the restrictions for example-, delayed economic recoveries for 2021. Activity in Q3 and the beginning of Q4 however resumed strongly. We expect the "new normality" to continue in 2022 as the new variants become less dangerous for public health thanks to high rates of vaccination. The rapid spread of the Omicron variant in winter 2022 in various Western European countries has been bringing yet other lockdowns, albeit less severe than the previous ones, and the region is getting ready for a relative normalization of the sanitary situation.

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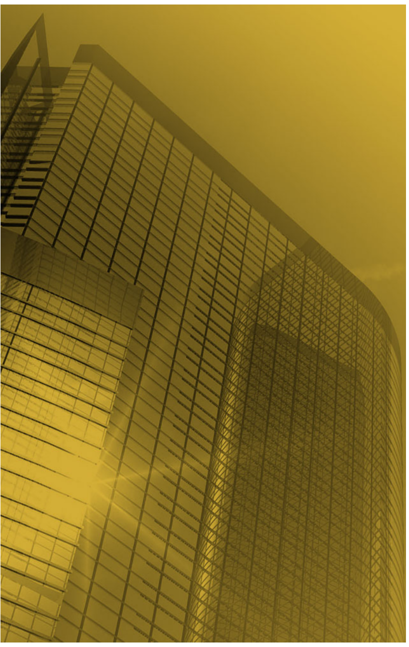

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3. ECOSYSTEM

With a production worth EUR 160bn, retail sales of more than EUR 270bn and some of the biggest retail brands of the globe, the development of the F&A sector is in part explained by the strong and dynamic ecosystem in which it plays: Without easiness of trade, access to a strong pool of talent, a logistics and banking sector ready to support the needs of a growing e-commerce trend or the support to innovate, the F&A sector in Europe would have developed very differently. This ecosystem formed by companies, schools or government agencies and supporting sectors has indeed been key for the strategy of differentiation that European countries have followed, as they specialised in high technology, skilled people, quality and reputation. More importantly, the success of the strategy of differentiation followed by Europe needs a constant dialogue within the participants of the whole ecosystem in order to adapt to changes and finding the way to add value.

Chart 3.1- The F&A ecosystem

Source: Baker Ing International

Europe combines a number of assets that are part of the ecosystem -described in Chart 3.1- that underpin the development of the sector. The region presents an adequate environment to conduct international business -including international trade to benefit from specialization of production- and a level playing field for transnational operations that can bring knowledge, expertise and innovative ways of doing business. Europe is an extremely open economy. EU has 45 preferential trade agreements with 76 partners that represent around 33% of total EU external trade. The EU Common Customs Tariff (CCT) applies to all imports coming into countries from outside the EU (there are no tariffs levied on trade between members of the customs union). As such, the applied weighted mean tariff rate in the EU member states is 1.8%, significantly lower than the equivalent tariff rate in the US, which was 13.8% in 2019, and Japan (3.5%). In terms of easiness of trading across borders, the EU countries show low cost and fast procedures. The combination of an internationalised economy with a number of tools to facilitate trade has helped a number of companies to export. More than 700,000 EU27 enterprises exported goods outside the EU -of which 615,000 were SMEs-, representing around 30% of EU exports.

Advanced infrastructure has proven key for the development of complex and flexible logistics operations. Adequate facilities for international trade -ports, airports and roads- in combination with good urban and metropolitan infrastructure for urban distribution have helped create efficient supply-chain operations, in a sector in which timing is key. The high level of technology used in the majority of companies of the region -across all manufacturing sectors- has created a fertile land for modern manufacturing, introducing quality controls, remote inventory management systems and efficient communications between companies. Moreover, a dense system of supporting companies -from generic legal and accounting services to ones that are specific to the F&A sector such as graphic design, material development, printing technics- combined with a relatively easy access to funding, means that the majority of companies have access to processes and products that help them operate in the technological frontier. Finally, a solid IT backbone and other e-commerce-related activities such as a modern and widespread banking system are necessary to support the growth of online purchases.

Box 3.1- Technology adoption in the F&A sector

European companies in general operate in an environment of high productivity due to the rapid adoption of technologies, which further supports the expansion of the sector. As can be seen in Table 3.1, companies in Europe have a considerable use of technology in activities related to internal organization, integration with customers and suppliers, usage of services on the cloud and utilisation of modern tools for organisation of the production (use of robots and 3D printing) or for understanding the market in which they operate. In textile and F&A manufacturing, we can see that the sector has not managed to achieve the same level of technology adoption as the other branches of manufacturing. However, around 30% of the companies have digitally integrated their internal process and use cloud-based services.

Table 3.1- Companies with at least 10 employees in the EU28 using digital technologies for different business activities, by economic activity, in % (2020)

	All the economy	Retail	Manufacturing	
			All the activities	Textiles, F&A
Integration of internal processes	36	30	47	32
Integration of supply chain	18	28	18	14
Cloud computing services	36	27	36	31
Big data analysis	13	11	9	5
Use of 3D printing	5	2	12	3
Use of robotics	7	4	19	9
Internet of Things	18	16	19	10
Artificial Intelligence	7	8	7	5

Source: Baker Ing International based on Eurostat

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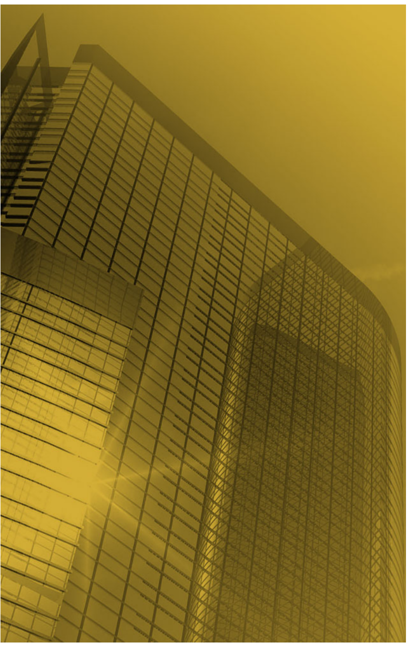

Europe also boasts a pool of highly skilled people that can be part of a modern, flexible and world first-class industry. Each year, around 7 million students graduate in the EU27 from tertiary, bachelors, masters or doctoral degree. Around 20% graduate from masters or doctoral programmes. Skills of people -years of formal education, work experiences, exposure to global business- are not just in the overall economy but also in the F&A sector. The relevance of the highly skilled people in the sector is reflected in the educational institutions specialised in the topic. Europe hosts some of the best fashion and design schools of the world, such as Central Saint Martins, London College of Fashion, the Royal College of Art in the UK, Istituto Marangoni, Politecnico di Milano and Raffles Milano Istituto Moda e Design in Italy, Institut Français de la Mode or ESMOD in France, or the Royal Academy of Fine Arts Antwerp in Belgium. These schools are extremely integrated into the productive sector and their programs tend to be around a particular segment of the market such as Menswear, Womenswear, Technology, Jewellery. Moreover, these schools have schemes for professional training, scholarships and collaborations with global sponsors such as a Christian Dior, Louis Vuitton or Nike.

The presence of big companies with a global footprint and massive number of resources that mark the way fashion is seen and consumed, creates a stimulating and competitive environment, where innovative ideas -including about brand positioning, marketing, social media presence and go-to-market channels- are the rule, making the sector extremely dynamic and innovative. The presence of a highly developed specialised print and especially online media sector that can relay and amplify these ideas, contributes to the success of the F&A sector, and encourages further the innovative trend.

Finally, in general European countries have been very pro-active in supporting their respective economies during the pandemic, especially in 2020-2021, when monetary stimuli and rescue packages have been put in place by all governments. The F&A sector, particularly affected during the early stages of the crisis, has been supported, as well as activities that are part of its ecosystem, allowing the sector to continue in spite of COVID-related the difficulties.

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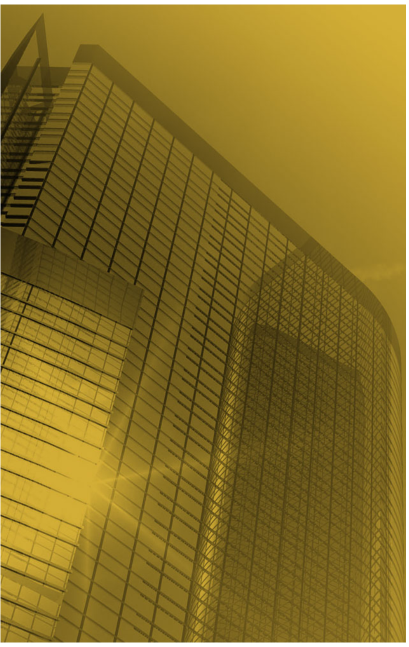


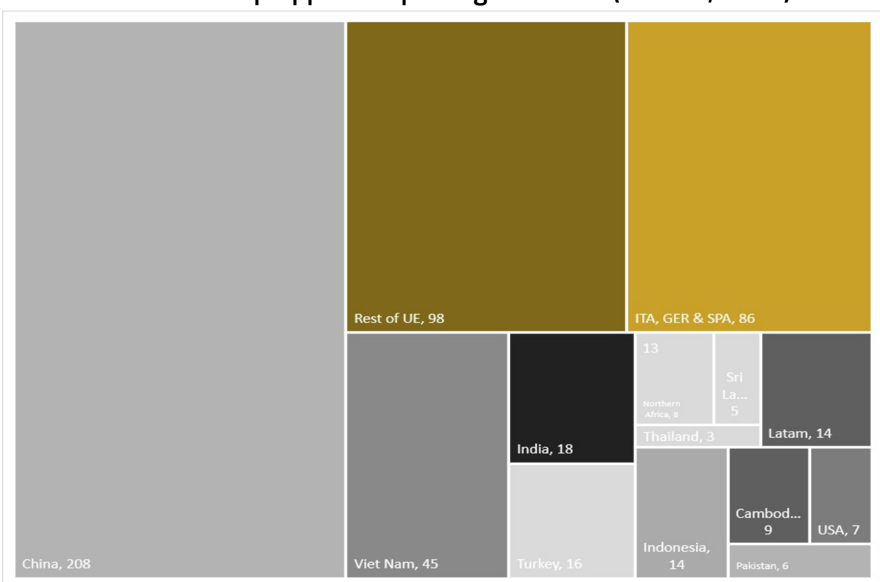
4. SUPPLY CHAIN

With huge production volumes, new collections coming to the shelves sometimes as frequently as every two weeks, and expectations of low-cost manufacturing, the supply chain in F&A has become extremely complex. Brands often contract suppliers from other countries, whose lower relative costs and production capacity respond to the challenging demands of the market in terms of price, volume and flexibility. Visibility of the further steps of the supply chain, and guarantees of the respect of good practices in the making of the products is difficult, and in this global context, key assets are needed to ensure good delivery of the products, from traceability or inventory management to quality control or efficient logistics. Meanwhile, in order to stay relevant, Europe's manufacturing landscape completely transformed in the past decades, and the remaining manufacturers have specialized in highly skilled production or technology-intensive innovation.

A Global Value Chain

The apparel manufacturing industry is extremely globalised, employing directly and indirectly millions of workers worldwide, and with thousands of companies participating in the production through sophisticated Global Value Chains (GVCs). European and American brands, who control the retail market thanks to marketing, branding, innovation and differentiation efforts, outsource in particular their manufacturing all around the world, which has enabled them to produce at extremely low cost in countries where labour is cheaper. In recent years, brands have also been re-investing locally or in countries closer to their core customer base, pressured by consumers who are looking for more local solutions, and/or attracted by some of the high technological advantages of local manufacturing suppliers.

Chart 4.1- Top Apparel exporting countries (USD bn, 2019)



Source: Baker Ing International with data from COMTRADE

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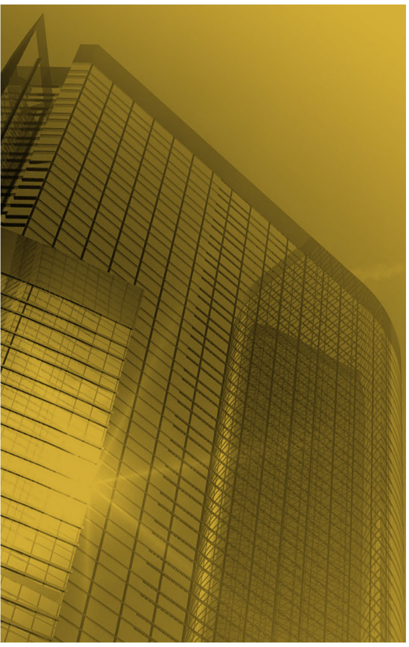

F&A manufacturing represents 3% of the total global trade, with total exports on average of USD 0.6tr in the 2017-2019 period. Exports of F&A products are mainly dominated by China (37% of the total exports in the 2017-19 period) and by the EU (31%). Within the EU, some countries are particularly strong in exports, such as Italy (6.2%), Germany (5.6%) and Spain (3%). The main importers are the US, countries in the EU and Japan. Europe's imports of clothes from non-EU countries came mainly from China (EUR 21bn or 30% of extra-EU clothes), Bangladesh and Turkey (EUR12 billion and 8 bn, respectively) for example. The internationalization of the F&A production has benefited some countries who became important global players. The most important example is probably Vietnam, who, at the beginning of the 21st Century used to export around 1.5% of the global F&A products and in the 2017-10 period reached almost 8%. To a lesser extent, Bangladesh, India and Cambodia also increased their weight in exports.

Consumers in the biggest countries (including Europe) have been in recent years growing concerns over the lack of transparency in these global supply chains, with particular concern over bad working conditions and practices that are detrimental to the environment. Re-location or near shoring are growing practices, benefitting from consumer movements towards products made locally (Made in France, Made in the USA amongst others). This re-location movement is being possible thanks to changes in the production of Europe in recent decades. In combination with a robust ecosystem, good part of Europe's rich economies has indeed started to specialise in the "Production 4.0 and differentiated" system of production, with high added value thanks to a strong and innovative sector. As a consequence, European exports tend to be directed to rich countries (both inside and outside Europe) where the quality is key, as opposed to countries like China whose exports are directed in an important proportion to non-rich countries.

Key developments in supply chain and the impact of COVID

As material sourcing, manufacturing, logistics and inventory management are usually outsourced to other companies, coordination and control of the supply chain have become key elements of success for any F&A company, as the manufacturing process is often outsourced to many different suppliers, in order to keep the same level of quality for all the garments made. More recently, the control on the supply chain has been expanding to focus not only on the quality of the products, but also on the way the product is made. The Rana Plaza disaster -where a factory in Bangladesh collapsed due to poor installations-, shed a light on the poor working conditions within factories that supply a wide range of famous brands. Trust in big brands has been affected, and, following this event and others that appeared, consumers have increasingly been demanding more transparency and better practices in the way the clothes they purchase are made, pushing brands to place more efforts in traceability and quality control.

The F&A manufacturing sector has inevitably collapsed during the COVID sanitary crisis. Demand for clothes across the globe has dropped in 2020, meaning many orders were cancelled, unpaid or put to a halt. USD 40bn worth of finished or in production products are estimated to have been cancelled in the world. More importantly, the manufacturing sector was forced to close and stop production as

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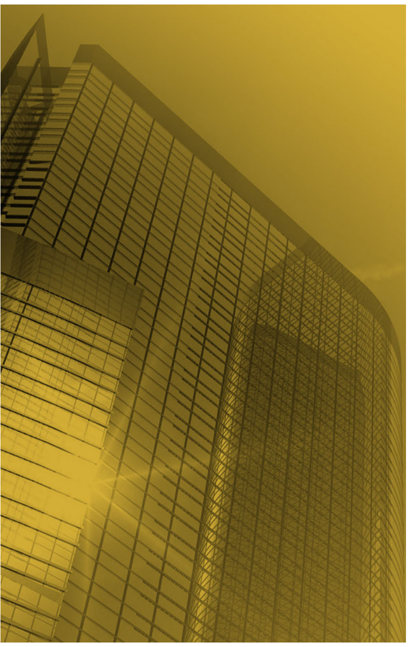
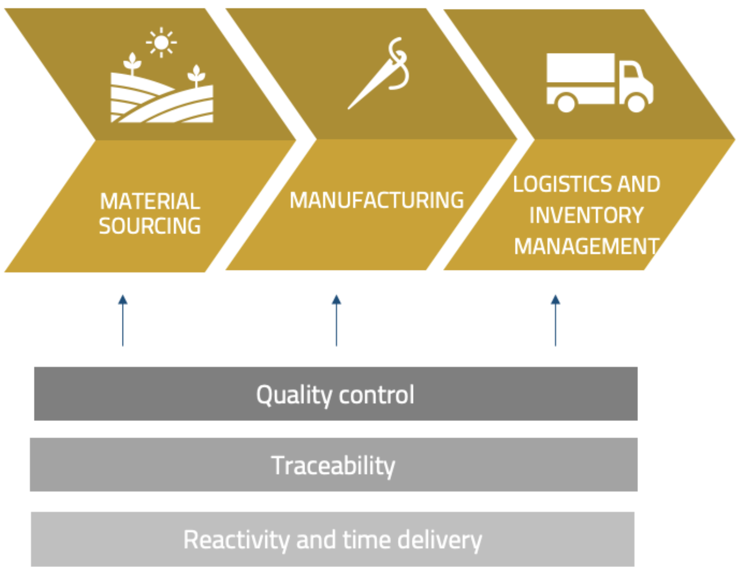


part of the health and sanitary policies applied in various countries. The capacity of companies to react to the shock and to return to normal operations depends on a number of factors. Contingency plans in place in supply chain and inventory management, financial health prior to COVID, and flexibility to adapt production processes to manufacture different outputs, will or have already been key to determine how well companies can recover from the crisis.

Chart 4.2- Key factors for success in the management of the supply chain



Source: Baker Ing International

Some changes are also likely to be implemented. The crisis left retailers and manufacturers which huge amounts of unsold stock and are adjusting their strategy accordingly. According to a BOF McKinsey survey in 2021, top fashion executives quote the reduction of Stock Keeping Units (SKUs) as their main strategy to avoid overstock in the future (61% of respondents), followed by better analytics for consumer insights (60%), a more agile supply chain (55%), and a review of the assortment and seasonality (54%). There is therefore a profound change in terms of designing collections and what will be exposed in store, combined with a search for a more optimized supply chain management

The apparel manufacturing sector in Europe

The apparel manufacturing sector in Europe is made of many SMEs, with often high technical expertise in particular niches. They are dynamic and innovative, and have been investing on average EUR 5bn per year, contributing to making sector more technology-savvy, for example through the creation of intelligent fibres, or the use 3D printing. Outwear and accessories represent more than 40% of the total manufacturing output, followed by fabrics (17%), industrial and technical textiles (16%) and home textiles (13%). Technical textiles has been the

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biggest area of growth in the region. Italy concentrates most part of the production, with around 40% of the turnover of the European Union. With more than 23,000 companies in manufacturing, it is made of a lot of SMEs producing high quality goods, with relatively high productivity. Germany, France, Spain, the UK, Portugal and Greece make up for around 40% of the EU production.

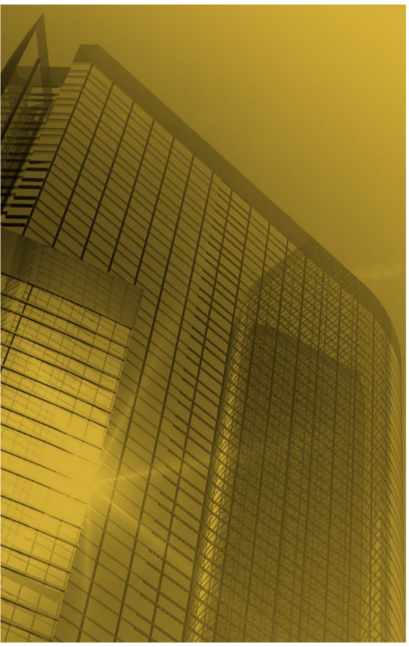

Table 4.1- Some examples of European F&A manufacturers

TREND SRL	BAXTER HOUSE	RIOPELE
FLORENCE, ITALY	LONDON, UK	PORTUGAL
Production of leather for luxury goods	Clothes manufacturing	Textile production
. USD 28.6m sales per year . Factories in Italy and Romania . Half of its 70+ employees are in design and development . Manages a range of sub-suppliers	. Small company focused on ethical manufacturing . Produces in Romania, and outsources to other sub-suppliers based in Europe	. 140,000m2 factory optimized for timely reactivity . High investment in R&D and tech to produce smart textiles

Source: Baker Ing International

Italy, Germany, France, Spain and the UK's productivity are above the EU average. Differences within this category are also present with the UK or Germany's productivity being almost double the productivity of Spain. Portugal and Greece see their productivity below the average of the region. In contrast with countries in the first group they haven't been so successful in the transition from a massive and low-labour cost system of production to a 4.0 Production with differentiated scheme. With lower GDP per capita and reduced access to R&D by SMEs than the rest of the Western members of the EU, Portugal and Greece are likely to continue having low levels of productivity. Poland, Romania and Bulgaria are the biggest producers among the Eastern countries, concentrating 9% of the production, 19% of the companies and more than 35% of the overall employment of the region. They have however productivity levels well below the average of the EU. Despite receiving for the past years a considerable amount of official funds to upgrade the economy and private investment, productivities continue to be low.

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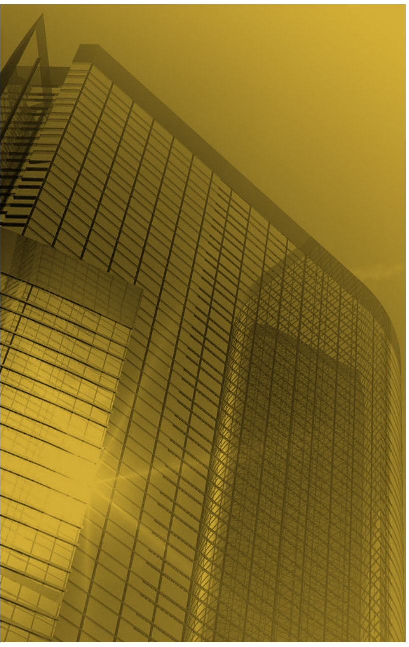
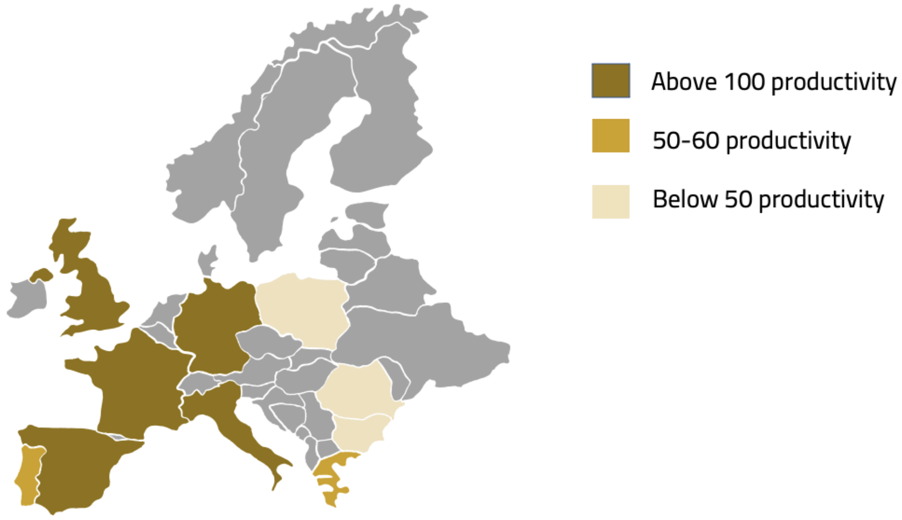


Chart 4.3- Productivity of the manufacturing of apparel sector per country (Index EU=100, year 2020)



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In the past decade, the sector has been increasing its productivity while employing fewer workers. Jobs decreased by around 12% between 2011 and 2018 in the EU for manufacturing of apparel, and productivity increased by around 8% in the same period. Increases in productivity were not just the only innovations in the sector. In recent years, the sector has moved towards a more environmentally friendly production, including initiatives towards increasing the proportion of green energy and reducing the environmental impact of waste. At the same time, the industry has continued to reduce its CO2 emissions and continued its exploration for the development of new materials as part of the circular- economy paradigm. All these innovations are taking place thanks to the dynamic ecosystem.

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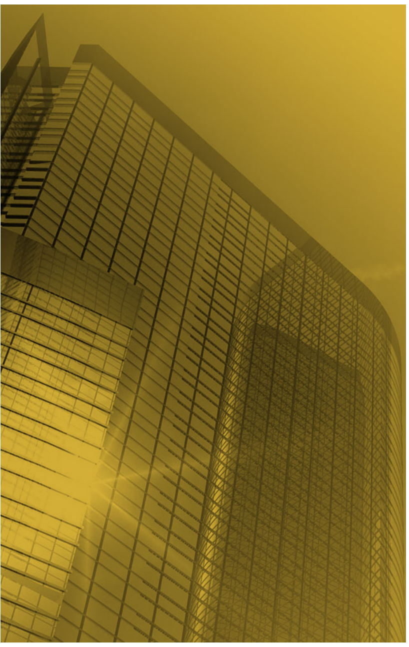
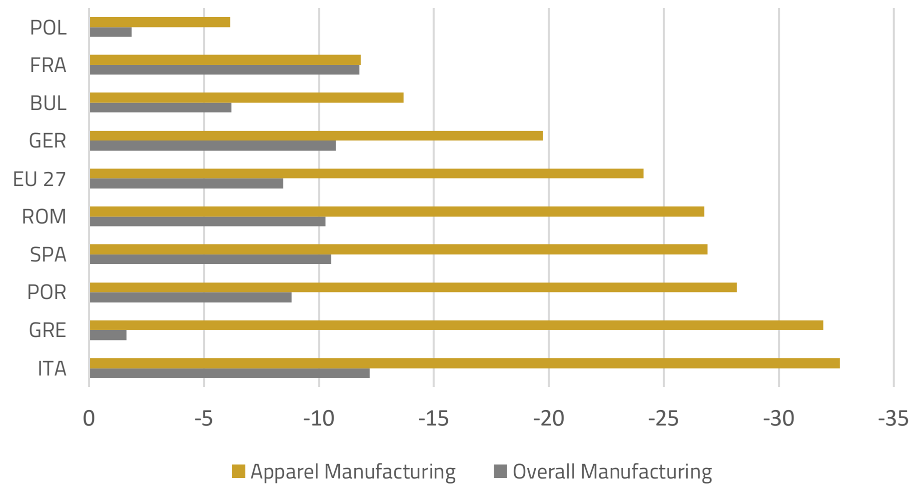


Chart 4.4- Performance of the manufacturing sector (% YoY production, 2020)



Source: Baker Ing International with data from Eurostat

The biggest countries in terms of manufacturing in Europe (Italy, Germany and Spain) have been suffering in different ways from the COVID crisis. The collapse in Italian apparel production reached almost 35% in 2020, when the overall industry went down by just more than 10%. In Spain, a similar pattern could be observed: the drop in apparel manufacturing was almost three times the value of the overall industry. In Germany, where the apparel production contracted by around 20%, the gap was smaller. In France the apparel manufacturing and the overall manufacturing performed similarly, with drops of around 12%. Poland was the most successful of the key producers, containing the drop in apparel manufacturing as the contraction was just around 2%. Early estimates indicate that production in Europe increased by around 10% for 2021 with for example 15% increase in France and 7% in Poland.

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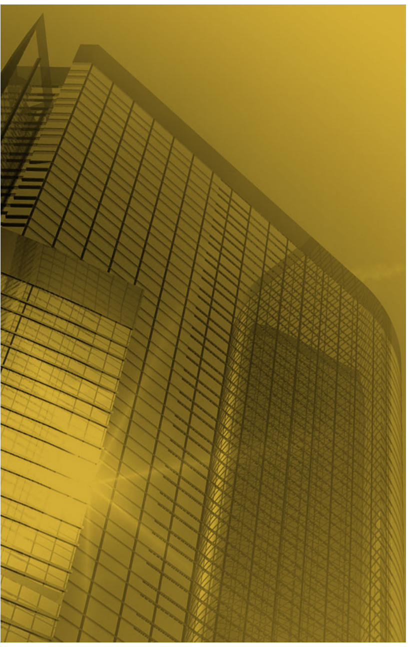
5. BRANDING AND RETAIL



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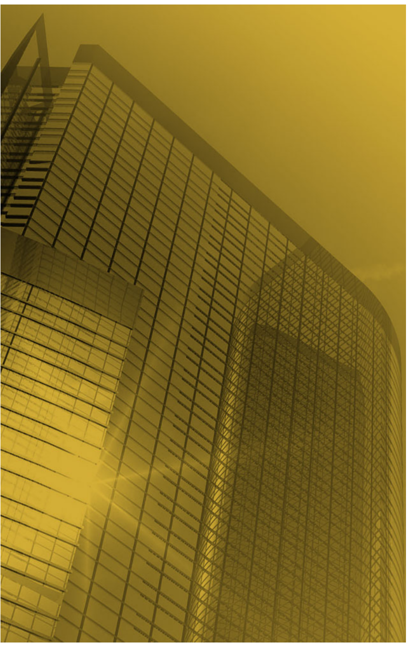
The F&A retail sector is extremely dynamic and sophisticated. More than 350,000 companies sell clothing or footwear in Europe and are responsible for more than EUR 270bn sales. Over the past three decades -and as part of the globalization of the sector-, the retail industry has been through a profound evolution. High streets and shopping malls used to be dominated by department stores and smaller shops that were selling clothes from different brands (aggregator-type retailers). Today many retailers are companies with strong identifiable brands who design and go to market with their own range of clothes. Their size varies from small and local brands to big multinationals such as Inditex or H&M, and they have replaced small to medium-size aggregator-type retailers, who have almost completely disappeared in some countries. These global brands control many key aspects of the value chain, including design and sophisticated sales and marketing through multiple channels.

Chart 5.1- Branding development through the value chain

Source: Baker Ing International

Brand differentiation has become a key element in the commercial success of any F&A company. It defines the brand, from the conception of the collections through to making sure the clothes respond to the expectations of the consumers that go to the shop. The exercise goes beyond the clothes themselves as brands are become symbols. Wearing a Luis Vuitton bag, a dress from Zadig & Voltaire or Puma or an Adidas tracksuit are conscious actions to demonstrate social status, search for 'tribe' belonging. Brands we wear tell something about us, so we choose which brands match our aspirations, and we know exactly what each brand would project. There are various 'families' of brands based on various criteria, and brands would compete within each family. Style, cost, type of clothing and increasingly today eco-friendly values are among the many factors of differentiation of a brand, which plays a role in the final purchase. After doing an overview of the retail performance in Europe, we will look into these different strategies and how they apply to the key players in the region.



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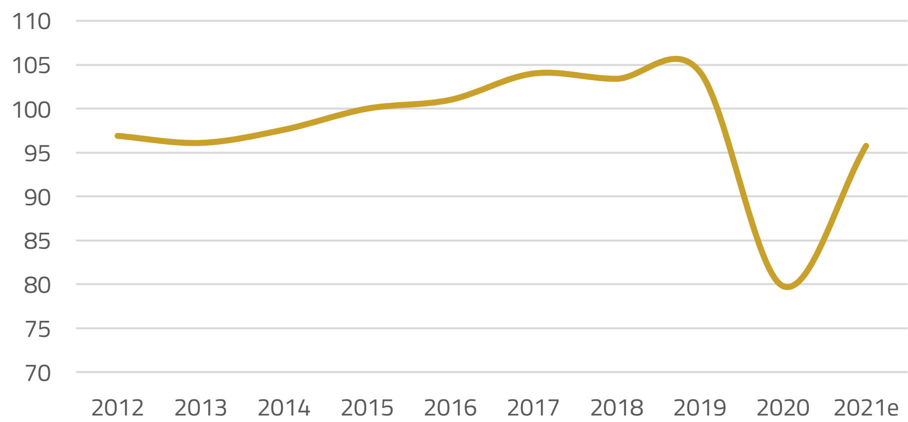
Retail performance in Europe – an overview

Until the COVID crisis, the F&A sector in Europe was showing a strong stability, with an average 1.8% growth per year in clothing retail sales, oscillating between -5.1% in 2009 (a consequence of the subprime crisis) and +6.7% in 2015. In 2018, the total sales in the region reached EUR 222.5bn in clothing and EUR 47.4bn in footwear. With around 294,000 companies selling clothing and 63,000 selling footwear, Europe is a very dynamic and sophisticated market. Gross margins for the combined products (clothing and footwear) totalled around EUR 100bn. The impact of COVID has however been particularly sharp in the sector, whose retail sales performance dropped by more than 20%. Early estimates for 2021 point towards a gradual recovery with roughly 20% growth vs 2020.

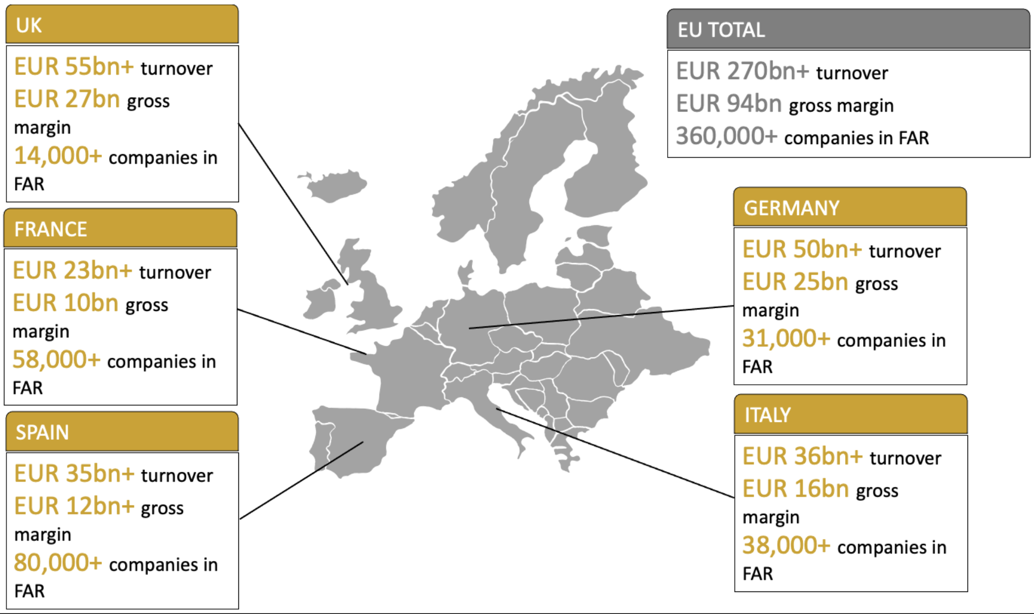
Chart 5.2- Retail sales performance in Europe, clothing only (index 2015=100)



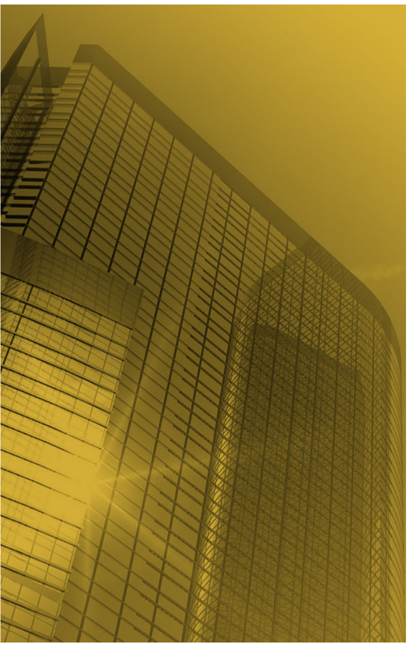
Source: Statista

The UK is the biggest F&A retail market in the region in terms of turnover (more than EUR 55bn in 2018). It is also the most concentrated with only 14,000 companies who generate on average EUR 4.2m turnover, the highest in the region. In terms of profitability, companies in the UK also show the highest figures: gross margin/turnover in the UK is 50, above the other main countries of the region. With more than EUR 50bn turnover, Germany is also a leading country in the sector, generating high gross margins of EUR 25bn. Spain is the home of F&A giants such as Inditex, and with EUR 35bn+ turnover is a strong country, albeit extremely fragmented, with an impressive 80,000 companies working in F&A retail (nearly 25% of them are footwear retailers, the biggest proportion in the region). Italy is also strong with more than EUR 36bn turnover, accounts for a relatively large number of companies in the sector (38,000), a figure explained through the traditional know-how in craft and luxury of the country. Similarly, France boasts a large number of retailers working in the sector (more than 58,000), including more than 11,000 footwear retailers.

Map 5.1- Clothing and footwear retailers in Europe (2018)



**data for gross margin is just for the six countries in the table*
Source: Baker Ing International with data from Eurostat



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Brand differentiation strategies

Perhaps in F&A more than in any other sector, the differentiation strategies chosen by brands are key to enable them to compete. F&A brands use different positioning, brand values, and adapted go-to-market strategies to target and capture particular segments of the market. We have identified brand differentiation strategies that revolve around two main axes: a) the go-to-market strategy and b) the segment or niche of the market targeted. As reflected in Table 5.2, the first relevant consideration is whether the go-to-market strategy is based on low prices or quality attributes. The low-price type of strategy represents in the world the biggest part of the F&A market, including in the EU. Within this strategy, brands target different segments such as accessible luxury, outwear and casual, footwear, sportswear and specific segments such as socks, glasses or accessories. The low-price strategy doesn't mean that the companies don't have good quality standards or specific certifications for process or products. However, their positioning and branding are not usually based around those quality attributes. Instead, they are based on other aspects, such as the rapid adaptation to diktats from trends in fashion. In general, however, the production of the brands in the low-price strategy is done in countries with low-cost labour, as mentioned previously.

Companies like Italian Armani and Dolce & Gabbana, French The Kooples, Zadig & Voltaire or Maje, and British Reiss for example are in the "Aspirational luxury"

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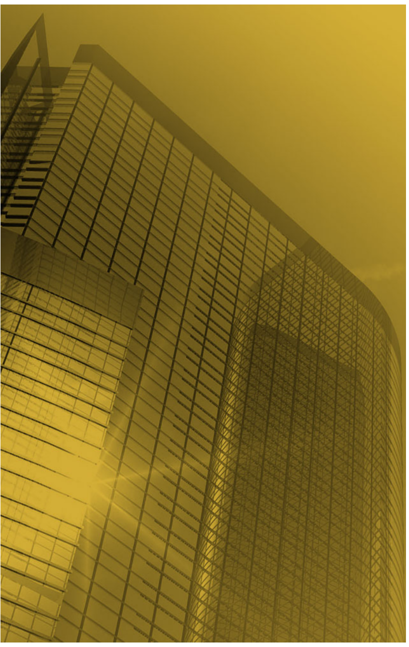

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category. They offer ranges of clothes whose design is akin to luxury or "casual luxury", yet they remain relatively affordable. The biggest companies in the world operate mostly in the "Outwear and casual" segment: H&M, C&A, Zara, Gap, Uniqlo are some of the brands that lead the market. Among the "Footwear and sportswear", we can mention German Adidas and Puma, American Nike, British Clarks and Spanish Camper. "Specific segments" includes for example Italian Calzedonia, specialised in hosiery and socks, British Accessorize or French socks retailer Kindy. The reality of the market is actually a bit more fluid, and some of the biggest companies in the world operate across several segments at the same time, through different brands. In addition, segmentation within the segments themselves is also key, as the competition is rife between each brand.

Table 5.1- Differentiation strategies for F&A brands

		SEGMENT OR NICHE			
GO-TO-MARKET STRATEGY	LOW PRICE	**Accessible luxury** (Dolce & Gabbana, Armani, The Kooples, Zadig & Voltaire, Reiss)	**Outwear & casual** (Inditex, H&M, C&A, Primark, Gap, Uniqlo, Next)	**Footwear & sportswear** (Adidas, Puma, Nike, Clarks, Camper)	**Specific segments** (Calzedonia, Accesorize)
	QUALITY ATTRIBUTES	**Design by author** (Hermés, Louis Vuitton, Viviene Westwood, Versace)	**Valuable standards of production** (Hircus, EKYOG, House of Sunny, Armedangels)	**Circular economy** (Charity shops, Percentil, eBay, Le Bon Coin)	

Source: Baker Ing International

The strategy based on quality attributes is followed by fewer companies. Their goal is to exploit a series of attributes that are associated to the production or sale of the product. The attributes can be diverse, and the value consumers give them also changes with time. However, it is easy to affirm that "Design by author" is one of them. Within this category, we can mention French Hermès, Louis Vuitton, Vanessa Bruno or Chanel, British Vivienne Westwood and Italian Versace. Among the segment of "valuable standards of production" we can find a variety of companies, some basing themselves on environmental credentials, others on fair-trade, and some may even highlight their origin. In order to illustrate the diversity of this segment, we can mention French Hircus specialised in knitted clothes made in France, EKYOG exploiting its organic clothes, Le Slip Français which champions the "made France" for underwear, or Sezane's sustainable fashion for jeans. In the UK, House of Sunny's core strategy revolves around

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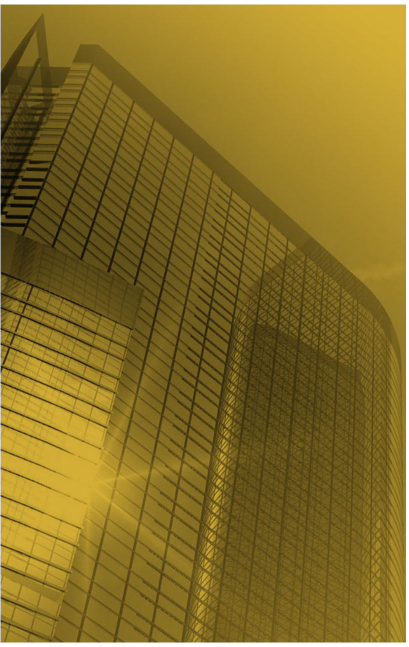

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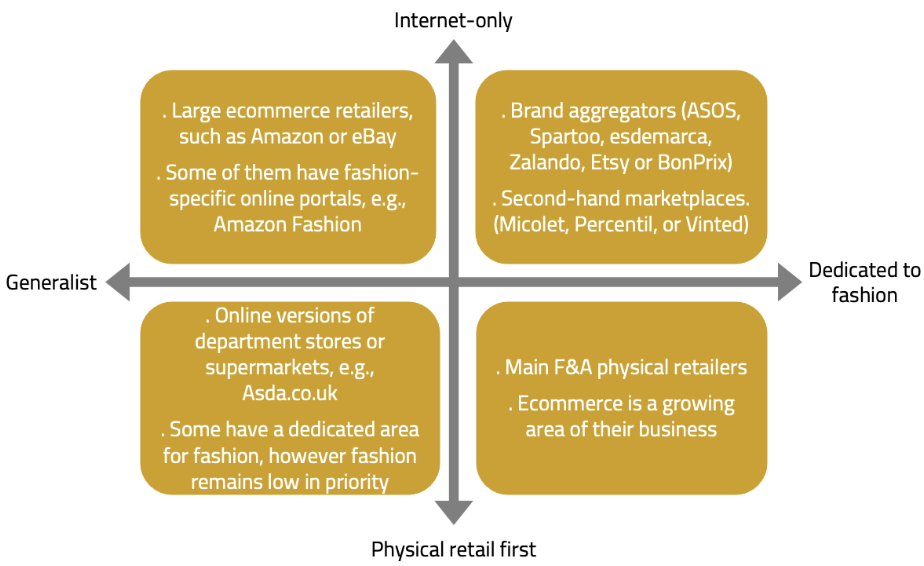
sustainable clothes, just like German Armedangels. Finally, in the "circular economy" niche, we can mention all the second-hand markets that have recovered prestige in recent years. In the UK, this niche has been historically well organised thanks to charity shops. In Spain, the brand Percentil works with second-hand clothes in almost new conditions for example. An important new channel for this segment is e-commerce, including sites like Amazon or eBay. In France, for example, Le Bon Coin, has positioned itself as a marketplace for second-hand clothes, and is one of the top 5 most visited websites in the country.

Box 5.1- The online F&A market

The transition from physical stores to e-commerce has been one of the most impactful shocks the retail of F&A has been through recently. The development of e-commerce had started well before the COVID crisis: In 2019, 67% of the British people were purchasing fashion or sports goods online. The pandemic accelerated it. E-commerce has already started to transform markets (including sectors as different as books, food, transport, travel and entertainment). F&A retail is also changing quickly. According to Eurostat, e-commerce clothing sales in Europe increased by 25% in 2020; however, the figure grew by 10% GARC in the 7 years prior to COVID.

E-commerce can be viewed as new channel that brands are going to adopt. However, it could also bring challenges for established leaders who have built their leadership on the physical stores. Firstly, they can find themselves overinvested in stores. Second, they may be less flexible to adapt. E-commerce requires changing the way the business works, including process in inventory management, new logistics and storage, and different communication strategies.

Chart 5.3- Four categories of players in the online F&A market



Source: Baker Ing International

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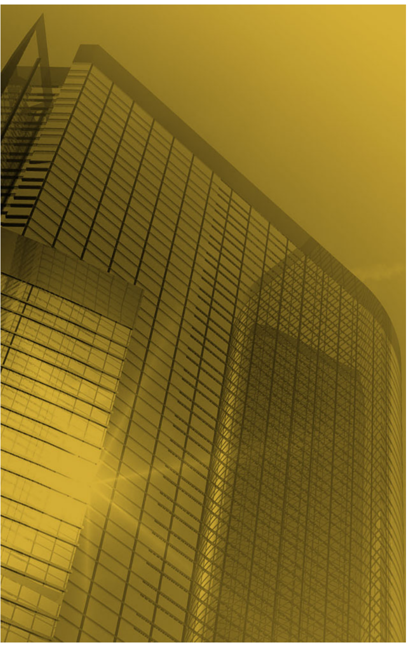

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There are currently four main categories of players in the online F&A market, based on two main criteria: Their level of specialization, from generalists to dedicated to F&A, and whether they are at their core a physical retailer, or an online-only retailer. Many huge e-commerce generalists have risen in the past decade, such as Amazon or eBay. Their scale has made them some of the biggest competitors in F&A retail, and, boosted by the pandemic, Amazon has now become US' first clothing retailer, with 11-12% of all apparels sold in the country, and 34-35% share of apparels sold online. In most European countries, F&A was the main product segment for shopping online in 2020. Other online-only retailers have positioned themselves on the fashion segment and have proved extremely successful. German Zalando is a prime example of a successful online-only fashion retailer who is today the third F&A retailer in Europe. The share of online marketplaces selling second-hand goods is also growing strongly, with Vinted as the market leader. It is estimated that by 2025 second-hand sales will be 1.5 higher than fast-fashion sales and will represent 13% of the average wardrobe. Younger generations in particular are driving that growth: 18-27-year olds buy 2.5 times more used clothes than other age groups.

As these pure-online players see an impressive growth, physical retailers are making huge efforts to catch up. All supermarket chains or department stores now have online stores, a key element of their success. Fashion may not be a key area in physical stores, however it is a key online area. They benefit from brand exposure and are adapting their communications strategies to be omnichannel. French iconic department store Galeries Lafayette for example are now offering personal shopper services via video. Fashion retailers such as Inditex, Next, Primark are making online a big priority as they see a drop in footfall, and they want to make sure they benefit from the growth of online fashion purchases. Online sales of some segments of Zara, for example, have already reached 20-25% of the total sales.

Key players in Europe

The high purchase power of European consumers -in addition to the millions of affluent tourists that visit the main European cities every year-, in combination with the robust ecosystem the F&A sector evolves in, has helped towards the development of strong European F&A brands, who are operating in different segments and are global leaders. This is the case, for example, in the outwear and casual segment of companies like Inditex (Spain) or H&M (Sweden), in the luxury segment of LVMH (France), or in sportswear like Adidas (Germany). Interestingly, European brands have managed to maintain their dominating position in the domestic market despite the efforts of companies like American GAP or Japanese Fast retailing (who owns UNIQLO, for example) in the outwear and casual segment, or Michael Kors in luxury and Nike in sportswear. All these companies have a global footprint, and some dominate their segment: the two biggest F&A companies are European (H&M and Inditex). They represent almost 40% of the Top 10 F&A companies' global sales, and 15% of the total clothing sales in Europe.

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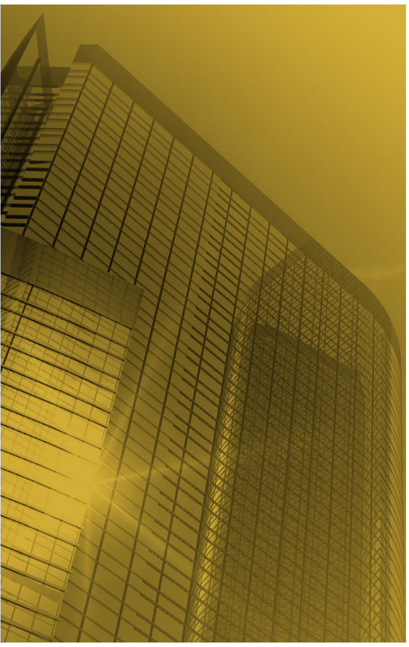

Although not present in the top 3 retailers, UK retailers represent half of the biggest fashion retail chains. The weight and dynamism of the domestic market has created many companies that are extremely competitive and that have developed in many segments, especially low-cost (Primark and Pep&Co), but also sportswear and casual. Spain and Sweden dominate of course with giants Inditex (owner of Zara, Oysho or Pull&Bear) and H&M. Germany's e-commerce pure player Zalando has successfully managed to grow, to become Europe's number 3 F&A retailer. France strength and specialisation in luxury is reflected through the presence flagship group LVMH among the top retailers.

Table 5.2- Key F&A retailers in Europe (2020)

Retailer	Headquarter	Turnover (in EUR bn), 2020	Stores
Inditex	Spain	12.9	4,459
H&M	Sweden	12.5	2,430
Zalando	Germany	8.0	Online
Primark	United Kingdom	7.5	380
C&A	Belgium/Germany	6.0	1,382
LVMH	France	5.5	1,300
JD Sports	United Kingdom	4.9	1,500
Marks & Spencer	United Kingdom	4.6	1,216
Pep&Co	United Kingdom	3.5	3,021
Next	United Kingdom	3.4	550

Source: Baker Ing International based on retail-index.com and companies' websites

Inditex. The most important company in the European market boasts around 7.5% market share of the European clothing sales. Headquartered in Spain, European sales of Inditex represent around the 75% of the global income. With a broad range of brands (Zara, Pull&Bear, Massimo Dutti, Bershka, Stradivarius, Oysho, Zara Home and Uterqüe), the group has around 5,000 stores in Europe. Zara is the flagship brand of the company. The ownership of supply chain steps allows for a rapid product turnover: it only takes a month for a product that is being designed to be manufactured and to hit the shelves. Zara's main manufacturing centre is in Spain, in La Coruña. According to the company, 54% of production facilities are in Spain, Portugal, Turkey and Morocco, although they also have suppliers in Pakistan, Cambodia, Vietnam, China and Brazil. Zara's strategy is based on a high number of items available to sell. While most clothing retailers manufacture and offer to the public between 2,000-4,000 different clothing articles per year, Zara

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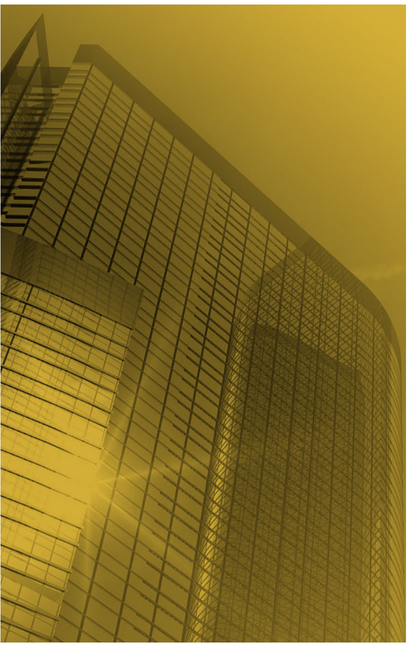

offers over 10,000 pieces annually. This strategy has allowed the company to target a broader number of customers.

H&M. Swedish H&M is the second biggest F&A in Europe. With a turnover of EUR12.5 bn, the European market represents around 75% of its global revenues. The company represents around 6% of clothing sales in Europe. The company has several brands, including H&M, Monki, Weekday, H&M Home, & Other Stories, Cheap Monday, Afound, and Arket. H&M has expanded considerably over the last few years. It has 4,372 stores open worldwide (April 2021), and far more physical stores than Zara (around 2,100). H&M's strategy to penetrate the US market has also been more effective than other companies', as the company has managed to open 559 stores. Although H&M has plans to roll out thousands more stores in the next few years, it has also closed stores as part of the company transition from a physical sales-based model to an e-commerce one. Part of the strategy of H&M is to offer customers featured products that have been marketed as designer collaborations with well-known names, such as Versace and Alexander Wang. By offering these products within H&M locations, the company boosts its own reputation by partnering with valuable figures in the fashion world, and it offers its customers additional lines for purchase that are different in look and style from the traditional style of the company.

Zalando. Founded only in 2008, Zalando is an e-commerce pure player, who started in Germany and now expanded to other European countries. It is the only online-only fashion retailer among the top 10. Their sales grew by 55% between 2014 and 2019, boosted by a wide range of strong brands present on their platform, and a returns policy free of charge for the buyer. The company operates in Germany, Austria, Switzerland, France, Belgium, the Netherlands, Italy, Spain, Poland, Sweden, Denmark, Finland, Norway, Slovenia, Ireland, Luxembourg, the Czech Republic, the United Kingdom, Lithuania, Latvia, and Estonia. Zalando also invested in the development of its own logistics network and information technology and created the largest logistics centre in Europe located in Erfurt.

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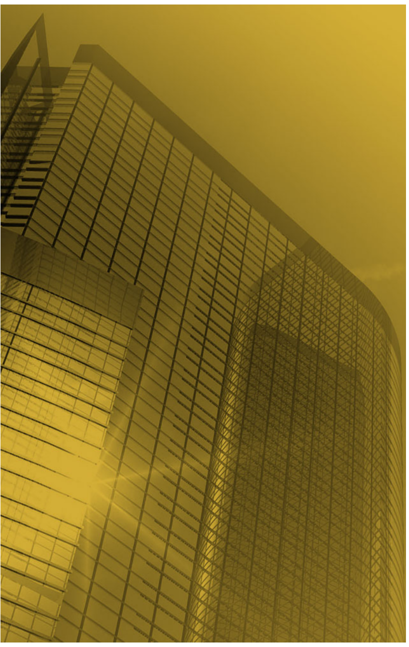

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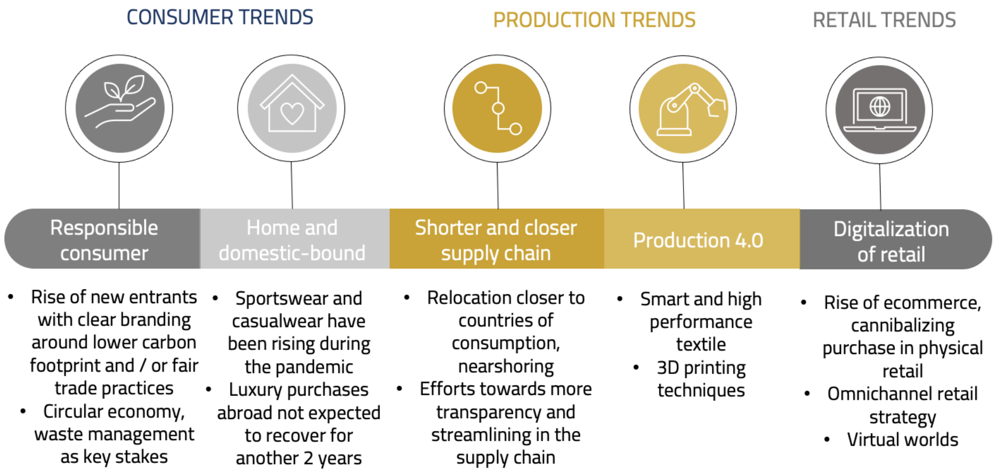
6. TRENDS AND RISKS

The F&A sector has been profoundly changing in the past years. Digital transformation, changes in consuming habits, production complexity and of course COVID are sources of great opportunities for businesses in F&A, but also of heightened risks as the landscape is moving fast and as costs, in terms of retail space, logistics and R&D are high. In this context, businesses need to make decisions to adapt to the new paradigm, gain the trust of consumers whose new generations are increasingly challenging the way fashion has been produced and marketed so far, and who are looking for different values from brands.

Main trends in F&A

The F&A is changing, shaped by different types of trends that are profoundly shaking the way it used to work. Firstly, consumers are becoming increasingly demanding in terms of the way their clothes are made. A more responsible type consumer, aware of the ecological and labour implications of fast fashion, is asking brands for more transparency, more respect of human rights and of the environment. 'Old' brands have seen the trust consumers place in them eroded by various scandals, and new entrants such as trainers makers Veja for example are challenging their market shares. The COVID crisis also had an impact not only on the volume and choice of quality of the items that are bought, but also on some type of clothes: Being often in lockdown situations and home-bound, many consumers have invested more in sportswear and casualwear, a trend expected to go back to pre-COVID times this year as restrictions are lifted. Luxury clothing however, a sector highly influenced by travelling (from Duty Free shops in airports to shopping for French brands in Paris or luxury shopping in Dubai for example) is to focus on domestic consumption.

Chart 6.1- Main trends in F&A



Source: Baker Ing International

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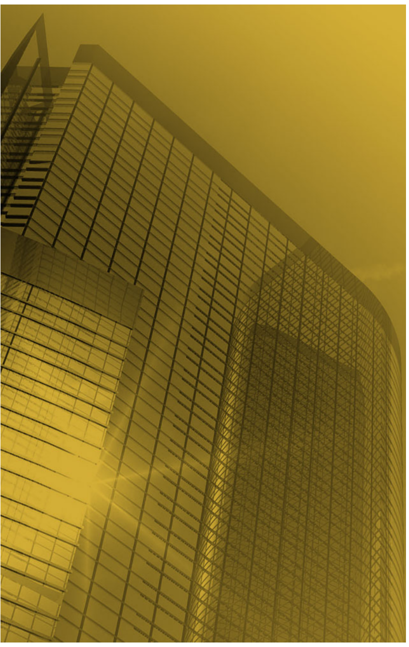

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As seen before, the production of F&A is also changing rapidly. The demands for more transparency in the supply chain, combined with many logistical issues are pushing companies to shorten their supply chain, and to bring their suppliers closer, in a relocation or nearshoring movement. These changes are validated by a stronger demand for products made locally, e.g., the 'Made in France' label. Production techniques are also changing the way clothes are made, with new 3D printing techniques and smart and high-performance textiles. Finally, the digital transformation affects all aspects of the value chain, from supply chain to design. It is however extremely impactful in retail, where the shift to e-commerce has accelerated in the past years. Many brands have invested heavily into e-commerce capabilities and into digital marketing techniques. H&M has even expanded its footprint to Meta's virtual world, opening its first virtual store at the end of 2021, paving the way for further transformations in retail.

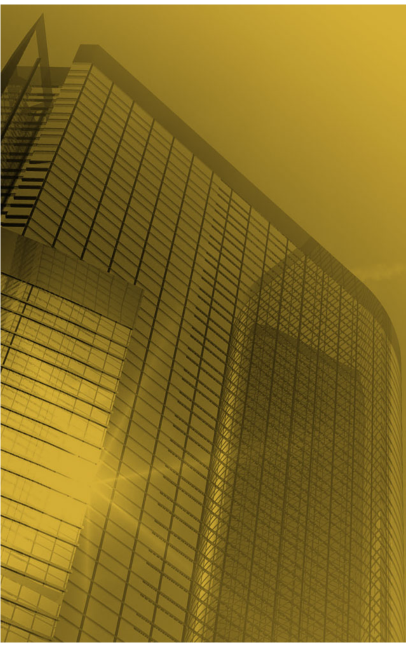
Box 6.1- Circular economy

The circular economy is a practice that is affecting the F&A sector in transversal way. It impacts design, material sourcing, manufacturing and sales. The concept of circular economy has gained momentum in the F&A sector a few years ago and with the COVID crisis. It is estimated that in the UK each household throws out 35kg of clothes a year, which is equivalent to 90 pairs of jeans. Only 1% of the materials used for clothing are reused to produce new garments, and approximately 70% are disposed of in landfills or incinerated, in spite of the fact that 95% of the clothes we throw away could have a second life. The reasons for such waste all point towards a F&A industry that has been in the past decades intensifying the frequency of change in clothing lines, making clothes at such low cost that buying a new item makes more economic sense than mending old ones.

Table 6.1- Some key participants in the clothes' circular economy in Europe

Company	Headquarter	Type of products in the marketplace
Beyond retro	UK	Clothing for women, men and children; accessories; bags
Loopster	UK	Clothing for women and children
Hardly Ever Worn It	UK	Luxury clothes; shoes for women, men, and children; jewellery & watches
Vinted	Lithuania	Clothing for women, men and children; accessories; bags
Re-SEE	France	Clothing for women
Vino Kilo	Germany	Vintage clothing for women and men
Desert Fox Collective	France	Vintage clothing for women
Haute Vintage	Poland	Clothing for women
Percentil	Spain	Clothing for women, men and children; accessories; bags

Source: Baker Ing International



The circular economy is a response to the fast fashion. Criticism comes not just from consumers that are increasingly conscious of social and environmental issues, but also from within the sector. Some designers are starting to speak against fast fashion, from Vivienne Westwood to Stella McCartney, pointing out the waste and damage done to the environment. Europe is at the forefront of this trend. The European Commission launched its first circular economy action plan in 2015, which included actions to help stimulate Europe's transition towards a circular economy. The robust, innovative and dynamic European ecosystem can be also a helpful tool to support this transformation.

The second-hand market has been driven by few developments. Firstly, in recent years, clothing retail has been an early (and big) adopter of e-commerce. Online marketplaces, developed thanks to e-commerce, are an efficient way to put together sellers and buyers at low cost. Secondly, the cost reduction to promote new technological developments in digital platforms has contributed to a rapid and wide spread of the second-hand trend and its alternatives, all of which have been supported through communication campaigns by a number of celebrities all around the world. Thirdly, perceptions have profoundly changed around second-hand clothes. A growing number of people now associate second-hand with environmental responsibility rather than with savings. Young people, the main users of second-hand clothing, don't seem to have as many prejudices as the previous generation. Finally, the changes in patterns of consumption as a consequence of COVID have encouraged forms of consumption that point towards more sustainability; these forms are almost the opposite of fast fashion.

Business risks

The F&A sector has seen in the past decade a large number of businesses facing bankruptcy. They have been facing different types of risks, from issues related to the macro-economic context (in particular COVID), to issues specific to the sector (Sectorial risk). This type of risks ranges from any supply chain issue that is specific to the sector (e.g., bad working conditions) to the arrival of new low-cost entrants for example. The way each company reacts to an issue, or is managed in general, is part of the micro-economic risks.

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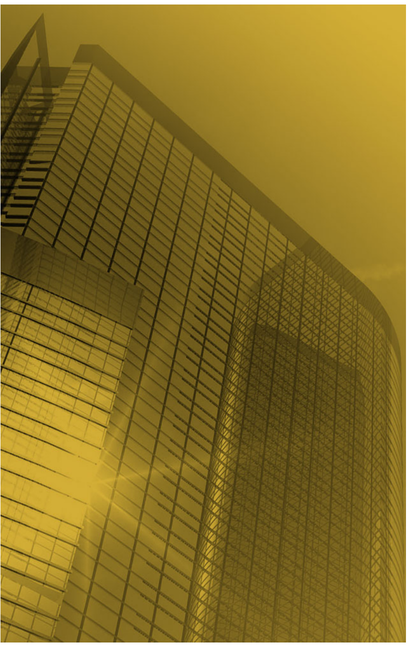

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Chart 6.2- Examples of risks according to sources and type in F&A

SOURCES OF RISKS

TYPE OF RISKS	OPERATIONAL	COMMERCIAL / FINANCIAL	REPUTATIONAL	REGULATORY	CHANGES IN CONSUMER HABITS
MACRO	Logistical issues, e.g., Suez Canal blocking, Brexit	Rent increase Inflation	Use of chemicals that are environmentally damaging	Change in tariffs (especially with Brexit)	Rise of e-commerce Use of mobile Growth of circular economy
SECTORIAL	The demands of Fast fashion increases possible operational risks	Drop in footfall in retail	Bad working conditions exposing F&A in particular (e.g., Rana Plaza)	Schedule of sales promotion	Consuming less (vs fast fashion) Organic and fair trade Search for low cost clothes
MICRO	How the company is managed, how it responds				

Source: Baker Ing International

We have classified the risks in F&A in Chart 6.2. Usually, companies face a mix of different types of risks (macro or sectorial) as seen above, with various sources of risks: Operational, commercial/financial, Reputational, Regulatory, Changes in consumer habits. The way companies manage the situations, the Micro, influences greatly the risks faced and the level of difficulties specific to each company. Arcadia in the UK for example, owner of brands like Topshop, Miss Selfridges, Evans, Wallis, Dorothy Perkins, Burton or Top Man has been facing the same risks as many fashion retailers in the country: a mix of changes in consumer habits (shifting to online and/or looking for low-cost options offered by new competitors such as Primark) and the COVID pandemic that led to a drop in footfalls in shops whilst rent remains due. How the company responded (difficulty to change its positioning and slowness to transition to digital) has accelerated the decline. In 2020, the group went under administration and its brands were sold or closed.

Table 6.2- Examples of bankruptcies in the F&A sector in Europe

Company	Positioning of the company	Year of bankruptcy	Some of the causes	Status
Roland Mouret (UK)	Design by Author	2021	Drop in sales with COVID	Under administration
Camaieu (F)	Outdoors casualwear	2020	Debt Rent of retail space during COVID	Re-structuration
Arcadia Group (UK)	Outdoors casualwear	2020	Couldn't compete with online and discount competitors Rent of unused retail space during COVID	Under administration

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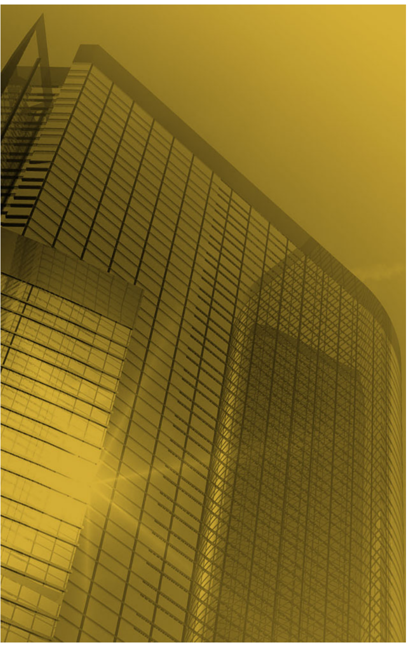

Jaegger (UK)	Aspirational luxury	2017	Couldn't compete against lower cost (Zara, H&M) and more high-end rivals such as Burberry's	
Vivarte (F)	Outdoors casualwear	2017	E-commerce competition	Re-structuration: Some brands have been sold to other companies

Source: Baker Ing International with data from Fashionlaw.com

The past couple of years have been particularly hard for the F&A sector, and many retailers went under administration. From the drop in footfall in retail to the re-shaping of the type of clothes needed in a world where remote working is becoming more important (which favours casual sportswear at the expense of clothes worn in a social and office environment), some companies have not been able to overcome the difficulties they faced. In particular, many upper-end brands have been struggling in 2021 as a consequence of COVID. Most governments in Europe had been artificially maintaining the companies in crisis alive through special rescue packages in the early months of COVID, however as these measures are slowly reducing, we are starting to see the consequences of the crisis on the sector.

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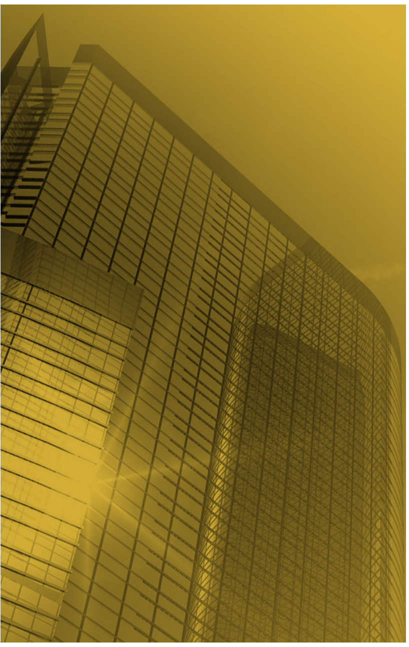
7. COUNTRY PERSPECTIVE

F&A in France



COUNTRY DATA		F&A DATA	
USD 45.0	GDP pc (,000)	EUR 7bn	Turnover manufacturing
6.3%	GDP growth, 2021	EUR 20bn	Turnover retail
1.9%	Inflation, 2021 (annual average)	-22.6%	Sales drop 2020 vs 2019

- Extremely strong brands in the medium to high end market, with know-how and innovative approach
- Some companies are responding to the emerging trends in e-commerce and responsible fashion
- Luxury sales and travel purchases dropped during COVID, leaving France's F&A sector more exposed

The process of transformation of the French economy has led to a substantial reduction of manufacturing in general, and of textiles, clothing and footwear in particular. However, with around 12,000 companies and almost 40,000 employees, the sector is not minor. France is globally associated with the high-quality fashion, with some of the most iconic haute couture designers of the 20th century (such as Chanel, Christian Dior or Yves Saint Laurent), who are almost considered as a synonym of the country. France was also the home of the prêt-à-porter concept, a revolution in fashion in the mid-20th century.

The tradition of high quality and innovation is still present in the contemporary industry. Groups like LVHM -the biggest group in the luxury segment in the world- and Hermès continue this tradition, but in a modern version and with a global scale. Actually, LVHM is responsible for the expansion of luxury beyond the rich segment of society.

In parallel to the luxury segment, France has a considerable amount of small-to-mid-range designers (such as Vanessa Bruno, agnes b., Isabelle Marant) that base their expansion on high-quality combined with style and strong brand identity. In recent years, companies like Comptoir des Cotonniers, Zadig & Voltaire and The Kooples have emerged to target a middle-end consumer. Brands in the low-end of the spectrum, although strong locally (such as Celio or Pimkie), haven't managed to expand much internationally.

More recently, French customers have become increasingly demanding in terms of environmental and social impact of the clothes they wear. As a consequence, a multitude of SMEs has emerged, whose development is based on a broad range of attributes. Finally, e-commerce has been relevant with companies like Le Bon Coin – a second-hand online marketplace– who are performing well in the clothing market.

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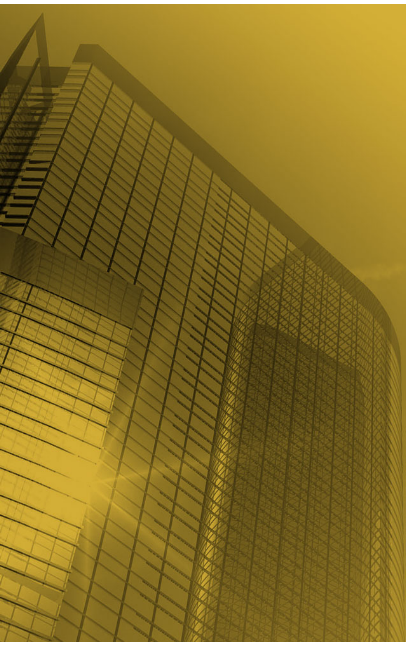
F&A in Germany



COUNTRY DATA		F&A DATA	
USD 50.8	GDP pc (,000)	EUR 7.6bn	Turnover manufacturing
3.0%	GDP growth, 2021	EUR 39.2bn	Turnover retail
2.9%	Inflation, 2021 (annual average)	-23.5%	Sales drop 2020 vs 2019

- Strong adoption of technology makes the sector competitive at both manufacturing and retail levels
- Brands such as Puma or Adidas are extremely strong competitors in the sports segment at global level
- The success of online specialized marketplace Zalando makes Germany a leader in fashion e-commerce

The F&A sector in Germany has been going through a significant transformation, in a similar way to other European countries. The overall reduction in manufacturing output and employment and the move towards high-tech at the expense of low-tech manufacturing in the past decades has radically changed a German F&A sector who has been able to modernise and adapt to globalization, specialising in products with high added value, for example technical clothing (e.g., security, health).

German brands have also specialised in sports products and giants Adidas and Puma are leading the world scene in the segment, together with American Nike. German/Dutch/Belgium C&A is also the most important brand for fast fashion with a global presence.

The German ecosystem is supporting not only the manufacturers in innovation and how to reap the benefits of the adoption of technology in internal and external processes, but it has also been useful to boost the emergence of a number of marketplaces specialised in fashion (e.g., Zalando, today one of the biggest retailers in Europe).

The ecological and social awareness of German consumers is leading a number of companies to adopt more sustainable processes.

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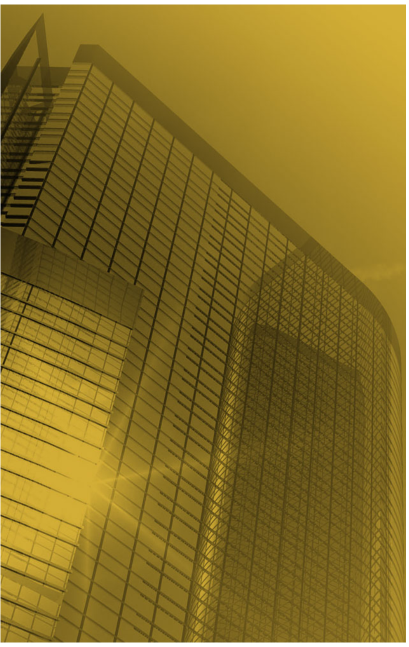

COUNTRY DATA		F&A DATA	
USD 31.6	GDP pc (,000)	EUR 31.2bn	Turnover manufacturing
5.8%	GDP growth, 2021	EUR 27.9bn	Turnover retail
1.7%	Inflation, 2021 (annual average)	-27.1%	Sales drop 2020 vs 2019

- Italy is the biggest F&A manufacturer and exporter in Western Europe
- The manufacturing landscape is made of many competitive, specialized and highly-skilled SMEs
- Italian companies are not however showing signs of adapting quickly to new trends and environment

With around 30,000 companies and 175,000 employees in the clothing manufacturing F&A sector, Italy is the biggest producer of Europe. Italy is the biggest exporter of the EU; exports outside the EU (including rich and not rich countries) represent around 50% of the total. The wide distribution of destinations (including countries with quality requirement lower than the EU's) shows that the sector is flexible, adaptive and diverse.

As is the case in other sectors, small family companies often form the F&A manufacturing, who have been able to access bank funding, training or new technologies. This has however been a barrier to fully benefit from globalization, in contrast with other countries such as Spain, France or the UK, and few Italians companies are among the biggest global or European retailers.

In the aspirational luxury segment, Italy boasts internationally-renown companies like Armani and Dolce & Gabbana that have managed to expand globally. Calzedonia, traditionally specialised in socks, has also managed to expand in other segments of the market, with operations in several key markets such as the UK, the US, China and Japan.

Few actors have appeared in the context of the new challenges that the sector is facing. In contrast with other countries, we don't find new companies leading the online go-to-market strategy or new specific marketplaces for clothing.

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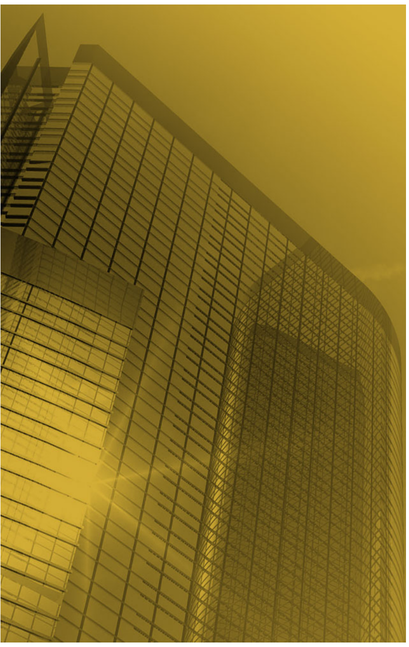
F&A in Spain



COUNTRY DATA		F&A DATA	
USD 21.2	GDP pc (,000)	EUR 9.0bn	Turnover manufacturing
5.7%	GDP growth, 2021	EUR 27.2bn	Turnover retail
2.2%	Inflation, 2021 (annual average)	-31.7%	Sales drop 2020 vs 2019

- Spain saw the emergence of global F&A retail giants in the past decades
- These groups are particularly threatened by new consumer trends looking for slower fashion and more respectful practices
- The sector is however dynamic and allows some local companies to emerge to respond to these new trends

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With 70,000 companies and sales in retail generating almost EUR 30bn annually, the F&A is a key sector of the economy. It is relevant not just due to its direct contribution, but also for its indirect contribution in terms of reputation, tourism, and positive externalities in terms of expertise acquired to succeed in such a competitive market.

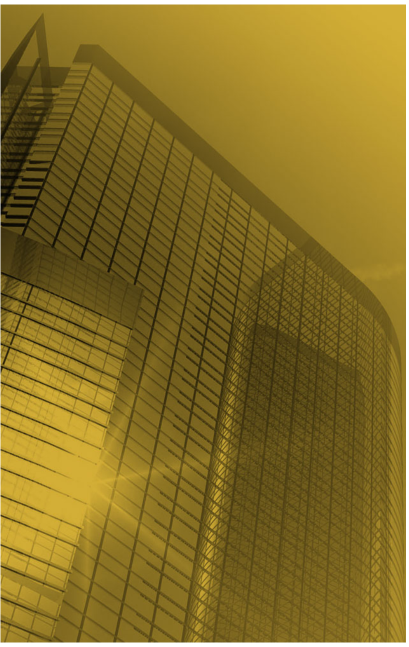
Home of global leaders in casualwear such as Inditex -the controlling company of Zara-, Mango, Camper, and Desigual, Spain has become a key player in the European and global F&A market. The combination of its long tradition in design (Modernism in Catalonian architecture, for example), in modern painting (with Miro, Picasso and Dali), its sophisticated industrial base (mainly in the north of the country) and an efficient use of the benefits of accessing the EU in mid-1980s (macroeconomic stabilization and access to affordable credit) have led to a robust growth of the sector that found its way to expanding globally.

Although companies like Zara have been extremely innovative and created a new way of consuming fashion, the rapid expansion of the sector in recent decades could find challenges. Threats to globalisation (coming from the trade tensions between China and the US and Brexit) in combination with the emergence of a more responsible fashion consumer encouraging the circular economy, the respect of social and environmental standards or the slow fashion movement could affect Spanish companies particularly hard.

Moreover, the emergence of e-commerce, that has been amplified by the COVID crisis, will require from good part of the Spanish companies -whose expansion has been driven by a strong physical presence- to adapt rapidly to the attributes demanded by an increasing portion of European consumers.

In recent years, a number of new companies have emerged to be part of new market niches such as the second-hand one (e.g., Percentil), or to develop new marketplaces for clothing such as esdemarca.

F&A in the UK



COUNTRY DATA		F&A DATA	
USD 46.2	GDP pc (,000)	EUR 2.9bn	Turnover manufacturing
6.8%	GDP growth, 2021	EUR 48.9bn	Turnover retail
2.2%	Inflation, 2021 (annual average)	-26.5%	Sales drop 2020 vs 2019

- The UK F&A sector is extremely dynamic and competitive, driven by strong purchase power and an environment favoring investment
- Brexit will be adding extra pressure on the sector, from supply chain to international trade facilitation

The UK retail sector is the biggest in Europe, with London being its vibrant centre, specifically for F&A. Companies in clothing retail in the UK are bigger than in the rest of the region's as the number of multinationals and companies with branches is bigger than in other countries. All the main brands of the world have a key branch in London, if not a flagship store. This is explained by the Londoners' high purchase power and the constant inflow of tourists.

The combination of highly sophisticated logistics, economic openness and the easiness to adopt changes and innovations has created an extremely efficient sector. The international relevance of the F&A in the UK has not been a barrier for the development of local brands.

Companies like Next, JD Sports or Marks & Spencer have become leaders in the UK and the European market. A more specialised and high-quality F&A sector is also present in the country. A number of local companies (e.g., Burberrys, Stella McCartney or Vivienne Westwood) have leveraged the British cultural tradition that combines innovative design and British style, and expanded globally.

As part of its dynamism and innovative spirit, a number of alternatives have emerged in recent years to compete in the segment that challenges the "fast fashion". On top of the traditional charity shops (the Oxfam Online Shop is an example of a digital version), a number of second-hand marketplaces such as Thrift+ or Hardly Ever Worn have stepped into the market, competing with foreign companies operating in the county such as Lithuanian Vinted. E-commerce has also been thriving in the country, helping the development of a few companies (including Asos) that emerged and expanded rapidly.

The F&A sector in the UK will face not just the same challenges that the industry faces in the rest of the continent. It will also need to adapt to the changes driven by Brexit, which is expected to affect a number of key elements such as international trade, conditions in the labour market, tourism real estates and supply-chain management to name a few.

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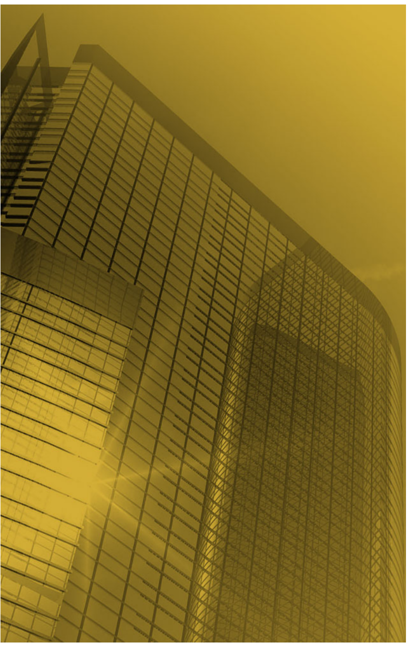

	FRA	GER	ITA	SPA	UK
Macroeconomic indicators					
GDP, 2021 (USD bn)	2,940	4,230	2,120	1,440	3,108
GDP per capita, 2021 (USDs)	45,028	50,788	31,604	21,179	46,200
GDP expansion, 2021 (% change)	6.3	3.0	5.8	5.7	6.8
Inflation, 2021	1.9	2.9	1.7	2.2	2.2
Unemployment rate, 2020	8.1	3.7	10.3	15.4	5.0
Population (m)	65.3	83.3	59.6	47.2	67.7
Exports, 2021 (% change)	7.5	9.4	12.9	11.9	0.4
Investment, 2021 (% of GDP)	25.7	22.3	19.5	21	17
Ecosystem performance					
Doing Business Index	76.8	79.7	72.9	77.9	83.5
Degree of openness, 2019	65	80	60	67	64
Infrastructure (WEF Index)	89.7	90.2	84.1	90.3	88.9
R&D (as % of GDP)	1.4	2.2	0.9	0.7	1.2
F&A Manufacturing					
Number of companies (in 000s)	12.1	2.9	29.7	9.0	3.9
Number of employees (in 000s)	39.8	39.6	175.6	36.7	20.7
Turnover (EUR bn)	7.0	7.6	31.2	9.0	2.9
Productivity	209	230	187	122	233
Production, 2020 (% change)	-11.8	-19.7	-32.7	-26.9	-11.2
F&A Retail					
Number of companies (in 000s)	38.3	30.2	80.5	58.1	14.0
Turnover (EUR bn)	20.0	39.2	27.9	27.2	48.9
Gross margin/Turnover	43.6	47.5	46.0	35.3	49.0
Sales, 2020 (% change)	-22.6	-23.5	-27.1	-31.7	-26.5

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