FASHION FOR GOOD

THE FUTURE OF CIRCULAR FASHION

ASSESSING THE VIABILITY OF CIRCULAR BUSINESS MODELS

A COLLABORATIVE REPORT BY ACCENTURE STRATEGY AND FASHION FOR GOOD

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FOREWORD

Driven by an insatiable consumer appetite for newness and variety, the model of how we make and purchase fashion has rapidly changed. Today, more than ever, consumers are buying more clothes and keeping them for less time. Global fashion production has more than doubled in the past 15 years, while the associated impact on the environment is increasing. The fashion industry, as it currently operates, is not sustainable.

We need to create a circular fashion system. A system that combines new business models with innovative design, technologies and materials that eliminate waste and pollution and drive positive impact across the fashion value chain.

There is a growing recognition of this need - and the industry has started to transform. New sustainable materials have emerged, circular design principles have been incorporated, and take back and material recycling schemes have become more conspicuous. Global fashion brands have committed to circularity and some governments are creating legislation to help accelerate circular adoption. Fashion for Good is at the centre of this systemic change and drives the acceleration and scaling of innovative solutions, to move away from the linear 'take-make-waste' model towards a circular approach. It is in this context that circular business models have emerged as a key area of focus. In transforming how fashion brands and retailers create value, circular business models present an opportunity to fulfil consumer demands, drive innovation and simultaneously reduce environmental impact.

Meaningful progress has been made and disruptive start-ups are implementing a wide range of circular models. However, established brands and retailers have been slower to act with hurdles inhibiting large scale adoption. These include the perceived risk of cannibalisation, operational complexity of new models and uncertainty on the financial viability.

For this reason, Accenture Strategy and Fashion for Good have collaborated to produce this report, combining our unique expertise of the circular economy and fashion industry, to explore the financial viability of circular business models.

Our analysis, which explores the economics of circular models at a garment level, is the first of its kind in the industry. We have undertaken a detailed analysis of three circular business models; Rental, Subscription-Rental and Recommerce, across four industry segments; the Value Market, Mid-Market, Premium and Luxury. The results help identify both where circular models are attractive today and some of the critical levers to enhance their viability in future.

We would like to extend our thanks to the dozens of fashion retailers and innovators that have helped us to develop this report – their detailed input has allowed us to build a robust analytical framework and substantiate our findings with detailed insights. Our hope is that this report can accelerate the journey towards large-scale adoption of circular business models in fashion.

The time to commit to a circular economy transition, is now.

Harry Morrison,
Managing Director,
Accenture Strategy,
Sustainability

Lynda Petherick,
UKI Retail Lead,
Accenture

Katrin Ley,
Managing Director,
Fashion for Good

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EXECUTIVE SUMMARY

CONTEXT

The fashion industry is not sustainable in its current form. The environmental footprint is accelerating due to raw material consumption, pollution and waste. The need for a more circular system, where garments and materials are reused, is urgent. Some progress has already been made:

- Brands and retailers are experimenting with new materials and take-back schemes.
- Consumers are increasingly aware of the environmental impact of the industry and expecting new solutions.
- Policy is beginning to tackle some of the key waste challenges.

Unfortunately, the scale of this progress is not yet sufficient to offset consumption growth and reduce the environmental impact.

Circular business models can enable brands to decouple growth from the use of scarce and finite resources. But there are significant barriers to adoption. These include the complexity and operational risk of circular models and a lack of clear evidence on long-term financial viability. These barriers are particularly relevant for established retailers currently operating a successful linear model, with many uncertain about how to best implement a new circular economy approach.

OUR APPROACH

This report hopes to help accelerate the transformation by addressing one of the main barriers: an understanding of the financial viability of circular models for established retailers.

To do this, we developed a financial analysis for three circular business models:

- **Rental**: A one-off rental of a garment for a short time period.
- **Subscription-Rental:** A monthly fee paid for access to a range of garments.
- **Recommerce**: The recovery and resale of a garment by the original retailer.

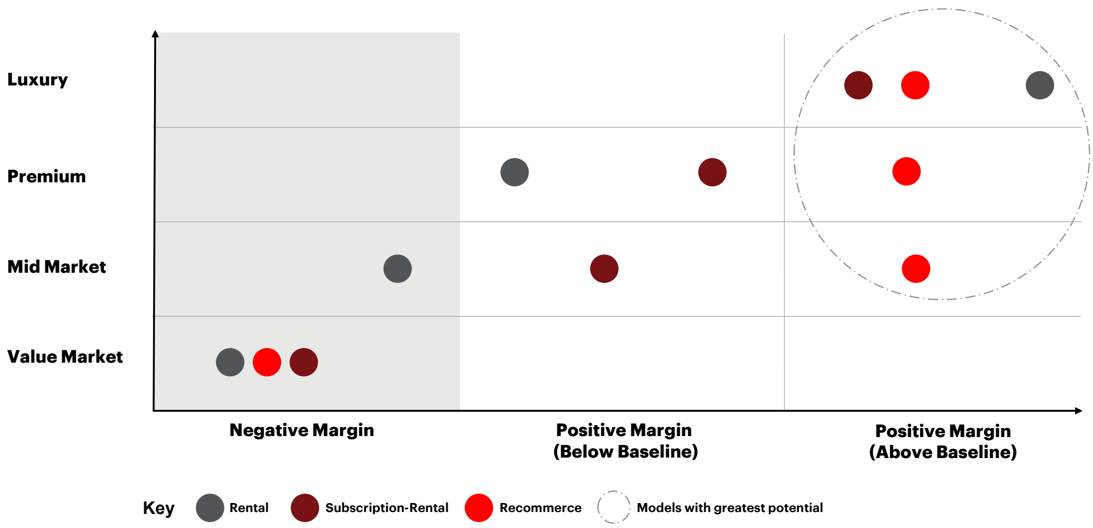
Each of these circular business models have been explored across four industry segments; the Value Market, Mid-Market, Premium and Luxury, using a bottom up approach to calculate margin on a per garment basis. Our modelling logic and assumptions were validated by leading fashion retailers, circular innovators, and industry experts. We conducted a combination of interviews (with 15 leading fashion retailers and innovators) and undertook in-depth research to gain qualitative insights to support our financial modelling.

OUR FINDINGS

There is a strong case to explore circular business models. All three of the models explored can be financially viable for existing fashion retailers, presenting opportunities that could drive a higher margin per garment compared to the current linear model – the baseline.

Rental appears to be very attractive in higher-value segments, Subscription-Rental has consistently strong potential, while Recommerce appears to be the most financially attractive of the models analysed. The margin potential varies significantly by segment. Luxury would appear to represent the biggest opportunity, while new variable costs associated with each model make the Value Market consistently challenging (see Figure 1).

Figure 1: Visual representation of the financial viability of circular business models based on our analysis



Our findings challenge value retailers to innovate low-cost fulfilment channels, to get better data on garment durability, to implement changes in product design to improve quality, and to change the perception of low-cost fashion as disposable. For the Mid-Market and Premium segments, financial viability is very sensitive based on a few key levers (see Figure 2).

Figure 2: Illustrative overview of key financial levers associated with each circular business model

Business Model	Key levers
Rental	Number of rentals; rental price; postage and packaging
Subscription-Rental	Churn; customer acquisition cost; number of garment exchanges
Recommerce	Inventory acquisition cost; recommerce price; logistics

Circular business models can also drive value by improving customer engagement and retention. The visibility of customers' product usage data available through these models may also provide advantages for circular models over traditional retail.

Each of the models has the potential to fundamentally change the commercial incentives of the fashion industry. It could shift from a volume focus to an industry that is incentivised on quality – in which garment durability and number of uses would become the critical enablers of commercial viability. These benefits are not however guaranteed, and new business models must be designed with an explicit sustainability focus to recognise the potential environmental benefits.

WHAT NEXT?

Our hope is that this report can support a journey toward large-scale implementation of circular business models in fashion. Retailers should use these findings to build a deeper understanding of each model and the key strategic considerations for successfully building and scaling new circular economy services.

There has never been a better time for fashion retailers to commit to the circular economy. Technological advances, infrastructure improvements, the emergence of start-ups, shifting consumer preferences, new circular design practices, alongside increasing regulatory pressure, are creating an enabling environmental for established retailers to pursue circular economy initiatives with certainty.

The time to start the circular economy transition, is now.

INTRODUCTION

CONTEXT FOR THIS REPORT

The fashion industry, in its current form, is unsustainable. Since 2002, global clothing production has more than doubled, the average consumer buys 60% more, and each garment is kept for half as long.[1] Today, fashion is one of the world's most polluting industries and, on the current trajectory, it is projected to use 25% of the world's carbon budget by 2050.[1] With two billion more people set to join the global middle class by 2030[2], these challenges, and the industry's impact, will continue to accelerate unless we fundamentally change how fashion operates.[3]

The solution is becoming increasingly clear – we need a circular economy. Defined as "the decoupling of growth from the use of finite resources by eliminating waste at every stage of the value chain," a circular economy combines Fourth Industrial Revolution (4IR) technologies with innovative circular business models to drive competitiveness and deliver value to consumers, citizens and the global economy.[4]

In fashion, a circular economy requires the combination of new garment design strategies, sustainable materials, advanced recycling technologies, alongside new service-oriented business models, to create desirable, low-impact & long-lasting garments.

The shift to this circular fashion system has already begun – 12.5% of the fashion industry has committed to circularity[5], while many leading retailers have set bold ambitions towards a sustainable future. Consumer awareness of the environmental impacts of fashion is accelerating the pace, and urgency of this transformation.

The focus of circular transformation to date, as discussed in Accenture's recent Circular Advantage report, has been on innovations and business models at the start and end of the value chain. In fashion, this focus is clear; most of the circular innovation has been on developing sustainable materials, establishing take-back schemes, and improving recycling infrastructure. While these solutions are important aspects of a circular fashion system, they only serve to treat the symptoms of the industry's inefficiency and still lack scale. Today, just 1% of clothing is recycled back into clothing, 73% goes to landfill.[1]

The establishment of a circular fashion industry depends on the holistic transformation of products and services, alongside the creation of an enabling environment for ecosystem change.[6]

It is within this context that the importance of adopting the full range of circular business models is critical. Combined, and applied holistically with innovation technology, they can fundamentally alter the basis of the industry. Circular models move beyond simply selling more stuff, towards a focus on addressing customer needs and creating more value the longer a garment remains in circulation. Retailers can drive a higher margin, as is discussed further in this report, and can also provide a more convenient, flexible and personalised service for customers.

Circular business models can deliver a triple win; for retailers, for customers and for society.

Meaningful progress has been made; innovative and disruptive retailers are already developing and implementing solutions. However, current examples are not yet at a scale that impacts the dominant model of the industry, while barriers remain in place preventing large scale adoption.

This report seeks to address one of the main barriers to circularity: an understanding of the financial viability of circular models. We analyse three business models across four industry segments; (from Value to Luxury) (see Figure 3), with a focus on consumer facing, established fashion brands and retailers, to provide new insight on where and how circular models are, or can become, commercially viable.

> **"Established companies are finding it hard to make the unit economics for circular business models work in"**
> Circos

Figure 3: Scope of the report including models and segments

Scope of the report

3 CIRCULAR BUSINESS MODELS

Rental
One off rental of a garment for a short term period, with no option for purchase

Subscription - Rental
Monthly fee paid for access to 4 garments that can be exchanged by the consumer, at any time, with an option to purchase at a reduced price

Recommerce
The recovery and resale of garments previously sold by original retailer

4 INDUSTRY SEGMENTS

Value Market
Low price point offering, high volumes of sales and broad product range

Mid-Market
Retailers offering value garments at mid-low price point

Premium
Premium retailers offering affordable luxury, standardised product range

Luxury
Luxury designer retailers, high price point and high quality

ASSESSMENT APPROACH

This report is a quantitative assessment to support established fashion brands and retailers (referred to as retailers from here onwards) in their strategic decision making to implement circular models into their existing businesses. The analysis looks at the relative profitability of each business model, across each segment, on a per unit basis.

To do this analysis, a few core considerations have been made (for the detailed methodology, see Appendix):

Segment price points: We selected a typical price point to represent each segment for this analysis. Price points were validated by interviews and external research to make them as representative as possible. Details on the price points can be found in the Appendix.

Baseline: To enable a comparative analysis with today's linear models, this analysis established a guideline margin across each of the four industry segments. This is referred to as the baseline. The baseline was calculated based on publicly available financial data, with the margin percentages verified by retailers during interviews.

Point in time: The analysis looks at marginal profitability at a point in time, assuming a mature and scaled model, rather than attempting to understand free cash flow generation potential over time as a new circular model is developed, launched & scaled. This is done to avoid the need to make assumptions about initial investment costs, the roll-out or maturity curves of these models. This means it is not possible to quantify NPV or RoI within this analysis.

Maturity: We have assumed the models under examination have reached a level of maturity and scale that allows for like-to-like comparison with the baseline.

Cost ownership: Our model assumes that all operating costs associated with new circular business models are taken on by the retailer.

Cost focus: This financial analysis focuses on changes to the operating cost base (opex) rather than capital expenditure (capex). We account for COGS and new variable costs associated with each model, including additional manpower and customer acquisition cost associated with the operations of each model. All models will require some upfront, and some ongoing, investment but the precise nature of that investment will depend heavily on the strategic choices made by the retailer (e.g. on brand development). These are not included as part of this analysis.

Sustainability impact: In all cases we have assumed that these models are explicitly designed to address sustainability challenges posed by the industry – i.e. by improving material utilisation and eliminating waste. This would have to be an intentional goal of any new circular model.

The financial model we developed was based on a series of assumptions, each of which was validated with retailers, innovators and industry experts to form the base case of the model. Core assumptions include (see Figures 4-6):

Figure 4: Rental model core assumptions

	Validated base case assumptions by segment			
Assumption	**Value Market**	**Mid-Market**	**Premium**	**Luxury**
Rental price (% of original)	20.0%	18.0%	15.0%	10.0%
Number of Rentals (per garment lifecycle)	5	10	20	30
Postage and Mailing (per rental transaction)	€3.50	€3.50	€4.20	€5.04
Laundry Cost (per 1kg of volume)	€3.00	€3.60	€4.32	€5.18

Figure 5: Subscription-Rental core assumptions

	Validated base case assumptions by segment			
Assumption	**Value Market**	**Mid-Market**	**Premium**	**Luxury**
Average time per garment exchange (months)	2	2	2	2
Probability of item purchase (per garment)	17.5%	17.5%	17.5%	17.5%
Customer acquisition cost (% of monthly subscription price)	100%	100%	100%	100%
Churn (monthly)	12%	12%	12%	12%

Figure 6: Recommerce model core assumptions

	Validated base case assumptions by segment			
Assumption	**Value Market**	**Mid-Market**	**Premium**	**Luxury**
Average recommerce price (% of original)	50.0%	50.0%	50.0%	50.0%
Discount Voucher (% of recommerce price)	15.0%	15.0%	20.0%	40.0%
Photography Cost (% of recommerce price)	10%	10%	10%	10%
Packaging	€0.30	€0.50	€1.00	€2.00

This report focuses not only on the financial results but also tests key sensitivities which most influence profitability.

To augment and deepen the financial analysis, we conducted a series of interviews with companies from across the industry. These interviews helped to test and refine our logic and to validate assumptions where required. The outputs from these interviews have been included in the report on an anonymised basis.

OUT OF SCOPE

There are a series of things that are beyond the scope of this report and are not explored in detail as part of this analysis (see Appendix for full detail). These include:

Cannibalisation: Market cannibalisation, the risk sales via new model's replace the sales in traditional retail channels, is a real consideration for corporates adopting circular business models. Cannibalisation has been included qualitatively within this report but is not part of the financial modelling.

Detailed sustainability impact assessment: Sustainability is referenced in this report based on interviews and desk-based research. We have not attempted to measure the sustainability impact (e.g. the additional impact of laundry, logistics etc. with new model's vs the tonnes of material, water or CO2 saved) of new models. In each model, improved clothing utilization, the extension of the life of a garment and the displacement of purchasing new garments are key levers that drive sustainable impact.

OVERVIEW OF FINDINGS

CIRCULAR BUSINESS MODELS WILL SHAPE THE FUTURE OF SUSTAINABLE FASHION

Circular business models will have a big role to play in ensuring the sustainable transformation of the fashion industry and understanding their impact is an imperative for incumbent retailers seeking to future proof their businesses and remain competitive. Some innovative retailers have started this transformation. (see Figure 7) - those who don't act risk losing market share in response to shifting customer demands, increasing competition from circular economy inspired start-ups, and the growing need to take demonstratable action towards a more resource efficient fashion system.

> **"Circular business models are going to significantly change the fashion industry, presenting major challenges and opportunities to today's fashion retail world"**
> C&A

Figure 7: Illustrative overview of established retailers that have adopted circular business models

Established retailers adopting circular business models		
Rental	Subscription-Rental	Recommerce
Filippa K	American Eagle	Eileen Fisher
Tchibo	Ann Taylor	Filippa K
	Express	Icebreaker
	Gwynnie Bee	North Face
	New York & Company	Patagonia
	Rebecca Taylor	Prana
	Vince	REI
	Y Closet	Zalando

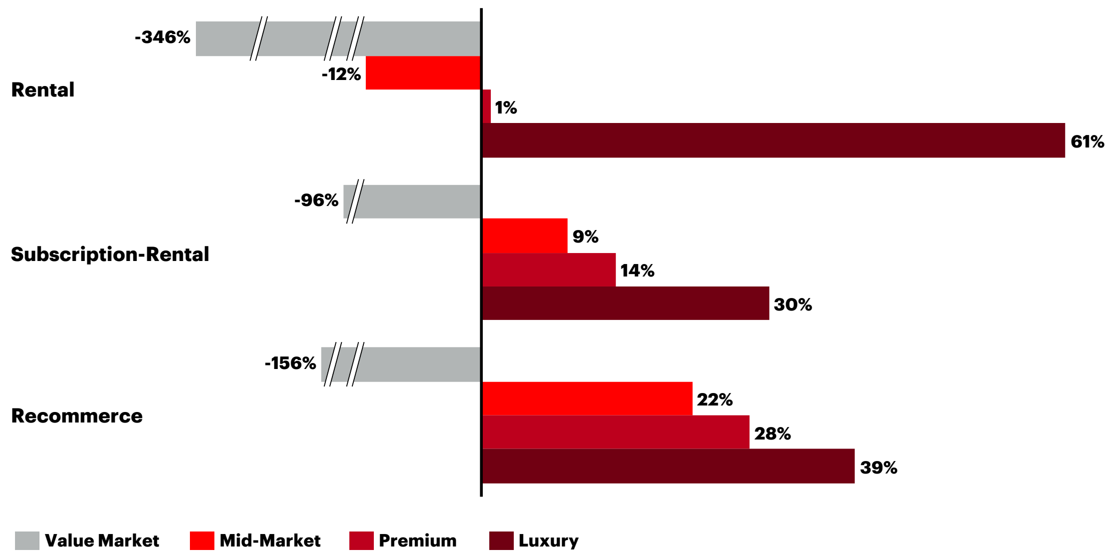
CIRCULAR BUSINESS MODELS CAN BE FINANCIALLY VIABLE

Each of the business models examined here, Rental, Subscription-Rental, and Recommerce, could be financially viable for existing fashion retailers, but this varies significantly by industry segment (see Figure 8).

- **Rental** appears to be very attractive in Luxury, with a potential margin of >60% per garment. For the Mid-Market and Premium segments, specific product characteristics that influence rentability, for example how often it is worn, could drive improved viability. The opportunity for Rental in the Value Market seems challenging given the high variable costs incurred per rental, relative to the low price-point for purchase as new, which puts a ceiling on the feasible rental price.
- **Subscription-Rental** has consistently strong potential, and it appears viable in 3 of 4 segments. Beyond the Value Market, estimated margins are largely consistent with those in our baseline for traditional retail.
- **Recommerce** appears to be the most financially viable circular business model, with profitability exceeding the baseline in Mid-Market, Premium and Luxury segments. This is intuitive given the relative operational simplicity of a Recommerce model in comparison to the other models explored. However, retailers will have to work hard to attract customers who have other outlets for resale – the direct sale of unwanted garments, through channels such as Depop or eBay, is easier than ever before. Retailers will therefore have to ensure that customers are sufficiently motivated and incentivised to return garments to build the requisite inventory.

In addition to direct financial returns, each circular business model presents fashion retailers with additional opportunities. These include engagement with new customers, often at lower price points and deepening relationships with existing customers. Retaining an engaged customer base and learning more about their product usage habits could be a key long-term, structural advantage for circular models over traditional retail.

Figure 8: Operating margin by circular business model



CIRCULAR MODELS MAY INITIALLY BE MOST ATTRACTIVE FOR HIGH PRICE SEGMENTS

Higher price-point segments of the industry look the most attractive for the adoption of new circular models. Luxury represents the clearest opportunity; each of the models could enable higher margins per garment than the existing industry baseline (see Figure 9). The Rental and Recommerce models look most attractive for incumbent retailers in this segment.

In the Mid-Market and Premium segments, margins are more sensitive and dependent on key strategic choices. Each model has several levers that, if carefully considered, can help accelerate uptake and financial viability.

KEY INSIGHT

Making the Value Market financially viable

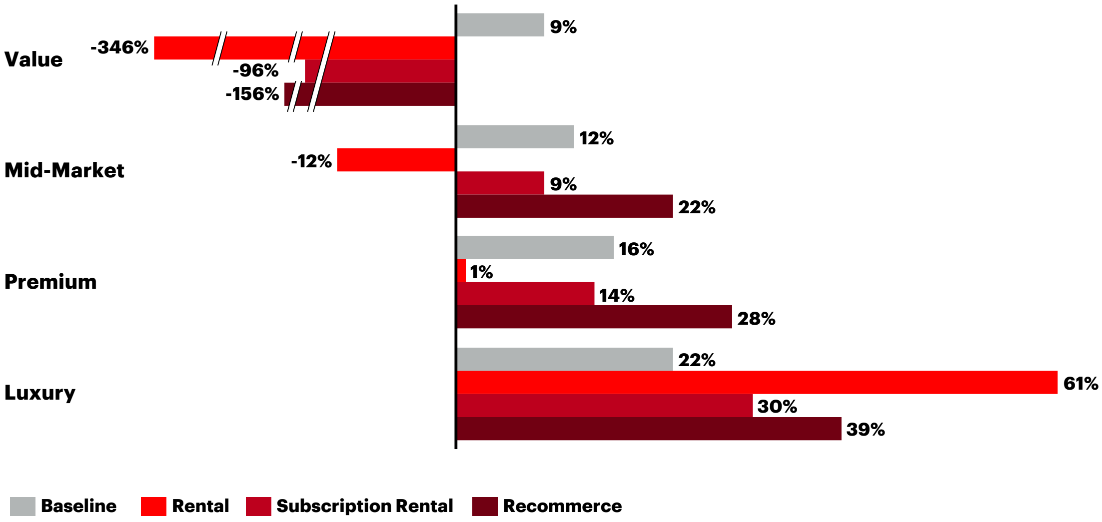
Based on where the industry is today, and our current assumptions, new circular business models will be challenging to deliver in the value segment due to a combination of factors:

- **Net-new costs** (e.g. logistics, packaging and manpower) incurred per transaction in new business models may exceed the revenue opportunities for low price-point items in fashion.
- **The lower life expectancy,** quality and durability of garments in the value segment makes reuse a challenge, with many items designed poorly, using cheap materials and processes to reduce costs of production.[7]
- **Consumer perception** of affordable fashion as poor quality and inherently valueless beyond point of sale – 44% of consumers believe the quality of fashion has declined in the last year along[7] – creates an inherent barrier for new business models in this segment.

Given the significant environmental impact of the value market, further attention should be given to exploring how new business models could become financially viable and successful solutions in the future. This will require an explicit focus on:

- **Finding low-cost fulfilment models** (e.g. via pick-up/drop-off points);
- **Embedding circular design principles** to improve garment quality and durability for selected garments; and, perhaps most importantly;
- **Changing the consumer perception of affordable fashion**, with a focus on sharing a message of quality and durability.

Figure 9: Operating margin, by segment



ACT NOW – OR MISS OUT

The consensus from our interviews as part of this research was clear: innovation and adoption of new circular business models is highly likely to grow across the fashion industry regardless of participation from existing fashion retailers – those that fail to respond risk losing the initiative on this topic and missing out over the longer term.

The time for established retailers to act on circular business models, is now.

This report should be used as a guide for fashion retailers to support faster mobilisation and action towards the adoption of circular business models into their existing businesses. The findings of our analysis are a starting point – and as circular models mature and the costs of technology and distribution fall, we anticipate that these circular models will become steadily more attractive across all industry segments. The following three chapters explore each of the three models, Rental, Subscription-Rental, and Recommerce in further detail.

> **"Circular business models are a key part of our future business"**
> Stella McCartney

RENTAL

CONTEXT

Rental in fashion is not new. It has been part of fashion for decades, focused on specialist items for one-off events, notably weddings, yet it has remained a small part of the industry. This continues today; an Accenture survey as part of this research found that just 4% of respondents had used Rental in the last year.[8]

Rental, however, is changing. Driven by fashion tech companies with expertise in reverse logistics and inventory management, Rental is transforming from an outdated model to an innovative, modern way of consuming fashion.[9] This disruption has been accelerated by:

Recognition of wasted capacity: There is an increased focus on the value of wasted capacity in fashion; c.50% of items in a customer's wardrobe are unworn[10], creating an estimated $30bn worth of unworn items in UK wardrobes alone.[11]

Demand for access over ownership: Customers are demanding newness, variety and access in fashion. Rental can cater to these demands in a less environmentally damaging way than the existing model. Furthermore, the same customers are increasingly demanding retailers to have a position on sustainability – 73% of millennial customers would shift to a brand with a clear purpose[12] – and those aligning proactively can capture market share.

Customer value: The key driver for rental is its ability to offer a customer centric, affordable solution for a rare occasion that would otherwise be too expensive. Rental allows customers to wear previously unaffordable and unattainable garments.

MARKET INSIGHTS

The fashion rental market is projected to be worth $1.9bn globally by 2023 – a doubling in value from 2017.[13] To date, innovation has been dominated by disruptive tech companies, focused on optimising processes for returns, inventory management, and data collection. This has tended to focus on high priced segments, with leaders including Rent the Runway and Girl Meets Dress, alongside peer to peer leaders such as Style Lend.

Uptake of Rental remains limited, but the opportunity is clear: research found 50% of millennials would like to use Rental fashion models.[14]

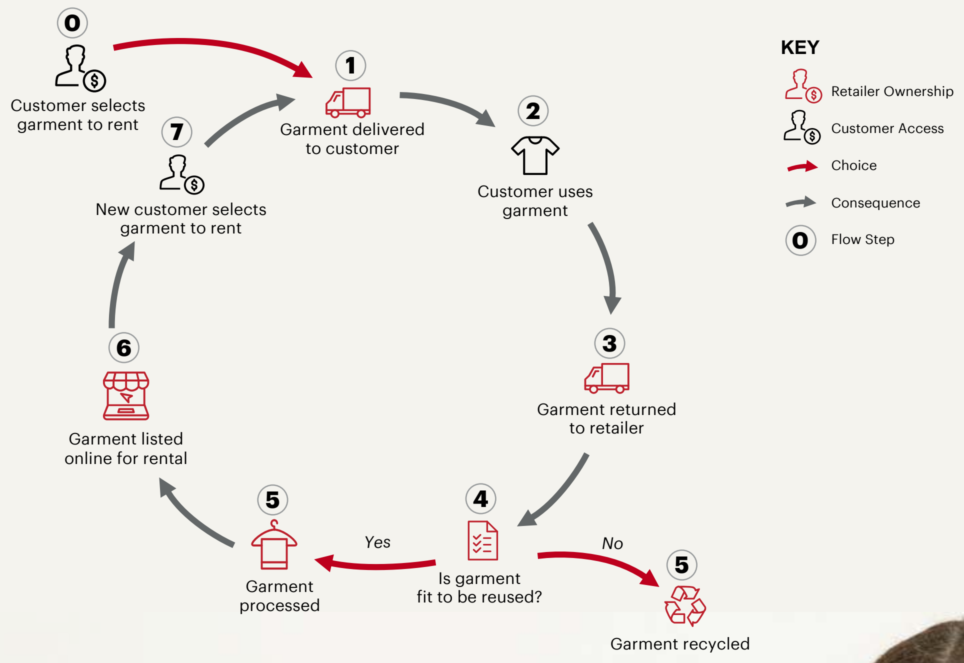
DEFINITION OF RENTAL

Revenue: A one-off fee paid for access to a specific garment for a set time, with no option for outright purchase.

Go-to-market channel: Digitally enabled/online solutions (i.e. not rental from a store).

Fulfilment: End-to-end ownership of all the processes and associated costs taken on by the incumbent retailer.

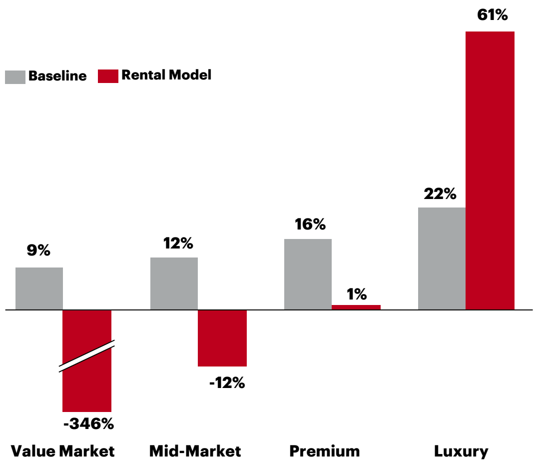
Figure 10: A visual representation of the Rental model garment flow



FINANCIAL VIABILITY

Rental presents a potentially highly profitable opportunity for Luxury. The variable costs associated with the model, including postage, packaging & processing/cleaning, alongside intrinsic limits to the feasible number of rentals, reduce the potential viability in lower value segments

Figure 11: Rental margin by segment vs baseline



RENTAL IS THE LUXURY OPTION:

Rental should be profitable for incumbent Luxury retailers and should be explored in detail by industry leaders. Our base case analysis shows a 3x improvement in operating margin vs. the baseline on a per garment basis. This is driven by earning revenue on multiple occasions with a high number of rentals per item. The Luxury opportunity is not limitless, however; our interviews and additional research identified there is a threshold above which customers are not willing to pay for a one-off rental at around €200. This analysis assesses the viability of Luxury at the upper end of this threshold (€170 per rental, 10% of retail price in base case) and retailers should carefully consider pricing to ensure demand and profitability.

RENTAL MAY BE CHALLENGING IN THE VALUE MARKET:

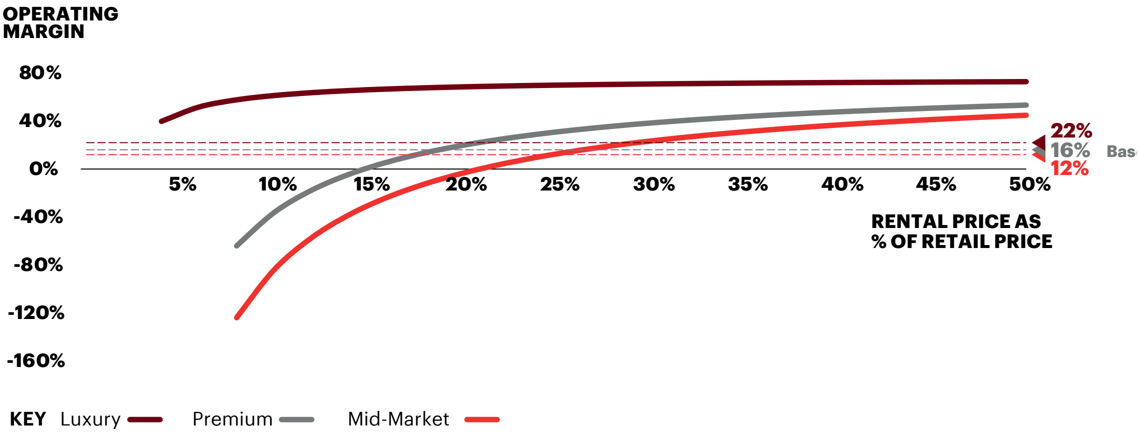
Beyond Luxury, making rental viable appears challenging, particularly in the Value Market, where net-new variable costs incurred each turnover, such as postage, packaging and laundry, hugely exceed the likely revenue per rental. Furthermore, research suggests lower value items are rented fewer times based on lower garment life expectancy, thus limiting potential revenue gains. However, Rental in the Value market is by no means impossible and finding a profitable solution in this segment is a fundamental necessity if circular business models are to meaningfully reduce the environmental impact of the industry.

Our research demonstrated that value retailers are committed to exploring new business models as part of their future businesses. To make this happen, efforts to measure and enhance garment durability to improve life-time revenue potential, alongside identifying economies of scale and innovative logistics solutions to reduce costs, must be an urgent imperative for value retailers if they are to make their commitment to Rental a reality.

KEY STRATEGIC CONSIDERATIONS

RENTAL PRICE: Rental price is a critical factor in determining viability. Holding all other assumptions constant, we can identify the rental price point which allows for breakeven, and for increased profitability than the baseline for each market segment (see Figure 12).

Figure 12: Operating Margin % as a function of rental price
(Base case assumption: Value: 20% Mid-Market: 18%, Premium 15%, Luxury 10%)



The value market is not displayed

For Luxury, the financial viability remains high, with an improved margin vs baseline profitability down to a rental price of c.5% of retail price. Based on these findings, Rental could be a financially viable business model across a wide range of high value items.

For Mid-Market and Premium segments, pricing dynamics can allow Rental to become viable. In the Mid-Market, a price point >25% of the retail price, c.€20 to rent a €75 garment exceeds the operating margin of the baseline linear model. Analysis of the Premium segment presents a similar outcome; a rental price >20% of retail, €26 to rent a €130 garment, drives an improved operating margin vs. the baseline (see Figure 13). Optimal pricing in these segments could drive a financially viable Rental model.

Figure 13: Impact of Rental Price on operating margin in Mid-Market and Premium segments

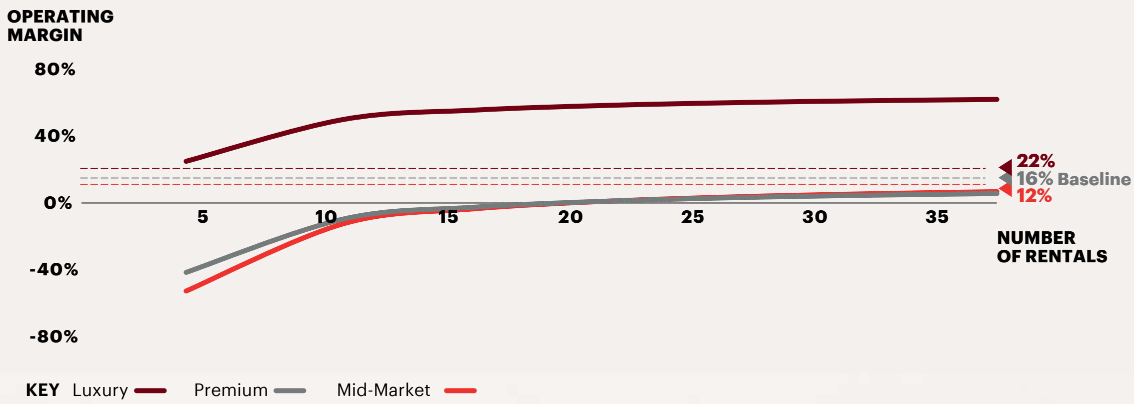
	Mid-Market - €75 garment		Premium - €130 garment	
Rental Price %	Rental Price €	Operating Margin	Rental Price €	Operating Margin
15	11	-30%	19	1%
20	15	-4%	26	20%
25	18	13%	32	31%
30	23	23%	39	38%

The Value Market is largely unprofitable, driven by high transaction costs and low revenue opportunities per rental. A focus on achieving a revenue c.€8 per rental transaction should be a target for value retailers to drive a financially viable model based on the base case assumptions included in this analysis.

GARMENT TURNOVER: The number of times an item can be rented impacts viability. For Luxury, an item must be rented more than 4 times for it to become profitable (see Figure 14).

This is well within the industry average, however still requires a management focus on ensuring viability – these considerations include the type of garment selected, its rentability and long-term demand, as well as the laundry, warehousing and packaging processes that can support longevity and mitigate damage. Furthermore, viability is still dependent on some external factors, notably customer usage and care for the item, which presents an element of risk.

Figure 14: Operating margin % as a function of garment turnover (total number of rentals) using base case rental price



KEY INSIGHT

Scenario analysis:

A retailer can balance the rental price point with the number of rentals, and, to some extent, these two levers can be used in conjunction to compensate for one another. This balance is particularly relevant in the Mid-Market and Premium segments, where variances of these two assumptions can influence the financial viability of the model. To enable a positive margin, our model estimates these segments should aim for:

MID-MARKET:
Rental turnover >15 rentals; charging circa (c.)20% of the retail price (Base case 18%).

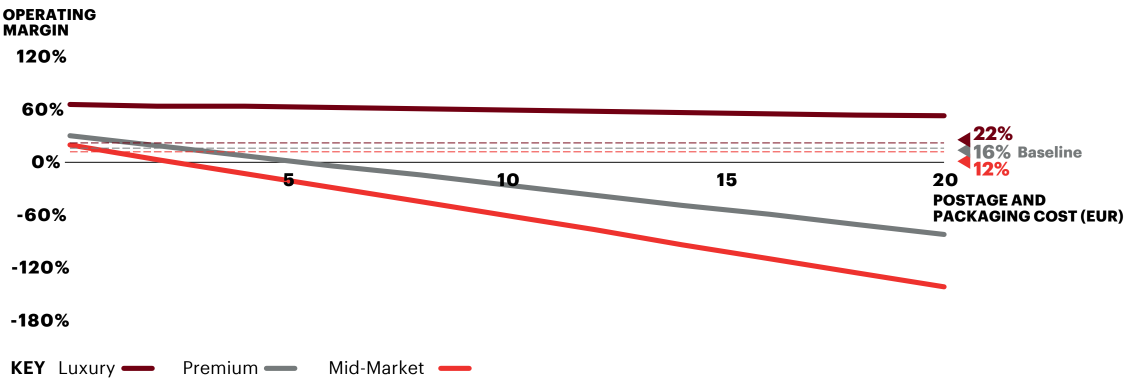
PREMIUM MARKET:
Rental turnover should be >10; charging c.20% of retail price (Base case 15%).

LUXURY:
Rental turnover should be >5; charging c.5% of retail price (Base case 10%).

LOGISTICS OPTIMISATION:

Postage and packaging is a significant cost for Rental, particularly in the Mid-Market and Premium segments where, if logistics costs remain low, Rental can be a profitable solution based on our base case (see Figure 15). To reduce these costs, retailers should investigate novel last-mile distribution models, for example bulk delivery to the workplace or optimised collection from transport hubs with automated pick-up facilities.

Figure 15: Operating margin as a function of Postage and Packaging Cost (€) per rental transaction



DRIVING ADDITIONAL VALUE

FOR RETAILERS

Innovation: This model provides an opportunity to be at the forefront of innovation. The concept of access over ownership is largely driven by new, millennial customers seeking engagement with disruptive companies – Rental provides an opportunity to align a brand with these values, in doing so, improving brand sentiment, trust and loyalty.

New data: Today, retailers have little or no insight on what happens to garments beyond the point of sale, with little understanding of how often an item is worn, in what conditions it is used nor what customers think about it. Rental could enrich data insights across each of these dimensions to improve the brand offering.

Customer engagement: Rental allows retailers to engage customers at a lower price, for specific one off, or rare occasions, whilst maintaining quality and reputation. Furthermore, the model can facilitate longer and deeper customer relationships and improve wallet share.

Case Study: GIBBON is tapping into the Rental market to cater for travelers who want to travel light or do not have the travel wear for alternative climates and seasonal activities. The intuitive AI rental marketplace matches excess inventory from brands and retailers with travelers to enable luggage-less travel. This allows GIBBON to extend the usage of excess inventory while reducing unnecessary buying from travelers.

FOR CUSTOMERS

Increased choice and flexibility: Rental creates an opportunity for customers to pay less and access more, better quality garments. Rental must be designed with the customer at the focus. This will include considering customer convenience and the demand for rental, asking questions around a garment's use, its price and its storage to help identify key customer pain points and rental opportunities.

Case study: Filippa K, one of the world's leading sustainable fashion retailers, based in Sweden, allows its customer to lease clothes for four days at 20% of the retail price. Their ambition is to help shift consumer mindsets and behaviours through making the solution fun and inspirational.[15]

FOR THE ENVIRONMENT

Reduced material demand: Rental could play a critical role in shifting the industry towards a less resource intensive model, through incentivising higher production standards and greater garment longevity. Purchase displacement rate must be considered as a key metric when assessing potential environmental benefits.

SUBSCRIPTION-RENTAL

CONTEXT

Subscription models in fashion have grown >100% in 5 years, driven by demand from high earning, young, urbanite consumers[16] with companies capitalizing on low barriers to entry. Fashion currently represents c.6% of the global subscription market and is rapidly expanding.[17]

Subscription models have already been adopted across a range of geographies and segments at reasonable scale. The increasing prevalence of subscription in fashion is predominately driven by consumers who are increasingly valuing access over ownership - with subscription services improving the diversity of accessible models compared to traditional retail, allowing for greater experimentation with new styles. Subscription fashion models, in this way, enable consumers to try new items and to experiment in a flexible, low-risk way.

MARKET INSIGHTS

Our research identified three distinct approaches to subscription models in fashion; subscription box services, subscription rental and closed-loop subscription (see Figure 16).

Figure 16: Summary of key observed variances within subscription models currently adopted in the fashion industry

	Subscription Box	Subscription-Rental	Closed Loop Subscription
Overview	Focus on personal style, designed to increase customer purchases	Focus on personal style, wardrobe optimisation and access to online wardrobe	Focus on return of items and re-use of materials
Revenue Model	Pay monthly, model dependent on purchase of items	Pay monthly, model dependent on garment longevity	Pay monthly, no option to purchase
Circular Impact	**Low** New buying option, potential to lead to higher waste	**Medium-High** Items designed for longevity, displacing purchase of new item	**High** Closed loop material cycle, with waste back in supply chain
Market Uptake	**High** Widespread innovation, high uptake driven by start ups	**Medium** Accelerating market adoption, leaders emerging globally	**Medium** Uptake limited to specific product categories, e.g. baby clothing
Example	STITCH FIX	RENTTHERUNWAY love. wear. return.	FOR DAYS

This analysis is focused on Subscription-Rental, given its scale in the market – innovative incumbents including Ann Taylor and Vince have already adopted this model, working directly with white label solutions that provide technology, logistics, marketing and merchandising subscription-rental services, in this case CaaStle – and the model's potential to enable positive environmental impacts.

DEFINITION OF SUBSCRIPTION-RENTAL

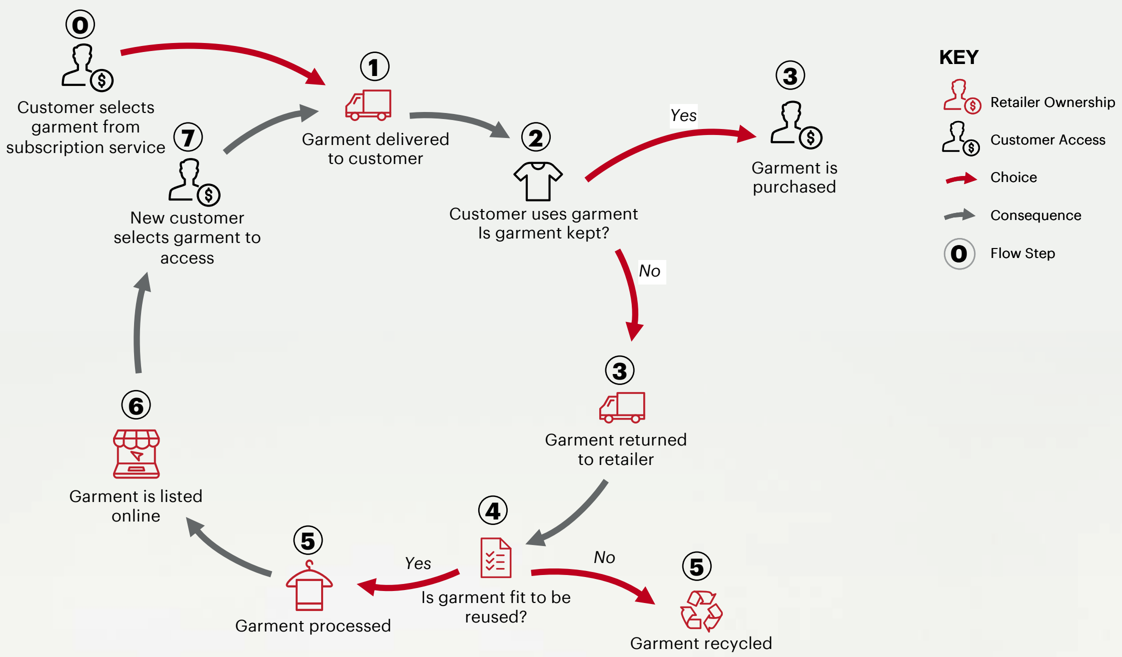
Revenue: Sum of the monthly fees paid by a customer for the duration of subscription, plus any additional revenue from customer purchase.

Customer offering: Access to up to four garments with unlimited exchanges.

Go-to-market channel: Digitally enabled / online solutions.

Fulfilment: End-to-end ownership of the garments, the processes and all associated costs taken on by the incumbent retailer.

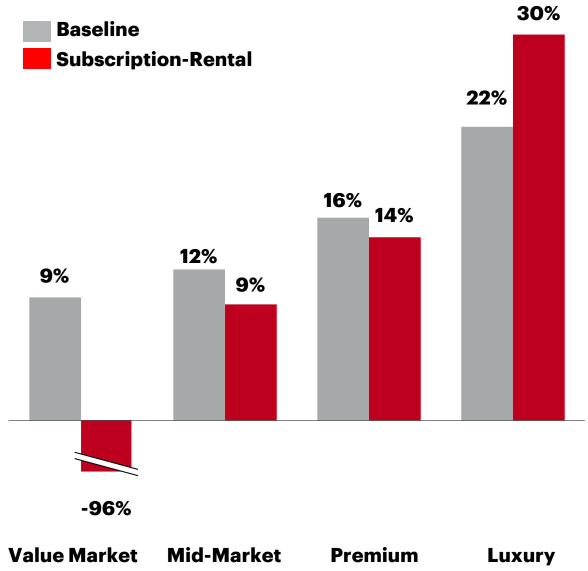
Figure 17: Visual representation of the Subscription-Rental model



FINANCIAL VIABILITY

Subscription-Rental represents a financially viable opportunity for retailers, however, viability is highly sensitive to price point, the rate of garment exchanges and customer churn

Figure 18: Subscription-Rental margin by segment vs baseline



SUBSCRIPTION-RENTAL IS VIABLE ACROSS SEGMENTS:

Subscription-Rental can be financially viable for retailers across the Mid-Market, Premium and Luxury segments. In the Luxury segment the operating margin is greater than the existing baseline. Mid-Market and Premium margins are roughly in line with the baseline and, as such, reflect the broad potential application for Subscription-Rental across the industry. Subscription-Rental in the Value Market does not appear profitable, largely due to variable costs associated with garment exchange (postage, packaging, cleaning etc.). However, our findings suggest that opportunities for Closed Loop Subscription models, targeted specifically for basics product ranges and focused on material take-back, could become interesting opportunities to explore in the Value Market.

LOWER COGS AND LOW CHURN DRIVES MARGIN:

The viability of Subscription-Rental in Premium and Luxury is driven by a reduction of effective COGS per garment; each garment generates revenue multiple times while COGS is only incurred once. In this way, Subscription-Rental can help transform the value proposition of the industry, with a focus on longevity as a driver of financial viability over volume. Customer churn is also a key consideration for Subscription-Rental. Fashion retailers that can deliver superior customer experiences and increase average customer tenure will be able to achieve disproportionately higher financial return.

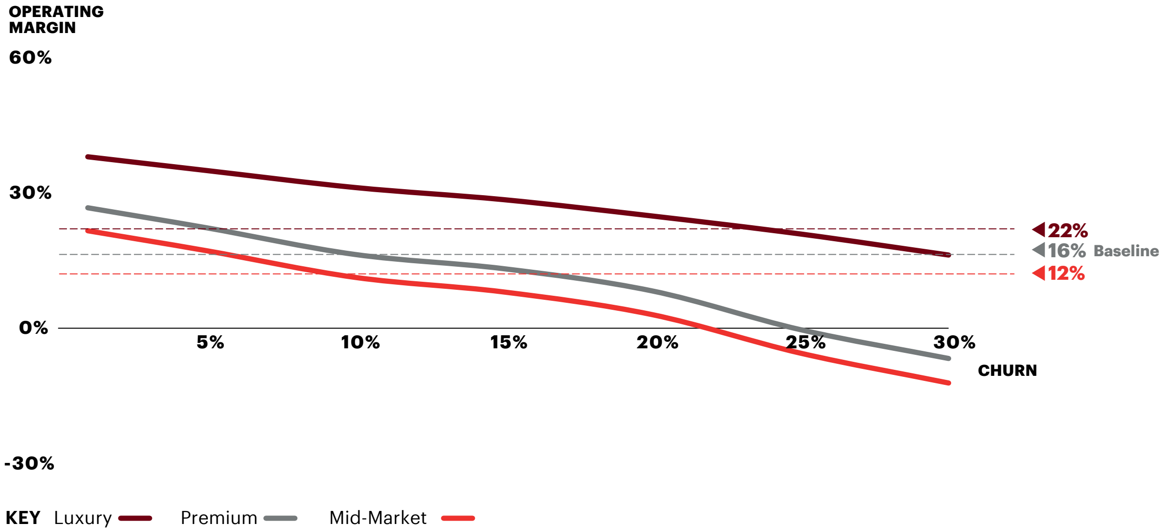
BALANCING VALUE WITH COSTS IS A CHALLENGE:

Variable costs incurred with each garment exchange are significant and, with the market offering unlimited exchanges for a flat fee, the financial viability of the model is highly dependent on attracting customers who under-utilise this option. Successful retailers will seek to encourage low refresh rates (through providing great product and retention incentives) whilst retaining the impression of complete flexibility.

KEY STRATEGIC CONSIDERATIONS

CHURN: Churn, defined as "the monthly percentage rate at which an existing customer stops subscribing to a service"[18], is critical for all subscription models. Retailers can try and reduce churn through price point, convenience, number of garments, and additional incentives, for example, through introductory offers.

Figure 19: Operating margin as a function of Churn %



Our model assumes a monthly 12% churn rate, consistent across all segments. Based on this the average subscription duration is 8 months. An increase of churn to 25% (average customer duration of 4 months) drives negative margins in the Mid-Market and Premium, while Luxury margin falls below the baseline model. In contrast, churn rates of 5% (i.e. 20-month average duration), drives margins c.20% in the Mid-Market and Premium segments.

Subscription-Rental models must pay attention to churn and identify key drop-off points and triggers to ensure it is reduced for example, through offering a monthly price reduction or improved access to more premium ranges.

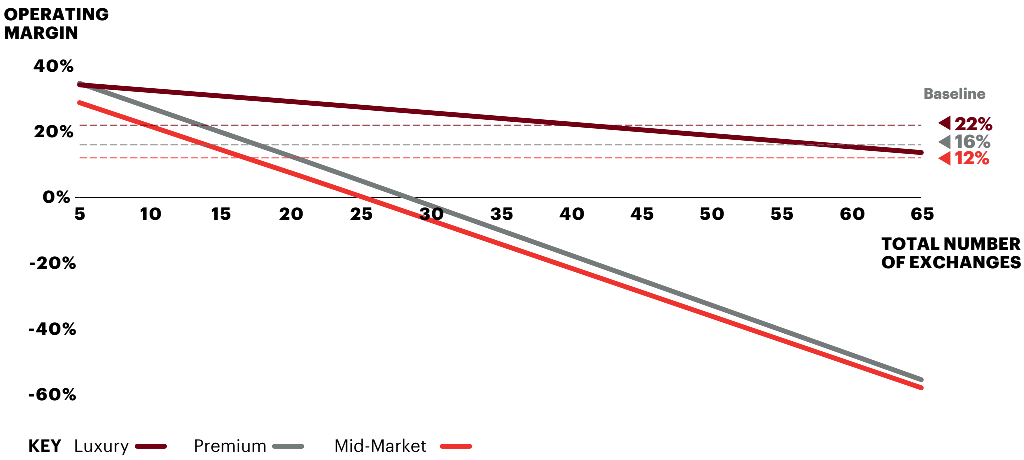
KEY INSIGHT

Number of garment exchanges:

Given a flat monthly subscription fee, number of exchanges - the total number of times a garment is exchanged during a subscription - becomes a critical factor in determining viability (see Figure 20). For the Mid-Market more than 15 exchanges per subscription would lead to the margin being lower than the current baseline – more than 25 garment exchanges, a number that would be reached if a customer exchanged a garment every c.5 weeks, the model would lose money. For Premium Market the equivalent exchanges are only slightly higher, 17 for margin lower than the baseline and 28 to drive a negative margin.

This sensitivity is linked to new variable costs, including postage, packaging, laundry and manpower, which are incurred for every exchange with no additional revenue uplift. The challenge is to ensure a balance between offering convenient, customer-centric models while optimising associated costs.

Figure 20: Operating margin as a function of total number of exchanges

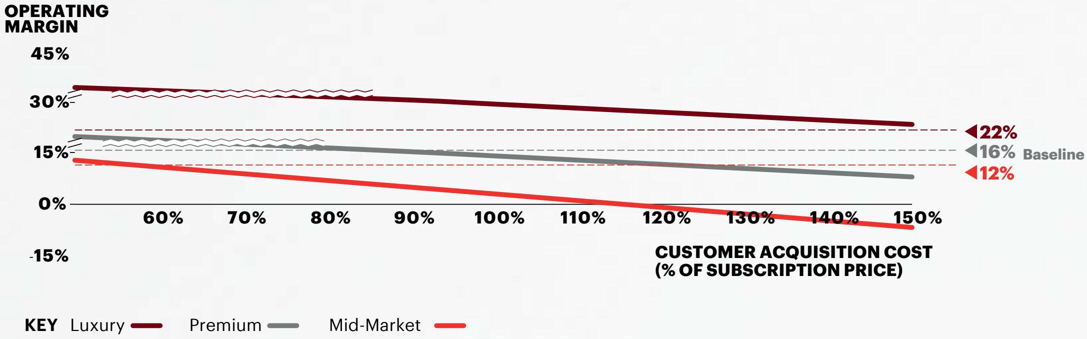


Case study: There are examples of innovative companies experimenting with new delivery and collection models to optimise costs; Rent the Runway partnered with WeWork to consolidate clothing box drop-offs at high volume work locations.[19]

CUSTOMER ACQUISITION COST (CAC):

This cost is important for Subscription-Rental given the need for retailers to effectively communicate a new way of consuming fashion. CAC predominately ranges between 50-150% of the monthly subscription price, with rare exceptions at either extreme, depending largely on maturity. For the purposes of this analysis, we assumed a CAC of 100%, consistent across all segments.

Figure 21: Operating margin as a function of Customer Acquisition Cost



For margins to be higher than the baseline for Mid-Market and Premium segments, we estimate that CAC needs to be kept below 60% of monthly subscription price.

In each case, this demonstrates the importance of effective and targeted marketing strategies to drive demand for Subscription-Rental. It should be assumed that CAC will reduce over time, with a high cost up front that declines as churn declines and growth becomes organic.

> **“Subscription-Rental is profitable, and it can attract new, young customers who value experiences over things to existing retailers”**
> CaaStle

DRIVING ADDITIONAL VALUE

> **"A business model that services a customer better should not be suppressed"**
> VF Corp

FOR RETAILERS

Loyalty and wallet share: Subscription-Rental creates an opportunity for retailers to drive loyalty by offering a more personalised service than is possible through traditional retail.

New data: Retailers have very limited insights on how customers experience, use or like their items. Subscription-Rental can change this, providing an insight into popular styles and individual preferences. This deeper knowledge can inform manufacturing and product design, in turn, optimising production and reducing waste.

New customer engagement: Subscription-Rental enables retailers to engage younger customers, fitting with their desire for experiences, access over ownership, and variety over uniformity. This, coupled with the level of innovation associated with adoption of new models, can further enable competitive advantage.

FOR CUSTOMERS

Access to fashion: Subscription-Rental allows a customer to augment their wardrobe with new garments, new styles and high value retailers for a fraction of the normal price. These factors, alongside convenience, are critical elements of the customer value proposition that must exist if subscription models are to be successful.

FOR THE ENVIRONMENT

Material savings: The environmental impact of Subscription-Rental is largely dependent on the purchase displacement rate. This will be especially important as Subscription-Rental is scaled, with a potential risk that overall consumption could increase if uptake of the model takes place alongside traditional linear fashion. If the new models are supplementary to existing consumer purchasing this will increase volumes of production and waste.

> **"Sustainability has to be a strategic priority of the brand when implementing a Subscription-Rental model"**
> adidas

RECOMMERCE

CONTEXT

Recommerce, the resale of previously sold items, is a well-established model in fashion. Historically it has tended to be somewhat informal, through charity shops and second-hand sales.

Today, Recommerce is becoming an established and formal part of the industry, and its growing – a recent report indicated that resale has grown 21x faster than traditional retail over the past three years.[20] This has driven innovation at scale, with early adopters seeking to establish a share of a formalised Recommerce market. This growth is driven by:

Changing perception of "used": The perception of previously owned garments has changed; used garments are no longer seen as dirty / outdated but instead customers place value on second hand, vintage products.[21]

Customer value proposition: Recommerce drives value for two groups:

- The original owner... who receives a return on their investment through returning their garment, either through cash or a voucher incentive.
- The new buyer... who purchases a garment at a reduced price and can therefore afford a higher quality garment, perhaps from a retailer previously out of budget.

The new buyer in this case is often outside an established retailers typical target market – this opportunity to reach a new customer base and build new, trusted customer relationships is a key driver for big corporates to adopt Recommerce.

Reducing process friction: Recommerce has become easier thanks to technology, optimised collection, enhanced merchandising and curation platforms, and through scale to further incentivise participation. Reducing friction at every stage of the customer journey is a critical consideration for the viability of Recommerce.

MARKET INSIGHTS

Recommerce is the most mature circular business model in fashion today and by 2023, the market is set to reach $51bn, growing at an annual rate of 16%.[20]

Growth has been driven by improved access to marketplaces for second-hand garments, with tech-led solutions such as Depop emerging with a specific focus on millennial consumers. Marketplaces have also emerged for specific segments and products[22], for example, The Real Real in Luxury. The dominance of independent platforms and start-ups creates risk for established retailers in terms of garment authentication and quality. At the same time, retailers miss out on the potential benefits of owning these channels, including additional revenue streams, deeper customer relationships, and new customer touch points.

Retailers are responding to this risk - and many innovative leaders have already incorporated Recommerce into their existing business.

These examples of Recommerce are often established as a collaboration between start-ups and established retailers – leading examples include Worn Wear, a collaboration between Patagonia and Yerdle, in which post-consumer garments are returned and resold; and The North Face Renewed, a collaboration between The North Face and The Renewal Workshop, focused on selling pre-consumer, defective or unsold stock that is refurbished and resold.

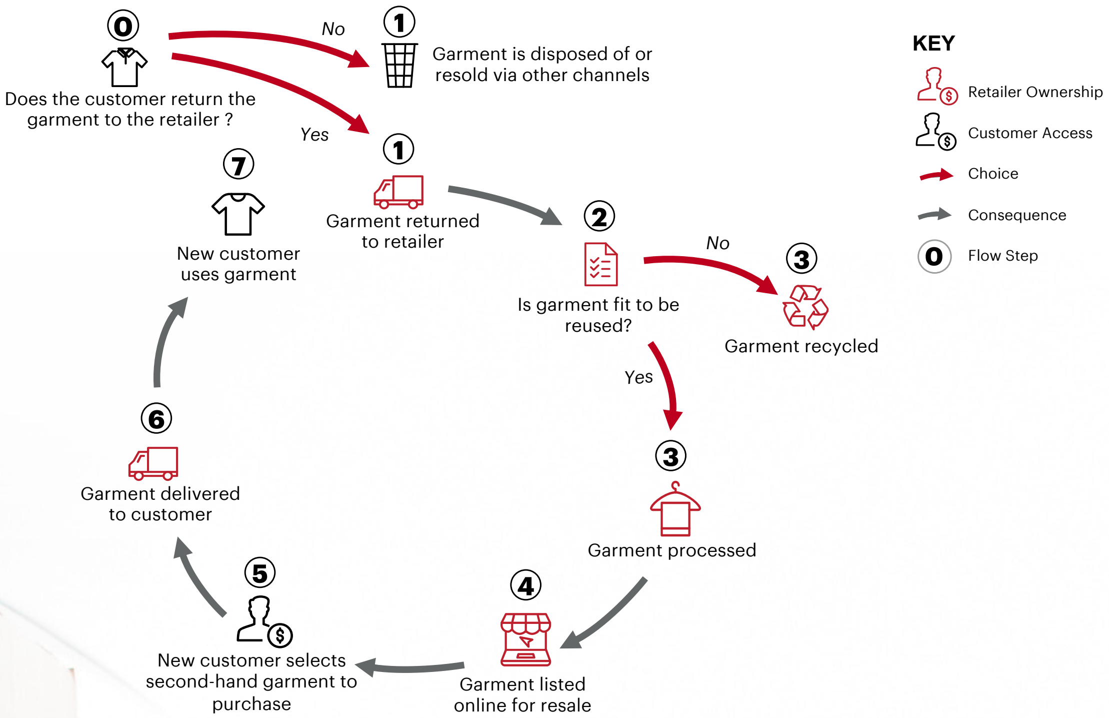
DEFINITION OF RECOMMERCE

Revenue: One-off fee paid to the retailer by the new customer to purchase a previously-owned garment (where the retailer has acquired the garment back from the original owner; no focus on pre-consumer, defective or unsold stock).

Go-to-market channel: A digital / online solution.

Fulfilment: Ownership of all the processes, and associated costs, taken on by the incumbent retailer.

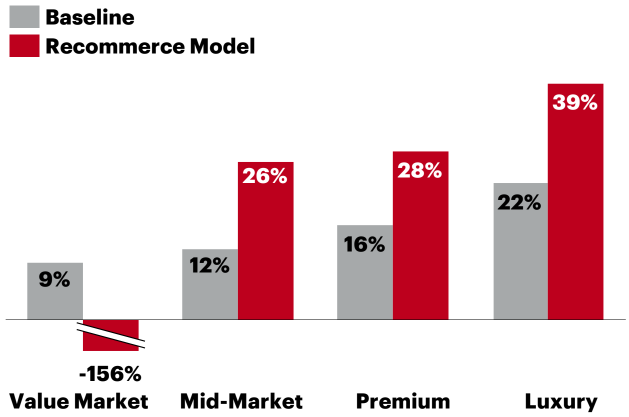
Figure 22: Visual representation of Garment flow in Recommerce model



FINANCIAL VIABILITY

Recommerce has the potential to be profitable in all segments, with good margins in the Mid-Market, Premium and Luxury segments

Figure 23: Recommerce Operating Margin vs. Baseline Operating Margin



RECOMMERCE IS VIABLE FOR A RANGE OF SEGMENTS:

Recommerce could be profitable for incumbent retailers across Mid-Market, Premium and Luxury segments, with an operating margin of roughly 2x the baseline across each of these segments. Profitability improves in the higher value segments, with Luxury demonstrating the best economics. Recommerce is difficult, but not impossible, to make financially viable in the Value Market.

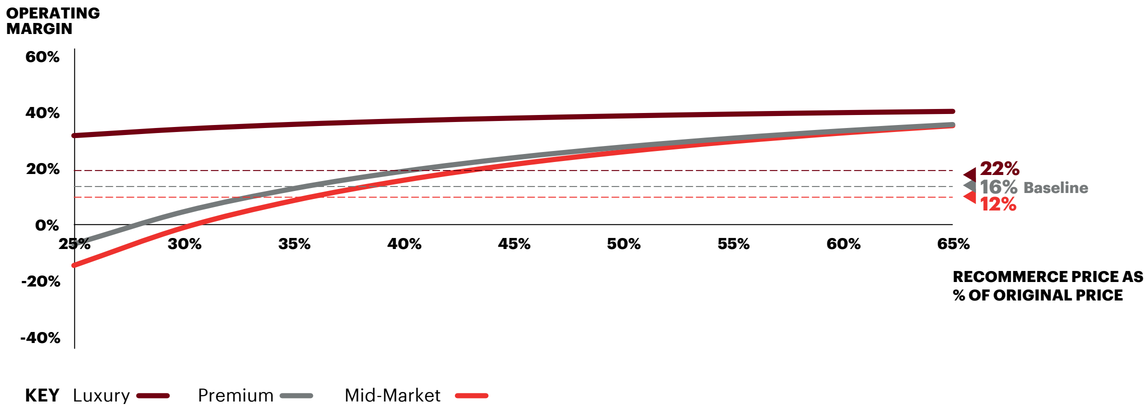
RECOMMERCE REQUIRES MATURITY AND SCALE:

Recommerce models take time to get started because of the need to obtain used inventory and engage customers. Recommerce can create a clear margin opportunity, assuming a level of maturity and scale of implementation, with established customer channels, sufficient stock and economies of scale on logistics and processes.

STRATEGIC CONSIDERATIONS

RECOMMERCE PRICE: The price at which the garment is listed for resale relative to the original retail price, ranges from 25% to 65% based on our research. Where retailers choose to position themselves on this spectrum is critical for determining financial viability, particularly in the Mid-Market and Premium segments.

Figure 24: Operating Margin as a function of Recommerce Price



In the Mid-Market a price of over 35%, within our base case model, should be charged for the model to be more attractive than the current baseline (see Figure 24). The Premium Market is slightly less price sensitive and should remain profitable with garment prices to below 30% of original retail price.

Luxury shows positive margins below 10% of the original retail price – demonstrating that luxury retailers have an opportunity to offer very substantial discounts on resale. This should provide opportunities to engage new customers at lower price points and improve the viability of Recommerce. However, while there is a saturated market for independent players in Luxury, our interviews identified some of the uncertainties that make retailers cautious. Uncertainties include the impacts on perceived value of new goods and the brand overall, changes in customer demand for new items and on cannibalisation of existing retail channels. Each of these would need to be carefully managed and explored further, with deeper customer research conducted, as part of the go to market strategy.

In all segments, Recommerce Price is dictated by many external factors (e.g. age of garment, use and its durability) and pricing strategy will vary on a case by case basis – retailers must ensure garments are of suitable quality, are authentic, and are priced effectively.

KEY INSIGHT

Improving viability of Recommerce in the Value Market :

The Value Market is not profitable based on our model, demonstrating a negative margin even if 100% of the original retail price is charged for Recommerce. However, this does not mean that Recommerce in the Value Market is impossible. Three critical factors can influence viability:

1. **The original price of the garment**: A focus on higher priced, premium products as part of Recommerce inventory could enable established Value retailers to adopt this business model.
2. **Garment quality must improve**: Our research identified that, on average, garments need to be durable enough to be worn 20+ times to be suitable for Recommerce. This number should be identified as a target for retailers to aim for, either designing products with this as a minimum threshold, or prioritising existing garments that meet this threshold for Recommerce inventory.
3. **Economies of scale**: Another key driver of financial viability of Recommerce identified in our research is scale. Given the size of the market and volume of clothing within the Value Market, this scale may enable further optimisation of costs and improve financial viability over time.

INVENTORY ACQUISITION COST: The cost of acquiring a garment from the original customer is a critical driver of profitability. These costs include both the direct compensation paid to the original customer and the costs of collecting the returned garment. The solution must be frictionless, and sufficiently valuable for the original customer to incentivise them to participate. This analysis focuses on the provision of a discount voucher. The discount voucher, modelled as a percentage of Recommerce price, provides a financial incentive for the original owner to return their used item to the retailer, above other alternatives (e.g. eBay). The discount voucher is a preferable alternative for retailers to a cash sum, which won't necessarily generate additional sales for the retailer.

Mid-Market demonstrates a high sensitivity to discount voucher costs; when the voucher is doubled from our base case assumption, an increase from 15% of resale price to 30%, it drives a 50% reduction in operating margin. The margin becomes negative with a discount voucher c.50% of resale price – a real value to the original customer of €12 - €14. (see Figures 25 and 26)

Figure 25: Impact of discount voucher rates on customer value and operating margin

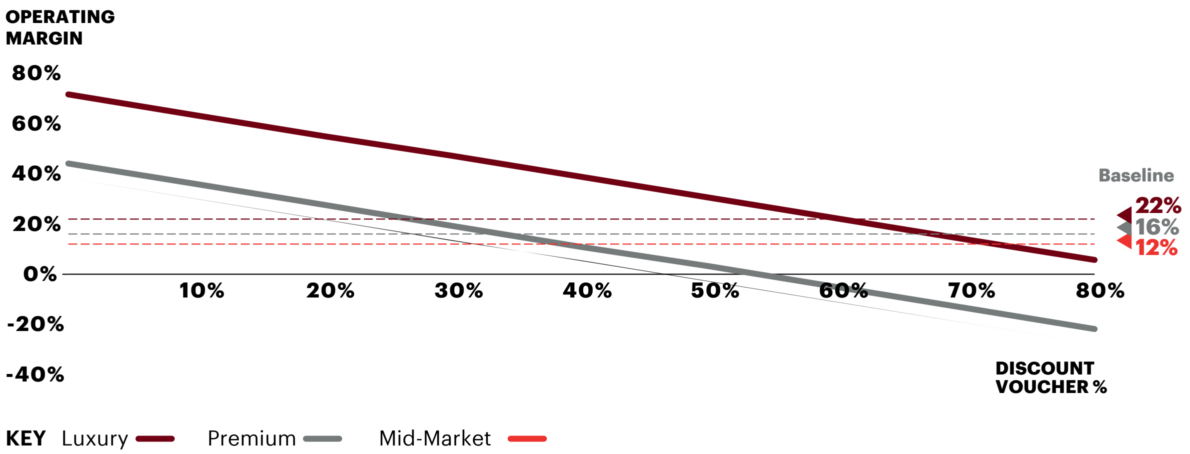
	Mid-Market - €75 garment		Premium - €130 garment	
Discount Voucher%	**Real Value to Consumer €**	**Operating Margin**	**Real Value to Consumer €**	**Operating Margin**
5	1.56	34%	2.69	40%
15	4.67	26%	8.06	32%
30	9.34	14%	16.12	19%
50	15.56	-3	26.87	3%

Luxury is not as sensitive given the high garment price point used in this analysis. However, the original customers that own the luxury garments are likely to expect a substantial financial reward for returning valuable garments, especially given the existing recommerce channels available, such as The Real Real, which are highly lucrative options for resale. The challenge for incentivising returns in Luxury is further complicated when additional customer factors are considered. For example, it may be the case that high earning customers are not motivated to return garments by financial or convenience led factors – in this case, ethical values may be positioned as the key incentive.

The variety of resale channels available means an offering must be sufficiently attractive relative to the rewards for listing a garment independently on external resale marketplaces. There remains a large amount of uncertainty on the key drivers of customer behaviour when returning garments for Recommerce; with motivations ranging from avoiding waste to convenience – further research should be conducted on this prior to implementation.

Case study: Reflaunt is a technology that promotes a circular economy by connecting first hand retailers with the secondary market. Reflaunt technology is a smart button (like a PayPal button) that allows customers to resell their past purchase in one click, directly from their personal account on the retailer's e-commerce. Once items are sold on the secondary market, customers are paid cash or a higher value store credit with the retailer.

Figure 26: Operating margin as a function of discount voucher

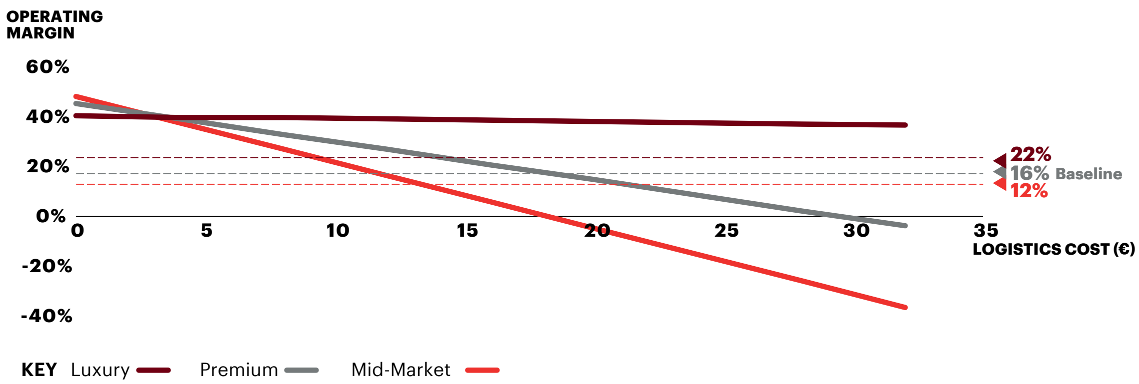


LOGISTICS: In all e-commerce businesses minimising logistics costs is crucial to ensuring profitability. Our model assumes two new logistics costs for Recommerce: inventory acquisition logistics and the new cost of distribution following resale. If logistics costs are reduced close to zero there is huge impact on the financial viability of Recommerce across all segments, particularly in the Mid-Market and Premium segments. In both cases, Recommerce margins increase to between 45 – 50% and exceed the margin in Luxury (see Figure 27).

Ultra-low logistics costs would only be possible if final delivery costs were passed on to the new customer, combined with mandatory in-store inventory drop off for the customer that originally owns the garment. This, although cost effective, may irreparably damage the value proposition. As a middle ground, retailers could reduce inventory acquisition costs through a network of collection points, ideally combined with in-store drop offs, while a price threshold for free delivery can be strategically considered to pass on some final distribution costs.

Case study: reGAIN app is a digital and multi-brand take back program that uses technology to connect fashion consumers with over 25,000 recycling drop off points across the UK, rewarding them with discount coupons for products and services for returned garments. reGAIN app enables garment collection at scale, while driving cost efficiencies on logistics.

Figure 27: Operating margin as a function of logistics costs



DRIVING ADDITIONAL VALUE

> **"Recommerce is now a proven way for brands to attract and develop completely new customers. In some cases, more than 10% of new Recommerce customers subsequently purchase full-price items from the brand within six months."**
> Yerdle

FOR RETAILERS

New customer acquisition: Recommerce provides an excellent opportunity to engage first time customers with a retailer. Customers that have previously bought a second-hand garment may be more likely to buy a new one. A positive customer experience can help build trust and drive future brand loyalty. This is supported by data that suggests Recommerce leads to sales via traditional retail channels.

Wallet share and customer insights: Recommerce can also grow a brand's wallet share with existing customers. A leading Recommerce model found 80% of customers returning garments utilise their voucher to purchase a new item from the same brand. At the same time, there is an opportunity to gather further insights about customers purchases and resales to guide product development and create a more customised offering.

Case study: Stuffstr's business model is designed to help large retailers incorporate Recommerce into their business, with a specific focus on creating a frictionless process to enable optimised inventory acquisition. Their tech solution, embedded into the app of an existing retailer, allows a customer an option for instant buy-back on each of their historical purchases. At the click of a button, a courier is mobilised to collect the item from the customer within 1-3 hours, with the instant buy-back voucher credited to the customer's account at the same time.

Brand reputation: Recommerce provides a low risk opportunity for a retailer to improve their reputation through a demonstrable commitment to reducing their environmental footprint. A brand-led platform can reduce risk, by ensuring legitimacy and product verification, a factor that is particularly important for Luxury. Recommerce will continue to grow and retailers should take ownership to ensure they benefit.

FOR CUSTOMERS

Customer value: Recommerce clearly creates value for both the customer returning and the customer purchasing the 2nd hand garment. The returning customer realises value from a garment that they no longer need in a quick and convenient manner. The new customer gets a high-quality garment at a much cheaper price than otherwise available on the market. In this way, Recommerce can enable customers, at scale, to recognise the value they have tied up in their garments, it could support a fundamental change in how people view and engage with the fashion industry.

FOR THE ENVIRONMENT

Material re-use: This model has clear environmental value. Re-use extends the lifecycle of a garment by an average of 2.2 years, potentially reducing its water / carbon / waste footprint by 73%.[23] Furthermore, if adopted at scale, Recommerce could shift customers' understanding of garments as retaining value beyond point of sale rather than being seen as disposable.

CONCLUSION AND RECOMMENDATIONS

> **"If we don't do it, someone else will, or already is"**
> VF Corp

Circular business models will play an integral role in the sustainable transformation of the fashion industry. Alongside rapid innovation and the emergence of start-ups, there has been a clear commitment from the industry to better understand their impact and to implement new models. The time for innovation and progress on circular models is now.

Successful circular economy innovators will focus on five imperatives:

01

PRIORITISE BASED ON MARKET SEGMENT: To be successful retailers will need to prioritise the circular models with the most potential for their industry segment, considering the specific requirements and aspirations of both their established and future customer base.

02

MATCH THE BUSINESS MODEL TO THE PRODUCT:
Different product types are best suited to particular business models.

Each of the circular business models explored in this report will vary in their viability depending on specific product characteristics. However, our research has identified some general product characteristics that can help retailer's prioritise which products may be suitable to which model. Some of these characteristics include:

- **Rental**: Products used infrequently, used for one off events, used for specific activities
- **Subscription Rental**: Products that need regular refreshing, that customers regularly purchase, that can supplement an existing wardrobe, used for a definitive and short period of time
- **Recommerce**: Products that are high quality and durable

03

GET THE INCENTIVES RIGHT: These models all require a fundamental behaviour shift from customers to achieve scale. That is notoriously difficult to achieve, even if there is plenty of evidence to suggest changing attitudes. Retailers cannot afford to assume that the change will happen just because it is "the right thing to do". To overcome this barrier, they must do three things simultaneously.

1. First, they need to incentivise their customers to act differently. Either through offering incentives to encourage desired behaviour (e.g. discount vouchers for Recommerce) or by focusing on the creation of a solution that is attractive and inspiring enough for customers to change from the status quo.
2. Secondly, retailers must ensure the customer experience is as frictionless as possible. This will require investment in the front-end customer interfaces as well as garment collection and delivery capabilities – ensuring requirements to deliver a high-quality service don't undermine the financial viability of the business model.
3. Thirdly, retailers must ensure models that are financially viable from a business standpoint and also deliver financial value to the customer. Our research explored this in some detail, however value to a customer is hard to quantify – there is limited garment level cost per wear data, while hidden customer costs within the current linear model, for example washing costs, are often not calculated. Proving customer value of new models will support implementation at scale.

04

MAKE IT SUSTAINABLE: Each of these models have the potential to make the fashion industry fundamentally more sustainable by reducing the net volume of new garments produced over time. But this outcome will only be achieved if it is made an explicit aim. For all models, retailers should track the extent to which they displace the purchase of new goods, engaging the customer to provide feedback and data at every stage of the process. There is also an imperative to ensure garments that are sold through these channels are made in a way that easily allows for reuse and maximises longevity. Finally, all new activities required to make these models work (e.g. laundry, logistics) should be designed to ensure they are delivered in the most sustainable way possible (e.g. chemical free cleaning with companies such as Tersus, or electric vehicles for last mile delivery etc.).

05

PILOT AND EXPERIMENT: The findings of this report are a helpful guideline – however they are no substitute for experimentation in the market. Circular business models should be tested by retailers at scale, incorporating the latest Fourth Industrial Revolution technological innovations, to develop data on customer behaviour, build capabilities to optimise costs and to help stimulate demand.

CALL TO ACTION

We hope to move the debate and collective knowledge base forward – and that these findings will support the development of circular business models in fashion, at scale. However, this will only happen if fashion's global brands and retailers take a stand and publicly commit to embedding circular business models as a core part of their business. In doing so, they can help make circular the 21st century model for how we consume fashion. The time for this commitment, is now. Here's why:

START-UP ECOSYSTEM: Emerging start-ups are now reaching sufficient scale to erode the market share of existing retailer. The numbers of companies in this space will continue to grow – if established retailers don't adopt circular business models then others will.

INFRASTRUCTURE IMPROVEMENTS: Infrastructure to support new circular business models, including logistics, cleaning services and inventory management software, often provided by white label solutions, is becoming more available, more efficient and cheaper.

EMERGING TECHNOLOGIES: Fourth Industrial Revolution (4IR) technologies, that allow the tracking and tracing of garments beyond the point of sale, enabling authentication, resale and material recovery, are more available and affordable.[24]

CIRCULAR DESIGN: Embedding of circular design principles, focused on durability and repairability, is becoming established within industry thinking and education.

CONSUMER DEMAND: Gen-z and millennials will be tomorrow's most valuable customers and their demand for access and variety, delivered in an environmentally responsible way, is something the industry must align to.

We recognise that circular business model choices alone will not solve this challenges, but it is an excellent place to start. Let's start.

APPENDIX

ACKNOWLEDGEMENTS

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DETAILED METHODOLOGY

BASELINE MARGIN

To enable a comparative analysis of the financial viability of circular business models in relation to today's current linear model, this analysis aimed to establish an approach to effectively calculate a guideline margin percentage, on a per garment basis, across each of the relevant industry segments; Value, Mid-Market, Premium and Luxury. To do this, the following steps were followed:

1. **Define segments**: Identify and define relevant industry segments.
2. **Identify representative retailers**: Develop and confirm a list of public fashion brands and retailers to represent each segment.
3. **Review public financial documents**: Review publicly available financial accounts of representative PLC companies within each segment, identifying key financial metrics including Revenue; COGS; SG&A as well as the Gross Margin and Operating Margins at a company level.
4. **Identify cost breakdown**: Review the cost breakdown and margin percentages to identify any anomalies and to determine average margins by segment.
5. **Margin per garment**: Normalise the margins to represent the baseline margin per garment within each segment.
6. **Verify margins**: Baseline margins per garment were verified in interviews with relevant companies during this research.
7. **Use of analysis**: Baseline margins are used in this analysis to develop a comparative analysis between the currently operational margins for brands on a per garment basis, by segment, within the linear model vs new circular business model.

The baseline margin within this analysis is illustrative and is not to be taken as an actual margin figure per garment. We recognise that margins will vary within and across segments, with large variances on a per garment basis across a retailer's product portfolio.

To conduct a like for like comparison, this analysis would need to be replicated using actual revenue and cost data on a per garment basis.

Figure 28: Baseline margin %

	Value	Mid-Market	Premium	Luxury
Baseline Margin %	9%	12%	16%	22%

SEGMENT PRICE POINTS

Having defined the four industry segments for the focus of this analysis; Value, Mid-Market, Premium and Luxury, it was necessary to determine an archetypal price point that could be used for the financial modelling to represent a typical garment or item within each segment. To do this, we followed this methodology:

1. **Identify relevant retailers**: Identify a selection of relevant retailers as representative of each of the segments as part of this analysis.
2. **Review typical garments**: Review a selection of typical garments sold by identified retailers within each segment.
3. **Identify price points**: Analyse the typical price points for garments / items within each segment and determine an average.
4. **Convert to euros**: Converted prices into Euros (€) if required.
5. **Verify price points**: Verify price points by segment during interviews with relevant representational brands.
6. **Use for analysis**: Segment price points were used for the analysis to calculate the marginal opportunity for each of the circular business models reviewed in this analysis.

Figure 29: Archetypal Price Point by Industry Segment

Archetypal segment price points remained static for the purposes of this financial analysis. To conduct a more detailed analysis, specific garment price points can be used to determine garment level profitability.

	Value	Mid-Market	Premium	Luxury
Archetypal Price Point	€10	€75	€130	€1700

CIRCULAR BUSINESS MODELLING

The financial analysis followed a clear methodology, consistent across all circular models:

1. **Segments in consideration:** Four segments have been included in the analysis namely Value, Mid-Market, Premium and Luxury.
2. **Archetypical segment price point:** To estimate revenue and costs, archetypical price points per segment were determined in consultation with Fashion for Good and its partners.
3. **Research and estimates:** We leveraged financial statements, secondary information and primary interviews to estimate margins. These were validated by industry players and confirmed as accurate.
4. **Profitability metrics:** Our analysis aims to compare baseline, rental, recommerce and Subscription-Rental Model on a Gross Margin and Operating margin % basis. Operating margin is calculated as Revenue – Cost of Goods Sold – Indirect costs .
5. **Point in time approach:** For the analysis, we have favoured a point in time analysis where we estimate the revenue and costs (variable) for a point in time in the future for the respective models, when the model has achieved some form of maturity.
6. **Cost ownership:** Our model assumes that all operating costs associated with new circular business models are taken on by the retailer.
7. **Logic validation:** The calculations for each circular business model is different, with variances in terms of revenue channels, variable cost factors, assumption values and calculation formula. In each case, the logic was tested and verified during interviews for validity.
8. **Assumption validation:** Each of the assumptions identified as part of this research has been verified, using a combination of desk-based research, existing reports and interviews.

ILLUSTRATIVE SAMPLE OF ASSUMPTIONS PER MODEL

Rental

Figure 30: Rental assumption values

	Validated base case assumptions by segment			
Assumption	**Value Market**	**Mid-Market**	**Premium**	**Luxury**
Rental price (% of original)	20.0%	18.0%	15.0%	10.0%
Number of Rentals (per garment lifecycle)	5	10	20	30
Postage and Mailing (per rental transaction)	€3.50	€3.50	€4.20	€5.04
Laundry Cost (per 1kg of volume)	€3.00	€3.60	€4.32	€5.18

Subscription-Rental

Figure 31: Subscription-Rental assumption values

	Validated base case assumptions by segment			
Assumption	**Value Market**	**Mid-Market**	**Premium**	**Luxury**
Average time per garment exchange (months)	2	2	2	2
Probability of item purchase (per garment)	17.5%	17.5%	17.5%	17.5%
Customer acquisition cost (% of monthly subscription price)	100%	100%	100%	100%
Churn (monthly)	12%	12%	12%	12%

Recommerce

Figure 32: Recommerce assumption values

	Validated base case assumptions by segment			
Assumption	**Value Market**	**Mid-Market**	**Premium**	**Luxury**
Average recommerce price (% of original)	50.0%	50.0%	50.0%	50.0%
Discount Voucher (% of recommerce price)	15.0%	15.0%	20.0%	40.0%
Photography Cost (% of recommerce price)	10%	10%	10%	10%
Packaging	€0.30	€0.50	€1.00	€2.00

INTERVIEWS AND QUALITATIVE INPUTS

We conducted a series of interviews with relevant fashion brands and retailers, including established incumbent brands, start-up innovators and sustainable fashion organisations.

These findings were used to validate baselines, assumptions and logic, while the qualitative inputs were incorporated into the report findings.

OUT OF SCOPE

In addition, there are a series of things that this report has not had the opportunity to explore in depth but would be important next steps to developing these models into commercial propositions. Out of scope areas include:

Investment Cost: No assumptions have been made about the up-front implementation and investment costs needed to implement a circular model. This means it is not possible to quantify NPV or RoI within this analysis.

Maturity and Implementation: No assumptions have been made about the roll-out or maturity curves of these models.

Cannibalisation: Market cannibalisation, the risk that sales and customers using new models replaces the sales in traditional retail channels, is a real consideration for corporates adopting circular business models. Cannibalisation has been included qualitatively within this report but is not part of the financial modelling. Further and more specific research is being conducted into the impacts of cannibalisation by new circular business models, specifically by Ellen MacArthur Foundation's Make Fashion Circular initiative. The findings from interviews, in regard to thinking on cannibalisation, were:

- **New customer engagement:** Each of the circular models explored target a different set of customers to traditional retail, therefore do not obviously create a direct cannibalisation threat.
- **Cannibalisation should be embraced:** In general, it is better you cannibalise your own business vs. losing market share to rivals or new start-ups.
- **Cannibalisation is hard to measure:** It is hard to justify or correlate individual's customer purchasing habits against hypothetical scenarios. The extent to which cannibalisation is a threat depends on specific product categories.

Sustainability impact assessment: Sustainability is an important consideration throughout this report, however a detailed study of the sustainability impacts on a per basis was not conducted. Findings discussed in this report are based on interviews or desk-based research as part of this report.

Detailed consumer insights: Insights into how consumers view Rental, Subscription-Rental or Recommerce products, in relation to garments in traditional channels or how they might impact perceived value of a brand, have not been explored. These challenges are particularly relevant for higher value segments, with detailed customer insights needed to further test readiness and gauge demand.

Garment usage data: A much deeper understanding of what happens to different garments beyond point of sale would support further analysis. Key areas to investigate include average number of occasions a garment it used, average lifespan of garments, decision factors for consumers when considering replacement &current patterns of disposal / recycling.

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FIGURE REFERENCES

PHOTO CREDITS

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GLOSSARY

TERM	REPORT DEFINITION
BASE CASE	The outputs of the financial model created for each business model and segment combination addressed in this report. These findings are based on static assumptions validated during the research and which is then tested through sensitivity analysis.
BASELINE	Baseline is an aggregated operating margin figure on a company level. The baseline was determined from publicly available financial data from relevant PLCs and is representative of sales from across multiple channels of the business. Baseline margins for each segment were verified by representative retailers during interviews.
CIRCULAR ECONOMY	The decoupling of growth from the use of finite resources by eliminating waste at every stage of the value chain, combining Fourth Industrial Revolution (4IR) technologies with innovative circular business models to move beyond linear models of take, make waste to drive competitiveness and deliver value to consumers, citizens and the global economy.
GARMENT	Any item of fashion, including clothing, shoes and accessories, that could be used in a circular business model.
OPERATING MARGIN	Operating margin is defined as net revenue less the sum of cost of goods sold and other net new costs associated with adoption of a given business model. No attempt has been made to allocate other pre-existing SG&A costs (e.g. wages and salaries, rental expenses, etc.) given the large degree of variability on treatment of these costs. Operating margin should therefore be seen as broadly comparable, but not identical, to EBIDTA margin.
PURCHASE DISPLACEMENT RATE	The rate at which using a new circular business model directly displaces the purchase of a new garment in the existing system.
SEGMENT	A grouping of similar types of fashion retailer, based predominately on their price point for representative garments.
SENSITIVITY ANALYSIS	Analysis conducted to test the impact of variability for a specific assumption, or set of assumptions, different from the base case.
WALLET SHARE	The percentage of a consumer's spending, in this case with regards to fashion, that goes to a specific company.

ABOUT ACCENTURE

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ABOUT FASHION FOR GOOD

Fashion for Good is the global initiative that is here to make all fashion good. It's a global platform for innovation, made possible through collaboration and community. With an open invitation to the entire apparel industry, Fashion for Good convenes brands, producers, retailers, suppliers, non-profit organisations, innovators and funders united in their shared ambition.

At the core of Fashion for Good is our innovation platform. Through our Fashion for Good-Plug and Play Accelerator we give promising start-up innovators the expertise and access to funding they need in order to grow. Our Scaling Programme supports innovations that have passed the proof-of-concept phase, with a dedicated team that offers bespoke support and access to expertise, customers and capital. Our Good Fashion Fund will catalyse access to finance to shift at scale to more sustainable production methods.

Fashion for Good also acts as a convener for change. In October 2018 the Fashion for Good Experience has opened: the world's first interactive tech museum dedicated to sustainable fashion innovation. In its hub in Amsterdam, Fashion for Good also houses a Circular Apparel Community co-working space, creates open-source resources like its Good Fashion Guide about cradle-to-cradle clothing.

Fashion for Good's programmes are supported by founding partner C&A Foundation and corporate partners adidas, C&A, BESTSELLER, Galeries Lafayette Group, Kering, Otto Group, PVH Corp., Stella McCartney, Target and Zalando.