

02.1 BACKGROUND TO THE GROUP

- Zalando is Europe's leading online platform for fashion
- ZALANDO SE and its 32 subsidiaries thus cover the entire supply chain of an online retailer
- Strategic investments to cement partnerships with customers and suppliers and in infrastructure
- Zalando expands fulfillment in Poland, France and Italy
- Sustainability is firmly anchored in the company's DNA

02.1.1 BUSINESS MODEL

Zalando is Europe's leading online fashion platform for women, men, and children. The Berlin-based company offers its customers a wide assortment of fashion articles including shoes, apparel, and accessories, with free delivery and returns.

Zalando cooperates with more than 1,500 international brands to offer an assortment ranging from popular global brands, fast-fashion, and local brands, and is completed by private label products. Zalando's offering has been extended and enhanced with Zalando Lounge, which offers registered members special offers at reduced prices. The brick-and-mortar outlet stores in Berlin, Frankfurt, and Cologne opened between 2012 and 2016 and serve as additional sales channels for excess inventory. The parent company, ZALANDO SE, was founded in 2008 and has its registered offices in Berlin. Zalando's online offering is tailored to local customer needs in 15 different European markets: Austria, Belgium, Denmark, Finland, France, Germany, Italy, Luxembourg, the Netherlands, Norway, Poland, Spain, Sweden, Switzerland, and the United Kingdom. In each of these markets, our country-specific websites and mobile apps respond to the specific needs and preferences of our customers. A network of four fulfillment centers in Germany enables Zalando to serve its customers throughout Europe efficiently, completed by an additional fulfillment center currently being constructed in Poland, as well as two new satellite warehouses in Italy and France that will help to address the rising demand in online retail. Zalando increasingly benefits from economies of scale generated by its centralized management of sourcing, fulfillment, and technology divisions.

In order to provide the perfect shopping experience, Zalando offers its customers free delivery and returns with a return policy of up to 100 days, a free service hotline, exciting online content, and customized recommendations. The group believes that the combination of fashion, operating excellence, and online technology is a crucial factor in the success of the company and allows Zalando to present compelling propositions to customers and fashion-brand partners.



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02.1.2 GROUP STRUCTURE

GOVERNANCE AND CONTROL

The Zalando group is managed by its ultimate parent company, ZALANDO SE, based in Berlin, Germany, which bundles all management functions and generates nearly 100% of group revenues. In addition to the parent company, Zalando comprises 32 subsidiaries that operate in the areas of fulfillment, customer service, product presentation, advertising, marketing, and in-house developed private labels for ZALANDO SE. ZALANDO SE and its subsidiaries represent the entire value chain of an online retailer. ZALANDO SE has full control over all subsidiaries, either indirectly or directly.

As a result, group reporting essentially corresponds to the reporting for ZALANDO SE. Supplementary information concerning the separate financial statements is presented in Section 02.6.

The Management Board of ZALANDO SE comprises three members, who are responsible for the group's strategy and management. Rubin Ritter is responsible for sales, operations, finance, and corporate governance. Robert Gentz is responsible for technology, human resources, and strategy. David Schneider's area of responsibility comprises brand marketing, sourcing, and private labels. Consisting of nine members, the Supervisory Board advises the Management Board and monitors its management activities. The Supervisory Board is directly involved in decisions of fundamental importance to the company. In particular, it reviews the annual financial statements and management reports and it reports on the audit to the annual general meeting. Zalando's Supervisory Board represents long-term investors, employees, and independent experts. The remuneration of the Management Board and the Supervisory Board, as well as the incentive and bonus schemes are detailed in the remuneration report. The remuneration report and takeover disclosures pursuant to Secs. 289 (4) and 315 (4) HGB, which are components of the combined management report, are presented in the corporate governance report. The corporate governance report also includes the declaration of conformity.

GROUP SEGMENTS

ZALANDO SE's internal reporting structure is primarily based on a sales channel-related perspective. The Management Board monitors the development of the business for the main sales channel Zalando shop by breaking it down geographically into the DACH regions (Germany, Austria and Switzerland) and Rest of Europe. All other sales channels are grouped under the Other segment, which mainly comprises revenues generated by the Zalando Lounge and outlet sales channels and the new platform initiatives.

02.1.3 STRATEGY AND OBJECTIVES OF THE GROUP

Zalando is Europe's leading online platform for fashion. Around 12,000 employees are committed to fulfilling and exceeding customer expectations. The company provides a fashion platform for almost 20 million active customers in 15 countries and is a key retail channel for over 1,500 brand partners.



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Zalando's successful development in recent years evidences the strength of its business model, which has consistently delivered against its performance objectives. The group aims to generate profitable revenue growth in a range of 20% – 25% in 2017, by further expanding its market share in the European online fashion industry.

The company establishes itself as a meeting place bringing customers and fashion together. On this platform, Zalando creates value for all participants by further developing its operational and technological infrastructure. Zalando's vision is to expand its platform to be the key operating system of the fashion world by introducing multiple ways of integrating a diverse group of fashion contributors and stakeholders, catering to their specific needs. It offers digital and infrastructure services such as analytics, advertising, and fulfillment. Participants include customers, brands/merchants, and intermediaries (e.g. fashion stylists, content creators, logistics, and service providers). Its platform approach will help Zalando deliver attributes that are highly valued by consumers, at scale and with the right cost structure, such as incremental selection and inspirational content, incremental delivery methods, incremental services, and access to fashion expertise. The company expects these attributes to trigger reinforcing growth dynamics and further unlock Zalando's growth and development potential. Improved merchandise selection and availability for example, feeds growth of Zalando's consumer reach and vice versa. For brand partners, access to this unprecedented consumer reach presents a huge benefit and commercial opportunity as they leverage our platform infrastructure.

Zalando's focus on technology forms the foundation for the fashion platform. It handles the increasing diversity and complexity of the platform as more partners and products join. Zalando actively addresses any challenges facing its fashion partners and provides solutions. The Zalando shop and its mobile applications provide an ever-increasing customer reach while simultaneously providing a wealth of information on user behavior and customer buying patterns. These analyses allow our partners to better address their target markets with relevant product offerings and advertising. Zalando aims to win partners, who are as diverse as possible to enrich its platform and combine them in an intelligent manner with the help of its technological expertise to create the most appealing customer offering in the market place.

Zalando's management defined three strategic investment areas for 2017.

INVESTMENT IN CONSUMER PROPOSITION

Zalando will continue investing in four key consumer propositions to strengthen its positioning as the most fashion competent destination – assortment, convenience, brand, and mobile.

INVESTMENT IN SUPPLIER PROPOSITION

To maintain the position as fashion suppliers' preferred e-commerce partner, Zalando will continue investing in the areas of wholesale solutions, partner program, digital services, and fulfillment services.

INVESTMENT IN INFRASTRUCTURE

Zalando's supporting investment in technology and operations infrastructure provide the strong foundation on which the group offers compelling consumer and supplier propositions.

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Zalando will continue to focus on growing its market share and thereby leveraging the continued growth dynamics of linking consumer reach and providing an industry-leading infrastructure. For consumers, Zalando will continue to be, more than ever, the top-of-mind destination to seek fashion inspiration, advice, and discover fashion products.

Detailed information regarding our strategy are provided in the separate Section 01.3 Corporate Strategy.

02.1.4 CORPORATE RESPONSIBILITY

In the face of global challenges like resource scarcity, climate change, and increasing inequality, we see a pressing urgency to reimagine fashion in a way that benefits all stakeholders involved in the fashion ecosystem. We believe that we can use our expertise in fashion, technology, and operations to make a substantial contribution to a more transparent and sustainable fashion industry.

To approach this goal in a targeted way, we developed and implemented our corporate responsibility (CR) strategy called the do.STRATEGY. The name of the strategy reflects the same philosophy we have implemented in all parts of our business. We have a bias for action. The do. is part of our DNA. Consequently, this is how we approach sustainability, too. The foundation of the do.STRATEGY focuses on five areas defined by the materiality analysis we conducted in 2014 and 2015 by consulting 5,000 customers and 1,200 employees on topics where we potentially have the biggest positive and negative impact. Furthermore, we organized internal workshops across all hierarchies and functions that aimed at finding those topics that are or will be crucial for our business model. The input received from these key stakeholder groups resulted in a list of 16 material topics in five different focus areas. We see it as a promise to our customers and partners, but also as a commitment to all other stakeholders we are connected with. In striving towards our company purpose, we want to leverage the commitment of our employees by empowering them to do their bit for a better fashion industry and a better society in general.

Additional information regarding our sustainability strategy, management and engagement are provided in the separate Section 01.4 Corporate Responsibility.¹⁶

02.1.5 MANAGEMENT SYSTEM

In addition to revenue, EBIT, EBIT margin and adjusted EBIT margin, other key financial performance indicators for corporate management include the adjusted and unadjusted fulfillment and marketing cost ratios, along with adjusted EBIT and EBITDA. Net working capital and operating cash flow are also taken into account. The Management Board steers the company at a consolidated group level.



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¹⁶⁾ The sustainability report is not part of the audited combined-management report.

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In addition to these financial indicators, Zalando also uses a range of non-financial performance indicators to manage the company.

- **Ratio of mobile site visits to total site visits:** Users are making greater use of mobile devices to access the internet. In our effort to offer customers the opportunity to enjoy high quality shopping on their mobile devices, Zalando continues to develop and refine its websites and apps. As a result, the ratio of website visits from mobile devices to the total number of website visits increased by around 8.5 percentage points in 2016, rising from 57.1 in 2015 to 65.6.
- **Number of active customers:** The Zalando group measures its success by the number of active customers. Each customer that has placed at least one order within the last year (based on the reporting date) is considered active. Compared to the prior year, the number of active customers increased by 2 million, rising from 17.9 million to 19.9 million in 2016.
- **Number of orders:** In addition to revenue, the number of orders placed is a key performance indicator for the management of the group. This indicator is monitored independently from the value of merchandise and is a key driver of growth. In 2016, the number of orders placed increased from 55.3 million in 2015 to 69.2 million.
- **Average number of orders per active customer:** The average number of orders placed by active customers during the last twelve months totaled 3.5 as of December 31, 2016 (prior year: 3.1).
- **Average basket size:** Similar to the number of orders placed, the average basket size has a direct effect on the revenue of the group. It is also an important indicator of the trust customers place in the company. The average basket size slightly decreased in fiscal year 2016 from EUR 67.8 to EUR 66.6.

02.1.6 RESEARCH AND DEVELOPMENT

Zalando develops key components of its software internally. This ensures that the software is aligned with the operating processes in the best possible way. For example, order and fulfillment processes in particular are supported using internally developed software. Important technical developments in 2016 included fashion store technical enhancements, Checkout Rebuild, Order Management Service, Merchant Inventory, A/B Testing & Personalization Service, Same Day Delivery, Fulfilment by Zalando, Ramp-up fulfillment centers Lahr and Stradella, Zalon Apps, and many more.

Software development at Zalando relates to the structured, labor-intensive phase of programming and implementing significant system upgrades, further developing components, and enhancing functionalities along the entire process chain.

Development work at Zalando is performed by teams of developers which are organized by the respective function/line: e.g. fashion store, Smart Logistics, Payments, Brand Solutions, etc.

In 2016, the group recognized development costs of EUR 57.7m (prior year: EUR 23.1m), of which EUR 36.4m relate to prepayments (prior year: EUR 9.2m). The increase in development costs is attributable to the enhancement of the above-mentioned software and new technical projects.

Research costs were immaterial.