CASE STUDY II.3

Zalando: how can the online apparel retailer turn financial losses into positive profits?

Zalando is an internet retailer of branded clothing and footwear for men, women and children. The company operates in the standard and premium segments, offering a wide range of products. It is expanding the number of exclusive brands offered by the www.zalando.com Internet shop.

Zalando GmbH was established in Germany by Robert Gentz and David Schneider in 2008. The company is headquartered in Berlin and has operated so far only in e-commerce. A customer service hotline and free delivery and free return of goods are offered.

Eighty per cent of Zalando's customers are women. Zalando's target customer group is women aged 20–40.

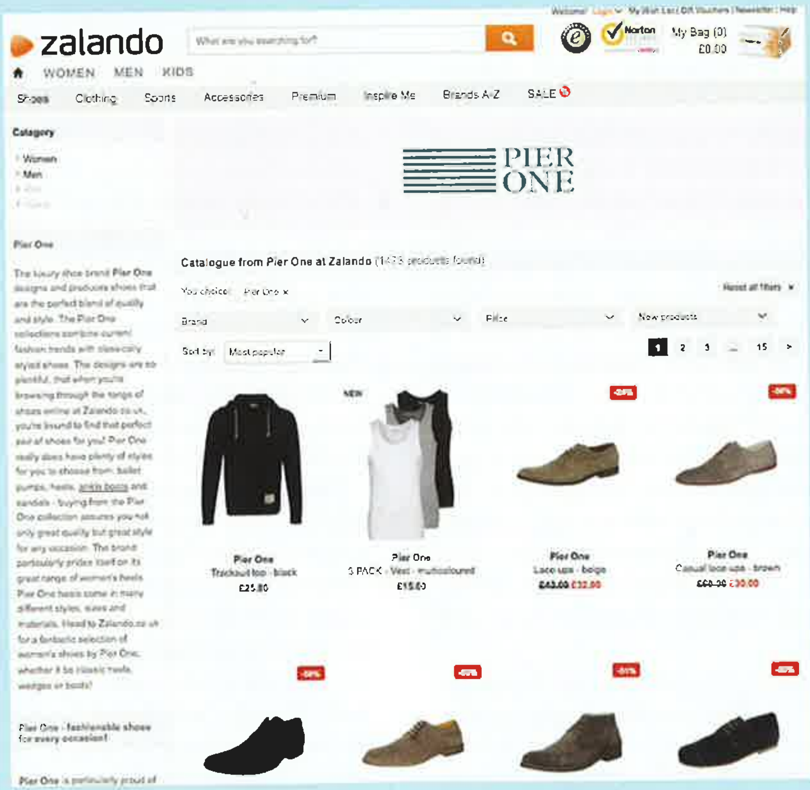
Swedish investment company Kinnevik is the biggest shareholder, with about 32 per cent ownership of Zalando.

History

2008: Zalando is founded in Germany
2009: The company starts delivering to Austria
2010: Launch of French and Dutch retail websites in France and the Netherlands
2011: Launch in the UK, Italy and Switzerland
2012–13: Launch in: Sweden, Belgium, Spain, Denmark, Finland, Poland, Norway and Luxembourg

As of January 2016, Zalando is represented with sales in the following 15 European countries: Germany, Poland, Denmark, Norway, Sweden, Finland, Holland, UK, Belgium, France, Switzerland, Austria, Italy, Spain and Luxembourg.

These countries together offer a population of 400 million people.



The Zalando UK website

Source: www.zalando.co.uk.

Zalando is the largest online footwear shop in Europe, offering a high number of international brands. Besides footwear, Zalando distributes women's and men's outerwear, wear, underwear, hosiery and clothing accessories, as well as bags and a number of other product types. In March 2010 Zalando expanded its product range by adding children's wear. In January 2011, the internet retailer started to sell exclusive perfume brands.

Zalando is a rapidly growing company. Its first acquisition took place in May 2010 with the buyout of MyBrands, an online designer outlet. With the acquisition of MyBrands, Zalando has broadened its target consumer group and its range of premium products.

Zalando has increased its brand awareness with the help of humorous TV spots. Its TV advertising campaign 'Scream for joy' promotes Zalando as simple to shop at. There are no minimum orders, no mailing costs and payment is made either upon receipt of invoice, by pre-payment or by credit card.

Meanwhile, Zalando has rapidly expanded into new markets and categories. The internet 'shoe-ting' star is now active in 14 European countries. The stunning revenue growth has been fired by massive investment in colourful TV spots and catchy online banners. It is estimated that Zalando has spent around €90 million in advertising and promotion per year.

Zalando has indulged its customer base with fancy store magazines, which are hardly distinguishable from conventional fashion journals yet are distributed on a complimentary basis. The lead publication, *Zalando Magazine,* has since reached a circulation of 1.5 million copies and is distributed in Germany, Austria, Switzerland, France and Holland. Needless to say, its content is also published as both e-magazine and smartphone app, along with numerous animations. Zalando exploits the potential a cross-media format has to offer.

With its new *Zalando Men* publication, Zalando seeks to approach its male audience in Germany. The 68-page magazine, produced in-house, made its debut in August 2012 with an initial circulation of 250,000 copies in Germany. Planned to appear bi-annually, distribution takes place as an insert in mail-delivered packages. In addition, the 36-page lifestyle magazine, *Zalando Wohnen* (*Zalando At Home*) aims at a predominately female and online-savvy readership in the 25 to 45 age range earning above-average net incomes. With a nicely balanced mix of journalism and subtle merchandise touting, the magazine presents offers, rating lists, seasonal themes, practical tips and recipes.

Another growth engine for Zalando has been the extension of its core shoe offering to include new categories such as clothing and household accessories, as well as own-label and designer brands. This enables Zalando to cross-sell and up-trade, which increases sales per customer. The company states that non-footwear in 2013 accounted for more than half of annual revenues.

In December 2010, Zalando opened a Christmas Sales Lounge in the centre of Berlin. The lounge attracted high consumer traffic as people sought bargains on branded clothing and footwear for Christmas. This first foray into offline retailing generated good revenues for the company.

Up until December 2013, Zalando has invested approximately €150 million in developing its logistics and technological infrastructure. More than €100 million of this went to equipping the distribution fulfilment centres in Erfurt and Mönchengladbach, Germany. A new technology hub is also being established in Dortmund to support the growth.

In July 2012, German TV channel ZDF broadcast a report on the packing and distribution centre operated for Zalando by a provider near Berlin. The report stated that some employees, who often commute more than 200 km from nearby Poland, were not allowed to sit in certain departments, and they were only paid €7 per working hour.

Considering the remarkable growth and huge expenditure of the company, some would question how sustainable a business model Zalando really has. Zalando's biggest cost-drivers, to help answer this question, are:

- ***Pre-financing:*** just like other trading companies, Zalando needs to pre-finance all its products. The Berlin company mass orders stock from a variety of brands to pack its warehouses. If the items prove to be unpopular among the customers, the shelves are soon full of unwanted products. It is not surprising, then, that Zalando opened the Zalando Lounge to create its own shopping club and to boost sales.
- ***Warehouse costs:*** When buying products there is always the issue of where they will be housed. With four huge logistical centres in Germany (see Figure 1), it is easy to imagine the complexity of Zalando's undertakings.
- ***Postage costs:*** As Zalando covers the costs of both postage and returns of items, the shopping giant has high costs that are most likely reflected in the product prices. The workforce required to dispatch vast quantities of products means that Zalando requires a workforce for three different shifts to ensure the work continues overnight.This is a costly procedure.
- ***Returns:*** An unfortunate fact within the fashion business, and particularly for online shops, is that people tend to change their minds. This returns policy is convenient and a free service for customers. Within normally 30 days (100 days in Germany), anything can be exchanged or returned free of charge, no questions asked. And here lies Zalando's Achilles heel. Rumours indicate that customers will order the same shoe model

Phase1 (2009–2010)	Phase2 (2011)	Phase3 (2012–2013)	
Großbeeren (Winter 2010)	**Brieselang** (Summer 2011)	**Erfurt** (Summer 2012)	**Mönchengladbach** (Summer 2013)
First logistics centre established	First logistics centre operated by Zalando	First logistics centre built to Zalando needs	Second large logistics centre construction
Operated by logistics partner DocData	30,000 sqm	Designed and operated by Zalando	Same concept used as in Erfurt
30,000 sqm		Largest eCommerce logistics facility in Europe	Test operations to start in summer 2013
		75,000 sqm (+45,000 sqm expansion ongoing)	75,000 sqm (+45,000 sqm expansion option)

- Logistics centres are located in central locations in Germany, servicing all European countries
- Zalando is leasing land and buildings to limit capital investment
- Combined capacity of >250,000 sqm operational/in construction (~300,000 sqm including option)

Figure 1 Zalando's four warehouses (as of end 2013)

Source: Hollensen, S. (2008) *Essentials of Global Marketing*, FT/Prentice Hall, p. 61. Copyright © Pearson Education Limited.

Zalando shoes

Source: Ulrich Baumgarten/Getty Images.

in three sizes, only to return two of them, or they will return the item after a single evening's wear (though that is not sanctioned by the company of course). Industry speculation is that Zalando has figures of as high as 70 per cent in returned merchandise. Zalando refuses to comment on this figure.

- ***Marketing:*** From traditional advertising TV spots to spots on Germany's *Next Top Model*, expensive search engine campaigns and online marketing, Zalando is sparing no cost in marketing its products. On the plus side this advertising saturation has resulted in 60 per cent of Germany's population recognizing the brand. The brand awareness in the target group (women of 20–40 years) is as high as 90–95 per cent. On the other hand the expenses are enormous.

General market trends in footwear and apparel

Table 1 shows World Bank figures regarding the total GDP, and GDP per cap.

Apparel online (internet) B2C retailing

The internet has become an important tool for browsing or researching clothing products, whether the purchase is eventually made online or in a store (see Tables 2–4).

While the US saw the highest value growth in apparel internet retailing over the 2006–11 period, the e-commerce channel held the highest share in Taiwan, due to the number of consumers purchasing clothes from overseas sites and the prevalence of online discounts. Unlike other trends, the global online sales boom has not been driven by BRIC economies. BRICs still lag behind in online apparel. The e-commerce channel's share was less than 3 per cent in all four BRIC countries in 2011. It is particularly weak in India, where only 10 per cent of the population are internet users.

Reason for increasing internet retailing (supply side)

There are numerous underlying reasons for the rise of internet retailing on the supply side. However, the

Table 1 Word Bank statistical figures – top 20 ranking (2012)

	Country	$ GDP per capita (PPP)		Country	GDP (PPP) $Billion
1	Luxembourg	91,388		World	85,538
	Macau (China)	87,765	–	European Union	16,805
2	Qatar	83,460	1	US	15,685
3	Norway	65,640	2	China	12,471
4	Singapore	61,803	3	India	4,793
5	Switzerland	53,367	4	Japan	4,487
6	Brunei	53,348	5	Russia	3,373
	Hong Kong (China)	51,946	6	Germany	3,349
7	US	49,965	7	France	2,372
8	Kuwait	45,455	8	Brazil	2,385
9	Australia	44,598	9	UK	2,333
10	Austria	44,208	10	Mexico	2,022
11	Ireland	43,592	11	Italy	2,017
12	Netherlands	43,198	12	South Korea	1,540
13	Sweden	43,180	13	Spain	1,510
14	Canada	42,086	14	Canada	1,484
15	Denmark	42,086	15	Turkey	1,358
16	United Arab Emirates	42,080	16	Indonesia	1,223
17	Germany	40,901	17	Australia	1,012
18	Belgium	39,788	18	Poland	854
19	Finland	38,655	19	Iran	838
20	Iceland	37,852	20	Netherlands	724

Source: based on Worldbank.com.

Table 2 Regions' development of online apparel retailing sales 2006–11 in percentage of total apparel sales (offline + online)

Region	2006	2007	2008	2009	2010	2011
Asia Pacific	2.2	2.4	2.6	2.9	3.2	3.7
Eastern Europe	0.9	1.2	1.3	1.8	2.0	2.2
Middle East and Africa	0.5	0.5	0.4	0.6	0.5	0.6
Western Europe	2.6	3.2	4.2	5.3	6.3	7.3
Australasia	1.3	1.4	1.8	3.0	4.0	4.8
Latin America	0.3	0.3	0.4	0.48	0.5	0.5
North America	3.9	4.3	5.1	5.8	6.3	7.3

Source: based on Euromonitor.com.

fundamental reason why so many retailers set up online store fronts is that it gives them access to new consumers without having to invest in costly stores.

But there are other incentives:

1. In some markets, tax is also a huge motivator. Pure-play internet retailers in the US avoid paying sales tax in the majority of states, giving them a significant advantage over store-based retailers. The UK and Australia also have similar tax loopholes available to foreign internet retailers.
2. The information from analytics tools available to retailers also gives a major incentive for internet retail. These low-cost (or free) tools can give retailers detailed estimates on who is visiting their site, for how long and where they go next. This is invaluable information that is unavailable to store-based retailers.

Table 3 Countries' online apparel value sales in percentage of total apparel sales (offline + online)

Country	% of apparel sales through internet retailing
Taiwan	13.5
UK	13.0
Germany	12.4
South Korea	12.1
Denmark	10.0
France	8.3
Japan	8.1
Developed markets average	7.6
USA	7.5
Sweden	6.1
Netherlands	5.2
Australia	5.0
Austria	4.8
Norway	4.0
Singapore	3.7
Czech Republic	3.3
Canada	2.2
Portugal	1.6
Italy	1.5
Hong Kong, China	1.3
Greece	1.1
Spain	0.3
Israel	0.2

Source: based on Euromonitor.com.

Reason for increasing internet retailing (demand side)

The demand for choice and convenience has fuelled the growing number of online shoppers:

1. With longer working hours, the opportunity to shop at leisure (24 hours) has drastically diminished. Historically, this has driven the growth of the hypermarket and convenience store channels. However, this same basic desire has attracted consumers to the internet, as all of their favourite brands are available around the clock.
2. In addition to the sheer variety of products available at the click of a button, consumers also benefit from the use of comparative tools. This can be either in the form of product reviews or price comparison sites.
3. Product reviews reassure the consumer that they are buying the right product for their needs. Price comparison tools have led to the perception that the best price is always found on the internet. Both these facilities further encourage consumers to browse online, which gives retailers the opportunity to sell products to them.

Table 4 Percentage of online users (compared to total population) vs percentage of online apparel value sales compared to total apparel sales (offline + online)

	% population using the internet 2011	% apparel internet retailing 2011
Germany	82	12.3
Denmark	89	9.9
UK	81	12.8
France	80	8.5
Russia	50	2.4
USA	78	7.0
Brazil	47	0.7
India	10	0.2
China	39	2.7
Japan	80	8.0
Taiwan	72	13.0
South Korea	85	12.4

Source: based on Euromonitor.com.

General development of the B2C apparel in different regions in 2012–13

Europe

Across Europe, apparel e-commerce is booming. In the EU, the share of individuals purchasing clothes and sports goods online increased in 2012, reaching over 20 per cent of individuals. In Germany, apparel is the largest e-commerce category, having grown by just under a third in terms of sales and reaching several EUR billions of sales. Among the leading players on the market, the Otto Group launched a new e-commerce fashion project named Collins in 2014, while Zalando more than doubled its apparel online sales in 2012. Asos and Debenhams were among the most prominent online shops for online fashion products in the UK in 2013. In France, nearly a half of internet users shopped for clothing online in 2012, with La Redoute, 3 Suisses and Zalando being the most popular destinations for shopping.

Eastern Europe

In Russia, apparel online sales (clothing and shoes) grew by over 40 per cent in 2012, and accounted for almost one fifth of total online value sales. Clothing, shoes and accessories became the most popular online product category in 2012, with nearly half of online shoppers making purchases. Online apparel retailers in Russia have seen significant increase in revenues, some growing by up to six times, with Wildberries, Lamoda, Quelle and KupiVip as leading online merchants.

Several players, such as KupiVip and Lamoda, attracted large investments from local venture capitalists and from abroad. Clothing and shoes is the leading online category in Poland, with a high double-digit percentage of online shoppers making purchases. The number of online shops selling clothes in Poland grows rapidly every year. In Estonia, Croatia, Macedonia and Turkey, and some other European countries, apparel was bought by a high percentage of online shoppers, and was one of the most popular online product categories in these countries.

North America

In the US, apparel and accessories was second only to consumer electronics in terms of total online value sales. This category is expected to grow by a double-digit percentage figure in 2013, with the growth continuing but slowing down throughout 2016. Nevertheless, apparel is expected to remain the fastest-growing product category in total online value sales. Players such as Abercrombie & Fitch compete to increase their share of the booming US online market for apparel.

South America

In South America, apparel ranks high in popularity for online shoppers in such countries as Peru, Uruguay and Venezuela, but is outperformed by electronics. In Brazil, apparel is the fourth most popular online product category, purchased by around a third of online shoppers in 2012. In Mexico this share is less than in Brazil, as apparel falls behind computers, electronics, books and some other products and services.

Asian-Pacific

Apparel is the most-purchased product category in online retailing in Japan. The globally active apparel retailer Gap Inc. opened an online shop in Japan in autumn 2012, joining other national and international players. In South Korea, apparel was among the highest-selling categories in 2012, growing at a one-digit percentage rate, which is slightly slower than the total online retailing market, signalling high maturity.

In China, fashion and accessories had the highest reach of online shoppers, amounting to three-quarters of females and a high, double-digit share of male online shoppers. Online apparel sales increased by over 50 per cent to several tens of EUR billions in 2012. Although C2C remains the largest segment of the online market for clothing in China, the market share of independent B2C platforms grows, with large international players, such as Levi Strauss, Inditex, Macy's and Asos, launching or planning to launch local online shops. In Australia, apparel was the second most-purchased product category in online retailing after electronics in 2012 and is expected to remain the fastest-growing product category in online retailing through the next five years.

Middle East and Africa

In the Middle East and Africa, local online fashion stores attract large investments from established capitalists, indicating a positive view of the market potential. The Middle Eastern online vendor of clothing, Namshi – a Rocket Internet's (subsidiary of Kinnevik) project – raised several USD millions of investment in May 2013, while a South African online apparel store, Zando, received an even larger sum from investors such as JP Morgan. Moreover, in South Africa, the discount sector started to emerge within the online market for clothing, with apparel discount online shopping clubs, such as Runway (launched in 2012), growing rapidly.

Zalando's financial performance to 2012

In the online business big sales often mean high costs. Thus far, Zalando is a victim of its own success. Marketing and expansion, free delivery and free returns, as well as inventory, IT and logistics costs have all weighed heavily on Zalando's bottom line – see Table 5.

The sales of shoes accounts for 50 per cent of Zalando's total turnover; the remaining sales are mostly within clothing. Fifty per cent of the Zalando sales are taking place outside Germany.

In 2012 Zalando reached break-even in its three-core DACH markets (Germany, Austria and Switzerland).

Table 5 Zalando's financial performance

	2009 EUR	2010 EUR	2011 EUR	2012 EUR
Turnover	6 million	150 million	510 million	1,150 million
Net profits (before taxes)	Minus 1.6 million	Minus 20.4 million	Minus 60.0 million	Minus 90.0 million

Source: based on a variety of public sources.

Competition

Despite growing popularity, the company has to compete with other well-known internet retailers, such as Asos, Sarenza and BuyVIP in the premium segment. Initially, Zalando could convince its growing number of customers with good service and additional bonus campaigns. The increasingly strong competition will force the company to devise new strategies, such as the opening of its first retail-based outlet.

The e-commerce giant Amazon did not remain inactive and fights for its slice of the cake. It launched a new online shop, Javari.de, which operates separately from Amazon and focuses on shoes, handbags and accessories. It strives to attract customers through a free delivery service, a guarantee of low prices and a long deadline to return goods. Zalando hopes to overtake Amazon's position in the clothing and footwear category in Europe.

In addition to that, more and more manufacturers/retailers (such as Zara and H&M) are opening their own online stores due to the good growth prospects of e-commerce. This leads to an increase in competition and makes it more difficult for Zalando to maintain its high growth pace.

Zalando has been extending its lead over British primary rival Asos Plc as Europe's largest online fashion site, expanding from shoes to clothes and now selling over 1,000 brands. It doubled its 2012 net sales to €1.15 billion (£1 billion) – see Table 6.

The business model of Asos – full name, 'As seen on screen' – is to sell cheap clothes in the style of celebrities such as Lady Gaga, Kate Moss and Alexa Chung. This has given it a young and loyal customer base, which is turning from the high street to the internet for shopping.

But the growth-orientated Zalando fashion site, founded in 2008, is still loss-making as it spends to boost brand awareness to get its name out on television shows such as Germany's *Next Top Model*.

External brands sold on Zalando result in a guess-timated profit of 30–60 per cent. The profit margin could be significantly higher with an in-house brand – possibly between 60 and 80 per cent.

The role of Anders Holch Povlsen (Bestseller) as investor

In August 2013, Anders Holch Povlsen, the owner of Danish fashion company Bestseller A/S, bought a 10 per cent stake in Zalando GmbH, adding the German online clothing retailer to an investment portfolio that includes its main UK competitor, Asos Plc.

Table 6 Zalando in comparison with its primary competitor

	Zalando Annual report 2012–13	Asos Annual report 2013
Turnover	€1,150 million	€920 million
Growth in turnover from one year earlier	+125%	+39%
Net profits (before taxes)	Minus €90 million	€66 million
Growth in net profits from one year earlier	Minus 50%	+19%
Number of employees in company group	2,000	1,360
Total number of products in the product range/number of brand	150,000 products/1,500 brands	65,000 products/800 brands
Number of countries with local country sites	14 (Germany, Austria, Switzerland, Poland, France, UK, Sweden, Denmark, Finland, Norway, Netherlands, Belgium, Spain, Italy)	9 (UK, France, Germany, Italy, Spain, Australia, US, Russia, China)
Return rate (number of customer returns compared with total number ordered)	60% (estimated)	50% (estimated)
Anders Holch Povlsen (Bestseller) ownership	10.0%	27.5%

Source: based on different public media.

Anders Holch Povlsen already holds a stake of 27.5 per cent in Asos – the UK's largest online-only fashion retailer. The Danish company first disclosed it held Asos shares in May 2010, and since then the stock has surged more than tenfold.

Alone, these two investments make Anders Holch Povlsen the biggest shareholder in Asos and the third-biggest in Zalando, after Kinnevik (37 per cent) and European Founders Fund (EFF) (18 per cent).

Founded in Denmark in 1975 by Anders Holch Povlsen's parents, Bestseller sells clothing brands including Jack & Jones and Vera Moda and has more than 3,000 stores in 38 markets. The company is the eighth-biggest retailer in the Asia-Pacific region (it is especially strong in China) and only the 29th biggest in Western Europe.

QUESTIONS

1. Compare and evaluate Zalando's and Asos' key competitive advantages and strategies in the world online apparel market.

2. Discuss and evaluate the criteria that you would use for Zalando's selection of new markets outside its current 14 countries. End up with a ranking list of the three most attractive countries.

3. Discuss and evaluate the pros and cons for Anders Holch Povlsen and Bestseller, regarding the investments in Zalando and Asos.

Source: based on a variety of public sources.