Webvan

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Introduction

November 5, 1999 Webvan went public with a total market capitalization of more than $8 billion by the end of the first day. Chairman Louis Borders planned to expand the online grocery industry into nationwide territory. From his experience founding Borders Books, Louis wanted to use his experience digitizing inventory management customer focus to a new market. Revolutionizing the grocery delivery industry has spiked a lot of attention as companies attempt to transition their business models to the internet. "The three measurements… central to knowing if the company is making money: net profit, ROI and cash flow" (Goldratt). Borders has entered this growing market in hopes that the convince of grocery shopping online will generate the three money making goals. Ecommerce in the grocery industry has not proven itself to be the better alternative so far.

Problem Statement

Webvan struggled to bring their online grocery shopping platform to the market. Entering the same market as traditional brick and mortar grocery stores held a challenge for them to transition customers to purchase from their online stores. Producing and shipping groceries held the challenge of customer's having bounded rationality to purchase groceries over the internet. Customers cannot inspect quality of their products, perishable products must be shipped in a specified time, and the operational costs are high. The online grocery market's primary issue they need to solve is the profitability of their business model. "The relative economic efficiency of the physical-versus-virtual organization of work and product delivery need to be formulated and researched" (Zwass). Webvan struggled with doing market research to discover the costs and sustainability of operating in the online grocery shopping market. Financial projections and unsuccessful competitors lead to Webvan trying to create a unique platform to save themselves from the failing online grocery industry.

Industry Competitive Analysis

Mission Statement

Webvan's mission was to replace traditional offline grocery stores by providing an internet grocery shopping delivery service. Their e-commerce model offered a variety of 50,000 products for customers to create an online grocery list that can be delivered to them from a distribution factory. This unique industry offers customers the convenience of not having to take hour-long trips to in-person grocery stores. Orders can be processed and delivered in half the time with online grocery shopping. Orders were shipped out of centralized warehouses and in temperature-controlled vehicles.

Generic Strategy

Webvan's online grocery stores have a differentiation strategy. In order to leverage the internet by not having physical stores, their strategy is to sell as many different grocery products as their warehouse can support out of a large warehouse space. The main distribution center was a prototype of 26 other centers that Borders planned to use to expand operation across the country. Their operations included programmers that created proprietary systems to automate, link, and track the grocery ordering and delivery process. Webvan's model also offered differentiation in their customer service. Customers could create their shopping lists online then receive their orders in a 30-minute time period without interacting with grocery store employees and checkout line traffic. Orders were delivered by Webvan "ambassadors" that were screened and selectively hired to deliver to homes while customers were either present or not. They ambassadors did not accept tips and their revenue was exclusively made from orders and delivery fees. Delivery fees were free for orders over $50 and customers were charged a fee of $4.95 for all orders under $50. With 50,000 products to select from, online grocery shopping offers a greater variety of items compare to grocery store that can only carry around 30,000 items.

<u>Competition</u>

Peapod.com

Peapod, founded in 1989, is one of the first online grocery stores. They served 400 households in the greater Chicago area. In 1998 they claimed 44 percent of the online grocery market. They switched from a personal shopper model to a warehouse model. They shipped nonperishable products across the US by UPS. They had also established membership alliances with Walgreen's for delivering health and beauty products. Their customer memberships declined in 1999 and they announced their bankruptcy in late 2000.

Streamline.com / Shoplink.com

Both companies were founded in Boston with the mission the simplify shopping for busy suburban families. They charged a monthly fee for a wide variety of products. They delivered their items to portable cooling containers or refrigerators that they would be installed in their customer's garages. The delivery employees were given authorized access to these cooling units. Their primary issues were privacy, theft, and safety concerns with their business model. Their model also excluded a lot of shoppers that lived in apartments. Their model had unappealing high fixed and variable costs.

Netgrocer.com

Netgrocer was the first online grocer to use the warehouse delivery strategy. They delivered out of a warehouse in New Jersey out to 48 states using Federal Express three-day delivery. They were the only service that charged customers by the weight of their order. They delivered

only nonperishable products. Their model was for frequent reoccurring shoppers that order the same groceries. Customers could create a shopping list then reorder items at the click of a button. This platform assumed customers would separate their shopping for nonperishable products while still having to enter grocery stores for fresh perishable goods.

Hannaford Brothers / eGrocer.com

Hannaford Brothers and eGrocer had collection centers located convenience stores, office buildings, gas stations, drive throughs, and in existing grocery stores. Grocery and prepared meals were ordered online and delivered to Hannaford grocery store by the end of the day. They sent customer orders to a local supermarket to distribute the orders. This enabled customers to save time shopping while still having the ability to inspect their products at the stores before purchasing them. They saved on costs by not having to have large warehousing, but still had to share property with the local supermarkets.

Supermarkets

While the online grocery shopping market has many new entrants, they all realized that their greatest competitor are the established supermarkets such as Kroger and Safeway. The controlled the grocery shopping market and created as much revenue in a day as Webvan and online stores would make in a year. The brick and mortar stores planned to enter the online delivery market. In their experiments in different locations they noticed that the online grocery delivery market had an insignificant impact between 1999 and 2002. With their existing stores and distribution models they incumbent saw a growth in online sales and customers.

Five Forces

For Webvan the threat of new entrants was very high. The online grocery industry was determined to focus on expanding their operations across a national scale customer base. During the booming years of ecommerce companies seized the opportunity to leverage the internet for the convenience of online grocery shopping. The threat of substitutes was also high as they fought for market share with large supermarkets and struggled to expand their operations. The bargaining power of the suppliers are low because Webvan have a wide variety of products that they buy at the lowest possible price. The bargaining power of the buyers are very high because customers could purchase from traditional grocery stores at a lower price. The switching cost of going to online shopping must match the convenience of using the internet to do your grocery shopping then have it delivered to your home. The rivalry between competition is high because many competitors are pushing to expand into new areas and deliver to more homes.

Internet Enabled Business Model

Webvan's profit site was solely based on the sale of grocery products and delivery fees. Their model was based on customer grocery lists created online then orders are recorded and sent to a warehouse distribution center. Delivery employees would ship orders out to homes whether the customer is home or not. Webvan's customer value point is their focus on differentiation. They focused on selling thousands of more products that could be offered in a traditional grocery store. The scope of their operations was limited to homes near their distribution center in Oakland, California. They shipped within a 40 square mile radius around the San Francisco Bay Area. They offered menu pricing of $4.95 delivery fees for orders under $50 and free delivery for all orders above $50. Their online grocery shopping model allows for them to sell and deliver goods with half the labor and double the product selection compared to retail grocery stores. With this workforce their distribution centers were able to handle over 8,000 orders, 225,000 items, a day. Their annual revenues were $300 million. The sustainability of Webvan is difficult to manage because of a high ability to imitate. "The procedure is to compare a firm's profit margins, revenue market share, and revenue growth rate with those of industry competitors… a firm has a competitive advantage if it scores higher in these measures than do industry competitors." (Afuah & Tucci 161). The gross margin so far has caused the business to operate at a loss for two years and they are projected to still operate at a loss in the future. Webvan must have a perspective on the profitability of the industry and take action to either turn a profit or exit the market. Their complementary assets are free to purchase for new entrants. Their strategy is based on their shipping and delivery capabilities. "The less a firm charges per unit of value, the more difficult it is for other firms to take away its market share" (Afuah & Tucci 164). The traditional offline grocery industry will continue to thrive in the market because of their scale and ability to operate at lower costs per product. Taking away the labor requirements is not the only expense online shopping may need to take away to make profit.

Stakeholders

The highest stakeholder in Webvan is the chairman and founder Louis Border. His large stake comes from his implementation of his inventory management and customer service strategies into the online shopping industry. Webvan had 80 software programmers and had employees in their distribution center. In 1999 Webvan signed a $1 billion agreement with Bechtel Group engineering and construction firm to build their 26 new distribution centers over the next 2 years. If the business fails to expand, they will also fail Bethel Group their predefined agreement significantly. Their customers are a large stakeholder and their platform is built around their customer service for customer retention.

Alternate Decisions

1. Do nothing

If Webvan chose to do nothing their financial projections for 1999 forecasted losses of $35 million with total sales of $11.9 million. They were also project to have sales of $518 million by 2001 operating at a loss of $302 million that year. The high operating expenses and low sales in the market will eventual lead to Webvan going out of business. If they do not change their business model to generate revenue from another source their chances of seeing profit is very low.

2. Buy regional grocery chains

Buying a regional grocery chain will allow them to expand into new markets and use their existing distribution centers and supplier networks. This purchase could eliminate some competition.

3. Get taken over by a large grocery chain

If Webvan were to be bought out by a large grocery chain or supermarket then operations would be entirely controlled by the company and Borders would no longer be in control. Webvan would likely no longer exist and the company will use there distribution centers and delivery operations to enter the new market.

4. Push additional product lines

Pushing additional product lines would allow for Webvan to offer a wider variety of products giving them the advantage over grocery store product limits. If they added additional products to their inventory, they will likely have to expand the warehousing space and build more distribution centers. With one current distribution centers Webvan will likely have to sell more of their current product line to have the sales revenue necessary to expand.

5. Closeout the business and exit the market

For several new entrants and competitors, the online grocery store industry has not had profitable and sustainable gross margins for the companies. Webvan needs a large flow of entering customers into the online grocery shopping market in order to profit. Profitability has been a challenge because of the high operating expenses and low sales revenue.

Recommendation

It is recommended that Webvan leaves the online grocery industry and closes their business. They should exit at a loss because the more they continue to sell to a small a customer base the operating expenses will continue to grow and they will never see a profit. If they were to push new product lines this would increase their inventory expenses and cause them to expand to additional distribution centers, increasing their expenses significantly. To cover these expenses they will need to increase sales revenue by a significant amount. To increase their sales revenue

they either needed to charge steeper fees or change their business model to generate more sales. "Some would argue that the main question of E-commerce today is how to convert Web-surfers from browsers into consumers by creating an encompassing market space for information, services, and goods." (Zwass) Exiting the market still outweighs the alternatives because the cost of each will not change the profit margins of the industry and do not solve the issue of bounded rationality. The internet is not a sensible mode of grocery shopping for most to switch because of the lack of trust customers have with delivering perishable products and temperature sensitive products. Buying regional grocery chains will also increase their projected losses for delivery. The grocery chains would be their main source of profit while they are betting for the delivery operations to turn profitable.

The option to get taken over by larger grocery industry is the next best option for Webvan. If they were bought, Borders would likely get a massive payout and leave his company behind. The reason this is not the best alternative is because of the experimenting Kroger and Safeway have done with online grocery shopping. Large grocery chains have the infrastructure and operations to build a delivery service onto their stores. In their trials, while the online grocery delivery market was growing, it had an insignificant effect to their grocery sales between 1999 and 2002. "In order to significantly increase sales we have to increase the perception of value of the market for our products" (Goldratt). The online grocery market has not proven itself as being any better than the alternatives, causing it to continually create a low amount of sales. The ability to imitate Webvan's operations is very high and a buy-in is unlikely unless a company is looking to buy their warehouse facilities. Leaving at a loss before the debt increases is the safest bet they could make.

References

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