CASE FOUR

Webvan

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Executive Summary

Webvan, a first mover on the online grocer market, is facing financial issues with their aggressive strategy. Louis Borders, the founder of Webvan, is wondering about the future of Webvan and if this current means of operations is sustainable for the company. Webvan currently is running on a profit of $11.9 million with a loss of $35 million. It is not uncommon for new organizations to run in the red for the first few years of operations due to startup costs; but their projected products show now change in profits.

Webvan has a few issues that cause their negative profits. Webvan is a first mover. This means they are aggressively growing in the market to obtain as large of a market share as possible before other organizations enter the market; and this is very expensive. Also, due to being a first mover, is building their own hub-and-spoke delivery mechanism. Causing Webvan to sign a $1 billion two year contract with Betchel Group. And lastly, due to the infancy of online delivering the perceived value of the service was low due to the delivery fee offsetting the savings in online orders.

Webvan has a few potential options in their solution: merge with a competitor, cease operations, and continue operations as is. These operations are not recommended with the idea that the online grocer market has large potential in profits, if utilized correctly. Each of these potential solutions, do not increase the profit margins of Webvan; in fact, ceasing operations would only attempt to reimburse stakeholders.

The proposed solution is to increase the product line, following in suit to Amazon who just added movies and music to their product line. This allows Webvan to potentially increase its basket size, therefore increasing its profit margins. Increasing the product line also enables Webvan to increase its consumer base with more options to the products offered to consumers, filling different needs. If

Webvan increases its product line and increase its profit margins this would be beneficial to all the stakeholders; by increasing their dividends.

Background

Louis Borders opened an ambitious perishable home delivery service, Webvan. Within the first five months of being opened Webvan amassed 10,000 customers; unfortunately, Webvan was only projected to hit sales of $11.9 million with a loss of $35 million. Is it possible for Webvan to continue such aggressive operations?

Mission Statement

“Arguably the most ambitious e-commerce initiative to date.”

Issues

Building their own delivery infrastructure

At the time of Webvans inception, the “next day” delivery was still at its infancy. Webvan, in order to deliver perishables, had to adapt and innovate to the lack of “next day” delivery. This, in turn, caused Webvan to invest heavily - $1 billon over a two-year span - into a hub-and-spoke delivery mechanism. This coupled with the internet infrastructure created a hefty startup cost.

Rapid Growth

Louis Borders, the chairman of Webvan, saw massive untapped potential in the online grocer market. This made Webvan a first mover for the online grocer market. In order to gain the market scale massive growth was necessary and expensive.

Highly competitive market

Webvans inception was during the dot-com-boom, therefore many businesses were moving towards the internet business model. The case recognized a few direct competitors: Peapod, Streamline, Netgrocer, Hannaford. The high amount of competition increased expectations of the consumer and lowered their switching costs.

Customer perceived value lower than actual

The savings customers received via online orders was generally offset by the deliver fee, lowering the consumers perceived value of the service. In the relatively new market of online ordering, this would be a hard issue to overcome.

Razor-thin margins

No numbers were given in the case; but it mentions that razor thin margins structures were common in the online grocery industry. With small margins, there is less room for errors in orders and loss of customers.

Stakeholders

Louis Borders

Louis Borders, as the Chairman of Webvan, is the most responsible for the sustainability of his corporation; at least until the IPO and the hiring of a CEO – George Shaheen.

Shareholders

Three years after opening in 1999, Webvan filed for its IPO. Once publicly traded, shareholders become stakeholders in the sustainability of the organization; they have money to lose.

Webvan employees

The employees of Webvan hold a stake in the sustainability of the organization, because they want a stable work environment. The employees don't want to worry if tomorrow they will all get laid off; this creates a negative work environment.

Webvan customers

Webvan customers have invested time, energy, and money choosing to purchase products from Webvan. Due to the low switching costs, the customers have the lowest stake; but they still have a cost involved if the Webvan ended operations.

Five Forces

Threat of new entrants

The threat of new entrants was high. The dot-com boom was in full swing during the time of Webvans inception. Businesses were looking to incorporate, or fully immerse, the internet business model to cut costs and increase profits. The costs of internet infrastructure was much lower than physical infrastructure; and with the interconnectivity of the internet the potential customer base was ten fold.

Threat of substitutes

The threat of substitutes was very high. The base substitute would always be the consumer going to a physical grocery store, but this coupled with the threat of new entrants made for a massive threat of substitutes. Dot-com internet businesses had to find their differentiation.

Bargaining power of customers

Based on the high threat of new entrants and the very high threat of substitutes, customers bargaining power is very high. Customers had a low switching cost, so if their expectations were not met they could easily switch to another.

Bargaining power of suppliers

The case does not directly mention suppliers of Webvan (beyond a few mentioned deals); but, an assumption can be made that suppliers had a relatively high bargaining power due to Webvans need for low cost products, in order to remain sustainable.

Competitive rivalry

With the high threat of new entrants, high threat of substitutes, the infancy of the online grocery, and the massive scale of the physical grocery industry competitive rivalry was massive. All of the companies mentioned in the case are fighting for a customer base, some in the same geographical area.

Proposed Solution

Expand product line

When implementing an internet enabled business model an organizations general strategy must be differentiation. (*Dr. Barker The IEBM*) Webvans differentiation strategy, currently is exceptional customer service; but unfortunately, this is not enough. Webvan needs to increase the product line in order to set itself apart from its direct competitors.

Increasing the product line not only sets up differentiation; but, allows Webvan to increase its average grocery order from $71 by allowing consumers to have additional product lines to fit different customer's needs – hopefully to $101 to meet the profit needs. This is the route Amazon took a few years prior when the expanded their books product line to include movies and music. Webvan has the delivery mechanism in place and could easily be a direct competitor if they increase their product line to match.

This is the recommended solution since this allows for Webvan to continue operations, aggressively, whilst working towards creating a larger profit stream. In Afuah-Tucci they determined a model for analysis that looks at different aspects of the internet business model (mostly for Amazon). In this case, Webvan is increasing its scope by increasing its product line.

Alternate Solutions

Do nothing

Webvan can continue the aggressive growth model without altering anything, but this is not recommended. With Webvans small margins and low projected sales, their needs to be a change in operations. According to Gary Hamel, founder of Strategos a strategic consulting firm, mentioned that first movers need to capture the market share at a discount; not to over pay. If Webvan continues operations as is, they will over pay for their market shares. The cost of physical infrastructure is too large and requires strategically spaced business units to capture another section of the market. This coupled with their low profit margins spell disaster for Webvan. “The moral is simple: If you want to profit from a first-mover advantage, you'd better make sure you start with a unique strategic insight that, at least initially, is unattractive to would-be competitors or protected by a wall of patents” (*Gary Hamel, Smart Mover Dumb Mover…*)

Cease operations and exit market

Webvan can cease operations and exit the market due to the internet business model having low exit costs. This would allow Webvan to cease operations before the company went way under, allowing for them to potentially reimburse their shareholders by selling off their current assets. This is not a recommended solution either. Louis Borders is right, there is an untapped market available for the taking and exiting the market fully commits the market to another organization. Every stakeholder would agree making profits is better than a zero gain.

Merge with competitor

Webvan does have a large consumer base, which would be exiting for another corporation. If Webvan merged with a competitor it would allow for Webvans innovative, and expensive, delivery system to be incorporated with a more stable business. Combining the two markets would also, most likely, allow for the corporation to be less aggressive in obtaining a large market share; since now they have a combination of the two markets – assuming the purchaser is a more stable corporation. This is not recommended. Fundamentally, Webvan needs to determine the issues it has with operations and overcome these issues, if they don't and get bought out, the issues are just transferred.

Citations

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