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*Webvan*

Case Analysis

The mission of Webvan is to provide an online grocery shopping and delivery service to customers front doors, that eliminates the brick and mortar cost of a store front. The generic strategy of Webvan is a mix of differentiation and cost leadership. The case states that Webvan wanted to eliminate the costs associated with the brick and mortar stores, for example a store front. They also differentiated themselves with their Webvan model. This model was based on massive distribution centers that would store groceries before transit and their computer programs and algorithms would keep track of all inventory and orders. In lecture it was stated “that you are able to be a cost leader and differentiate your product or service when it comes to e-commerce or the internet.” [1]

The problem Webvan is having is that they created their own infrastructure from scratch with the Webvan model. The fact that the model is so complex and a brick and mortar store front could serve as a lower cost distribution center, makes it an overly costly investment. It is stated in the case that Webvan signed a 1 billion dollar agreement with a construction firm to build the distribution centers at a cost of 25 million to build each distribution center. According to the Internet Business Model “Firms that want to improve their chances of survival during a burst need a good business model.” [2] Webvan’s business model could prove to be too costly since they are encountering 35 million in loses and not profiting at all. Also, they are trying to expand their market too quickly. Stated in the case Borders believes that Webvan can prevail over its internet competitors by expanding aggressively. According to the Internet Business Model and lecture “the scope is not always whoever has access to a browser.” [3] Webvan has a bounded model to wherever Webvan can build distribution centers and keep groceries fresh for consumers. The costs of the distribution centers is being overlooked and expanding aggressively would keep them from profiting.

In assessing Webvan with Porter’s Five Forces. The bargaining power of Webvan’s consumers seems to be high. Physical goods tend to be undifferentiated, which means consumers tend to buy the cheapest. According to Porter’s Five Forces, factors that increase customers bargaining power “products have little differentiation.” [4] The only reason consumers would use Webvan to buy groceries is because it is convenient, definitely not the cheapest.

The bargaining power of Webvan’s suppliers seems to be low. If one farmer decided to raise the price of their goods that Webvan sells to consumers. It would seem that another farmer would sell it for less, because farmers tend to have a generic strategy of cost leadership due ti all their goods being undifferentiated. According to Porters Five Forces, factors that increase supplier bargaining power “raise prices without affecting demand.” [5] Farmer’s cannot raise prices without affecting their demand from Webvan and other consumers of the farmer’s goods.

The threat of new entrants into Webvan’s industry, seems to be high. There are no barriers to entry when it comes to someone building a website to sell groceries. Also, there are no barriers stopping large grocery chains like Kroger Co. from entering the internet grocery delivery service market. They would have economies of scale greater than Webvan and distribution channels already in place across multiple markets. This would create a significant threat to Webvan if it happens.

The threat of competition seems to be very high. This is because there are no switching costs between competitors. The grocery industry was already highly competitive before the online grocery industry started. All the products you find at a grocery store you can find at any other competitor’s grocery store. This is the same for online grocery shopping. The only thing that can be differentiated between competitors is price and convenience. Price and convenience is what Webvan wants to exploit and make a profit from.

The threat of substitutes seems to be high. This is because there are no switching costs between the substitutes. Nothing is stopping someone for driving to the grocery store rather than ordering online groceries through Webvan. Also, the substitute of driving to the grocery store would seem to be cheaper because there is no Webvan delivery cost to your door step.

The stakeholders invested in Webvan would be Louis Borders (Chairman), Shareholders (CBS, Yahoo!), Customers, and Employees. I’ve assessed Webvan, now I am going to provide three alternatives and how they affect the stakeholders of Webvan.

The first alternative would be to do nothing. If Webvan continues down their same path I believe that they will go bankrupt. The reason being is that Webvan is trying to expand their market by building 25-million-dollar distribution centers in certain locations, but also wanting to be a cost leader compared to brick and mortar grocery stores. This rapid expansion will cost Webvan a significant amount of money and if Webvan thinks they are going to be a cost leader they need to think again. It is stated in the case that Webvan’s 1999 sales were expected to amount to 11.9 million less than large grocery chains make in one day, while loses would amount to 35 million. How is Webvan going to expand if they lose 35 million in 1999 and it costs 25 million to construct new distribution center? This does not appear to be a good investment to me. Also, I believe that large grocery chains will enter the online grocery ordering market and Webvan will not be able to compete. Considering most large grocery chains like Kroger Co. already have distribution channels over many geographical locations. They would not have to endure the huge cost of massive distribution centers like Webvan. The only cost they endure would be the program development cost and maybe more employees which is not necessarily a problem for a large grocery chain.

Louis Borders (Chairman) would not be pleased with doing nothing, because his company would soon go bankrupt. Shareholders would also not be pleased, because their stock would be worthless and they would lose their money. Employees would not be pleased because they would lose their job. Customers would not care too much either because they can still go to the grocery and get the same goods they wanted from Webvan. They just would not have the luxury of a delivery service.

The second alternative would be to narrow focus on Webvan’s target market. I believe that Mr. Borders is too focused on expanding to different markets within the grocery industry and trying to be a cost leader by eliminating costs, like a brick and mortar store front. Borders states in the case in the Internet economy first to scale, not first to market, counted. I believe that Borders is confusing what his profit site is according to the internet business model. Webvan’s core competency is not being a cost leader because they will not make money or have the ability to expand quickly due to the cost Webvan is enduring with distribution centers and other costs. Webvan’s core competency is a luxury service that provides groceries delivered straight to your door step. Webvan would need to increase their prices for goods and for their delivery service. Then Webvan focusing their target market on consumers who will spend the extra dollar on their luxury service. They could then potentially stabilize themselves in that market, by creating a bounded rationality for the people in this target market. According to lecture “a bounded rationality is basically a habit or a way you always do something because that’s the way you’ve always done it.” [6] Once Webvan creates this sustainability they can begin to expand their market when they become profitable. Also, starting small will let Webvan build an e-business strategy. According to e-business 2.0 roadmap to success “an e-business strategy formulation starts with knowledge building. Knowledge building is defined as: helps the company understand what the customer is looking for and where the industry is going. This phase opens a window on the future and provides opportunity to really understand what customers value.” [7] If Webvan begins to understand what customers really value by starting with a focused target market. Webvan can profit off of this value and expand their market because of the better understanding of the customers value they want to support.

Louis Borders would be pleased because his company would be profiting from his online grocery service. Also, he would have a better understanding of his customers values. Shareholders would be pleased because their stock prices would go up and could potentially receive dividends for Webvan. Employees would be satisfied with potential job security because Webvan is finally making money. Customers would enjoy the luxury service and be pleased that Webvan’s service meets their values in online grocery shopping.

The third alternative is to team up with large grocery chains. Safeway, Inc. and Kroger Co. already have economies of scale and distribution channels in place. Webvan could partner with these large grocery chains and not have to deal with the cost of massive distribution centers that could be their downfall. Webvan would still be differentiated in the market and could successfully be a cost leader because they would have the support of their partner brick and mortar stores and have economies of scale to make Webvan profitable. Also, they would decrease competition among themselves creating more opportunity to make a profit in the market. According to the Internet Business Model and lecture “team up is an easy way to make money and expand your market.” [8] Borders is set on expanding the market because he stated the Internet first to scale, not first to market, counted. This is a great opportunity for Borders to do what he wants and make a profit while he is doing it.

Louis Borders would be pleased because they would be profiting off of the partnership and have economies of scale like he wanted. Shareholders might not be pleased at first because teaming up with another company may cause Webvan’s stock price to fall but would rise again if all goes well. Employees might not be pleased because some jobs could be replaced or not needed anymore. Customers would enjoy a team up between Webvan and a large grocery chain because they might already use that grocery chain to buy groceries. This gives customers more incentive to use Webvan’s service because they might have brand loyalty to that grocery chain.

To conclude, I believe the best solution would be the third alternative. To team up with a large grocery chain. With the support of a large grocery chain that enjoys economies of scale and already established distribution channels. Webvan can start making a profit quicker than the second alternative of increasing prices for their goods and their delivery service just so they can attempt to make a profit. This would take longer due to the fact the they would have to build massive distribution centers and other cost just to establish a distribution channel. Also, I believe this a better and easier solution than alternative two when wanting to start formulating an e-business strategy in this market. Alternative two could turn out to be too costly for consumers when increasing prices and delivery service fees. When formulating an e-business strategy you start to knowledge build and you gain a better understanding of customers values which gives you a better understanding of how to support the market. This better understanding of customers values and teaming up with a large grocery chain will give Webvan sustainability they can build on.

**Sources**

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