Case V – 2

Webvan

CIS 410-01

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**Problem**

Webvan is a new online grocer. They raised a lot of capital with a surprisingly large IPO. They’ve started doing business, but they aren’t meeting the sales numbers they need to grow to profitability. Their founder is now considering the company’s future goals.

**Industry Competitive Analysis**

**Mission**

Webvan sells groceries and delivery service through the internet to shoppers. The shopper orders online, Webvan packages their order in a warehouse, then delivers it to their door.

**Generic Strategy**

Webvan is using a differentiation strategy by offering a new type of service in an established market.

**Five Forces**

1. Competition: moderate threat. Webvan isn’t the first company to try online groceries or the warehouse strategy. In particular, Peapod has an established customer base, existing partnerships, and already operate in Webvan’s area (San Francisco). However, they are struggling to stay in business and, in comparison, Webvan has a lot more money.
2. New entrants: high threat. Established grocery store chains are looking into trying online order and delivery for themselves.
3. Substitutes: very high threat. The alternative to ordering groceries online is going to the store and buying them, which everyone already does.
4. Suppliers: low threat. Webvan’s suppliers make commodities. To them, Webvan is just someone else to sell goods to; they are no different to any other grocery store.
5. Customers: high threat. Webvan’s customers have essentially zero switching cost. They can just go to the store like they already do.

**Stakeholders**

1. Stockholders. Webvan just went public for $800 million. Webvan’s stockholders are expecting to see some significant dividends.
2. Louis Borders (and Webvan as a company). They want to become profitable and make money.

**Alternatives**

Webvan has a few options going forward.

1. Do nothing. Webvan will continue operating at its current capacity in the San Francisco area and rely on its customer base and order size to grow with an increase in demand. Once the business becomes profitable, the company and stockholders will benefit.
2. Expand. Webvan might consider buying a regional grocery store chain. This would expand their potential customer base, accentuate their current distribution ability, and eliminate some of their competition. Webvan can save some money and expand, which could benefit the stakeholders.
3. Get bought out. Webvan might entertain the idea of getting taken over by an existing large grocery chain and becoming their online grocery division. Webvan could use their value and newfound customer interest in online groceries to attract interest and sell for more than they went public for, thus satisfying the stakeholders.
4. Get out. If Webvan doesn’t get any offers from larger groceries, they should consider cutting their losses. The business doesn’t seem to be doing as well as expected.

**Recommendation**

The heart of Webvan’s issue is its business model. Webvan is trying to be the ‘last mile’ of grocery shopping; be the person that brings the good/service the last mile to the customer. (Afuah, 24) However, this ‘last mile’ concept doesn’t work with groceries as well as it does with communications, media, or even other online retail. Various advantages of the internet on B2C commerce (Afuah, 42) are lost when working with groceries. The time moderator effect lets customers shop whenever they want without lines, which is an advantage. However, it’s currently being limited by the fact that Webvan does business in one area. People aren’t going to order groceries at night. Infinite virtual capacity allows a business to list as many products as they want on their website, but there’s only so many products a grocery store would sell, Webvan doesn’t have the ability to expand for other products, and the warehouse can only hold so much, so that advantage is limited as well. The distribution channel effect is completely nullified; groceries can’t be delivered instantly, and there are no real network externalities. Additionally, groceries by nature need a lot of tacit knowledge to secure purchase; a customer needs to see and touch the items before buying. (Afuah, 45) Grocery shopping online doesn’t offer significant enough advantages, and that shows in the market share. Online grocery orders accounted for a total of $156 million in 1998; that’s 20% of what Webvan went public for. Webvan has no market share to work with, which is essential for a firm in its early life. (Afuah, 59) In addition, grocery stores traditionally operate on small margins. With no market share and minimal margins, there is nowhere for Webvan to make back the money that was invested. The business model is not sustainable by any means. They face a high amount of threat from the five forces and they would struggle with all of the responses outlined by the complementary assets model. (Afuah, 70) They can’t run because they have no capacity to innovate with. They can’t block very well because their substitutes are too big. They have tightly held complementary assets and are also rather easy to imitate. (Afuah, 79) This leaves Webvan with a team up strategy, but who would they team up with? The only real suitable answer would be a grocery store. The best possible outcome for Webvan would be to team up with a bigger grocery business, either by making a partnership or, more likely, getting bought out. Every other option is a bust for Webvan. They can’t afford to sell more products, buy out a regional grocery, or even to do nothing. At the end of 1998, Webvan posted a $12 million loss with zero sales. In 1999, sales were $11.9 million with losses of $35 million. Webvan is a prime example of a company on the dot.com bubble. They had a very successful IPO, but in reality, they have no way to make money. A closer look at the complementary assets model would have made this clear. (Afuah, 97) With high imitability and tightly held complementary assets, they are in the worst possible position. They shouldn’t have gotten into business in the first place. Webvan won’t survive without external intervention, but with these kinds of losses, no grocery business in their right mind would do such a thing.

Afuah, Allan and Tucci, Christopher. *Internet Business Models and Strategies.* 2nd ed. McGraw Hill, 2001.