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## Case 4: Webvan

### **Introduction to Webvan**

Webvan was a product of the dotcom boom in the mid to early 90's. It was an ambitious attempt to capture a slice of the grocery industry by Borders Bookstore CEO, Louis Borders. Borders envisioned a service in which customers would place online orders and have groceries delivered directly to their homes. Webvan aimed to maximize convenience by delivering products as quickly as possible. They based their logistics chain around custom-built distribution centers and warehouses.

The offline grocery market was a formidable foe, and other online competitors had only captured a single percentage of the market share. Webvan was growling slowly despite a loyal customer base and successful infrastructure. They were failing to pull customers into the online shopping realm. Their customer acquisition costs, the sales and marketing costs associate with acquiring a customer, were extremely high (Olenski). People were comfortable buying groceries the way they always had, early adoption was low.

Investors were excited about Webvan, despite their low sales and large losses, their initial public offering made headlines. On the first day of trading, shares were at an incredible 80% premium. At the end of the day, Webvan's market value was more than \$8 billion. Simply put, Webvan was overvalued, and investors and company personnel began to worry. They claimed nearly half of the capitalization of the grocery industry, yet

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their sales for the entity of 1999 wouldn't come close to touching what a larger chain made in a single day. The apparent overvaluation suggested that the current burn in capital would not be sustainable. The forecasted payoffs would not be realized, and Webvan would continue digging itself into a hole.

Borders knew he needed to aggressively expand. He began planting new infrastructure and developing the logistics chain for a greater reach. The margins on losses were growing, they needed more customers to support their operations and expansion. The Teece Model could be applied to the Webvan case. Borders wasn't worried about being imitated, but knew his complementary assets were important. Protecting his distribution channels, marketing capabilities, relationship with customers, licensing, and company reputation were at the forefront of his mind (IWZ). Before deciding on the best course of action, we need to analyze the business as it stood and the industry it resided in.

### **Porter's Five Forces**

Webvan is dependent on suppliers. Food and home goods are sourced from a variety of retailers and distributors. However, food suppliers operate on a low-cost basis so their bargaining power is low. Webvan could shop around and contract different suppliers, especially for their home product categories. To retain competitive prices, Webvan needs to offer services that are more affordable than traditional groceries. In 1998, the average American household spent around \$7,000 on groceries per year (Johnson). Taking their yearly budget into account, that was a little over 16% of their

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disposable income. To put that into perspective, a peak occurred in 1933 with Americans spending 25.2% of their income on food (Miller). Before the turn of the century, Americans weren't spending as much money on food when taking their income level into account. When Webvan focuses on commodity foods, the suppliers don't hold power over them because the model is built to supply at low costs.

Several competitors are listed in the case. Competitors that are larger in size have a competitive advantage over Webvan. This is accomplished through their customer bases, converting customers to the online grocery platform was extremely difficult. Their rival, Peapod, spent 10 years to accumulate 100,000 customers. While impressive that Webvan had 10,000 customers in five months in San Francisco, the growth wasn't fast enough. Other competitors launching features such as lockers in garages may set industry standards depending on market reception.

Webvan does face the threat of new entrants. The dotcom boom led to talented developers entering the workforce and introducing new software products. Webvan's platform would be easy to replicate. However, the capital companies like Webvan need to operate isn't easy to come by. Their ability to engage with their market allows them to retain power over this force. Webvan's advantage is preexisting distribution centers. Without major funding sources, competitors couldn't simply enter the market and build infrastructure to rival Webvan. They can counter the lack of security for internet-based business with physical infrastructure and assets.

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Webvan's greatest threat is customer acquisition and retention. The grocery industry is extremely diverse. Customers can choose from a wide range, chains, independent markets, even convenience stores attached to gas stations. Many will be reluctant to make the switch to online ordering and home delivery. Switching costs, learning to use the software, making delivery schedule adjustments, and paying premiums all serve as deterrents. Customers hold the most power over Webvan.

Lastly, Webvan has a few key substitutes. Brick and mortar grocery stores are the largest threat in this category. They hold the largest segment of the market. They have a successful business model and loyal customers. There are other online grocery retailers, but traditional stores are the biggest concern. Webvan is attempting to undercut these chains and secure their customers. They need to convince potential customers to make the switch so they can scale the business in a sustainable fashion.

### **Stakeholders**

Peter Drucker describes the most important stakeholders as the investors and the corporate employees (Destination Innovation). They are the most affected by major decisions within the company. Their wellbeing and day-to-day work must be taken into consideration before making heavily reasoned decisions.

### **Doing Nothing**

Webvan could continue operating as they currently are. They will continue with little to no momentum in their customer acquisition endeavors. They will struggle to gain a meaningful market share and their losses will prove this option fiscally impossible.

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They will continue to hemorrhage their capital and file for bankruptcy. Investors' capital will be burned. Corporate employees could lose their positions due to the losses and high costs of acquiring costumers. Recovery would be extremely difficult. Current customers would have to make the switch back to traditional shopping or a competitor's delivery service. Doing nothing would doom Webvan.

### **Brick and Mortar Buy-Out**

Webvan could position itself to be an attractive acquisition. A larger company could absorb them as a subsidiary. This would ease the customer acquisition issues and integrating existing logistics chains will end the need for expansion. On top of this, the chain will be exponentially larger than what Webvan was implementing already. This option benefits not only Webvan, but the competitor. A traditional chain could add delivery as a competitive feature and absorb Webvan's existing customer base.

Corporate employees would either be satisfied or extremely upset with this option. Ownership of the company would cease, and personnel may be replaced by the new owners. However, Webvan would still continue to exist, so many employees would retain their jobs, a stark improvement. Investors will also hold mixed opinions because Webvan will continue to operate, but their stock will be bought by the new parent company. This may or may not create gains for the investors. Customers would be happy because their accounts will still be supported and may have access to a larger selection of goods. This alternative doesn't please every stakeholder, but it is an improvement from their current business model.

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### **Online Services Team Up**

The final option is to team up with other online distributors. Each online grocery delivery service struggles with customer acquisition. It is unlikely that there is a large customer overlap between companies. Combining customer bases will allow these companies to absorb multiple markets and grow their market share. It is extremely difficult to retrain customers to shop differently. They are comfortable at brick and mortar stores and encouraging them to make the switch is not difficult. If Webvan is acquired by a brick and mortar store, it does not mean their pre-existing customers will try out delivery services. Customers that know and trust a delivery service are more likely so stick with it. As we age we become more inclined to what we know and are familiar with (Grohol).

Webvan has a large amount of capital and they are rapidly expanding their infrastructure. Even with these advantages, they are struggling to grow. It is extremely likely that other delivery services share these growing pains. Teaming up could be a lucrative choice for Webvan. Customers will be happy because the combined features will come into effect and corporate employees will continue to operate and retain their ownership. Investors will be happy because Webvan will grow their customer base and will reap the revenue.

### **Recommendation**

If Webvan wishes to continue operating, they should seek out a corporate buyout from a reputable retailer such as the Kroger Co. or Walmart. Other online delivery

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services are struggling to grow just as Webvan is. Teaming up with them won't provide the mutual benefits necessary to propel them forward. They won't be able to capture a large enough market share and will eventually fold. Pursuing this option would only delay the inevitable. A buyout and integration with an established company could keep Webvan afloat and give the new owners a competitive advantage against other retailers. Webvan would subsequently have access to an expanded logistics chain and an exponentially larger customer base. It would give Webvan even more capital to improve their services and guarantee longevity.

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