

Case 4 – Webvan

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Mission, Overview, Problem:

The Internet can be a powerful tool in the world of business, especially when a company can identify a clear need to satisfy and use the Internet to achieve satisfaction of that need. It has shown that, if utilized correctly in an appropriate Internet enabled business model, it can upset established industries and provide a competitive advantage to innovative firms. Webvan was one such ambitious attempt to use internet-enabled ecommerce to upset and revolutionize the way consumers purchase and receive their groceries. By focusing on enhanced customer service and effective operations, Louis Borders believed Webvan could ensure strong profits by making grocery shopping more convenient. However, the company's financial performance seemed to hint that they were experiencing some fundamental issues. "Internal financial measures such as profitability and return on assets are indicators of organizational effectiveness" (Cash).

The mission of Webvan was to provide a convenient, secure online shopping experience that offered an unmatched customer service experience with a wide selection of quality goods at prices matching or below in-store prices and delivery of goods in less time than it takes for a visit to a brick and mortar store. Despite this success, the young business was experiencing major problems, mainly stemming from a lack of funds due to poor sales revenues. This poor performance seems to have been caused by a flawed internet enabled business model, which is a result of misidentifying a consumer need.

Internet Enabled Business Model

- Profit Site

In an internet enabled business model, the profit site is what an organization does better than its competitors, i.e. its core competencies. For Webvan, they tried to create an operation that

could outperform traditional offline grocery chains, as well as their online competitors, and focus on superior customer service experience for users by offering a wide array of products. In the end, they wanted to be the most convenient option that could meet the demands of a many consumers.

- **Value**

Value is what a firm does or offers to maximize customer satisfaction. Most firms accomplish this by following one of the two main generic strategies of either cost leadership or differentiation. Although the Internet enables a business to pursue both, Webvan was largely focused on differentiation. Outside of selling groceries in a convenient way, Webvan attempted to provide a more personalized grocery shopping experience by providing quality customer service, a wide selection of products, fast delivery, and customized meal offerings from professional chefs.

- **Scope**

Scope is the reach of a business, usually determined by a geographic area. At the time of this case, Webvan's scope was limited to the San Francisco Bay area, though they planned to expand that scope nationwide through aggressive expansion. Webvan wanted to build numerous, massive distribution centers across the country that could, reportedly, meet the capacity of 20 supermarkets. A major problem for Webvan was their attempt to broaden their scope when, in reality, they only made up a tiny sliver of the market and lacked a solid foundation to build up from.

- **Revenue Sources**

The Internet enabled business model opens up all kinds of potential revenue sources traditional business could not pursue. Selling ad space on a website, or data to third party data

firms are two lucrative options Internet businesses can pursue, yet Webvan opted to use neither of these choices in attempt to remain unbiased. As stated earlier, while well intentioned, this is a major source of revenue they are simply forgoing, and in the face of their poor financial standing, they should have sought to utilize all potential sources of revenue. The main ways in which Webvan made money was through orders and delivery fees, and, if they had a much larger market share, this may have been enough to support them.

- **Pricing**

There are numerous methods of pricing products over the internet, with a few being menu pricing, negotiation, auction, and reverse auction. Each method has its strengths and weaknesses, but Webvan, like traditional retail stores, chose to use menu pricing. It is the most efficient pricing method, and since Webvan focused on providing a convenient shopping experience, it is a natural fit. However, if Webvan's prices are not to customers liking, they risk losing business, as consumers can rely on other grocery stores on or off line.

- **Connected Activities**

Webvan attempted to create an efficient and effective operating strategy that focused on quickly fulfilling and delivering customer orders. In order to do this, the act of a customer placing an order needed to be quickly communicated to the distribution warehouse for pickers to gather the items for the order, and get those items onto a truck and into a van for delivery. Every activity, from the customer ordering, to the picker gathering products, to the delivery driver delivering the order, all needed to be closely connected for Webvan to succeed.

- **Implementation**

How well the connected activities act together as a system depend on many factors such as the structure, overall strategy, people, and the environment. Webvan demonstrated they had an

effective implementation in their operations, as they were able to meet demands of their customers with extra capacity.

- **Capabilities**

For a business to succeed, its capabilities must be aligned with its strategy and overall goal. Webvan proved that it was very capable in achieving its goals of providing fast delivery at a large scale to many consumers. In fact, they did it so well, estimates showed they were only operating at 20 – 30% their total capacity, so they were very capable. The problem lied in the fact they simply lacked the market, and therefore profits, to support the business venture. Webvan's market place was overcrowded, and the percent of the grocery market cornered by all online stores only made up a fraction of the traditional grocery market.

- **Sustainability**

Sustainability involves how the company plans to stay in business. This involves a choice of strategy from three main options: run, block, or team-up. Running occurs when a firm chooses to constantly innovate and stay ahead of its competition. Blocking attempts to make it more difficult for new entrants by copyrighting, patenting, or licensing. Teaming-up involves multiple business collaborating to achieve a competitive advantage, as they can do things together neither could do by themselves. Looking at the imitability of a company's services, and its complementary assets, which are assets that enable it to do the things it does, can help a business choose the most appropriate strategy. In Webvan's case, the imitability of their services was high, as shown by the large amount of online grocery stores, and its complementary assets were easy replicate, so it chose a run strategy. In doing this, Webvan attempted to aggressively expand its scope and create economies of scale operations with massive distribution centers, which would enable them to reach a wider market than its competitors in a more efficient way. As

mentioned many times before, Webvan simply did not have the capital to keep this innovative strategy achievable.

- Cost Structure

Typically, Internet Enabled Business Models create situations where the marginal cost of doing transactions is practically zero. These economies of zero generally make it a walk in the park for online businesses to make money. Webvan should have been pretty much in the same boat, with only having costs for shipping and handling orders. Their major mistake was trying to build a huge infrastructure from the ground up, instead of using existing options, such as existing grocery stores to supply the goods. Their costs soared, and with weak revenues, Webvan had trouble from the beginning. Their cost structure made their business model unsustainable by pretty much ensuring costs would outweigh revenues.

Porter's Five Forces

Existing competitors pose a considerable risk for Webvan. Businesses like Peapod, Streamline, Shoplink, Netgrocer, and several others already existed in the online grocer marketplace at the same time as Webvan. Each attempted to cash in on the convenience consumers perceive from shopping online versus shopping in person. Peapod had already amassed a customer base of 100,000 after 10 years of operation. The fact they had remained in business for 10 years indicates that they had been doing something right, even though they were experiencing some financial troubles as of 1999-2000. If consumers do not like the service offered by Webvan, they are likely to find similar offerings from the existing online grocery stores, which is why Webvan attempted to differentiate itself with a large selection of goods to pick from and effective operations strategy that allowed them to simply out-perform the capabilities of the other online businesses.

The very nature of the Internet had created an environment with relatively low barriers of entry into the online grocer market, as access to the Internet was easy and could be done at low costs to companies and consumers. Also, as the usage of the Internet was growing at the time, more and more people and businesses were sharing the web with one another, making it easier and easier to reach consumers. Just look at Webvan, they were able to build a customer base 1/10th the size of Peapod's after only 2 years of operation. Nothing is stopping a new business from repeating that success and undercutting Webvan. Since the Internet enables many business models, it is easy for firms to innovate with new business models that Webvan may or may not be able to compete with.

Threat of suppliers is relatively low though. As a functional organization, many of the jobs in the distribution centers and delivery services are relatively low skilled, meaning finding labor is easier. If employees are causing trouble or posing a threat, they can be fired and replaced easily. In addition, Webvan aims to buy and offer a wide range of goods in large quantities, they will have considerable bargaining power in their supply chain, as they will be a valuable customer to food companies. To stock their massive distribution centers, they will be purchasing many goods, and being a main supplier to these centers could prove quite lucrative, so suppliers may be more enticed to offer products at lower prices, which would work in Webvan's favor. If the price of a certain item gets too high, Webvan can look elsewhere, or simply stop offering that product since they plan to offer so many different items and do not have to rely on a one supplier of a certain niche item.

Substitutes also pose a serious threat to Webvan. As mentioned above, there are many existing competitors in Webvan's industry, and if customers feel they can have a better experience elsewhere there is relatively little stopping them from taking their business elsewhere.

With the need for growing customer base being so strong, Webvan cannot stand to lose existing customers to other online grocery sites. Another point worth making is that Webvan, and the rest of the online grocery industry, has to compete with the well-established, traditional brick and mortar grocery store industry. Going to the store and picking up food and other necessities has, and will continue to be, an experience almost all consumers in developed countries have at some time or another. This behavior is very much entrenched in consumers, and is unlikely to change, so if customers are unsatisfied with the online shopping experience provided by Webvan and others or just simply want an item quickly and do not want to wait, they can always go to the Kroger's down the street and get what they want. Off-line grocery stores have the inherent advantage of being able to provide groceries to customers relatively quickly in impromptu situations.

As mentioned above, customers have considerable buying power in the online grocery market. These firms rely heavily on encouraging repeat purchase behavior from customers, and with so many similar businesses popping up customers have many options. If they do not like the prices or service times offered by one business, they can go to another either on or off line, and since Webvan is using menu pricing, they need to get the price just right so customers are more enticed to purchase from them in the future. Menu pricing is widely used by retail and grocery stores, but has many shortcomings, one main one being "the possibility that the menu price is too high, cutting off many buyers who would have bought the product at a lower price. At the same time, the seller is forgoing extra revenue," (Afuah).

If customers decide to leave, that is a revenue stream lost, and with the profit margins being so razor thin, every sale counts in the small, over-populated market space Webvan competes in. The Internet makes it easy for customers to find similar businesses online, so

having one grocery store to purchase from is becoming less common. This works well for consumers as they have more choices, but it increases competition among businesses. If Webvan cannot differentiate itself from its competitors in a big way and drive down customer bargaining power and increase switching costs, surviving in the online grocery store industry will be that much more difficult.

Effect on Stakeholders

No matter the decisions Webvan makes regarding the problems facing the business, its stakeholders will be affected. Two major internal stakeholders for Webvan are its employees and its shareholders. Since Webvan was a public company, it had a vested interest in generating strong returns for its shareholders. If Webvan could refocus its business model on a pertinent consumer need and deliver on that need, they may experience increases in profits as they can target services and goods more directly. However, it seems unlikely that Webvan will be able to quickly recover from its losses, especially as it incurs more costs in its attempt to aggressively expand. This means weaker (to no) return on investor's shares, which means negative consequences for shareholders, which will be good for no one.

A major aspect of Webvan's internet business model is that it can keep its variable costs low by not having to employ a large workforce and own/maintain physical storefronts. That being said, Webvan still requires employees and managers in the distribution centers to gather the goods for the orders, and drivers to ship the orders. The main benefit for employees, if Webvan can generate more business and recover from their financial losses, is continued employment. Without money, there can be no company, and if Webvan continues to operate at a loss, they will likely go under, leaving their workforce without jobs. While the jobs of many of

the employees probably lack a whole lot of depth and complexity, since Webvan functions as a functional organization, a job is a job and a source of income for the people working there.

Major external stakeholders for Webvan are its customers and contracting partners. Customers would likely benefit if Webvan could fix its problems and improve its business model. They would continue to have access to a safe and secure experience online from an ecommerce business that provides them with a wide selection of goods and solid customer service. If Webvan could better identify a customer need and deliver on that need, consumers would be more likely to continue purchasing goods from the site, working in theirs, and Webvan's, best interest. That being said, if Webvan goes under, customers do not have much to lose, as there were many other online and offline grocer businesses that offered similar services to Webvan and could fill the gap. Contract partners such as Bechtel may suffer as well, as in order for their deal with Webvan to continue, Webvan needs to stay in business.

Alternatives

There are several alternatives Webvan could pursue to fix the problems facing the business. The first would be to do nothing, that is, continue to operate the business as it currently is. While this solution is the easiest, it also almost guarantees certain failure for the business. While predictions estimate Webvan could see profits of \$518 million by 2001, they will still see an overall loss of \$302 million for the year. The current business model is not conducive for the company's continued survival. Inevitably, the company will fail as ballooning operational costs and weak grocery sales suffocate any sale revenue. Within the company, employees from all levels of the organization will be negatively impacted. Management would continue to struggle looking for ways to make up for the losses before they, and the employees under them, eventually lose their jobs.

Customers would feel little impact if Webvan decided to do nothing, as they could either continue to shop on the site or look elsewhere for another similar option. Reiterating previous statements, consumers, at this point, had no stake in Webvan's success; they had relatively little reason to be loyal to the company. So, if it fails or succeeds customers would be fine either way, as they always have other options for the services and goods Webvan attempted to provide. Shareholders would not be happy, as the business would continue to operate at a loss, meaning pitiful returns and growing losses on the investments they made into the company. Contractors and suppliers would likely be negatively impacted as the business would eventually fail, leaving them without a source of business.

A second option would be for Webvan to try to buy regional grocery chains in an attempt to grow the business and eliminate some competition in the process. This move would allow Webvan to move into new regions, which means new potential customers to sell to, and if they buy these regional chains, they leave themselves as the one of the major options for buying groceries. In addition, they may be able to build recognition of their brand in the process, as more and more grocery chains are taken under the guise of Webvan. With more people recognizing the brand, the more likely new customers will try out the services offered by Webvan, which means more business and more money for the company.

This move would likely make employees, both high and low, happy, as managers see a way to improve the company, and employees and management stand a better chance of keeping their jobs longer. Shareholders may be happy as well, as they stand a better chance of not seeing losses on their investments into the company. Contracted partners, like Bechtel, would see this as a positive option since this signals more distribution centers to build. Customers may or may not see much benefit in this option though, if Webvan cannot provide the same level of service as the

chains that were bought out. Customers would lose bargaining power and options to choose from, which increases their switching cost.

A third option would be to exit the market altogether. This would involve Webvan selling all their assets and cutting their losses before they dig themselves into an even deeper hole. The company is currently operating at a major loss, and is predicted to continue doing so for the next few years. Webvan can only operate in the red for so long before they have to file for bankruptcy, and while this would be a major blow to individuals who have stake in the company, in the end, it will save a lot of trouble.

Employees from all levels of Webvan would not be happy with this decision, as it would mean them losing their jobs. Shareholders may not be exactly thrilled with this decision either because an investment they made failed. They may be able to see some return on their investments though as the company sells its assets, though likely not as much as they put in. Contract partners would be unhappy with this decision, as it would mean Webvan will no longer need their business, and their contract with the company ends, hopefully with some sort of exit agreement that entitles them to some amount of compensation. Customers would likely feel little effect since the market both on and offline for buying groceries is so saturated, with many viable options. Their needs are already easily satisfied by these existing firms.

Recommendation: Exit the Market

Exiting the market altogether is the most realistic option for Webvan. The major reason for the problems facing Webvan is that their business model centered on satisfying a need that did not exist. “For a chance of success in this marketplace, the firm must identify an actual customer need and the firm's relationship with the customer must build on the key feature of the

medium, namely interactivity” (Zwass). Webvan attempted meet the needs of all grocery shoppers in a way that most shoppers could not relate to or fully utilize and appreciate. Research indicates that many customers enjoy going to the store, picking their own meat and produce, talking with store personnel, and get confused when faced with many options (Hiser).

Customer’s want to be able to pick up an avocado and see if it is to their liking, not leave it up to someone in a warehouse to decide for them. Also having a large mix of products to offer does not guarantee customers will be any more willing to purchase from you. Webvan’s business model directly conflicts with many of these wishes, leaving many grocery shoppers unwilling to use their services, and this is why Webvan, and many other online grocers, struggled to generate sustainable sales from customers. Grocery shoppers were satisfied with going to the store themselves and picking the items they wanted.

Operating on this flawed idea of appealing to mass-market consumers, Webvan attempted to aggressively expand without proving their idea could be successful in their test market. In doing so, they incurred heavy costs as they attempted to build the infrastructure for their operations from scratch. “Irrespective of whether it pursues a low cost or differentiation strategy, a firm would like to keep its cost per revenue dollar per unit customer value very low” (Afuah). Operating at a loss, Webvan had a very high cost per revenue dollar, and would likely to continue this trend into the future no matter the option they chose. They could have collaborated with existing supermarkets to act as their suppliers for goods, but that meant they had to share the operations with them, so instead Webvan opted to build their own distribution centers. They could have attempted to buy out regional grocery chains, but with what money, and how would this drive down their cost per revenue dollar when they were already struggling to attract customers in their test market?

Another major reason Webvan should exit the market are the insufficient revenue streams. Louis Borders wanted Webvan to remain unbiased to consumers, and chose not to sell their data and allow ads on their site. The case makes note of Webvan needing to increase the amount of money customers spend per order. One way to do this would be to place ads for items that are typically purchased on impulse, or are frequently bought by customers. Webvan is already capturing the data, so why not make use of it instead of sitting on it. “Data become ‘information’ when they are analyzed and interpreted; that is, give meaning” (Cash). If they did not want to sell the data to ad companies or allow ads on the site, Webvan could attempt to analyze the data with their own algorithms and tools to create information about consumer purchase behaviors and try to target consumers with products or deals that may entice them to spend more. If Webvan had attempted these options from the beginning, they may not have dug themselves into as deep a hole financially as they are now.

As the case mentioned, the online grocer market was not doing well, and its future was uncertain. Knowing what we do now, the dotcom bubble would burst soon, putting many of these companies out of business. Online grocers did not have a large enough customer base to support many of their ambitious goals. “Shopping remains relatively uncommon as a principal motivator for Web use, and it is believed that ease of access should ultimately determine the success of Web shopping” (Zwass). At the time of this case, only 435,000 of the 53.5 million users on the internet used the web to purchase food. Unless this number drastically increased within the next few years, which, as discussed above, seems unlikely, Webvan will not be able to continue doing business. By leaving the market, Webvan can cut its losses and provide some returns to its shareholders.

Works Cited

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