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Case Study Analysis: Webvan

Webvan finds itself stuck between good news and bad news. The company's recent initial public offering was a huge success, with investors excited about Webvan promise of being the leader in the burgeoning online grocery ordering and delivery services. Despite this, Webvan's first year in business fails to turn a profit and casts doubt on the viability of the business model. Webvan targets an aggressive national expansion without proof that the business is sustainable. Webvan faces the question of how to proceed with increased investor funds but significant projected losses. It is recommended that Webvan reduce the scale of their planned expansion and focus on the profitability of their business model given its internet enabled nature. They should do this through using collected data to increase profitability of customers, using data as a revenue stream, and exploring team up opportunities with brands and traditional grocers.

Webvan is a national online grocery delivery service that accepts orders for grocery items through the internet and delivers these items to the customer's front door from centralized distribution centers in various city-based markets. Webvan uses a generic strategy of differentiation to compete in the market. To succeed, Webvan needs to find a way to differentiate themselves from competitors in the online grocery space. The best way to do that is to find an innovative and scalable way to solve the major problems facing online grocery. To differentiate themselves, they chose to focus on product pricing that matched traditional brick-and-mortar groceries while still being high quality with a vast selection bigger than the traditional stores.

The Internet Enabled Business Model allows for more competition via Cost Leadership even when pursing a differentiation strategy (Kalakota). Webvan uses technology developed through Borders to efficiently manage the inventory of distribution centers, therefore lowering costs.

Webvan faces high competitive rivalry. Many startups are crowding the online grocery market, as well as mature online grocery companies and established offline supermarket chains. Peapod is Webvan's closest rival, with very similar market strategies. Peapod is much more mature with ten years in the market but has been slow to scale into new cities. In 1999, they only operated in eight cities compared to Webvan's plans for 26 future expansion markets. Peapod has taken time to ensure their business model works before aggressive expansion. Other small players exist, leaning on higher differentiation to separate themselves. Some focus on automatic delivery of static lists, delivering ethnic and hard-to-find items, or leased containers that allowed for unattended deliveries.

The threat of new entrants is high as well. Use of the internet as a business tool make the "Four E's" of business much easier: Enter, Expand, Extend, and Exit (Kalakota). The market is already crowded with differentiated competitors, and the ease of using the internet for taking orders from customers makes entering the market for new competitors more attractive. Traditional grocery chains are also becoming new entrants. Some chains are attempting pilot programs and once these chains are up to speed, they will be tough competition without differentiating from them.

The ease of access and longstanding habit of visiting traditional groceries makes the threat of substitutes quite high for Webvan. Customers that are already price sensitive will not make grocery delivery a habit due to fees and delivery costs. One of two main limitations to ecommerce is tacit knowledge or wanting to have first-hand experience with a product before buying (Afuah 45). Tacit knowledge is a major sticking point for online groceries; customers want to pick and choose when item variability is high, such as produce.

Webvan faces the decision about how to proceed with business after a successful initial public offering, but low revenue. Webvan is projected to have a loss of $35 million dollars for 1999. Despite this, investors were happy to buy newly minted stock in the company with a market cap of over $8 billion on the first trading day. These investors were excited about the potential of the internet to disrupt traditional groceries, especially when backed by the founder of the successful bookseller Borders.

Still, Webvan's business model is unproven both before and after scaling. Margins in groceries, online or off, are very small. Webvan's model uses a very expensive distribution center model, requiring massive capital investment for each market they expand into. The company has only been in operation for about one year in their flagship market of San Francisco and has not come close to meeting financial targets. Average order value in 1999 was $71, short $30 of their target of $101. Since Webvan is such a new firm and much of their success is predicted to come from the aggressive market expansion, investors still see potential.

Webvan must now develop a strategic plan that both insures good financial health for the company and meets the lofty expectations of new investors. These investors are expecting a return and need to be shown that Webvan isn't just dot com hype. This strategic plan should work to close the financial gap as soon as possible. The sooner this happens, the sooner Webvan's initial investors will be proven right about the potential of online grocery. Webvan also needs to be solvent quickly for the sake of Webvan's staff and management. George Shaheen gave up a hefty retirement sum to be Webvan's CEO based on its potential in the market. With massive capital investments, the company can only proceed for a short time before going bust and jeopardizing Webvan's personnel.

Going forward, Webvan should use the investment funds to reduce the scope of their market scaling and focus on proving the business model to be profitable and sustainable. There are other options Webvan can pursue, but these will not be as successful and may further put Webvan on track to crashing and burning. These options include expanding future market scaling by buying regional grocery chains, building out existing planned markets with delivery of non-grocery items, and freezing expansion and focusing on profitability of grocery items only.

Webvan has planned to scale too aggressively and planning further expansion by buying regional supermarkets is a bad idea. While using the supply chain infrastructure and distribution centers of purchased supermarkets will help with the costs of expansion, this is only building a deeper hole that Webvan hasn't proved they can dig out of. Increased costs increase the danger that if Webvan can't close the financial gap, they go under sooner rather than later. Webvan's major focus is not absolute cost leadership. Buying more grocery chains does not help Webvan differentiate from other competitors in anything but national size. Webvan's potential success hinges on customers buying more and becoming habitual users of the service.

Freezing the scope of market expansion combined with branching out into non-grocery items is a better idea, but ultimately does not help prove the viability of the business plan. Webvan cannot afford to gamble more on expansion, so freezing expansion helps the solvency of the company. Webvan executives are strongly considering being a home delivery service for items that are not grocery, such as home goods. This does help the company differentiate from their competitors. Most competitors are focusing on niche grocery items or special delivery methods, not straying far from the original online grocery concept. Again, Webvan's current business model of only grocery items is still not proven. Further expansion into new product types does not help the solvency of the company. If non-grocery delivery does not give the returns Webvan expects, they will be out of business quickly.

Although a better idea than others, it is not recommended for Webvan to commit to the planned expansion of 26 city-based markets and focus on proving the business model on only grocery items. This choice is best for making sure the current investors stay happy, but not the best for solvency. The main problem here is that 26 markets is too much for an unproven business model. Louis Borders' argument of "first-to-scale, not first-to-market" does not guarantee success or profitability. Attempts to increase profitability will be seriously hamstrung by the albatross of 26 markets. Webvan will be better served in the long term with fewer markets.

The best course of action for Webvan is to reduce the scale of expansion, focus on profitability of the internet-powered core business process, and explore additional revenue possibilities using data collection. Pulling back on market expansion has the potential to upset initial investors, but arguments about proving profitability can ease investors' concerns. One important aspect of the Internet Enabled Business Model is Sustainability (Afuah 70). Sustainability translates to how the organization can maintain its competitive advantage and revenue sources in the face of competition.

As discussed, Webvan faces high competition from existing rivals, new entrants, and substitutes. Its current projections do not point to sustainable profits. Webvan must figure out how to increase the number of online buyers as well as average value of orders before focusing on expansion. When faced with high competition, internet enabled businesses have three options: Run by continuously innovating, Block by prevent new entrants, or Team Up with joint ventures or strategic alliances (Afuah 70). The use of the internet is freely available and easily imitable, so blocking is hard to do for online grocery. Some innovation is possible for Webvan, but not likely at this stage of their growth. It is recommended that Webvan pursue Team Up opportunities with product brands or traditional grocery chains to help bridge the financial gap.

Additional revenue streams enabled by Webvan's use of the internet are important to consider in closing the company's financial gap (Afuah 62). Currently, Webvan has no plans to sell customer data to third parties to maintain neutrality between product brands. This is money being left on the table. When customers order through the internet, this creates data that can be reused by Webvan for other purposes, including for revenue. It is recommended that Webvan leverage the data being collected during the online ordering process both for revenue and for increasing customer orders and order value.

By scaling down market expansion and focusing on the core internet enabled business model, Webvan will be in much better position to weather the proliferation of online grocery competitors. They can keep investors happy, stay profitable, gain breathing room to innovate, and stay sufficiently differentiated from the competition. Webvan can be an example for everyone of the success of the new internet enabled business model.

Works Cited

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