Door step delivery of groceries by Webvan: A case study approach

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Abstract

Webvan was a dot-com company and grocery business that filed for bankruptcy in 2001 after 3 years of operation. It was headquartered in Foster City, California, United States. It delivered products to customers' homes within a 30-minute window of their choosing. At its peak, it offered service in ten US markets: the San Francisco Bay Area; Dallas; Sacramento; San Diego; Los Angeles; Orange County, California; Chicago; Seattle; Portland, Oregon; and Atlanta, Georgia. The company had hoped to expand to 26 cities by 2001. The main aim of this case study to examine the problem faced by Webvan and intends to propose solutions for it.

Keywords: Webvan, grocery, bankruptcy, service, products.

1.Introduction

Webvan was founded in the heyday of the dot-com bubble in 1996 by Louis Borders, who also co-founded the Borders Group in 1971. Examines Webvan's operations and the processes by which it delivers groceries that were ordered from the Internet to customers' homes. Recounts Webvan's history from founding through early 2001 and concentrates on the unique approaches to warehousing, delivery, scheduling, and to a lesser extent, marketing and information technology. Also examines the rest of the Webvan business model and how it was formulated. At the time of the case, there is great pessimism, reflected in the press and the company's share price that Webvan will be able to execute its business model profitably or even stay in business. Webvan's business model relied heavily on properly designed and executed operations, and it appears clear that the company's operations were neither. In addition, the mismatch between visiting operational capabilities and the operational requirements imposed by the rest of the business model appear to be severe.

1.1 Growth

The company's investors pressured it to grow very fast to obtain first-mover advantage. This rapid growth was cited as one of the reasons for the downfall of the company. Webvan started taking orders in the San Francisco Bay Area in June 1999. Webvan placed a $1 billion order with Bechtel to build its warehouses, and bought a fleet of delivery trucks. In 2000, Webvan bought HomeGrocer, a competitor that was also losing money, for $1.2 billion in stock. At its peak in 2000, Webvan had $178.5 million in sales but it also had $525.4 million in expenses.

1.2 Financing

Benchmark Capital, Sequoia Capital, and Borders each invested $3.5 million in the company in a Series A round in 1997, buying shares for $9.58 each. Sequoia later invested another $50 million, Softbank Capital later invested $160.3 million, and Goldman Sachs' venture arm invested $50 million. E-Trade and Yahoo! each invested $10 million. In total, venture capitalists invested more than $396 million in Webvan. The company raised an additional $375 million in an initial public offering in November 1999, during the dot-com bubble that valued the company at more than $4.8 billion.Up to that time, the company had reported cumulative revenue of $395,000 and cumulative net losses of more than $50 million.

1.3 Management

None of Webvan's senior executives or major investors had any management experience in the supermarket industry, including its CEO George Shaheen, who had resigned as head of Andersen Consulting (now Accenture), a management consulting firm, to join the venture. Webvan had a contract to pay Shaheen, who gave up a $4 million per year salary at Andersen, $375,000 per year for life. When the company filed bankruptcy in July 2001, Shaheen was an unsecured creditor. Shaheen resigned in April 2001, while the company was on the verge of shutting down.

1.4 Bankruptcy

The company lost over $800 million and shut down in June 2001, filing bankruptcy and laying off 2,000 employees. As part of its shutdown process, all non-perishable food was donated to local food banks.

2. Industry profile

Webvan was online retailer sector, probably the first of its kind. It exclusively dealt in grocery products.

Online shopping is a form of electronic commerce which allows consumers to directly buy goods or services from a seller over the Internet using a web browser. Consumers find a product of interest by visiting the website of the retailer directly or by searching among alternative vendors using a shopping search engine, which displays the same product's availability and pricing at different e-retailers. As of 2020, customers can shop online using a range of different computers and devices, including desktop computers, laptops, tablet computers and smartphones. An online shop evokes the physical analogy of buying products or services at a regular "bricks-and-mortar" retailer or shopping center; the process is called business-to-consumer (B2C) online shopping. When an online store is set up to enable businesses to buy from other businesses, the process is called business-to-business (B2B) online shopping. A typical online store enables the customer to browse the firm's range of products and services, view photos or images of the products, along with information about the product specifications, features and prices.

Online stores usually enable shoppers to use "search" features to find specific models, brands or items. Online customers must have access to the Internet and a valid method of payment. in order to complete a transaction, such as a credit card, an Interac-enabled debit card, or a service such as PayPal. For physical products (e.g., paperback books or clothes), the e-tailer ships the products to the customer; for digital products, such as digital audio files of songs or software, the e-tailer usually sends the file to the customer over the Internet.

3. Problem identification

Webvan was the biggest flop during the dotcom era of startups. At its peak, in 1999, it was valued at $1.2 billion. It could potentially be considered a startup ahead of its time, their vision was a home-delivery service for groceries, and where customers could order their groceries online, but that’s not where the problem lies. 15 years later it’s still being studied by business schools around the world as a forewarning against excess and ambition. Here’s the cliff notes edition. Webvan can also be considered a product of its time, the result was that it followed the ‘Get Big Fast’ (GBF) business model that every other startup was religiously following at the time. Much like how Eric Ries's lean startup methodology can be considered the bible for this generation of entrepreneurs. So in 1999 Webvan announced they would expand to 26 major cities. The following two years became a logistical nightmare with Webvan ultimately losing a total of $830 million before filing for bankruptcy. Their problem?

Their vision became too big to handle

Webvan committed the cardinal sin of retail, which is to expand into a new territory before we had demonstrated success in the first market. In fact, we were busy demonstrating failure in the Bay Area market while we expanded into other regions. At some point every successful startup will have to start scaling up and expanding their business. It seems like common sense, but expansion should only be undertaken when a business model has first proven to be successful. A few rules of thumb are that a scalable business model should be flexible to be able to adapt to different market conditions, core users and customers are evaluated and understood, and the business model should be able to operate without your direct supervision. Common sense right?

Yet according to Startup Genome Project's survey of over 3200 startups, 74% of startup failures can be attributed to premature scaling. Another key finding was that startups, on average, need 2-3 times longer to validate their market than the founders expect. This underestimation of an appropriate timelines applies unecesare pressure on founders to scale prematurely.

Despite early validation Webvan failed to consistently evaluate the data. If they had paid closer attention then they would've seen that their business model was shaky and could not possibly support their desired plans for expansion. It's only natural for entrepreneurs for entrepreneurs to want to grow their business. It's easy to be blinded by groupthink andattempt to scale quickly. But as Webvan learnt, it's important to grow your business for the right reasons. To pay attention to the data at hand, and never grow for the sake of growth.

That was just the primary mistake made by Webvan, but that wasn't all. A multi-millionaire venture won't simply fail based on a single shortcoming. Here are some of its other problems:

a.Wrong Target Audience Segmentation and Pricing

Webvan's go-to market strategy in each city was: the quality and selection of Whole Foods, the pricing of Safeway, and the convenience of home delivery. In other words, it was a mass-market strategy (unlike Whole Foods which is an upmarket strategy). The target audience therefore was not selected to be "price insensitive." If you advertise yourself at Safeway pricing, you will attract a price-sensitive audience. Whereas those who go to Whole Foods are more price-insensitive: They believe they are getting a higher quality of selection and product, so price matters less.

The customers who would have made Webvan profitable were those who said, "Wow, I can get quality selection and products delivered to my home: heck I'll pay anything for that." Yes, that's a smaller audience than a mass-market audience, but after all, even smartphones started out as a tool for stockbrokers and corporate executives before becoming mass-market devices. Webvan should have priced at least 30 to 40 percent higher and ignored the customers who didn't want to pay those prices. A company must be clear on what it is providing and price for it – Webvan was providing a luxury; an ability to order sushi and organic fruits directly to the home, and thus it shouldn't have tried to compete with Safeway's prices.

b. Complex Infrastructure Model

Webvan decided to build its infrastructure from scratch. I was responsible for the hundreds of engineers who built the software algorithms to make five miles of conveyor belts in our Oakland Distribution Center (DC) transport 10,000 totes around the DC daily. After conveying the item to automated carousel pods, webvanwhich would spin like juke boxes to transfer the item in question into the tote, the entire process would rinse and repeat until the order was completed and integrated at the shipping dock. Additional real-time inventory management algorithms would make sure that if a customer ordered milk on the website, it was currently in stock; software algorithms would route delivery vansto multiple delivery stops while minimizing drive time; and software on Palm Pilots in drivers' hands would deal with real-time delivery confirmation or returns.

Combining these mistakes was a dangerous cocktail of the lower margins of mass-market pricing, and colossal capital expenditure associated with complex infrastructure. This cocktail, combined with mistake of premature expansion, pushed Webvan over the edge.

So to summarise the problems of Webvan:

- Aggressive expansion to many cities without proving its business model in its first market
- A business model targeting price-sensitive mass-market consumers rather than upmarket consumers who would be more profitable
- Building its own warehouses and fulfillment infrastructure from scratch, in contrast to services such as Peapod which survived the dot-com bust and used the infrastructure of existing supermarkets (as did the later successful but not profitable Instacart)

4. Lessons

A failure in business model, especially something which works in principle, always has some interesting takeaways. And it's for the rivals to grab onto the chance and improve, or even build, their business models on these very failures. Amazon did just that:

a. Hire those in charge of the failed strategy

If you wanted to get into a new business, you could not be faulted for hiring someone who had been spectacularly successful in that new business to run your operation. But Bezos did the opposite -- hiring executives responsible for Webvan's failed strategy.

As Reuters reports, AmazonFresh is led by "Doug Herrington, Peter Ham, Mick Mountz and Mark Mastandrea -- former Webvan officials who have spent years analyzing and fixing the problems that led to its demise."

Hiring people who have failed is hardly a guarantee of future success. But it seems to be working for Bezos because these four Webvan vets know the business intimately, have thought about what they did wrong, and are eager to prove that they can apply the lessons learned to revive their reputations.

b. Acquire technology invented by the failed executive

Mountz built Kiva technology on ideas and technologies originally developed at Webvan and that are a key part of AmazonFresh's strategy. In 2012, Amazon acquired Kiva for $775 million in one of its largest-ever acquisitions.

c. Focus on attractive micro-segments

While the grocery industry is huge, only a tiny fraction of that market is attractive as a place to operate an online grocery business. Finding those micro-segments is a crucial element of AmazonDirect's strategy.

Gary Dahl, vice president of distribution at Webvan from 1997 to 2001, told Reuters that he learned about the importance of segmenting markets based on mean travel time between delivery stops. As Dahl said, "travel one block in San Francisco and you have passed 200 people, travel one block in Moraga and you have passed about six people."

AmazonFresh and FreshDirect only deliver to densely populated areas. Keith Anderson, an executive at consulting firm RetailNet Group, told Reuters, "If you drive into certain neighborhoods in Seattle you will see a lot of front doors with AmazonFresh totes. That's because Amazon expanded gradually into specific neighborhoods and tried to deliver to lots of homes in those specific areas."

d. Fix the business model before expanding

One of the most interesting points of the Webvan case is the company's obsession with getting big fast -- its then-CEO, George Shaheen, likened running Webvan to building a rocket to Mars. As Mike Moritz, a Webvan board member and partner at Sequoia Capital, told Reuters, Webvan "committed the cardinal sin of retail, which is to expand into a new territory -- in our case several territories -- before we had demonstrated success in the first market. In fact, we were busy demonstrating failure in the Bay Area market while we expanded into other regions."

Through AmazonFresh's very gradual expansion, Bezos demonstrated that he learned from that Webvan mistake.

The general takeaway for any business model from this is:

Lesson #1: Know the Industry

- Are the profit margins sufficient for your company to achieve success?
- How many sales can your company realistically expect to make in the first six months and then in the first year?
- How many customers do you need for those sales?
- What do you need to charge per sale?

Lesson #2: Know Your Customer

- Do people want your product or service?
- Are there enough customers who will buy it?
- How much competition will you have?
- What will you have to do to get customers to buy?
- How long will it take to generate a profit?

Lesson #3: Don’t Reinvent the Wheel

- Use existing infrastructures whenever possible.
- Test and refine early versions before building new ones.

5. Solutions

5.1 Do nothing

This alternative tells Webvan to continue doing business in its current state. If they do, Webvan would have to head down the bankrupt road. Overall loss of $302 million for the year, with its high total operation expense and not enough sales, Web would inevitably fail.

This alternative is highly not requirement based on the information given about this case. Webvan's shareholders would lose their investment.

5.2 Attempt to get bought out

While Webvan did have a large valuation that provided some protection against takeovers, a buyout was still in the realm of possibility. Organizations like Amazon will have the size to purchase Webvan. This alternative would allow Borders to continue to utilize the capital and assets of its new organization provided. Best of all, perhaps their employees may be able tokeep their jobs.

5.3 Exit the market

Webvan leaving the market and liquidating all assets. Stopping all operations andleaving early is better than late since they were not doing well in the market. This alternative could potentially save shareholders a large loss o their investment. Perhaps, they may be able to investment or focus on a different business. For example, a simple software company or a grocery store.

5.4Purchase Regional Grocery Chains

"These regional chains already possessed supplier networks as well as their own distribution centers. Webvan could possibly leverage some equipment from these distribution centers while attempting to replicate its existing distribution centers. This option would also eliminate a few competitors in these regions." Webvan would be purchasing regional grocery chains to become a brick and mortar stores while maintaining their online grocery. This way, Webvan would be able to invest elsewhere instead of being stuck in online grocery business.

Our recommendation would be for Webvan to exit the market, but we know that Amazon bought out Webvan. Nevertheless, in this case, we do not know such a thing. Webvan made numerous mistakes. One of which, "Neither Louis nor his executive staff had any prior experience in the retail grocery business." (Ground Floor Partners). "Despite the hype of Internet companies and e-commerce as the "wave of the future," analysts and grocery industry experts were unsure about the actual growth potential of the online grocery market. Industry analysts estimated online grocery sales of $156 million in 1998, less than 1 percent of the entire grocery market. Market projections for the year 2003 ranged from $4.5 billion (Andersen Consulting) to $10.8 billion (Forrester Research). With such vastly different market projections, it appeared difficult to predict which online companies would do well, if any. Additionally, of the 53.5 million people who were online in the United States, only 435,000 ever purchased food online. This number represented less than 1 percent of the 14.5 million users who had made purchases online.

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