WebVan:

A Cautionary Tale

MBA 605.1

Group Report

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Abstract:

The story of WebVan is a cautionary tale for organizations contemplating entry into the online grocery delivery arena. WebVan was an online credit and delivery grocery business that went bankrupt in 2001. It's often seen a perfect example of what happens when internet technology is extended to an existing form of business. WebVan also suffered sudden demands from venture capitalists for short-term profitability, instead of growth and market share.[1] WebVan failed for a number of reasons not the least of which was the company's overly aggressive business strategy. They shelled out huge initial investments, lacked grocery experience, and lacked market research. Despite WebVan's spectacular failure, the future of online grocery has been proven successful through Tesco.com as well as other successful online retailers such as PeaPod.com and Amazon.com.

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[1] WebVan. (2006, September 18). In *Wikipedia, The Free Encyclopedia*. Retrieved 14:22, September 26, 2006, from http://en.wikipedia.org/w/index.php?title=Webvan&oldid=76372514

What is WebVan?

WebVan was founded in the heyday of the dot-com boom in Foster City, California in 1996. It began life as an online grocery delivery service. Webvan's founder Louis Borders envisioned a much grander mission for his creation. Borders saw his company tackling the "last mile of e-commerce, selling and delivering anything and everything to its customers." Borders saw WebVan becoming Amazon.com, UPS, Wal-Mart and United States Postal Service all rolled into one.[1]

WebVan began operation in 1996 by delivering groceries. It offered customers the convenience of shopping from home and having their purchases delivered within a 30 minute window of their choosing. Customers liked the WebVan service, however because of its huge initial investment in infrastructure, the company basically lost money on every delivery.

WebVan never achieved its founder's grand vision. During its short existence, it only delivered groceries. Although, well funded, WebVan never made a profit, thanks in large part to its investment in infrastructure. WebVan executives decided instead of partnering with established grocery chains, they would build an entire distribution network.[2]

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[1] WebVan. (2006, September 18). In *Wikipedia, The Free Encyclopedia*. Retrieved 14:22, September 26, 2006, from http://en.wikipedia.org/w/index.php?title=Webvan&oldid=76372514

[2] Anders, G. (1999). How Webvan conquers e-commerce's last mile. *Wall Street Journal Eastern Edition,* 234(117), B1.

Why was WebVan so Unsuccessful?

Seemingly, WebVan posed as an innovative business idea. However, the online grocer went bust before it ever flourished. Why was WebVan so unsuccessful? Although outside analysts, former employees, and WebVan executives all have different theories, they all agree that there was no single factor that contributed to the fall of WebVan.

The following *possible* factors are consistently brought up when the fall of WebVan is discussed:

1) **Huge initial investments**
2) **Lack of experience in the grocery industry**
3) **Not knowing their target market.**

The first of the three factors is the huge initial investment that WebVan shelled out. Other successful, online grocers started their online ventures on a smaller scale and first tested their business models in a smaller, local market. WebVan began building huge distribution centers in market after market with out any proof that their way of doing online grocery was going to work. Each of these distribution centers cost approximately $30 million to build and they were never utilized to their maximum capacities.[1] Another investment decision that turned out to be costly, was their merger with their major rival, HomeGrocer.com. Customers who were familiar with HomeGrocer.com were mostly on the west coast, and were put off by the unfamiliarity of the new WebVan website and orders then dropped **10-30%**. As a result, WebVan, then poured more money into a rebranding campaign, which consisted of a blue and green "W". This was one more failed attempt.[2] When WebVan started losing the money, they decided to close down distribution centers in the Southern metropolitans like Dallas and Atlanta. This further caused bad buzz about the company and turned out to be another nail in the coffin for WebVan.[3]

WebVan not only invested too much, too soon, but the second possible cause of its demise could be the lack of knowledge they had in the grocery business. The CEO, George Shaheen, was the former CEO of Andersen Consulting. He had no former background or knowledge in the grocery business. "(They) never understood the value chain of the grocery business."[4] Because of the lack of experience, WebVan was not ever able to master inventory management, warehousing, and efficient distribution of goods.[5] Another indication that they lacked experience is that they were too optimistic in their operation planning.

[1]Food for Thought at Tesco and WebVan: Online grocers in search of an ideal business model. (2003, September). *Strategic Direction, 19, 9,* p.21.

[2] Helft, M. (2001, July 23). The end of the road. *The Industry Standard,* pp. 26-29.
[3] Evans, B. (2001, July 16). WebVan: Who's to blame?. *Information Week, 846,* 80.
[4] Rizzo, T. (2001, Aug 1). Web Observatory: The death of WebVan. *Internet World, 7,* 4.
[5] Blackwell, R. (2001, July 16). Manager's Journal: Why WebVan went bust. *The Wall Street Journal,* p. A.22

They promised to deliver groceries within a 30 minute window, which was unrealistic considering they had to pull items from shelves then drive the distance for the delivery. The cost WebVan figured for each delivery was $15, which included the transportation costs associated with the actual delivery. They did not include in the $15 the cost associated with the operation and overhead of the distribution centers.[1] With the lack of inventory controls and the unrealistic cost structure, there was no way for WebVan to compete with the economies of scale of the major grocery stores such as Wal-Mart, Kroger, and Safeway, etc.[2]

The third factor that perhaps was a contributor to Webvan's failure is that they did not know their target market well enough. First of all, they did not take into consideration that capturing a market for online grocery shopping would not be that easy. "It takes a long time to get consumers to adopt new ways of doing things."[3] The average consumer, for one, was not used to the idea of their groceries being delivered at home. They were also not used to shopping for their groceries online. Customers tend to prefer the process of going to a store and picking out their groceries, especially their produce, meat, and deli items.[2] The customers that did try WebVan had few complaints about the level of customer service they encountered, however, WebVan overlooked that most customers were not willing to trade the convenience factor for the extra cost for the delivery. Although, WebVan did not charge a delivery fee, groceries were sold at a higher price because WebVan did not have the low cost structure like its competitors, Kroger and Safeway had. WebVan was not giving them a service that consumers felt like they needed to pay for. And most consumers that could afford the extra cost were customers that worked long hours and did not have the time to sit and order the groceries, much less have the time to be available to wait for the delivery. [2]

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[1] Food for Thought at Tesco and WebVan: Online grocers in search of an ideal business model. (2003, September). *Strategic Direction, 19, 9,* p.21.
[2] Blackwell, R. (2001, July 16). Manager's Journal: Why WebVan went bust. *The Wall Street Journal,* p. A.22
[3] Weber, J. (2001, July, 23). The fall of WebVan. *The Industry Standard,* p. 3.

WebVan vs. Tesco

Even though WebVan was unsuccessful as an online grocer, there are several effective online grocers. Assailed by analysts during the peak of the dot-com boom for its go-slow approach to selling groceries over the Internet, Britain's No. 1 supermarket chain has watched one rival after another put up the white flag. Now, Tesco.com has assumed the mantle of the world's largest and most successful online grocer.[1]

Tesco started out small with a single store in Osterley England in 1996. They accepted orders by phone, fax and web site. Tesco strategy was to test the market for online grocery delivery prior to investing a large sum of money into the idea. To keep start up cost to a minimum, Tesco decided to pick groceries out of existing supermarkets. In Tesco's first year of operation, they net a profit operating income. The second year, Tesco had an increase in their net operating income. Tesco carefully evaluated their market and by 1999, they had 100 stores and had a net operating margin of $22 million dollars. Through strategic planning, Tesco kept overhead and operating cost to a minimum by employing fewer than two dozen employees per store. According to Tesco, the number of employees was adequate to pull products off the shelves and schlep them in vans to customers in the neighborhood.[2]

Tesco had several contributing factors for their success. One of the most important factors is the leverage of its brand name and database. When Tesco decided to test the idea of online grocer, they had an existing customer database of 10 million affinity-card holders. The name Tesco had been in business for over 50 years. Research has shown that people are willing to try new ideas from companies with a reputation in good standing. Tesco capitalized on their brand name and their existing database to advertise their new adventure. And with the go-slow approach, they evaluated the market and within a couple of years they had proved a market for online grocers. Over the course of four years, Tesco had invested only $56 million in start up cost.

Tesco employed experienced knowledge workers. Their knowledge expanded from grocery business, inventory management, warehousing, and distribution of goods to realistic promises. Majority of their Board appointments were from within the company with many years of suitable experience. Tesco attached high importance to the values of trust, honesty and integrity of personnel. The Board of Tesco comprised five independent non-executive directors and eight executive directors. The full Board, which met every month, managed overall control of the group's affairs by the schedule of matters reserved for their decision. The Board delegated day-to-day and business management control to the Executive Committee which comprised the executive directors. They met formally every week and their decisions were communicated throughout the group on a regular basis. Tesco was relentless for improving opportunities for their staff through training and development.[2]

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[1] Tesco bets small. (2001. October 1).*Businessweek e-biz,* pp.26-32

[2] Retrieved September 25, 2006, from
http://www.tesco.com/investorInformation/report97/accounts/page2.html

Inventory management was a key factor for Tesco's success. They stocked goods on the shelf. This provided addition space for a variety of items. Each supermarket was divided into six zones – groceries, produce, bakery, chilled foods, frozen foods, and "secure" products such as liquor and cigarettes. Each picker scours a single zone retrieving products for six customers at a time. Each item is scanned at the moment it's picked. Then, customer shipments are assembled in the back room and stacked in vans for delivery. [1]

Tesco made a strategic move to charge a delivery fee against all odds, but it was proven to be the masterstroke. Tesco insisted customers would be willing to pay for the convenience of not having to lug home groceries and they were correct. The strategy helped increase the typical size of an order. Customer wanted to get their money's worth would purchase additional items. So the average purchase from Tesco.com was three times a typical $35 supermarket transaction, a vital contributor to the online operation's solid gross margins. Customers could buy as late as noon and receive a delivery by 10 that night.[1] Delivery was guaranteed within a specific two-hour period.[2]

	WebVan	**Tesco**

[1] Tesco bets small. (2001. October 1).*Businessweek e-biz,* pp.26-32

[2] Delaney-Klinger, K., Boyer, K., & Frohlich M. (2003). The return of online grocery shopping: A comparative analysis of WebVan and Tesco's operational methods. *The TQM Magazine, 15, 3,* 187.

Brand name	No existing	Existing
Customer database	No existing	Existing
Board members	Experienced out of field	Experienced in field
Marketing strategy	Low prices	Convenience
Start up cost	$1.2B / 3 years	$56 M / 4 years
Number of Stores	24 / 3 years	1 – start up
Inventory mgmt.	Stocked goods by the palette	Stocked goods on the shelf
Delivery charge	Free delivery	Charged
Logistic	Distribution centers	Existing supermarkets
Delivery time frame	30 minute delivery	Order in by noon- delivered by 10pm / two hours

What's in Store for the Future of Online Grocers?

The online grocery delivery market has been proven to be a viable business market. Companies like Tesco and Peapod have entered the delivery market and not only survived, but also thrived in the grocery delivery arena. In the future companies will have to follow the Tesco and Peapod model and not the WebVan model to become successful.

The Peapod approach to the online grocery delivery market was the complete opposite of the WebVan approach. Peapod didn't set out to build its on distribution network, instead it partnered with existing brick and mortar grocery stores to gain entrance into the market. Peapod began small in Evanston, Illinois by partnering with Jewell Food Stores to fulfill customer orders. Although Peapod's growth process the company has partner with existing stores to gain entry into new markets. Peapod has continued to grow and expand and in 2006 it moved into the Medford, NY market in partnership with Stop & Shop grocery chain.

The increase in e-commerce and the proven track record of companies like Tesco, Peapod, and Amazon.com lead observers to believe in the viability of online stores. In the future the e-commerce market should increase in scope and variety. As for the online grocery delivery market, companies will have to partner with established firms to gain entry into the market.[1]

Conclusion:

Although WebVan was an innovative idea, it proved to be unsuccessful, mainly, because of its overly-aggressive business model. WebVan's huge initial investments and lack of experience and research were likely factors of its demise. Tesco and a few others proved that the sustainability of online grocery can be achieved through go-slow approaches and partnerships with existing grocery chains. WebVan should be an example of what a business should not do when entering the online grocery industry.

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[1] http://www.peapod.com/corpinfo/GW_index.jhtml;jsessionid=2O5Q1MD5GEXPYCQBD0WCFEQ. Retrieved September 26, 2006

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