

MarketLine Case Study

Online Grocery Retail

Lessons learned from Webvan's
dot-com era excesses

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The MarketLine logo is located at the bottom right of the page. It features the word "MarketLine" in a bold, white, sans-serif font. The "Line" part of the logo is stylized, with the "L" and "i" connected, and the "n" and "e" also connected. The entire logo is set against a blue background with a subtle wave pattern.

OVERVIEW

Catalyst

Despite the spectacular failure of Webvan, the US based pioneer of e-groceries, witnessed in 2001, entering the online market today seems inevitable for grocers who do not want to lose the race for market leadership in the omni-channel world. Learning a lesson from Webvan's mistakes, retailers who are experimenting with innovative, more cost-efficient logistics models are successfully reviving strategies that failed before, changing the traditional grocery sales scene.

Summary

- The global market for online groceries is expected to increase at double digit rates towards 2018, as consumers continue to embrace internet shopping. Low online penetration and significant pent-up demand create business opportunities for grocers.
- Webvan, one of the pioneers of online grocery retail, was created with a vision to revolutionize the market but crashed spectacularly in its early stages. It consequently became synonymous with one of the largest dotcom failures, serving as a prime example of the pitfalls to avoid while expanding a business.
- Years after Webvan's failure, successful online grocers are learning from its example, turning market threats into opportunities with the use of new technologies and innovative delivery strategies.

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ONLINE GROCERY RETAIL: OPPORTUNITIES & THREATS

The global market for online groceries is expected to increase at double digit rates towards 2018, as consumers continue to embrace internet shopping. Online grocery sales have already reached a substantial size in several developed economies, where the retail market in general sees substantial competition. However, even there, the penetration of online grocery shopping is very low, leaving plenty of room for growth.

Surveyed consumers expect to use an online grocery service offering either a click-and-collect option or home delivery, which indicates substantial pent-up demand and opportunities for those able to address customers' needs.

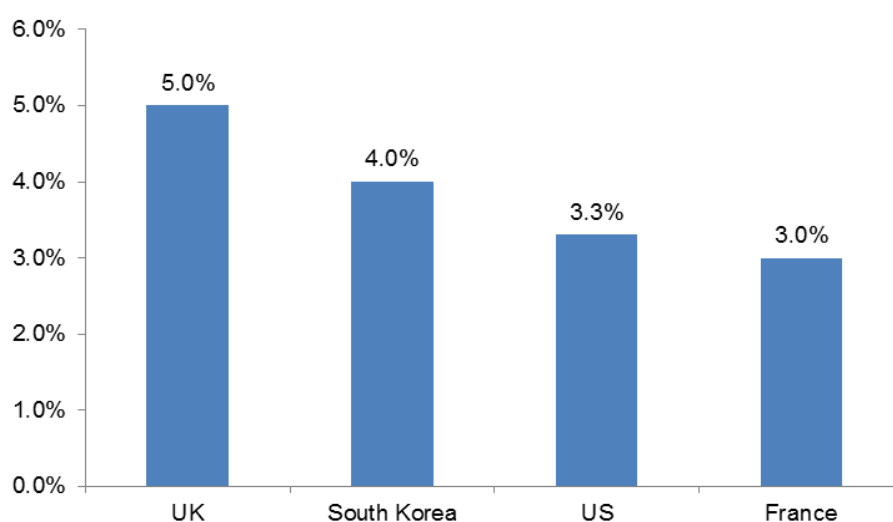
Despite rising customer interest in buying groceries online, many grocers are taking a wait-and-see approach to moving into internet sales, as it is a rather low-margin business, which requires economies of scale before profitability can be achieved. High costs of delivery and picking, as well as a need for flawless service to satisfy demanding customers, make the online grocery game challenging.

Great growth potential as online sales are only a fraction of grocery business

Online grocery shopping has already reached a substantial size in several countries; most of all in the developed economies, where the retail market in general sees substantial competition. As competing grocers are looking to incorporate new sales channels into their distribution system and necessary infrastructure is already in place, they are investing in building and marketing their online offerings. Any market in which two or three grocers engage in an online fight for customers sees a substantial rise in online penetration.

However, even in developed economies, where online retail is in the furthest stage of growth, the penetration of online grocery shopping is very low and only accounts for a small percentage of total grocery sales.

Figure 1: Share of online shopping in total grocery sales in selected countries, 2013 (%)



SOURCE: www.bcgperspectives.com

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For example, in the UK online grocery market, which has more online grocery shoppers than anywhere else in Europe, it accounts for only 5% of total grocery sales, even though the country is the trailblazer of the European online grocery market, according to BCG. Shoppers here buy food online once a month and spend a surprising five times more money than in-store. According to industry analysts, online grocery sales are expected to reach 8.3% of total grocery sales in 2019.

In other countries with developed online grocery spending, the situation looks similar. In the US, online grocery sales account for only 3.3% of grocery sales, in France 3% and in South Korea 4%. This means, there remains a huge potential for further growth.

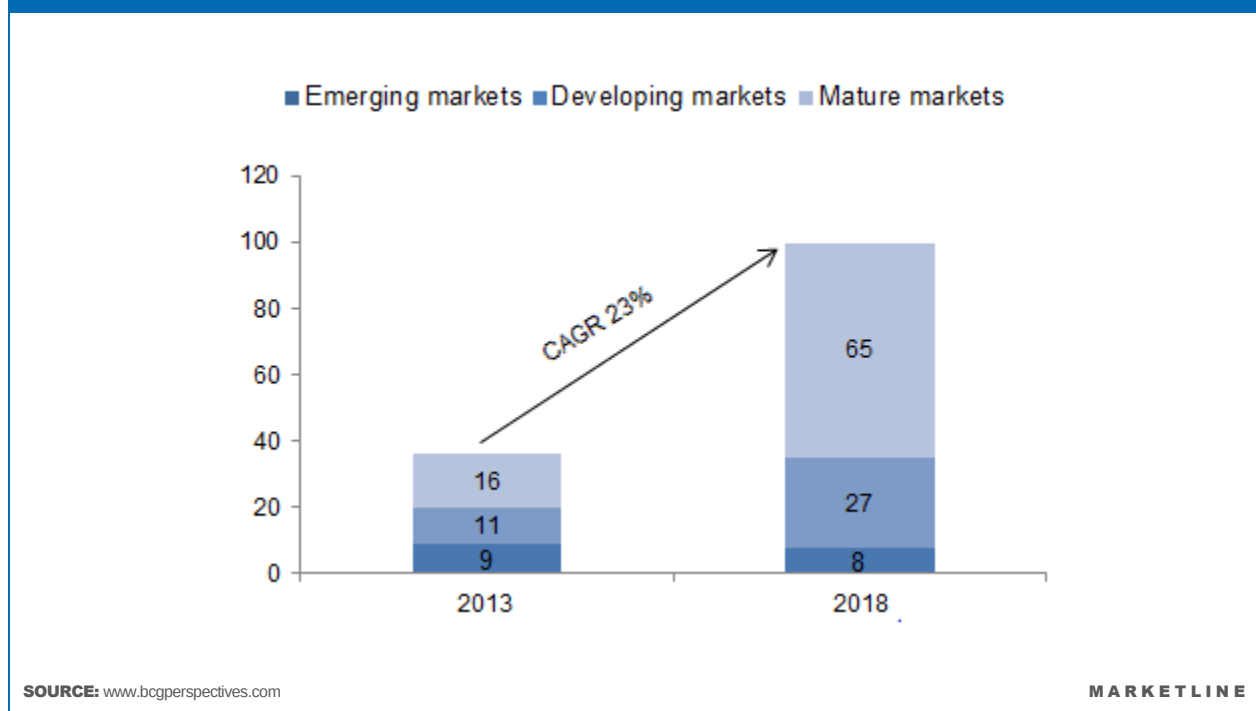
According to BCG, the online share of grocery shopping is growing at rates of 20% to 50% per year in leading markets and should double in many markets, including the UK, France and Germany, by 2016 (as compared to 2013 levels).

In markets where there is significant pent-up demand, companies can grow more aggressively. However, there may be a need to make substantial upfront investments, primarily in infrastructure, which proves costly.

Online grocery market expected to reach \$100bn in 2018

The global market for online groceries in 2013 was worth \$36bn in 2013, according to the Boston Consulting Group (BCG).

Figure 2: Global online grocery sales, 2010-13, (\$m)



The global online grocery market is expected to reach \$100bn by 2018. This represents a compound annual growth rate (CAGR) of 23% between 2013 and 2018. The market is expected to increase as consumers continue to embrace internet shopping as retailers are developing better, faster, more intuitive sites with more options for mobile grocery retail.

Once markets become more competitive and service levels rise, profitability is expected to become more challenging as more players enter and competitors engage in price wars. The traditional store format serves as a good example of what happens in this industry as a consequence of price wars. Price matches, refunding the difference if you could have bought it cheaper elsewhere; all of these tactics negatively impact players' profits. Online grocery retailers must bear this in mind when deciding whether to pursue an aggressive price cutting strategy.

However, companies that target realistic returns have a chance to succeed, even in more advanced markets.

Furthermore, with the popularization of online grocery shopping, product prices should go down, which in turn should bring more business.

Customers switching to online grocers spend 30% more

According to BCG, customers who switch to online grocery shopping spend 30% more than those who shop in-store. Online forms of buying groceries are most appealing to young families and affluent couples, who, once they move online, are likely to spend far more across all channels than they would have done by shopping only in the traditional, in-store way.

Time saving and convenience remain the most important reasons for buying groceries online, according to a report by media analysts and advisor Kantar Media Group.

Figure 3: Top 5 reasons for buying groceries online



SOURCE: www.kantarmedia.co.uk

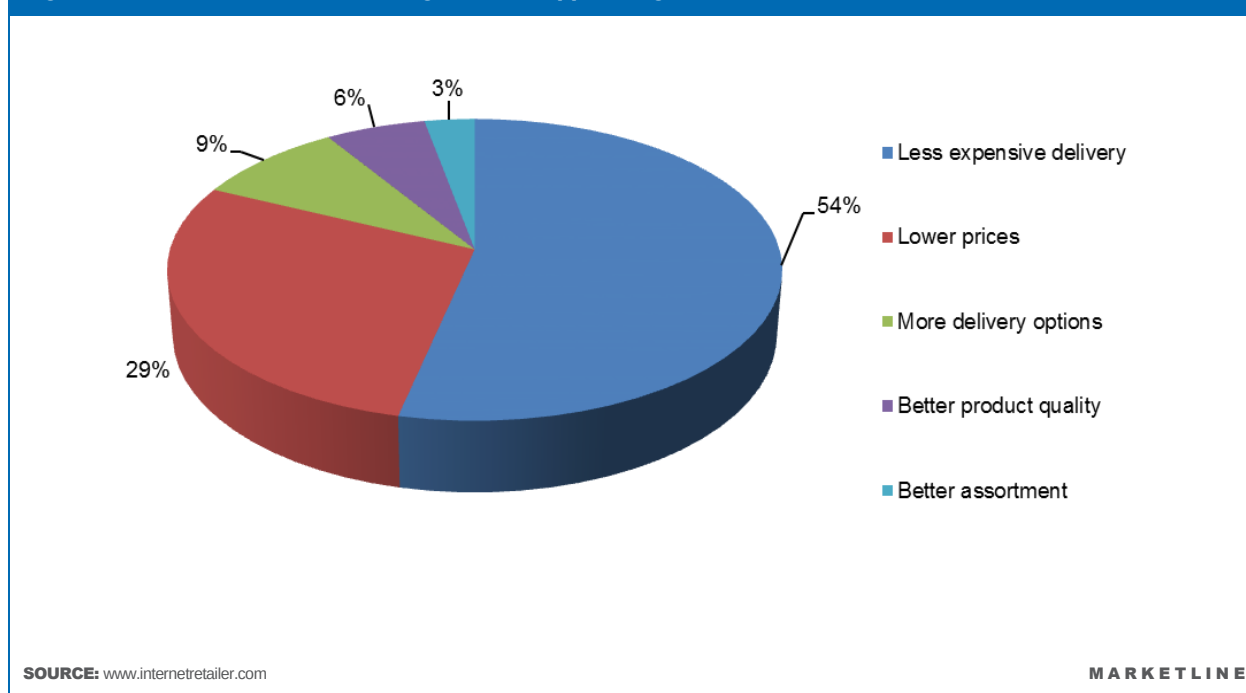
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According to the Financial Times, internet shoppers tend to be more loyal than traditional ones. For example, online shoppers at Tesco spend 46% of their total grocery budget with the retailer, while the average offline Tesco shopper spends just 29%.

Surveyed consumers in developed online grocery markets, expect to use an online grocery service offering, either a click-and-collect option or home delivery, an average of 13.5 times a year—more than once a month. Consumers in South Korea, France, China, Portugal and Spain spent twice as much online compared to physical shops and in the UK about five times more. In some markets, such as Brazil and China, consumers typically shop for groceries online nearly twice a month. In the United States, approximately half of the respondents said that they would try home delivery or a click-and-collect service. This shows substantial pent-up demand meaning opportunities for those able to address the needs.

According to a study completed in 2013 by Etailing Solutions, an e-commerce consulting firm, factors that would encourage more reluctant shoppers to buy more groceries online include: most of all lower cost of delivery (54%) and lower prices of online groceries (29%). This could be an issue for the retailers, who want to meet these wishes by dropping their prices, which takes a toll on the industry's revenue and players' profitability.

Figure 4: Factors that would encourage more shoppers to groceries online



Other factors include more delivery options, better assortment and better product quality.

Grocery retailers are reluctant to move online

The grocery industry has evolved from mom-and-pop stores to mega-markets and finally to online grocery buying, with many different forms along the way. However, while grocery is the biggest category in retailing, it is also the most resistant to the advance of online shopping. The difference between the leading countries and the countries in which online grocery shopping has yet to establish a significant presence has a lot more to do with the reluctance of retailers than the desires of consumers.

Many grocers are taking a wait-and-see approach to moving online. At present, brick-and-mortar chains are cheaper than Internet grocers, in part because they have economies of scale. Selling groceries, online or not, is a famously low-margin business, which means that economies of scale are needed before profitability can even be hoped for.

The perishable nature of the product and relatively low profit margins achievable in the groceries segment, raise concerns amongst grocers, that online commerce will reduce sales in stores, but not the costs associated with them and that they will also lose impulse buys when shoppers move online. However, it should be noted, the notion of the internet taking spend away from bricks and mortar stores seems to be a misconception. Having an online offering helps retailers to secure additional revenue and retain the custom of those shoppers who do not have time to shop in store and would just go to another retailer that offers online solutions.

While the grocery industry is huge, only a tiny fraction of that market is attractive as a place to operate an online grocery business and finding those micro-segments is a crucial element of a successful strategy, according to Amazon. Plenty of players struggle to hit volume and profitability targets.

High delivery costs and need for excellent service provide challenges

The need for excellent logistics chains and an ability to deliver swiftly provide a great challenge. It is hard enough to deliver goods to the home in one day or less; it is significantly more difficult when those goods are perishable. Online grocery virtual shopping-carts contain dozens of low-value items, which must be stored at different temperatures. Picking and packing of orders, combined with the need for flawless execution to keep customers coming back, may also prove challenging.

Retailers can get in-store staff to pick them off the shelves, which becomes disruptive once volumes rise, or build dedicated warehouses, which is costly. Additionally, they need to pay someone to do something that customers do for themselves if they shop in store, an added cost. At the same time, they are not able to pass that cost on customers, as they would go elsewhere if they find a lower price. This can easily lead to profit margin erosion for retailers.

Home deliveries are also generating high costs; even in densely populated countries like the UK, every home delivery costs grocers around £10 (\$15.60), but shoppers typically pay little more than £3 (\$4.70). In the US, consumers are willing to pay from \$5 to \$10 per delivery, while the actual cost to grocers can run as high as \$20 per delivery in low-penetration areas. Additionally, home deliveries also take away key levers for controlling when customers book their deliveries, an important key to managing delivery costs.

Moreover, success in this business heavily depends on reliable suppliers. Establishing a strong link between the online operations and the company's existing supply chain is critical, as it is the key to providing fresh products through the online channel and critical for running online grocery shop. Failure in establishing stable cooperation leads to disruption of the business and loss of unhappy customers.

Online grocery shoppers harder to satisfy

Grocery shoppers tend to be even more demanding online than in the store. They look for grocers to meet their basic expectations: satisfactory range and quality of products; low rates of substitution and high levels of freshness, consistent and punctual delivery of the expected goods in convenient time slots, as well as ease to use service and website.

A significant percentage of customers try out online grocery offers once and once only; if the experience disappoints, they do not return. Ordering groceries online is often a time-consuming task, placing an order can take up to an hour, and consumers who must wade through too many products online often become exasperated and abandon the process. In order to combat this, retailers have devised solutions allowing saving and storing of customers' shopping lists, favorite products, etc. Delivering flawless service to all first-time customers, especially in the startup phase, is essential in this business. Quality of the product is also at the top of the priority list.

According to David Shukri of the Institute of Grocery Distribution in London, consumer satisfaction is harder to achieve in the online groceries segment. Many shoppers try grocery websites but get discouraged. Grocery shoppers want to examine fresh produce before they buy it. They are not happy when online grocers deliver "substitutions" instead of what they ordered or if they find that they have not received all the ingredients ordered. It does not take many such frustrations before they decide to abandon the idea of buying their groceries online.

For a large and growing share of online shoppers, especially younger ones, the digital experience is becoming increasingly mobile based. The reasons include the maturing of the Millennial generation and the fact that the majority of the global population lives in developing markets where mobile internet infrastructure and access is often better than fixed-line. This trend should be addressed by companies planning online grocery operations, if they want to tap into the market of new generation shoppers.

WEBVAN: THE BIGGEST DOT-COM BUST

Webvan, an online "credit and delivery" grocery business, was one of the pioneers of online grocery retail, created with a vision to revolutionize the grocery market. The idea got massive support from tech-savvy investors and went public after what at the time, was the biggest IPO to date in Silicon Valley.

Like many businesses born in the days of the dot-com boom, Webvan tried to get too big, too fast. It invested vast sums in infrastructure, building everything from scratch rather than leveraging existing resources. The pressure to expand rapidly blotted out all other considerations and Webvan immediately started launching in new cities, before its business model had proved successful even in its home market.

Trying to offer the top quality and wide selection of Whole Foods, the pricing of Safeway, and the convenience of home delivery, the company failed to get its target audience and price right. As shoppers were not signing up so quickly, Webvan could not get enough sales to make its massive investments pay and in 2001 it filed for bankruptcy. The company's name became synonymous with one of the largest dotcom failures, serving as a prime example of what to avoid while expanding a business.

Start up with a vision to revolutionize grocery retailing

Webvan was an online "credit and delivery" grocery business founded in 1996 by Louis Borders and headquartered in Foster City, California, USA. It was one of the pioneers of online grocery retail. Initially, the company started operating only in the San Francisco Bay area.

Figure 5: Webvan – the pioneer of the online grocery market



SOURCE: Webvan/CNN

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The idea behind its establishment was to revolutionize American grocery retailing and introduce a modern online grocery shopping service. The name became synonymous with dotcom failure instead.

The biggest IPO to date in Silicon Valley

Webvan went public in 1999, amid the dot-com rush, when it was still operating only in the San Francisco Bay area. Amazingly, the company, with an ambitious but untested plan for a modern online grocery shopping service, managed to inspire private investors to instantly part with hundreds of millions of dollars, proving that great potential was seen in the online grocery market many years ago.

Webvan raised close to \$800m from blue chip venture capital funds like Sequoia Capital, Benchmark Capital, Softbank, Goldman Sachs and Yahoo. It also raised \$375m from its IPO, selling 25 million shares at \$15 each. This was considered the biggest IPO to date in Silicon Valley at the time. Shortly after its IPO in November 1999, the company was valued at \$8bn.

Rapid expansion based on assumptions

Like many businesses born in the days of the dot-com boom, Webvan tried to get too big, too fast. The early enthusiasm of its investors pushed Webvan to expand more quickly than was wise. Once it went public, Webvan started investing heavily. The company built its extensive infrastructure from scratch, instead of leveraging existing solutions.

In order to fulfill its ambitious expansion plans in 26 cities, it signed a \$1bn contract with Bechtel to build several large-scale, state-of-the-art refrigerated warehouses and distribution centers worth more than \$30m each and manned by advanced robots, which was expected to help speeding up the product selection and shipping. For example, the Oakland Distribution Center had approximately five miles of conveyor belts that could transport 10,000 totes and a large part of the order creation could be automated.

The company hired hundreds of engineers to build the real time software algorithms for ensuring inventory availability and optimizing delivery van routes, software on the Palm Pilots carried by the delivery drivers, and so forth. A huge fleet of vans was rolled out in the Bay Area, Seattle, Chicago, Atlanta, and each city's capital requirement was well over \$50m just to start operations.

The pressure to grow big and fast blotted out all other considerations and the company immediately started launching in new cities based on the assumptions that the unit economics of home grocery delivery would be profitable. The company committed the cardinal sin of retail, expanding into a new territory before demonstrating success in its first market – the Bay area, being too optimistic about customer's willingness to ditch traditional grocery stores in favor of something new and different. Additionally, while Webvan was ahead of its time, coming with its technological advancements while online commerce had not reached a mature stage yet, shopping on its website could be a frustrating experience for a typical home PC user connecting to the Internet through a dial-up phone line at that time.

As commented by Phil Terry, CEO of Creative Good consulting firm, "one of the fundamental mistakes that everybody made is the assumption that because there are some problems with the offline experience that everyone would flock to online. Although many people grumble about tedious checkout lines at regular grocery stores, that doesn't mean they intend to stop standing in them."

Wrong target audience and pricing

Wrong target audience and pricing were the next pitfalls of the strategy introduced by Webvan. The company's mass-market strategy was to offer the premium quality and wide selection of Whole Foods, the pricing of Safeway, and the convenience of home delivery. As a result, the company did not really cater for any specific target market, but was trying to be all things to all people.

Webvan pampered customers with various services, including access to 24-hour-a-day, seven-days-a week online grocery ordering and home delivery within half-hour slots and quickly became popular. At the end of its last year of operations, Webvan was averaging 2,160 orders per day in the Bay Area and breaking even in the Orange country area. Also, for the first three months of the same year, Webvan's average customer order increased to \$114 and was big enough to make the expense of running delivery vans more reasonable.

On ratings site Epinions.com, the company enjoyed an 89% approval rating from 109 customers who submitted reviews. Parents of young children were particularly excited about how Webvan saved them the hassle of regular trips to the grocery store. In a survey by Gomez Advisors, Webvan ranked first among all Internet grocery stores, followed by Albertsons.com, Shoplink.com and Peapod.com.

However, the attempt to match Safeway's pricing attracted a mass market, price-sensitive audience, instead of those customers who are ready to pay a higher price in exchange for better quality and wider selection of products. As Webvan was providing luxury and ability to order directly to home, it should not have tried to compete with Safeway's prices but price at least 30% higher and ignore the customers not ready to pay these higher prices instead.

Revenue growth failed to support enormous investment

While Webvan built up its empire of tech warehouses and fleets of delivery trucks, shoppers were not signing up quite so quickly. The money that Webvan spent on its modern infrastructure far exceeded its sales growth. The company had \$178.5m in sales in 2000, but that revenue was swamped by \$526.4m in expenses. As a result it posted a net loss in excess of \$450m.

Table 1: Webvan – selected key financials, 1998-2000 (\$m)

	1998	1999	2000
Sales	0.9	13.3	178.5
Total operating expenses	12.9	155.9	526.4
Net loss	-12.0	-144.6	-453.3

SOURCE: www.rocketfinancial.com

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Webvan's business model was simply not economically viable, with its high-cost warehouses, fleet of vans and its labor-intensive delivery system that could not compete. Its 300,000-square-foot distribution centers were the most automated in the world. However, the company could not get enough sales to make these investments pay and this has proven deadly for its strategy.

The largest dot-com flop in history

Despite the fact that Webvan quickly gained popularity, the money that the company spent on infrastructure far exceeded sales growth. Webvan closed all operations and filed for Chapter 11 bankruptcy protection just a year and a half after its remarkably successful IPO. With the market crash of 2000, the capital dried up and the company was forced to sell its assets to Kaiser Permanente in 2001. The infrastructure, as well as the software systems, was bought by Kaiser in order to deliver drugs and supplies to its hospitals. As part of the Webvan shutdown process, all non-perishable food was donated to local food banks.

None of Webvan's senior executives (or major investors) had any management experience in the supermarket industry; however, they encouraged the start-up company to take advantage of the first-mover strategy and rapidly build its own infrastructure to deliver groceries in a number of cities. At the time it closed, the company was already delivering groceries in Chicago, Los Angeles, Orange County, California, Portland, Oregon, San Diego, San Francisco; and Seattle. This move was considered as a serious error of judgment by industry analysts.

In 2008, Webvan was named by CNET, American interactive media and marketing company, "the largest dot-com flop in history".

Its spectacular failure intimidates many potential followers even a decade later, showing that regardless of how innovative a company is, if it costs too much to do what it wants to do, the business will likely fail.

Webvan's overly ambitious rush to the biggest IPO to date in Silicon Valley, which helped steer it off a cliff can serve as a prime example of what to avoid while expanding a business.

NEW WAVE OF ONLINE GROCERY RETAILERS

Webvan's failure has proven that the online grocery business is challenging and has its deadly pitfalls, which managed to intimidate many potential followers showing a fine line between success and failure. However, despite not being profitable in its early stages, grocery delivery gained popularity fast, proving there is a potential in dropping off groceries at customers' doorsteps.

Online grocery retailing is still at a baby stage there is plenty of development expected going forward; this will include development in ordering, delivery and mobility as the multichannel boundaries begin to blur. Easy access, technological development, convenience and ease of price comparison are the main factors driving consumer demand for this service.

As shopping habits are changing, and niche online grocery services that compete on convenience and selection are gaining popularity, grocers who do not want to lose the race for market leadership in omni-channel retail look for innovative strategies to tap into online grocery market again.

Learning a lesson from Webvan's mistakes, retailers like Instacart, who are experimenting with innovative, more cost-efficient logistics models are successfully reviving strategies that failed before, changing the traditional grocery sales scene. There are also still some dotcom survivors still operating and proving that getting the business model right will bring the return on investment. Tech giants like Amazon are fronting the cost of expensive delivery infrastructure that has so far held back grocery e-commerce and cause market disruption by taking the price down.

Easy access and convenience expected to drive online grocery growth

Entering the online market today seems inevitable for grocers who do not want to lose the race for market leadership in omni-channel retail. Easy access, convenience and ease of price comparison are the main factors driving consumer demand for this service.

Changing consumer habits are one reason for the market expansion. As lifestyles become busier and there is more and more integration of mobile technology into everyday lives, customers are increasingly shopping "on-the-go". Online shopping is convenient as it saves time and fuel, while allowing fitting in grocery shopping around busy schedules.

There is a rising customer focus on mobile sales. According to Google research, online grocery searches from smartphones jumped 94% in 2014, with grocery searches overall up 22%. As mobile shopping increases, online retailers are paying more attention to transactional apps as engines for growth. These are becoming sleeker, more intuitive and more relevant and online selling platforms move towards shoppers, missions and occasions and away from replicating the store layout online. Big retailers including Walmart, Tesco and Waitrose have all re-launched their mobile apps recently. The advent of smartphones and apps may even aid the return of traditional grocery delivery methods.

According to Jason Goldberg, vice president of commerce strategy at Razorfish digital agency, "we all used to get our dairy delivered to the front porch. In the US, this practice had faded by the 1960s, replaced by the supermarket. In other words, consumer behavior can change, and maybe it will change again. Perhaps all that was needed for the return of the modern-day milkman was a smartphone."

Additionally, offering new ways to shop online is driving customers' loyalty and spending. The more channels retailers make available to their customers, the more they are likely to shop and spend. One example of a trend that has already taken off within recent years is click & collect service, offered by major retailers like Tesco and Asda in the UK. It is convenient for shoppers and allows retailers to target new customers outside their regular store catchment and home delivery demographics. This trend is particularly aimed at busy workers and parents.

Click & collect service has been rolled out not only in the majority of those companies' stores but they are also looking to start it from remote locations, including travel hubs and workplaces, schools and nurseries areas and more remote or rural locations. There are lots of variants of the service, ranging from drive-thru to vans in car parks and chilled lockers, as retailers experiment to see what works best.

As commented by Apoorva Mehta, the founder and CEO of Instacart, a grocery-delivery startup, "When Webvan started people didn't even necessarily have broadband, much less a handheld computer that could do most of what a PC does. Plus, most people still weren't used to shopping on the internet. The behavior to transact online was not there. Nowadays, people are transacting more and more on mobile devices, making it a very seamless experience."

More players trying to adapt to the new medium

Despite the fact that the online grocery business has proven very challenging to e-commerce companies, e-commerce startups and big-name tech companies are pursuing to push more grocery sales online. Learning a lesson from Webvan's mistakes, retailers who are experimenting with innovative, more cost-efficient logistics models are successfully reviving strategies that failed before, changing the traditional grocery sales scene. As shopping habits are changing, niche online grocery services that compete on convenience and selection are gaining traction.

There are still some dotcom survivors operating and proving that getting the business model right will bring the return on investment. These include for example Peapod, started in 1989 and operating in the Chicago area, Winder Farms established in 1980 and serving the Western United States, and Gopher Grocery operating in the Minneapolis-St. Paul area. It is worth mentioning that Peapod and Winder Farms existed even before the Internet became popular, and managed to adapt their business models to the new medium. Peapod delivers an estimated half-billion dollars of groceries bought online for the Stop & Shop and Giant grocery chains.

Winder Farms, known as the "farmers market on wheels, reached its milestone of 10 million products delivered in 2013 throughout Utah, Southern Nevada and Southern California.

Other online grocers that have seen steady growth include FreshDirect, YourGrocer.Com and ShopRite from Home, serving the New York City market. A number of grocery chain stores, including Safeway, also started offering online ordering and home delivery. However, none of them is rushing but rather taking cautious steps, still remembering Webvan's spectacular failure.

AmazonFresh: The phoenix from Webvan's ashes

Webvan efforts did not end up going down the drain after all, but benefited another entrepreneur called Jeff Bezos, the founder of Amazon.

Bezos has recognized the opportunities arising from the use of technology advancements that Webvan was trying to introduce way ahead of its time. In 2012, Amazon acquired Kiva Robotics System, built and based on know-how originally developed at Webvan. The acquisition, worth \$775m, was one of Amazon's largest-ever acquisitions. The system is a key part of its AmazonFresh's strategy, online grocery delivery operations serving Seattle, Washington, Los Angeles and San Diego, California. Automated picking systems enable some dedicated fulfillment centers to operate at a cost well below 10% of sales; a few even approach 5%. Better routing and delivery software allows fuel savings and optimal fleet utilization, which translates into lower delivery costs. Tech giants like Amazon are tackling the cost of expensive delivery infrastructure that has so far held back grocery e-commerce.

Amazon has also hired Doug Herrington, Peter Ham, Mick Mountz and Mark Mastandrea – former Webvan executives responsible for its spectacular failure. It may seem a risky move; however, they certainly come with deep knowledge of the business and plenty of experience. It seems to be working for Amazon, as "these four Webvan executives have thought about what they did wrong, and are eager to prove that they can apply the lessons learned to revive their reputations", according to Forbes.

The icing on the cake is that from January, 2009, Webvan.com is operating as part of the Amazon.com family, shipping non-perishable items by UPS or other standard shippers, the way Amazon.com purchases are handled. It offers more than 45,000 non-perishable grocery items.

Amazon spent years testing its delivery program in its home city of Seattle before launching its AmazonFresh service. The fact that the world's most successful online retailer has taken such cautious steps is an indication of just how difficult online grocery retail can be. On the other hand, tech-savvy giants like Amazon are expected to compress margins and disrupt the whole industry, as their strategy is usually based on beating competitors by dropping their prices as low as possible and, in doing so, pressuring their competitors to make similar price cuts.

Instacart trying to succeed where Webvan failed

Almost 15 years after Webvan's spectacular failure, another company with soaring sales and surging valuation is emerging, attracting investors' bets. Instacart Inc., based in San Francisco is a grocery-delivery startup that launched in 2012. The company exemplifies the lean strategy of today's tech startups, which are cautious to avoid the excesses of the first dotcom crash. It will buy all your groceries from a customer's favorite stores and deliver them within an hour or two.

Unlike Webvan, Instacart started with strategy relying on individual shoppers, who visit stores (like Whole Foods, Costco, Safeway, etc.) and local independent grocers to buy goods for customers, rather than storing the products in costly warehouses. It marked up the prices of groceries and that is how it made money.

Instacart shoppers use their own cars, deliver goods directly to customers within an hour and get paid a minimum of \$10 per delivery, with more for large orders or for faster speeds. The shoppers are independent contractors who log into the Instacart system when they are available to shop and take orders.

This means Instacart does not have to provide them with salaries or costly benefits and this way, it avoids Webvan's devastating cost structure.

Instacart streams inventory lists from brick-and-mortar stores to its mobile app. Users can search the inventory and fill their in-app shopping carts just as they would on Amazon. They can also make custom requests and identify acceptable substitutes, since the order is going directly to a real person who will act as an offline surrogate, filling an actual cart in the store's aisles. This can be seen as an advantage over the Amazon/Webvan robot model as it can help reduce customers' dissatisfaction with substitutes.

Table 2: Webvan vs Instacart in their first two years of operations

	Webvan (2001)	Instacart (2014)
Revenue (\$)	239m	100m
Venture Capital (\$)	441m	275m
Inventory	Refrigerated Warehouses (cost \$40m each)	Existing supermarkets
Labor	4,500 employees	110 employees excluding couriers using own cars
Delivery Fees (\$)	4.95-9.95 depending on order size	3.99-5.99, item mark-ups
Market	10 metro areas	15 metro areas

SOURCE: www.wsj.com

MARKETLINE

After two years of operations, Instacart has more than 4,000 shoppers who deliver groceries to customers in 15 cities, with a delivery fee of \$5.99 for one-hour delivery and \$3.99 for two-hour delivery.

The latest funding round in January 2015, which values Instacart at \$2bn, came months after a \$44m round in June 2014, when the company was valued at around \$400m. Its investors include Comcast Ventures, Dragoneer Investment Group, Thrive Capital, Valiant Capital, Andreessen Horowitz, Khosla Ventures and Sequoia.

Instacart's founder and CEO Apoorva Mehta said the company plans to use the new funding for continued geographic growth, technology enhancements, and category expansion. It is also considering experimenting with other categories beyond groceries, concentrating mainly on items consumers buy regularly rather than one-off items such as electronics.

In 2015, the company announced that it is moving away from setting a surcharge on each delivered item (although it still does for many grocers), a practice that could endanger relationships with customers and cause revenue drops, especially in times of economic malaise. It now seeks to partner with retailers directly, receiving a fee from them to act essentially as the stores' own online ordering and delivery service. According to Mehta, "the next step is giving his grocer partners control over the Instacart shopping experience. Whole Foods, for example, will eventually be able to more fully brand and arrange its Instacart storefront."

CONCLUSIONS

Webvan failure provides lessons that prove online grocery retail can work

As consumers continue to embrace internet shopping, the global market for online groceries is expected to increase at double digit rates, providing significant business opportunities. Additionally, the penetration of online grocery shopping remains very low, leaving plenty of space for growth. Online shopping may be one of the smallest retail segments for food and beverage but it is also the fastest growing channel for grocers.

Webvan was one of the pioneers of online grocery retail, created with a vision to revolutionize the grocery market. However, like many businesses born in the days of the dot-com boom, it tried to get too big, too fast. The pressure to expand rapidly blotted out all other considerations and Webvan committed the cardinal sin of retail, launching in new cities, before its business model proved successful in its home market. As it also failed to get its target audience and price right and overestimated the customers' willingness to switch to online grocery shopping at that stage. This dangerous cocktail of the lower margins of mass-market pricing, and colossal capital expenditure associated with complex infrastructure pushed Webvan over the edge and it went busted. Instead of revolutionizing the market, the company' name became synonymous with one of the largest dotcom failures, serving as a prime example of what to avoid while expanding a business.

However, Webvan's failure did not prove that online grocery shopping cannot work, as it have had little to do with the quality of its delivery service, which received very favorable reviews from customers. The company quickly gained popularity; however it showed that this business has its pitfalls, which can be deadly to the business if overlooked. Learning from Webvan's lesson, substantial grocers are experimenting with innovative, cost-efficient delivery strategies, disrupting the traditional grocery sales scene and successfully revamping a business model that failed before.

It still remains to be seen whether anyone can make a real profit from e-groceries, as margins are low in this business and profit generation is slow. However, regardless of whether a grocer does not believe that it can drive big profits through an online service, it still needs to take a leap or risk losing the race for market leadership in the omni-channel world, as early movers will seize a significant competitive advantage over those that come late to the game.

The technology and attitudes towards online shopping have changed over the years and online groceries have a more realistic chance of succeeding today. Knowing what web shoppers want will help dictate online grocers' success. The focus is on finding the right tradeoff between an attractive range of products, a lean cost structure, and a fast delivery service. There is no single model that is right for all companies and situations. Efficiency depends in large part on individual market circumstances and where a grocer stands on the online growth curve. Smart grocers moving online will let the market, customer base, and the speed at which they can develop their own capabilities dictate the pace of their evolution.

APPENDIX

Definitions

The online grocery market is defined as the online sales of food and drink for in-home consumption.

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