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# Was Webvan the Hindenburg of the dot-com era?
## Why scalability is essential in e-commerce

*Some 10 years ago, online grocery initiative Webvan spectacularly crashed out of the retail market after spending its way through over a billion dollars in capital. As they battle against the current economic headwind, many wholesalers and retailers are keen to invest in a segment that is still demonstrating growth potential: e-commerce. As a modern-day classic, what can the Webvan case teach us?*

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### Webvan: the vision

In the late 1990s, entrepreneur and Webvan founder Louis Borders had a vision: to develop a cost-optimized model for supplying customers with everyday necessities. Cost optimization was to be achieved through highly automated warehouses. The internet made everyone a potential customer, and grocery items were – and still are – a daily requirement. Once the logistics operation was up and running, grocery products would be supplemented by other product groups to ensure further growth. With this vision, and his personal flair and charisma, Louis tempted numerous investors to join him on his adventure.

The Webvan business plan was based on a simple calculation: per customer, the average online order was expected to be 100 dollars, the purchase value 70 dollars, the order picking costs 10 dollars and the distribution costs (using the company's own trucks to deliver within an agreed 30-minute time window) also 10 dollars. When presented with a forecast operating profit of 10 dollars per order, the abovementioned investors were captivated.

### The reality

The average order value rose to 115 dollars and thanks to economies of scale the purchase value stayed below 80 dollars. However, these gains were more than negated by order picking costs of 27 dollars (for an average of 30 lines), almost 20 dollars in distribution costs in order to deliver within the agreed 30-minute window and an extra 10 dollars in after-sales service costs for responding to comments and rectifying complaints about the deliveries. Hence, an operating profit of 10 dollars per order actually became a loss of close to 20 dollars per order. The capital buffer evaporated in no time, and the company was declared bankrupt in 2001. But how was this able to happen?

### Five classic lessons

Webvan's downfall was analyzed thoroughly at the time. Nevertheless, the lessons that can be learned remain equally relevant today. The five lessons listed below had a major impact on the logistics costs:

1. **Know your market**: Webvan stepped into a world of both perishable and non-perishable goods, of high volumes with a relatively low margin and relative low line value. The cost structure was significantly different from the market with which Louis Borders was familiar, namely (online) bookstores. Attracting new customers was relatively expensive (200 dollars per customer) and generally remained limited to women from double-income families with

children. The Webvan customer service hotline, which was free to call, was overrun with questions ('I need dietary advice'), requests ('Can the delivery be rescheduled for later?') and complaints ('My ice cream had melted').

2. **High overheads are risky**: New and expensively automated warehouses were set up focused on achieving low variable costs (25 to 35 million dollars for each one of the 26 warehouses planned, comprising 30,000 square meters each). After all, even picking a tube of toothpaste or a one-dollar can of soup had to be done ultra-efficiently. But due to a disappointing level of customer response, the warehouses were running at only 50% capacity. If forecast sales growth is not achieved, or worse if turnover declines, high warehouse overheads make a significant dent in company profits.
3. **Know your products and processes:** In the warehouse, the handling was based on the use of a (horizontal) carousel system with pick to light that had been specially developed for Webvan. In theory, the system would offer a tenfold increase in productivity compared to picking using a conventional cart. In practice, partly due to the impact of frozen and heavy products as well as fast-movers which were not picked via the carousel, less than half of all lines were picked by the automated system.
4. **Know what you are promising to the customer (and what it costs you):** Customers could specify their desired delivery time from Webvan within a 30-minute time window. Delivery was free except for orders of less than 50 dollars, which incurred an extra charge of 5 dollars. Due to this narrow time window and the company promise to deliver everywhere, even in regions with few customers, transport became very costly. On average, a Webvan truck made just over 2 deliveries per hour. A subsequent rise in the minimum order value and delivery charge did not go down well with customers.
5. **Make realistic (and modest) plans**: Everything about the Webvan case is grand and ambitious. The company expanded into new regions while the existing ones were still experiencing teething problems. Implementing improvements also means taking the time to learn from your mistakes and to train management and staff.

### The future: does this mean that entrepreneurialism is ill-advised?

The answer to this question is, of course, 'No'. Even if a wholesale or retail organization does not choose to actively explore new markets or offer new services, it will eventually be forced to change by the existing market conditions or its competitors.

Customers are asking for the option of placing their orders later, for shorter delivery times, for a wider choice and for smaller quantities. Deliveries must be complete and faultless, there must be the opportunity to receive professional advice and the order process must be convenient. Greater cost transparency has made it easier for customers to compare prices. The payback time on any investment must be short (often within 2 to 3 years). The company's image and sustainability are subject not only to external demands but also to internal expectations: employees within the organization want to be part of a company they can be proud of.

## Think big: start off scalable and grow

The five lessons from the Webvan case do not provide a 'one size fits all' answer to all of these demands. However, they do form a basis for designing or evaluating a logistics set-up, and they are also important for small and medium-sized wholesale and retail organizations.

Needless to say, other factors also play a role in a company's ultimate success or failure. In the specific case of Webvan, these other factors were:

- The lack of grocery experience among the CEOs,
- Changing of the CEOs,
- A new logo and website redesign which caused confusion among customers,
- A corporate takeover,
- Lack of customer contact (and customer relationship management), and
- The (downward) adjustment of product quality and service.

Some people have scornfully referred to Webvan as the Hindenburg of the dot-com era. Another player dating from the same era acquired the Webvan brand in 2009 and is now supplying non-perishable grocery items through the same online channel. In contrast to Webvan, this company has become spectacularly successful. Its name is Amazon.

If you have questions or if you would like to offer your feedback to this article, you can contact Arthur Zondervan, Zondervan@groenewout.com or +31 76 533 04 40.

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