

# Online Grocery Shopping: Is there a Phoenix?\*

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## I. Introduction

The purpose of this paper is to highlight and discuss the issues involved in the online grocery shopping business in the U.S. Webvan will be the main E-commerce business used to illustrate the Dot Com failures. Current online shopping vendors will be referenced to show the ongoing challenges of online shopping business and discuss the steps it must take to gain and remain profitable. As a final discussion, this paper will explore trends, new players and survivors in the online grocery shopping business, such as Vons.com, Peapod.com and Safeway.com, and seek to see if they have the necessary ingredients to rise from the ashes and soar into the future.

## II. What went wrong with the Dot Com Market?

E-commerce was going to revolutionize how consumers conducted commerce. Businesses that piled their wares via the Internet, became affectionately known as Dot Com. With visions of grandeur, Dot Com was to be the next wave in economics. Venture capitalist began invested millions of dollars in Dot Com

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businesses. Economists predicted that Dot Com was to be the next wave in financial markets, earnings were infinite, and large returns were expected. Private investors followed the advice of financial brokers, and placed large amount of dollars into Dot Com stocks.

In a period of five years, the once highflying Dot Com market came to a halt, and quickly began to lower its valuation. What was once the new wave in economic development now was reduced to bankruptcies and chapter 11 filings. How could this rise and fall happen so quickly?

According to John Grieten, American Express financial market planner, factors that made the Dot Com market slump included, borrowing more money than needed, trying to grow the business at all costs; while worrying about making a profit later. When venture capital financing evaporated, the burden of debt and lack of profit forced many Dot Coms out of business<sup>1)</sup>. Grieten notes some of the dynamics that led Dot Com companies into the "Internet trap."

As far back as early 1996 I began to notice a general overvaluation of technology stocks, such as AOL, Cisco, and 3Com. Before the Internet stock bubble even got rolling, these large industry leaders set up stock investors to expect over priced stocks for an extended period of time. Many people don't realize that it was 1998 and not 1999, appreciation in stock valuation. 1999 was the year when everything else on the NASDAQ index soared and companies wanted to add .com to the end of their corporate name. At the beginning of 1999, the average Internet stock had a stock price that was thirty times its sales per Share. The historical norm for an industrial type company to become profitable is 1.5 times sales and a net Profit of 10%.

Internet companies did not have profits, so investors started using sales as their main gauge to fine the value of Internet companies. Corporate managers were lured into raising sales and then got their profits by selling stock<sup>2)</sup>.

As this paper progresses, more flaws will be recognized in association with the Internet trap. It was a period of financial excess. Many companies failed to follow

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1) Personal interview with John Grieten (November 5, 2004).

2) For example, widgets.com is currently generating sales of \$100,000 out someone's garage. He finds a friend to partner and invest \$100,000 for advertising to increase sales by just \$50,000. He is already not even getting back his advertising cost, let alone even a prayer for profit. However, with a price to sales ratio of 30/1, his company is now worth \$4.5 million.

basic steps for building a profitable business. The online grocery sector is no exception to the Internet trap. Dot Coms have come, gone, perished, and some are still in business. What is the difference between a successful and unsuccessful venture? What are the future trends? Will there be a Phoenix for online shopping E - commerce?

### **III. Overview of Online Grocery Shopping**

Online grocery shopping is an example of business - to - consumer E - commerce. Within consumer E - commerce, there are two types of Dot Com businesses, a traditional brick and mortar and Internet -based or pure - play company. As an example of these, safeway.com grew from an established brick and mortar company while Webvan.com ventured directly into E - commerce. In other words, a brick and mortar company has a door that a customer can walk through while customer access to a pure - play is restricted to the Internet. A sample of online grocer is safeway.com, homegrocer.com, vons.com, peapod.com, groceryshop - ping.com, and shopfast.com.

London based Food Ferry was the first online grocer. Food Ferry began business in 1990 using printed catalogs, and went online in 1998. Focusing on high - end and specialist products, it continues to serve customers in central London<sup>3)</sup>.

The first pure - play American companies to offer online grocery shopping are Peapod, Inc., and Webvan. In 1989, Andrew and Thomas Parkinson established the online grocery delivery concept in Evanston Illinois. The Parkinsons used their backgrounds in product marketing and technology and partnered with Jewel Foods to form Peapod. During the early days, Andrew, Thomas and their families did the picking and packing, and made the deliveries with their own cars. In 1996, Peapod, Inc. had a customer base of 43,000 and went online with its website www.peapod.com. In 2000, Peapod became a wholly owned subsidiary of Royal Ahold, and joined with Ahold U.S.A. grocers: Shop & Shop and Giant Foods. By 2003, Peapod, Inc. reached profitability in four out of five markets and delivered to its five million customers. Currently, Peapod, Inc. has two 75, 000 square food warehouses, delivers to 147,000 customers, and has 1, 500

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3) See D. Reed, Online Grocery Shopping, Precision Marketing, 16 (3) (Oct. 17, 2003).

employees<sup>4</sup>).

### **1. Webvan, what went wrong?**

Webvan was the brainchild of Louis Borders, the founder of Borders books. Borders applied his knowledge of computer inventory and retailing business strategies to online grocery shopping. During the heyday of the Dot Com era, Borders realized that there was a distribution bottleneck for online companies. Louis Borders theorized that if an online company could make efficient delivery of product from online grocer site to customer, he could revolutionize the grocery business. Even in an industry rife with razor - thin margins, Louis Borders believed that by eliminating store costs, he could reap sizable profits. Instead of stock clerks and multiple warehouses, Borders, envisioned giant distribution centers that would service major warehouses around the globe<sup>5</sup>).

Borders focused his business plan on operations and customer service. On the operation side, Webvan hired 80 computer programmers, and started building distribution centers. A total of 26 distribution centers were built nationally. The Oakland, California distribution center was a mammoth, 33, 000 square foot building and serviced customers within a 40 - mile radius. Inside the centers, products were distributed on conveyor belts, and stored in bins. Borders did his warehouse engineering and fined - tuned the working environment to be an efficient as possible. Borders made sure that the workers did not have to travel more than a 14 - foot radius to fill orders. The delivery drivers, called Ambassadors, did not travel more than a 10 - mile radius route. At peak performance, Webvan expected that each facility would handle more than 8,000 orders a day, totaling 225,000 items, and generate annual revenues of \$300,000 million. In comparison, a conventional stand - alone supermarket brought in \$12 million a year<sup>6</sup>).

On the customer service side, Webvan differentiated itself from other online grocers by offering gourmet, and high quality foods. Webvan also began to offer book and DVDs. Customers where offered free delivery within a window of half an hour.

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4) For detail see at <http://www.peapod.com>.

5) See A. Afuah and C. L. Tucci, *Internet Business Models and Strategies* (2000), pp. 192-201.

6) See id.

As with the rest of Dot Com industries, many which expanded on inflated financial records, the future for Webvan was looking very good. No one can accuse Webvan of lacking the killer instinct. In the past year, the company has pledged to spend \$1 billion on infrastructure and has steered itself into competition with the likeness of Amazon.com<sup>7)</sup>.

The main problem for Webvan was that it grew too fast for its own good. Even though Borders studied, built, and operated a very successful bookstore, he had no previous experience with the online grocery business. Borders was a master at designing efficient business operations, but he disregarded basic business theories. Webvan grew with the adage, "if you build it, they will come," and customers did not come to shop as vigorously as expected. As with many Dot Com companies, Webvan got caught in the Internet trap.

Borders is an intelligent man, but he did not anticipate the Internet trap, and continued to spend to outgrow the competition. The dollar amounts invested in Webvan were phenomenal, Webvan's fixed costs (FC) for general and administrative expenses (G&A) increased from \$8.25 million in 1998 to \$92.406 million in 1999. Further, G&A costs increased by \$200 million to \$292.335 million in 2000 as Webvan expanded geographic coverage and invested in the highest level of warehouse technologies<sup>8)</sup>.

Clearly stated, out of control spending was the demise of Webvan, and it went bankrupt in July 2001. At present Borders is working on a magazine archiving venture, Keep Media. Borders has not begun to burn through the \$850 million that Webvan did.

## **2. Brick and Mortar Online Shopping**

The brick and Mortar grocery markets (also known as Brick and Click) have ventured into the online grocery shopping market. The two main players are Albertson's and Safeway. However, about every major grocery market has started an E-commerce venture. Since Brick and Mortar companies have already established themselves and practiced sound business operations, it was

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7) K. Regan, Webvan takes a wrong turn, E-Commerce Times (June 6, 2000).

8) See M. Starr, Application of POM to E-business: B2C E-shopping, International Journal of Operations and production Management, p. 105.

fairly easy to begin marketing themselves online. The main up sell for the Brick and Mortars was that they did not fall into the Internet trap.

Going online enhanced the products that they have been selling for years. All they had to do was to build a website, hire an E - commerce IT department, but delivery vans, and they were in business. Brick and Mortars are also bringing technology into the stores. By "webifying" the stores, brick and mortars can help customers shop more effectively. Wi - Fi networks are being built so customers can use PDAs online. Computerized Kiosk is starting to be implemented to help to educate customers and locate products for customers.

Even the old tradition of giving, licking, and pasting Green Stamps has entered the E - commerce age. Banking on its success and still - wide brand awareness, Sperry & Hutchinson Co., Inc's new executive team has morphed its Green stamps program into the digital S&H Greenpoints. The program now issues virtual points that customers can accrue by shopping online with participating retailers, offline in select grocery stores in 11 states and with partners including Visa, Earthlink, and Hertz<sup>9</sup>.

There are smaller companies that are finding niche markets such as online grocers and farmer markets. Time will only what business ventures will morph from E - commerce.

### **3. Online Shopping Trends**

There are many reasons why people shop online. Basically everything that can be found at the grocery market can be found on the online version. For a small fee, everything from prescriptions to alcohol is a click away, and can be delivered to one's doorstep, overnight. If a customer is traveling to a vacation spot, the provisions will be delivered to the cabin. Then the customer can schedule a delivery for when he gets back home. Ease - of - use and search ability rank as the top two benefits of online shopping. Users gravitate toward well - designed sites that offer many options<sup>10</sup>.

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9) See A. Parmar, Green Stamps get a digital makeover-Old S7H program moves to real time, marketing News, 38 (6), p. 23.

10) See A. Rozgus, The Joys and sorrows of Buying Online, R&D Magazine (April 2000) (Ease-of-Use: 68%; Searchability: 53.7%; Immediacy: 45.8%; Flexible 24/7 Ordering: 44.2%; Comparison Shopping: 41.7%; Better Order Tracking: 30.8%; Lower Cost: 28.9%).

#### **4. Is there a Phoenix for Online Shopping?**

Is there a phoenix for online grocery shopping? Will E - commerce markets survive? The answer would be a definite yes. Currently, there are many E - commerce markets in business. The illusion of the Internet trap has faded away. E - commerce companies have learned from the Internet trap, and proceeded with caution when starting a new venture. One of these new venture is the Joe Fedele and Joe Ackerman venture FreshDirect.

FreshDirect is eager to avoid the Webvan mistake of overreaching. It delivers in only five zip codes, mostly in Manhattan, and is adding new ones slowly as it fine - tunes its systems. It has no immediate plans to expand beyond New Ycrk. The longer tem goal is to open one or more additional plants in the region before expanding to four or five other East Coast cities. It seeks densely populated areas, because that keeps delivery costs low.

Joe wants to sell raw, semi - prepared, and prepared food to institutions as well. Fedele thinks eventually he can get about 5% of the New York food market, which he calculates would give FreshDirect revenues of about \$2 billion. Executives say that the company can be profitable within six to eight months, once it hits \$60 million or so in sales. They will not consider an IPO until the business in solidity in the black<sup>11)</sup>.

The market is there. Consumers like the availability and convenience of using online shopping. E - commerce is here to stay and is still in its infancy stage. In 2002, online retail sales in the U.S. grew 26.9% to \$45.6 billion versus a 3.1 percent increase for retail sales overall. Online retail spending is projected to reach \$105 billion by 2007, with the Internet influencing 34 percent of all U.S.<sup>12)</sup>.

#### **IV. Concluding Comments**

There are two ways to approach going into an online grocery venture. The first, and most effective would to be a traditional brick and mortar grocery store, which develops an Internet E - commerce as a side venture. This is the model that Safeway and Albertson' s have adopted.

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11) D. Kirkpatrick, The Online Grocer Version 2.0, Fortune 146 (11), p. 217.

12) See id.

The second would be a pure player Internet grocer. Historically, those that enter the pure play market already have had some experience with the grocery business. If the pure - play venture is started with careful planning, strong business and operations management, sound financing practices, and effective site design, the business will survive.

The need and market is present for online shopping. As long as this fact remains valid, there will be an online shopping Phoenix. A few companies may fail along the way. However, E - commerce is here to stay.

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## 미국의 온라인 식료품 쇼핑에 관한 소고

박명섭 · 박인섭

식품관련 시장조사 기관인 **Food marketing Instittue**에 따르면, 미국전체의 식료품 체인 가운데 **25%**가 최소한 온라인 쇼핑을 운영하고 있다. **Safeway, Albertsons** 등 대형 슈퍼마켓 체인들이 연이어 온라인 시장에 참가했고, **Melon Seed, FreshDirect.com** 등 신규업체도 참가했다. **2002년 5월 Safeway.cm**을 설립한 **Safeway**는 동년 7월에 8번째 점포를 시애틀에 오픈하는 등, 온라인 비즈니스를 확대했다.

최근 할인매장, 드러그 스토어 등에 일부 시장을 잠식당하고 있는 이들 전통적인 슈퍼마켓 체인들은 고객의 이탈을 막기 위해 비록 소수이기는 하지만 고객의 온라인 수요에 대응할 필요성이 있다고 생각하기 때문이다.

본고의 목적은 미국의 식료품 온라인 쇼핑에서 발생하고 있는 여러 문제점을 지적하는 것이다. **Webvan**이 **Dot Com**의 실패를 예증하는데 사용되는 주요한 전자상거래 비즈니스이다. 오늘날 온라인 쇼핑 비즈니스의 도전을 보여주고 이익을 낳기 위해 취해야 할 조치를 논의하기 위해 온라인 쇼핑 밴더가 참조되고 있다.

또한 본고는 미국의 **Vons.com, Peapod.com** 그리고 **Safeway.com**과 같은 온라인 식료품 쇼핑 비즈니스에서 나타나고 있는 추세, 신규 영업자 및 잔존 영업자들의 특성과 온라인 식료품 쇼핑업자들의 성장에 필요한 요인들에 관해서도 논하였다.

key words : Online Grocery Shopping, E - Commerce, Grocery Business, Webvan, Dot.Com Market
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