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# EVALUATING B2C PROFITABILITY AND LONGEVITY ACCORDING TO PORTER'S STRATEGY

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## Abstract

*The recent dot-com bust has raised several questions regarding the economic and market structure of dot-com enterprises. This paper analyzes the success and failure of eight dot-com enterprises in context of the Porter's Strategy Model. When applied to our sample companies, it becomes clear that the pure-plays (or pure dot-com enterprises) do not have any advantages over their counterparts, the clicks-and-mortar (or companies that operate an Internet e-commerce channel in addition to their established storefronts). By lowering the barrier to entry and intensifying the rivalry among competitors, the pure-plays increase the bargaining power of consumers, giving up their chance of gaining and holding a sustainable competitive advantage. This paper draws on news articles, news reports, and corporate financial statements to analyze eight dot-com companies, four of them Internet pure-plays and four clicks-and-mortar hybrids.*

## Introduction

Internet enterprises, the core of the "new economy", had a banner year in 1999. It did not seem to matter to investors that most of the companies in which they invested money were not going to be profitable anytime soon, if at all. Venture Capital firms world-wide funded these companies. Until the first quarter of 2000, hundreds of dot-com companies either went public or filed their Initial Public Offering (IPO) with United States Securities and Exchange Commission (SEC). (See Table 1) Shortly thereafter, the new economy "bubble" burst.

How exactly did this happen? Was it really a bad idea to conduct one's business entirely over the Internet? Or was something else completely ignored in the midst of the euphoria? The Internet companies did not have bad business models: to use the new medium as a sales channel for selling items for profit. We assert that these Internet enterprises, however, ignored some of the core business principles to which even companies of the so-called "new economy" must adhere. These fundamentals as outlined by Porter (2001) are crucial in business operation and strategy. If they are ignored, it is only a matter of time before a company will be forced to realign its business goals or face failure. The venture capitalists and investors of the world distorted this view entirely so that it appeared that Internet pure-plays were immune to these basic fundamentals.

A review of the Internet business strategy literature reveals two business models commonly followed by the *dot-com* enterprises (Mahadevan, 2000; Gulati, et. al., 2000). Mahadevan (2000) classifies the pure-plays as Portals, Market Makers, and Product/Service Providers who rely on three economic streams for surviving in the new economy. They are the value stream, the revenue stream, and the logistical stream. To succeed, the dot-com companies must rely on some unique combination of each of the three streams. Although Mahadevan identifies the various possible revenue streams for the dot-com companies, these economic streams may never materialize. Nor does the amount of dollars spent on advertising compensate for all the expenses incurred trying to capture sales for the site. In hindsight, we have learned that more visits to a website does not equate to more revenue. The end result is high expenditures of cash on the part of the company with inadequate returns.

Similarly, Gulati, et. al. (2000), examine four major strategies that click-and-mortar enterprises follow to extend their brick business model on the Internet: (1) *high integration*, i.e., establishing and maintaining an in-house division, (2) *medium integration*, i.e., establishing a joint venture, (3) *medium separation* establishing a strategic partnership, and (4) *high separation* - creating a spin off company. They state that the benefits of being fully or partially integrated are greater than the advantages of

separation as pure-plays. The click-and-mortar business model does seem to have a greater validity than advantage over its pure-play counterpart. But, is this phenomenon true?

This paper's objective was to answer the above question with an exploratory analysis of the business strategies of eight<sup>1</sup> dot-com enterprises. We used the context of Porter's Strategy model in order to analyze which critical business fundamentals were followed and which were ignored by the firms. The comparison companies are broken down into two types: the Internet *pure-plays* and their *clicks-and-mortar* counterparts, as mentioned above. For the purpose of our study, an Internet pure-play is a company that only sells a product or service over the Internet sales channel. While, a clicks-and-mortar company is one that predominantly sells a product or service through an established storefront or actual traveling sales force. However, it also operates an Internet e-commerce channel, usually on a smaller scale internally or with an outside partner. The pure-play firms usually are the pioneers with first mover advantages and disadvantages. The clicks-and-mortar firms generally assumed the role of follower, learning from the mistakes of the pioneer.

We first review the basics of Porter's model followed by an analysis of six companies (three pure-plays and three clicks-and-mortar) based on Porter's model and compare pairs of company in the same market or industry.

## Porter's Model

We have applied Porter's basic strategic framework (Porter, 2001) for the Internet, which he suggests must be followed in order to be successful and profitable regardless of the type of firm. We selected Porter's framework because it has intuitive appeal and its longevity attests to its acceptability in business strategy literature. Porter outlines two major fundamentals that are influenced by the Internet: *industry structure* and *sustainable competitive advantage*.

### *Industry Structure*

The industry structure is built upon Porter's classic five competitive elements: 1) the barrier to entry for new competitors; 2) the amount of competitive rivalry that exists in the industry; 3) the general bargaining power of buyers; 4) the general bargaining power of suppliers; 5) the threat of substitute products

The Internet can have adverse or beneficial effects on each of these elements. The open nature of the Internet architecture has the largest effect on the competitive elements. Since the technology platform is common and little or no capital investment is required, anybody with minimal know-how can set up a website and start conducting e-commerce. This results in the barrier to entry being nearly non-existent in certain industries. This increases the rivalry that already exists between competitors and even compounds it logarithmically.

The Internet makes available a vast amount of information that can be acquired by potential buyers. This is great benefit for buyers because they can perform in-depth research before buying the product. They can, for example, get cost information that was not readily available to them before the emergence of the Internet. An example of this is the actual invoice paid by a car dealer, which is now available at a buyer's mouse click. This puts bargaining power into the hands of the consumer and reduces the dealer's advantage. A possible consequence of this is that the retailers (brick-and-mortar firms and pure-plays) may have to compete solely on the basis of price. Further switching costs are lowered allowing consumers to change vendors with little penalty.

Because of the Internet, suppliers can gain an increase in the number of potential customers directly, reducing the number of middlemen. The ease with which these potential customers are reached means more direct sales are possible from large suppliers. This is beneficial for suppliers but is a mixed blessing for consumers. For example, the consumer may have only one outlet for a certain product and has to pay the exact price stated. There are no intermediaries competing among themselves with whom the consumer can bargain for better pricing. Alternatively, introducing an intermediary can result in a higher initial price negating the effect of competition. The end result may be that buying directly from the supplier may result in a lower price.

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<sup>1</sup>Due to size limitations only six companies are discussed in this paper. CVS and PlanetRX were excluded. Full paper available upon request.

The last competitive element is the threat of substitute products. The speed and organization of the Internet, with its database storage capabilities and set standards, can foster efficiencies in the industry and, actually, expand the industry. This expansion leads to more competitors and newer, better technologies that increase the threat of substitutions. As Internet technologies change rapidly and become less expensive, they make it easier and cost effective for customers to switch to a substitute, perhaps better, product or service. If suppliers are not quick in their development, implementation, and time to market they may very soon be filing for bankruptcy.

### ***Sustainable Competitive Advantage***

Sustainable competitive advantage is the next fundamental that is crucial to a successful firm. It comes from either one or both of the following: 1) operational effectiveness and 2) strategic positioning.

Operational effectiveness means offering a better product or service than your competitors. This can refer to the speed at which something is done, the amount of customization that can be accomplished, the overall efficiency of operations, or even the manner in which something is sold. Operational effectiveness is what many refer to as “Internet Speed”; how quickly can a company come up to speed to meet or exceed the performance of its competitors. In the pure Internet world, duplicating a competing firm’s operations is relatively easy so that, realistically, operational effectiveness is not an issue. No real strategic advantage can be gained because a firm’s competitor can replicate its product and operation in a very short time. Indeed, with technology changing rapidly, a competitor can leap frog the firm and exceed the baseline set by the original firm.

Therefore, the advantage for sustainable competitive advantage comes from strategic positioning. To succeed a business should provide something of value to a consumer or client and then try to be an exclusive provider.

Mahadevan (2000) contradicts some of the Porter’s core strategies for an Internet business to be successful. He suggests that giving the customer more choices is in the best interest of the e-commerce firm. In examining dot com failures, hindsight indicates otherwise. Giving away too much bargaining power to the consumer has an adverse affect on the firm and the industry as a whole. Mahadevan (2000) also states that the pure-play has larger margins than do the brick-and-mortar firms. This may have been true initially, but at present the margins of pure-plays are thinner or negative in relation to the large “brick and mortar” firms. We believe that pure-play firms can still survive in today’s economic conditions. However, they must follow certain basic business strategies as outlined by Porter model.

## **A Framework for Dot-com Enterprises**

The dot-com enterprise analysis framework, shown in Figure 1, will be used to compare our sample companies by placing them in a two-by-two matrix. The variable “use of Internet strategies (Porter’s)” is based on a scale from *low* to *high*. It reflects how well companies took advantage of the strategies explained below. A *low* rating means that a company used some or none of the strategies, whereas a *high* rating means a company utilized a majority of Porter’s strategies. The variable is the “financial outcome” is also based on a scale from *low* to *high*, centered on the profitability realized by using these strategies. The two-by-two matrix represents a graphical depiction of how each company fared during the time period covered by this paper (between 1999 and 2001).

Business strategy information on the eight companies for this exploratory study were collected by reviewing news articles and reports published in trade journals, such as *ComputerWorld*, *NetRatings*, and *ZDNet*. The financial data were collected from the SEC filings, such as *10-Q* and *10-K* reports of these companies.

The quadrant ‘*well-positioned*’ is the desirable square for a company to be in. Companies that are middle to high in their utilization of Porter’s strategies and have realized greater financial gains reside in this category. The square ‘*caution*’ means that a company is getting mid to high monetary gains while ignoring the outlined strategies. Companies in this position should be cautious of what the future may hold. The quadrant ‘*not hopeful*’ is where a company chooses to ignore the fundamentals and as a consequence it is likely to fail. In the ‘*improving*’ position, companies are headed in the right direction with their use of Porter’s business strategies but as of yet have not been able to capitalize on these financially.

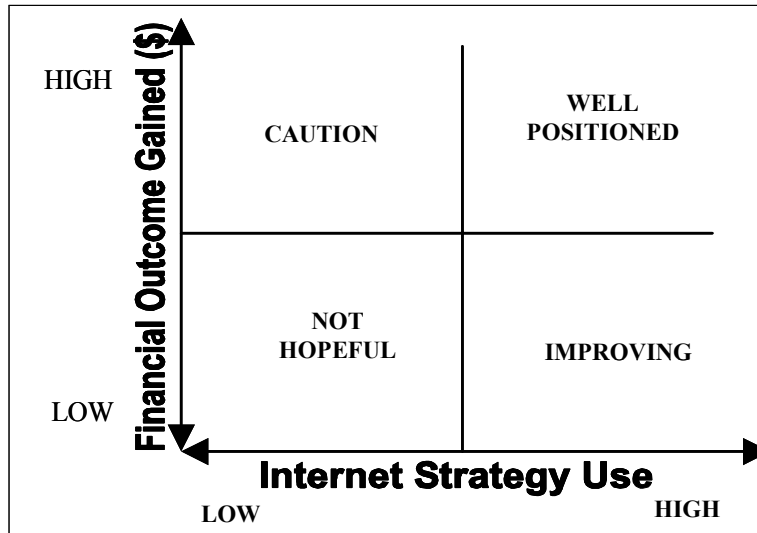


Figure 1. Dot-com Enterprises Analysis Framework

## Exploratory Study

This section provides an overview of six of the eight companies reviewed in our study. Companies were selected and paired by industry to provide a consistent basis for comparison.

### *Pets.com vs. Petco*

Pets.com, an Internet pure-play was founded in February 1999, went public in February 2000 and ceased operations in November 2000. The entire lifetime for this company was 1½ short years. Pets.com sold pet supplies solely through their e-commerce website. In the first half of 2000, Pets.com had revenues of \$16.4 million and a net loss of \$63.1 million.<sup>2</sup> Petco is a brick-and-mortar pet store that originally purchased a 20% stake in Internet pure-play, Petopia.com. This strategic partnership instantly turned Petco into a clicks-and-mortar firm. In December 2000, Petco acquired the remaining assets of Petopia.com thus reining in all online activities to be managed internally. The online extension is marketed as Petco.com where they sell pet supplies as well as provide advice for pet owners and directions to local Petco stores in case consumers don't want to shop online or need to return an item. In the first half of 2000, Petco had revenues of \$527.9 million and a net gain of \$9.1 million.<sup>3</sup>

**Industry Structure:** When comparing the barrier to entry between these two pet supply retailers, Pets.com was not in a unique situation with their e-commerce concept. Half a dozen major competitors (Petstore.com, Petopia.com, Petsmart.com, PetPlanet.com, and Allpets.com) sprang up at the same time or shortly after Pets.com opened its virtual storefront. Petco, on the other hand, has a traditional brick-and-mortar storefront that increases the barrier to entry. The advantage to Petco was that it possessed a traditional retail channel and by duplicating the efforts of Pets.com, it now has as an e-commerce channel as well.

Petco has two ways to sell pet supplies to the public. The potential consumers that weren't within commuting distance of one of their 500 brick store could still order pet supplies from them over the Web. Pets.com had one way to sell its goods, the Internet. Not everyone in the United States (US) has a computer or Internet access. According to Nielsen/Net Ratings,<sup>4</sup> for the month of July 2001 there were 165.2 million people in the United States that had home Internet access. With a total population of 285

<sup>2</sup>SEC filings, Pets.com, Form 10-Q, Quarterly report ending June 30, 2000.

<sup>3</sup>SEC filings, Petco Animal Supplies, Form 10-Q, Quarterly report ending July 29, 2000.

<sup>4</sup>"July Internet Universe", www.nielsenetratings.com, NetRatings, Inc., July 2001.

million people,<sup>5</sup> this equates to 58% of US population. This means the potential customers of Pets.com would be smaller than those of Petco's with its two sales channels. In addition, Petco can easily lure some of its' existing buyers to purchase online while Pets.com had to attract new customers all the time.

Advertising cost was another factor. Darrell Rigby of Bain, a Boston consulting firm, states that traditional retailers commonly spend between 3% and 5% of revenues on advertising. In 1999, Pets.com spent \$460 on advertising for every \$100 of revenue.<sup>6</sup> Without a store near every mall in America, pure-plays have to obtain brand recognition in the market in a more expensive manner. This cuts into the bottom line quickly.

In terms of the bargaining power of suppliers and buyers, the company that competes on price alone, the buyer always wins. Pets.com operated on a negative gross margin. In the first quarter of 1999, their operating loss was more than \$5 for every \$1 of merchandise sold.<sup>7</sup> They had to reduce the selling price of most of their products below the original cost of the goods in order to compete and capture sales from the public. They were going on the premise that they could make up the loss in volume. Petco doesn't have to sell their products at a loss. The reason being is that they have greater bargaining power over the suppliers than Pets.com. With over 500 brick establishments and a billion dollars in annual revenue, Petco can purchase pet supplies at a much lower cost. They can and did use this to their advantage by undercutting the selling prices of Pets.com.

**Sustainable Competitive Advantage:** Opening a virtual store is easy; it's much harder to differentiate yourself from competitors. Pets.com offered other things on their website besides merchandise. They offered advice, information and even entertainment. Petco had similar services and offerings on their site. The one thing that Pets.com didn't have was an actual store to go to in order to browse around, handle merchandise, or talk face-to-face with a live person. It was easy for Petco to duplicate the online experience of Pets.com. It was impossible for Pets.com to offer the reverse. It appears that the majority of consumers still have the desire to go to a brick-and-mortar pet store to get their food and flea collars. Therefore, it would be safe for us to say that Petco had superior operational effectiveness.

Both Petco and Pets.com adequately provided the consumer what they needed in pet supplies. Neither one was the only supplier in this retail market. Petco was in a better strategic position because it offered a marginally higher value to the consumer by way of their traditional stores. Not everybody has access or wants to shop online. Even customers that do, may have a need to return merchandise easily or want to handle the product before they make a purchase. The ability to do these things could be considered a unique value by some consumers.

Pets.com didn't have any hope of being able to compete solely on the basis of price with Petco. The firm that pays less for supplies usually wins a price war. Pets.com could not sustain a price battle with its negative margins. They thought that this was the only way to compete with the brick-and-mortar firms. If they could gain a substantial customer base of repeat buyers, then they could eventually raise their prices to become profitable. Unfortunately for Pets.com, Petco, with their greater buying power, could compete on a price basis. In addition, the shipping costs for bulky pet foods far outweighed the tax savings to Pets.com. This provided Petco with an improved strategic position over Pets.com.

### ***eToys vs. Toys R Us***

eToys, an Internet pure-play, was incorporated in November 1996, went public in May 1999 and ceased operations in March 2001. They focused their e-commerce on children's products, including toys, video games, books, software, music, and baby-oriented products. They owned a subsidiary called Baby Center where they concentrated on the market of expectant parents. They launched eToys.co.uk in the United Kingdom in October 1999 and babycentre.co.uk in March 2000. In contrast to pets.com, eToys had been around a lot longer and was more established in their global growth strategy. eToys had total revenues of \$151 million and a net loss of nearly \$190 million during fiscal year ending March 31, 2000.<sup>8</sup>

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<sup>5</sup>United States Census Bureau, US Department of Commerce, www.census.gov, September 2001.

<sup>6</sup> Kelly, Erin, "The Last e-Store On The Block", Fortune, September 18, 2000.

<sup>7</sup>Koudsi, Suzanne, "Why Is This Sock Puppet Still Smiling?", Fortune, June 26, 2000.

<sup>8</sup>SEC filings, eToys, Form 10-K, Annual report ending March 31, 2000.

Toys R Us is a brick-and-mortar toy store that launched its toysrus.com subsidiary in June 1998. The company sells toys, games, computer software, video systems and software over the web and in its more than 1500 brick establishments around the world. The online subsidiary is wholly owned by Toys R Us and has a strategic partnership with Amazon.com to build and maintain a co-branded website. Toys R Us had total revenues of \$11.9 billion and net income of \$279 million during fiscal year ending January 29, 2000.<sup>9</sup>

**Industry Structure:** eToys had many of the same woes that Pets.com experienced in its short business life. Since it conducted all of its sales generation from its website, the barrier to entry was low, leaving the door open for competitors to move in (RedRocket.com, Kbkids.com, Zany Brainy, SmarterKids.com Toysmart.com, to name a few). Toys R Us has over 1500 brick-and-mortar stores to fall back on if the competition gets too tight for their e-commerce venture. Toys R Us also has that advantage of being in two different sales channels, traditional and online. eToys doesn't have such a luxury.

Like Pets.com, eToys operated with a negative gross margin. A breakdown of their financials for 1999 reveals that for every \$100 in revenue, \$81 was spent on product cost and customer shipment, \$29 on website maintenance and technology, \$37 on advertisement, and \$33 on order completion.<sup>10</sup> Toys R Us has the advantage of greater buying power with the toy suppliers, thereby allowing them to purchase bulk toy items at a lesser cost than eToys. Again similar to Pets.com, eToys competes on price, which contributes to the ruin of most pure-plays.

One of the advantages held by eToys was their overall sales revenues. In 1999, eToys had total revenues of \$151 million, which was greater than the \$49 million generated solely from toysrus.com website. Due to the strategic actions of Toys R Us, this advantage held by eToys would vaporize quickly. Toys R Us aligned with Amazon.com the next year to operate a co-branded website under Amazon's Toy website. In 2000, Toys R Us CEO, John Eyler, announced that toysrus.com produced approximately \$180 million in net sales for the year.<sup>11</sup> At the same time of this announcement, eToys ceased operations.

Toys R Us was good at handling the threat of substitute products. It duplicated some of the strategies that eToys was using such as easy access to consumers and steering purchases to higher margin items. Then Toys R Us actually improved these strategies steering the consumer into the brick-and-mortar store. They successfully cut off this threat against eToys.

**Sustainable Competitive Advantage:** Here again, the operational effectiveness is a non-issue. Toys R Us imitated the online operations of eToys so quickly that all the strategic advantages that eToys once had were now out of the picture. Toys R Us did not get the duplication perfect when they launched in 1999. At the start of the critical Christmas season, Toysrus.com crashed under heavy Internet traffic and in the last few days before Christmas, a technical problem caused almost 5% of consumer's orders to miss the December 25<sup>th</sup> deadline. These mishaps allowed eToys to have one more banner year online. Toys R Us would never again let that happen.

Both companies provided customers with a selection and supply of toys for purchase. Neither retailer was the only game in town for getting toys. Although eToys was performing better financially than Pets.com, Toys R Us was doing a better job in applying Porter's strategic fundamentals. If you get your pet dog, Fido, the wrong flavor of doggie treat, chances are that he isn't going to complain enough for you to have to return the box to the pet store. The same premise is not true for your child. If you happen to get the wrong action figure character or the wrong Barbie, you will have to return it for the proper one. Although eToys could handle returns, Toys R Us allows instant exchange.

Seema Williams of Forrester Research in Boston states that consumers who visit a website of a major click-and-mortar are likely to spend 20% to 30% more in the physical store. This does not bode well for those companies such as eToys who do not have a brick store. eToys was closer to success with their business methodology than Pets.com, but they too could not compete on price alone. eToys did offer a different customer shopping experience than the traditional approach. If a consumer entered information pertaining to the child interests, eToys would then make suggestions of items that the child might like to have. This is unique value to some customers. The problem was that eToys was paying too much for the toys and in turn selling them for too little money.

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<sup>9</sup>SEC filings, Toys R Us, Form 10-K, Annual report ending January 29, 2000.

<sup>10</sup>Kelly, Erin, "The Last e-Store On The Block", Fortune, September 18, 2000.

<sup>11</sup>Chabria, Anita, "A Net Toy Story", The Industry Standard, March 16, 2001.

### **Webvan vs. Safeway**

Webvan, a pure-play, was started in December 1996, went public in November 1999, and stopped business on July 9, 2001. Webvan used its e-commerce website to take orders for food, non-prescription drug products, and general merchandise. The orders were routed to a distribution center and the goods were delivered to the consumer's door at a scheduled time. Webvan operated in eight different regions in the United States: Chicago; Los Angeles; Orange County, CA; Portland, OR; San Diego; San Francisco; Seattle; and for a short time in the Dallas/Fort Worth area. For the fiscal year 2000, Webvan had net sales of \$178.5 million with a net loss of \$453 million.<sup>12</sup>

Safeway, a brick-and-mortar grocery store, has a strategic partnership with Dallas-based GroceryWorks.com. In June 2000, Safeway and GroceryWorks signed an agreement for a strategic alliance in that GroceryWorks would become Safeway's exclusive online grocery channel. GroceryWorks is very similar to Webvan in the way it collects orders online and delivers the groceries to consumers. They currently operate solely out of the Dallas/Fort Worth area. Safeway operates 1688 brick establishments in the United States and Canada. Net sales for 2000 were nearly \$32 billion with net income of \$1.1 billion.<sup>13</sup>

**Industry Structure:** The online grocery industry was not as open as some of the other Internet retail segments. The barrier to entry was a little higher. An online grocery firm could not merely build a website and start selling items to the entire United States out of a single warehouse like a Pets.com or eToys. Groceries consist of some perishable products that need to be delivered within a close time frame to avoid spoilage. This means high-tech warehouses must be built near the consumers that are ordering. The barrier is still not as high as it is for a brick-and-mortar firm but it is considered high.

There were only two major pure-plays in this segment: Webvan and HomeGrocer.com. In September 2000, Webvan acquired HomeGrocer. On the clicks-and-mortar side, Safeway owns 50% of GroceryWorks.com. Due to the localized service involved with online grocers, the bargaining power of the buyers was not as strong as with other e-commerce models. For the most part, there was only one game in a single area where a consumer could order produce online and have it delivered. The online grocers were competing directly with brick-and-mortar establishments and the latter doesn't deliver. If people wanted to buy milk and bread over the web and have it delivered to their house, then there was typically only one company out there that could do this. It was either pay the price or get into a car and go to the corner convenience store or grocery store.

The suppliers had the bargaining power over the pure-plays. The online grocers did not have bulk buying power yet, as did the brick-and-mortar chains. Therefore the cost of goods was higher for Webvan than for Safeway. Although customers did not seem to mind paying a higher price for their delivered groceries, the difference in costs incurred did have a bottom-line effect on the margins of Webvan. It was not feasible to pass all of the higher costs for product off onto the consumer, as this would have turned away potential customers. Webvan needed all the customers that they could get. GroceryWorks.com had the established warehouses in place and could obtain supplies at a lower cost through the affiliation with Safeway.

**Sustainable Competitive Advantage:** Webvan had the edge on its clicks-and-mortar competition. Webvan offered the same product as local brick-and-mortar firms but did it one step better by coming to your house and dropping off your groceries. Clicks-and-mortar firms cannot easily match this. In fact, Safeway shut down its GroceryWorks.com site temporarily in order to study the business in further detail before moving forward. They have signed an agreement with Tesco, the English grocer that operates the successful online venture. In exchange for an equity stake in GroceryWorks.com, Tesco will share any intellectual property and strategies that they have learned or honed from their online division.<sup>14</sup>

Webvan had a better strategic position than all its competition, despite the fact that it did not have any brick-and-mortar ties. It was in most cases, the only supplier in local areas for this service. It provided busy customers exactly what they needed in an online grocery store. It offered a unique value to consumers by providing a convenient way to shop for fresh food without having to go the local, often busy grocery store. People who worked most of the time or who were shut in or who possessed certain medical conditions now had a way to get necessary food items without going out themselves or calling on a relative to do it.

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<sup>12</sup>SEC filings, Webvan Group, Form 10-K, Annual report ending December 31, 2000.

<sup>13</sup>SEC filings, Safeway, Form 10-K, Annual report ending December 30, 2000.

<sup>14</sup>Weiss, Todd R., "Safeway Turns to British Counterpart for Online Help", Computerworld, July 16, 2001.



People were willing to pay a higher price for a service like this. There were no margin wars with the competition because the two were like comparing apples to oranges, dissimilar types. The industry competed on exceptional value and not price.

Webvan's major problem was that they wanted to grow too rapidly. Trying to be in eight different areas at the same time without proving their business model in just one region spread the firm too thin. In contrast, HomeGrocer.com did the right thing by staying small until they were sure that their business could become profitable. This strategy was quickly lost on Webvan's executives. After the merger with HomeGrocer.com, Webvan needed new warehouses in every delivery area in order to make the process work. A clicks-and-mortar firm already has a distribution system, warehouses and retail stores (acting as temporary storage divisions) set up across the States to facilitate the moving of product into an area. These warehouses are expensive, costing up to \$30 million apiece.<sup>15</sup> When the venture capital money dried up, so did the expansion plans. If Webvan had concentrated on a smaller initial audience, perhaps they would have survived. Also, Webvan had to convert all of these sites to their own technology. The sites quickly lost money due to once loyal HomeGrocer.com consumers no longer using the new service.

## Conclusion

Our preliminary analysis indicates that the clicks-and-mortar firms were better positioned to gain a positive financial outcome from their Internet branches than their counterpart pure-play firms (See Figure 2). Since they were well established before they got into conducting e-commerce, they were already using some of Porter's strategies. They had the buying power and brand recognition to go along with the new Internet sales channel. They were well versed in providing the customer exactly what was needed and were in a position to compete on unique value, not price. When the Internet came along they were able to capitalize on the situation, rather than spending considerable dollars to build an e-commerce site from scratch like the pure-plays.

The exception to the above analysis was Safeway and Webvan. Webvan actually utilized and benefited more from Porter's strategies than Safeway. If Webvan would have set their sights smaller and proved out their business model in fewer markets, they may still be around and could possibly be generating a profit. They certainly had larger Internet sales revenue than the competition with FY2000 numbers of \$178.5 million. Before smaller-focused HomeGrocer.com was acquired, they were nearly break-even on the year. Webvan could have been in that position if thoughts of grandeur hadn't clouded their vision.

An important point to note is that none of the brick-and-mortar firms break out their sales and income data for their Internet subsidiaries. They state earnings for the company as a whole. It would be useful to get an actual financial comparison between pure-plays and the clicks-and-mortar subsidiaries.

By adhering to the Porter strategies outlined in this paper, an Internet firm can be successful. There are few pure-plays left that are not struggling to make a profit in the "old" new economy. The ones with the best chances seem to be steering more toward the traditional business model that follows a sound strategy. This paper represents an initial investigation in this area. More research including a wider sample of companies is necessary before we can justify our conclusions.

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<sup>15</sup>Farmer, Melanie and Sandoval, Greg, "Webvan bags it for good", ZDNet, July 9, 2001.

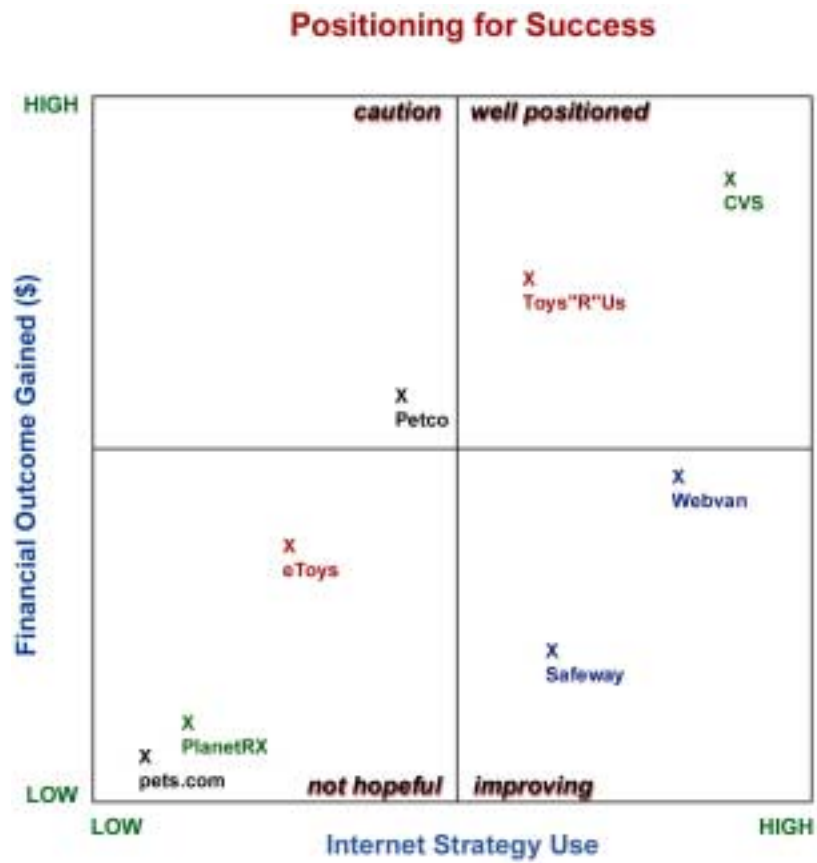


Figure 2. Framework and Positioning Matrix of Comparison Companies