



Strategic Analysis of Jet.com Acquisition by Walmart

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Introduction

Jet.com's meteoric rise from a young e-commerce startup founded by a Wharton alumnus in July 2013 to an acquisition by Wal-Mart in August 2016 is a living reminder that corporate acquisition is an important strategic option when trying to inject growth into an established firm. Indeed, Wal-Mart's own website never caught on with younger online shoppers, and the company was eager to fix the mistake they made when they let themselves get outbid and lost Diapers.com to Amazon. Marc Lore, a genius entrepreneur with Wharton pedigree, and Nate Faust, a brilliant logistics guru who went to HBS, were a juicy target and last hope to make Wal-Mart's online business attractive to the millennials who grew up with Amazon as the default choice for shopping online. In this paper we are going to set up a framework and then analyze whether the acquisition of Jet.com made sense from multiple angles, including the auction overpayment model, branding for millennials, logistics integration and true costs of post-acquisition integration. First, though, we start off with the background of Wal-Mart itself, as well as the backstory on Marc Lore's previous successful exit, Diapers.com.

Wal-mart Overview & Industry Changes

Wal-Mart Stores, Inc., doing business as Wal-Mart, is an American multinational retailing corporation that operates as a chain of hypermarkets, discount department stores, and grocery stores¹. Headquartered in Bentonville, Arkansas, the company was founded by Sam Walton in 1962. As of January 31, 2017, Wal-Mart has 11,695 stores and clubs in 28 countries, under a total of 63 banners. The company operates under the name *Wal-*

¹ <https://en.wikipedia.org/wiki/Wal-Mart>

Mart in the United States and Canada. It operates as *Wal-Mart de México y Centroamérica* in Mexico and Central America, as *Asda* in the United Kingdom, as the *Seiyu Group* in Japan, and as *Best Price* in India. It has wholly owned operations in Argentina, Brazil, and Canada. It also owns and operates the Sam's Club retail warehouses.

Wal-Mart is the world's largest company by revenue, according to the Fortune Global 500 list in 2016, as well as the largest private employer in the world with 2.3 million employees. It is a family-owned business, as the Walton family controls the company. Sam Walton's heirs own over 50 percent of Wal-Mart through their holding company, Walton Enterprises, and through their individual holdings. Wal-Mart is also one of the world's most valuable companies by market value, and is also the largest grocery retailer in the U.S. In 2016, 62.3 percent of Wal-Mart's US\$478.614 billion sales came from its U.S. operations.

Because of its massive size and the resulting Innovator's Dilemma, Wal-Mart has been struggling to adapt to the changing landscape of retail in the United States, where upstarts like Amazon quickly grew from a fringe online-only bookstore in 1994 to a service with US\$135.98 billion sales in 2016 (see **Exhibits 1 & 2**), sprawling from same-day delivery in many metropolitan areas to on-demand movies and music, with the convenience of never having to go to a brick-and-mortar store that is so coveted by the millennial demographic. Wal-Mart's several attempts at catching up proved unsuccessful, and in 2015 Amazon surpassed Wal-Mart as the most valuable retailer in the United States by market capitalization².

² <https://en.wikipedia.org/wiki/Amazon.com>

Making of the Deal

Jet.com was founded by Marc Lore with the aim of creating a club-type membership model in the ecommerce space, specifically targeting the Millennial consumer with aggressive marketing campaigns promising a dynamic pricing model that passed along product selection driven savings back to the consumer. Marc founded Jet.com with the belief that e-commerce was not a winner-take-all-market and a differentiated competitor could scale and succeed despite competing with Amazon. Marc's intention from the outset was to stay focused on becoming the #1 in e-commerce platform in the United States, before expanding scope or geography, create an experience that empowers customers through cost transparency to make smart shopping decisions, position Jet.com as the go-to destination for all online product purchases, and to build member trust by never profiting from transactions, only from membership fees.

E-Commerce has been crushing the brick and mortar retail channel, with year over year exponential growth. Many of Wal-Mart's traditional competitors, from Kmart Sears to JC Penney, were one by one falling by the wayside, in it's path. Wal-Mart is the 800-lb gorilla in the traditional brick and mortar retail space, but was growing ever more vulnerable to Amazon's meteoric rise, struggling to gain proportional footing in the e-commerce segment. The Millennial generation was growing ever more relevant in retail (as a percentage of the overall U.S. population, Millennials have already surpassed the Baby Boomers in size) and for Millennials, Amazon was the go-to means of making purchases, not Wal-Mart. In fact, Wal-Mart had thus far failed to connect with this critical segment almost entirely.

For Wal-Mart, Jet.com represented a possible answer to both these challenges. Marc Lore's past experience uniquely qualified him to disrupt the Direct to Consumer e-commerce segment and take on Amazon. Marc had, prior to establishing Jet.com, founded Diapers.com and Soap.com, which he had sold to Amazon. Post sale, Marc stayed on at Amazon and worked directly for Jeff Bezos for five years. Wal-Mart had missed the opportunity to acqui-hire Marc, in the last go around, Diapers.com and Soap.com, to Amazon's benefit and through Jet.com hoped to not make that mistake again. The downside risk to Wal-Mart was relatively small, recognizing that even \$3.3 Billion represents a small fraction of Wal-Mart's market value and liquidity, while the upside potential of a concerted effort to make up for lost ground to Amazon, led by Marc Lore, could possibly ensure Wal-Mart doesn't follow the same fate as many of its brick and mortar peers.

Wal-Mart acquired Jet.com for \$3.3 billion in cash and stock, which is largest ever purchase of a US e-commerce startup. The \$3.3 billion acquisition, announced in August 2016, was struck within months of Jet.com having raised funding at a relative valuation of \$1.3 billion. On the face of it, Wal-Mart paid a full, if not frothy, price for Jet.com. In conversation with Michael Aronson, Managing Director of MentorTech Ventures, an early investor in Jet.com, we've come to learn, that Wal-Mart had initially intended to pay no more than \$2 Billion for Jet.com. The challenge was that Jet.com had recently closed a funding round and its new investors would have wound up with a minimal return. Ultimately, Wal-Mart agreed to pay \$3.3 Billion essentially to acquire Marc (& Nathan) personally, to lead their Wal-Mart.com effort.

It's important not to overstate Jet.com's, and Marc Lore's, value on its own, in a vacuum, but to recognize that taken together with Wal-Mart's vast resources and capabilities, it may very well be the only plausible effort, potentially positioned to dethrone, or at the very least make a material dent in, Amazon. That said, it will by no means be an easy feat. In the Brick and Mortar channel, Wal-Mart is renowned for its operational efficiency and for its supply chain excellence. However, in the direct to consumer space, quite frankly, Amazon had built a seemingly impenetrable moat. Amazon has registered as an NVOCC to facilitate the movement of product from place of manufacture directly to their FBA fulfillment centers, enabling Chinese factories to sell directly on their platform. Furthermore, they've placed their fulfillment centers in close proximity to most major population centers in the U.S. and manned them with proprietary Kiva robots, that drives down the cost of picking, packing, and shipping a single toothbrush being delivered to a consumer's front door. In addition, Amazon has acquired a fleet of planes and already begun to take in-house the outbound delivery portion of the process, potentially offering faster delivery possibilities and at a lower cost. Wal-Mart, at the time of the acquisition, had none of that. In fact, Wal-Mart was getting by, by requiring its U.S. based vendors, through its DSV program, to fulfill directly to the Wal-Mart consumer, on its behalf, without all this cost saving infrastructure; an unsustainable proposition to say the least. Jet.com does nothing to solve any of these challenges. Even if Jet.com proves effective in getting Wal-Mart into millennial homes with a wider product selection and a "better" brand, that doesn't mean it could fill those orders at a cost on par with Amazon.

Considering all the aforementioned, one could ask, what exactly was their plan. Why spend \$3.3 billion on an effort that is doomed, before it even gets off the ground. Fortunately, we can see from the steps taken, by Wal-Mart and Marc Lore, to date, that in fact all is not lost after-all. Specifically, aside from the nearly 30% increase in e-commerce sales, reported in Wal-Mart's last quarter, and the various acquisitions of additional e-commerce platforms, Wal-Mart has taken many steps on the back-end of it's business, to position it for success. Some examples of what we've seen so far are as follows:

- 1) Wal-Mart has transitioned most of their vendors from net-30 day terms, to 90-120 payment terms, essentially leveraging their vendors' capital to help facilitate this mammoth focused catch up effort in the e-commerce channel.
- 2) Wal-Mart has broken down the walls between its e-commerce division and its in-store purchasing efforts; leveraging its experienced category buyers and Wal-Mart's obvious purchasing power, to ensure that its e-commerce offerings are competitively priced.
- 3) Wal-Mart implemented a requirement that, no products can be sold in-store, unless it too is available online at Wal-Mart.com.
- 4) Wal-Mart partnered with couriers such as FedEx or UPS, who now see their business with Amazon at potential risk, in light of Amazon's entry into the package delivery business, to offer attractive shipping terms to consumers.
- 5) Wal-Mart has recently implemented a new chargeback policy with its vendors that requires all vendors to deliver at least 95% of its merchandise by the Must Arrive by Date (MABD), or suffer a 3% deduction. Essentially, positioning Wal-

Mart's distribution centers and stores to act as a competitive advantage against Amazon.

- 6) As a continuation of the above, we've already seen Wal-Mart announce that its now offering an in-store pickup option for purchases made online, at a discount. Saving itself and the consumer the expensive courier costs, in a fashion that Amazon can't completely replicate.
- 7) Furthermore, its only a matter of time before Wal-Mart takes that very same competitive advantage to its ultimate end, and offer consumers a same day delivery option, instead of, or in addition too, in-store pickup.

All in all, its safe to say, that at a minimum, Wal-Mart and Marc Lore, had a plan and a vision at the time of the acquisition of Jet.com, as to how they can leverage their combined resources and capabilities, to leap ahead in the e-commerce space.

Acquisition Analysis

Wal-Mart acquired Jet.com for US\$3.3 billion in cash and stock, including a contingent payout. Under the terms of the transaction, Wal-Mart paid US\$3 billion in cash, and would pay an additional US\$300 million worth of Wal-Mart shares over time. The purchase price set a record for the largest acquisition of an e-commerce start up.

Since launching in July 2015, jet.com had grown to a marketplace for 1,600 sellers offering 10 million products. The company had registered \$1.0 billion in Gross

Merchandise Value at the time of acquisition³ and was adding 400,000 shoppers on a monthly basis.

On financial metrics alone, however, Wal-Mart paid an extremely high price for jet.com. Despite the meteoric growth metrics, at the time of acquisition, Jet.com was not yet profitable and had a high cash burn rate. It has been valued at \$1.5 billion or less than half the value that Wal-Mart paid less than nine months earlier by a suite of existing and new investors.

However, a larger driver of the acquisition was the desire to acquire the management team. Through their experience at Quidsi and Diapers.com, Marc Lore and his executive team had proven their ability to grow and scale e-commerce businesses – precisely the area in which Wal-Mart was lagging. Consistent with this goal, Marc Lore became Executive Vice President, President and Chief Executive Officer, E-Commerce Wal-Mart. This was despite the decision to keep jet.com as a separate brand and business line.

The success of a talent acquisition depends first and foremost on a company's ability to retain the talent in question. As part of the deal, Wal-Mart issued 3.5 million Wal-Mart shares to Marc Lore, to be paid over a five-year period. The restricted stock units were a portion of the US\$300 million of equity consideration related to the deal. Under the terms of the agreement, Lore would have to pay back a significant chunk of his share of the \$3.0 billion cash payment and forfeit unvested interests if he left before five years. Wal-Mart structured the \$300 million pay out vesting over a four year period. Lore's 3.5 million options vested 10% at closing, 15% in year 1, 20% in year 2, 25% in year 3 and 30% in year 4. Wal-Mart created an accelerating vesting schedule to create

³ Business Insider, April 19, 2016 ([Link](#))

incentives for him to stay for the five year period. In aggregate, our analysis suggests Marc Lore could have received as much as \$660 million in compensation by staying at Wal-Mart for five years.

Acquisition Alternatives

To set up its e-commerce business for success, Wal-Mart had three main options – focus on organic growth, joint ventures with third-parties or acquisitions. Wal-Mart had focused on organic growth prior to the jet.com acquisition with limited success. For the record, at \$13 billion in revenue, Wal-Mart’s e-commerce business was the 2nd largest e-commerce business in the United States, second only behind Amazon at \$79 billion⁴. However, Wal-Mart’s e-commerce growth rates had been anemic relative to Amazon and ebay. Several reasons contributed to this. Wal-Mart did not focus on e-commerce for many years after it began to take off. Even until recently, e-commerce was not a core focus area for management. This meant competitors out-invested in infrastructure necessary to succeed in dispersed delivery, infrastructure that is significantly different from what Wal-Mart had invested in to service its stores. Companies like Amazon also out-innovated Wal-Mart and created a better virtual user experience relative to Wal-Mart’s tired online feel and look. Given the low credence “online” was given in the Wal-Mart hallways, an organic approach to e-commerce was unlikely to be successful.

Wal-Mart could have considered an alliance. In order for it to move the needle for Wal-Mart, the JV partner would be of a certain scale. Ideally, the company would be an e-commerce only company rather than a company with a clicks and mortar business

⁴ eMarketer, March 7, 2016 ([Link](#))

model. The largest US e-commerce (only) companies in 2016 were Amazon (\$79 billion), QVC (\$4 billion), Wayfair (\$2 billion), HSN (\$2 billion), Overstock.com (\$2 billion)⁵. Amazon is Wal-Mart's primary competitor and there is little reason either would consider a joint venture. While the other companies are potential candidates, they are reasonably established businesses and unlikely to be the high-growth scalable engine that Wal-Mart was looking for.

An acquisition or a series of acquisitions would give it the best chance for e-commerce success. An acquisition would allow Wal-Mart to choose a built-for-purpose company that was building a comparative advantage in e-commerce, something Wal-Mart itself lacked. As the chart in **Exhibit 3** depicts, the Jet.com acquisition gave it an opportunity to acquire its way to the positioning frontier in e-commerce.

Implementation Planning

With \$3.3 billion invested and the strategic vision to win in the ecommerce space, it is critical for Wal-Mart to understand the challenges ahead of them and construct an approach to have a successful post-acquisition implementation. Our analysis considers three key areas that Wal-Mart should focus on to ensure that the value anticipated in the pre-acquisition analysis is actually realized in the post-acquisition process: the blending of two cultures, repositioning their brand and leveraging logistics and distribution.

⁵ Source: eMarketer

Blending of Two Cultures

The Wal-Mart culture was digitally challenged, hence the need for its acquisition of ecommerce attacker, Marc Lore. Lore, aware of the company's gaps, replaced the Walmart.com team with Jet.com on day one, to ensure the digital manpower was there to fuel his vision. This may have been a necessary step, as it is a fair conclusion that the existing team did not necessarily have the skillset that Lore needed. However, for Wal-Mart and Lore to be successful in this merger, the ecommerce business needs to blend with the other divisions of the company – e.g. logistics and distribution, marketing, and suppliers. Without coordinating and synchronizing the two businesses, the Company will not be able to realize its full potential.

To build a cohesive and collaborative business between the legacy company and the new digital company, Lore should implement three key items from our course learnings: (1) build communication governance and checkpoints between the ecommerce team and the rest of the company to ensure alignment on vision and success metrics; (2) increase transparency and inclusion between the divisions to build trust between the two cultures; (3) create opportunities for internal Wal-Mart staff to integrate with the ecommerce team (Jet.com) to unite the team (i.e. shared projects, shared services). Being visionary and strategic for their digital stake will help the company compete in the short-term, however, becoming collaborative and united will help them dominate and progress in the long-term.

Brand Repositioning

Jet.com has built a name for themselves with both suppliers and customers in the ecommerce space. Jet.com grew its customer base of urban and millennial customers with more than 400,000 new shoppers added monthly and an average of 25,000 daily processed orders. Jet also had over 2,400 retail and brand partners and they had over \$1 billion in sales in the first year of business.⁶

To maintain this rapport that Jet.com has and which Wal-Mart struggles with, the post-implementation needs to ensure the company relaunches its ecommerce brand for Wal-Mart with similar commitments from Jet.com, while maintaining co-branding in the medium term. The new ecommerce site for Wal-Mart should maintain the winning aspects of Jet.com to maintain trust by maintaining price transparency (via comparisons) and price options (lower costs based on spend type). The company needs to invest in specific resources to measure and monitor the type of customers it wins and retains, as well as commitment to agile tactics to alter any deviations to its ultimate target of Millennial. Additionally, it must maintain ease of purchase, through investments into technology. The advantage that this deal has is that Lore will maintain his leadership position for the first five years per the contract of the acquisition, which is the biggest advantage to help build the bridge for the millennial segment.

Logistics and Distribution

Although behind in online presence, Wal-Mart's current distribution in the US can offer a competitive advantage in ecommerce margins. For example, with 90% of

⁶ <http://news.walmart.com/2016/08/08/walmart-agrees-to-acquire-jetcom-one-of-the-fastest-growing-e-commerce-companies-in-the-us>

Americans living fifteen minutes from a Wal-Mart store, Lore can find synergies in the existing Wal-Mart cost make-up to drive stronger online sales without compromising margins as Amazon does⁷. Amazon has recently launched brick-a-mortar locations, as they realize this channel is still a desired option for customers. While Amazon invests in test and learn strategies for their physical space, and drives costs up for its aggressive shipping commitments, Wal-Mart can integrate the digital in physical channels today without delay. This could be a compelling and feasible way for Wal-Mart to gain share of the ecommerce market, and even more compelling reason for Lore to approach his vision holistically versus in a silo to the ecommerce space only.

Overall, Wal-Mart and Jet.com have the foundation for a winning dynamic, and if both companies realize and focus on these three post-acquisition tactics, they will better solidify their seat at the top of the ecommerce industry.

Early Results

Just seven months into its acquisition of Jet.com, the merged companies have launched a number of strategic initiatives to make a splash in the Retail space. As mentioned prior, Wal-Mart has offered discounts to ordering online and picking up at the store to connect its digital and physical strategy (see **Exhibit 4**). Additionally, the company has lowered its annual membership price from \$50 to \$35 to compete head on with Amazon⁸. More interestingly, Wal-Mart has not stopped its acquisition with Jet.com and has started to compete with Amazon in acquiring new ecommerce

⁷ <https://www.statista.com/statistics/269425/total-number-of-walmart-stores-in-the-united-states-by-type/>

⁸ <https://www.fool.com/investing/2017/02/22/amazon-vs-wal-mart-which-has-the-better-shipping-d.aspx>

companies to increase its online sales. This year alone, it has closed on three new online sites – shoebuy.com for \$70 million, Moosejaw for \$51 million and Modcloth for \$71 million⁹ (see **Exhibit 5**).

Lore's tactics and Wal-Mart's acquisition expansion has seen some early signs of success in its fourth quarter earnings report, this past March. The Company reported that its ecommerce growth in Walmart U.S. was strong as sales and GMV increased 29.0% and 36.1%, respectively¹⁰. More importantly, Wal-Mart's online channel has finally closed the gap on its ecommerce growth in comparison to Amazon once Lore was onboard, showing early signs his value (see **Exhibit 6**).

As it has not even been a full year since the merger, to conclude the two have been successful would be misguided. However, Lore's quick wins and aggressive tactics are making the right signals to the retail industry, as well as increasing sales *fast* which could imply that the two have just scratched the surface of their success together.

Conclusions & Forward Statements

To conclude, we believe that while Jet.com acquisition might look expensive today, it gives Wal-Mart one of the best opportunities to compete with Amazon, especially after failing to build a successful internal strategy for Wal-Mart.com website. Indeed, the pre-acquisition Wal-Mart was highly likely to miss an opportunity to win

⁹ <https://funglobalretailtech.com/news/quick-take-walmart-acquisition-spree-move-strengthen-online-presence/>

¹⁰ <http://news.walmart.com/2017/02/21/walmart-us-q4-comps-grew-18-and-walmart-us-ecommerce-gmv-grew-361>

millions of Millennials that are coming of shopping age, and are already starting to anchor to buying on Amazon.

The acquisition is also a great deal for the Jet.com team, as it provides them with the right scale in logistics, product offering, and talent acquisition. Successful e-commerce businesses, such as Amazon and Alibaba, have taught us that scale is key, as scale helps create a moat to protect the company against competition. Jet.com would have tough time growing as a stand-alone business, especially given intense competition from both Amazon and Wal-Mart. By joining a massive player, Jet.com gets instant access to billions of dollars of infrastructure and tens of thousands of vendor relationships, along with attractive terms on payables, etc.

Real conclusion can be drawn after integration is complete, but early signs are positive. If Wal-Mart manages integration well, and the Jet.com team is given sufficient autonomy while collaborating with key business areas, the combined business might become Amazon's formidable competitor very soon.

Exhibit 3. Walmart's relative cost position.



Exhibit 4. Walmart is now promoting in-store pickup of online orders.



Exhibit 5. Increasing scale through acquisitions



Exhibit 6. Walmart growth rate is up since acquisition.



* Overall revenue growth rate including all of Amazon's businesses.
 Source: Bloomberg/Fung Global Retail & Technology