TUCK SCHOOL OF BUSINESS AT DARTMOUTH
GLASSMEYER/MCNAMEE CENTER FOR DIGITAL STRATEGIES
Case #6-0017

Garden.com – At The End of the Runway

"Our objective is to be the leading online destination for gardening-related commerce, content and community."

-- Garden.com S-1, filed September 13, 1999.

"With all gardening, you're selling a promise, but if people can't see what they're creating, it's lost."

--Neil Grant, managing director, Ferndale Garden Center.

Introduction

Bill fidgeted in his seat as he spoke with controlled anguish about the pain of the past few weeks. "Last month we announced a restructuring effort that effectively reduced headcount here by 50%. Nothing I learned in business school prepared me to lay-off 11 of my 19 staff members. For some reason I didn't take any classes in "Massive Transition Management." It was a really tough thing to manage, but as Annie said so eloquently, "the sun'll come up tomorrow." Yet having to secretly plan the layoff of my best friends, even my wife, was almost more than I could bear."

Bill Pond, Director of Product Management, joined Garden.com in the summer of 1999. He left a successful position at Dell Computer two months before vesting $50,000 in stock options, to be on-board at Garden in time for its late summer IPO. He had no regrets when the IPO was delayed two months, since he was certain Garden would make it. In the etailing gold rush of 1999, Garden stood in a select group of virtual destinations that combined real content and community with commerce. Indeed the IPO went off as many had earlier that year, with the stock price doubling from its $12 base during its first day of trading. But it wasn't long before the market became hostile to etailers. The e-commerce sell-off in April 2000 pulled the stock below one-half of its IPO level and that price didn't last. As the summer rolled into fall, the stock slid relentless downward (Exhibit 1). Inside Garden, the management team planned and replanned how to reduce the capital burn rate. By the end of September with the stock below one dollar, the company announced a major restructuring,

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cutting the workforce by another 35% - bringing the head count down to 150 from its 300 spring peak. The cuts had been unusually painful for the tight Garden.com culture where few had left on their own even as the future dimmed. After the major layoff, movers worked over the weekend to quickly remove cubicles and equipment. Foiling the attempt to erase the sad memories, surviving employees erected tombstones on their cubicle walls to remember departed friends.

From the mezzanine that overlooked the converted warehouse in Austin TX, Bill gestured toward the center of the building where two of the founders, Cliff and Lisa Sharples, were meeting with some employees. Everyone was watching and waiting to hear about a feared final announcement. Garden.com was running out of cash and a board meeting was scheduled that evening to brainstorm the options. Rumors of possible buyers, investors, or shuttering the company were expected to be cleared by the next day, November 7, with a planned announcement. Already, many had noticed the early on-line business stories announcing the failures of two other highflying dot.coms – Furniture.com and Pets.com, and were wondering if they were next. As Monday afternoon dragged on, the office area below buzzed with the low hum of conversations and concern.

The office furniture and decorations of the workspace followed the funky bay-area motif, but piles of chairs and stacks of phones, computers and office equipment could be seen from above, hidden behind unused cubicles. Large vegetables were suspended from the ceiling over the cubes and in the center of the build a giant 20-foot stool towered over the room in a playful way. The stool was a custom-made prop for a multimillion-dollar TV advertising campaign that ran during the spring. Once viewed as a key to acquiring eyeballs and mindshare, the stool now stood as a mocking reminder of past excesses.

It was just hard for Bill to believe that it could all be coming to an end. “We felt like we had done the right thing. Our website draws more than half a million visitors a month, and we have won dozens of awards from researchers and the press, and consistently beat analysts' predictions of its financial performance. When times got tough last summer, we made changes and plans to bring the company to profitability by next year (Exhibit 2) and I think we really could make it work.” In meetings with employees and the press, Cliff Sharples strongly defended the decisions that rapidly burned through $50 million raised a year ago in the public stock offering. “We were on track every quarter. If we had known then that we'd never be able to raise another dollar for Garden.com until we achieved profitability, would we have made different decisions? Of course.”

Background and Company Description

Garden.com was the brainchild of three unemployed Northwestern MBA graduates. On a December evening in 1995, after buying their house and quitting their jobs, Cliff and Lisa Sharples, together with former classmate Jamie O’Neill, spent the evening drinking margaritas and dreaming about building an Internet related company. On the back of a napkin at the Iguana Grill in Austin, the idea for a gardening company sprouted. The concept was simple: sell products to consumers at a retail price and then ship them directly from the suppliers at a wholesale price: the virtual nursery. Customer orders for live plants, flowers, and bulbs would be simply passed to grower partners who would ship them directly to the customer. Gardening supplies and other related merchandise could be inventoried and shipped by Garden.com or directly from supplier based on the product attributes, volume, and supplier relationship.

Research indicated that gardening was a great business opportunity – the industry was fragmented, lacked a dominant player, and was a growing national past time. The trio formed Garden Escape and bought the domain name garden.com for $2,500. The company went online in March 1996, and in February 1999, Garden Escape changed its name to Garden.com. The Garden Escape name was kept for a print magazine the company published.

As the product and service offerings grew and Garden.com moved its headquarters out of the Sharples' house, the number of employees also expanded. Employees included a *Better Homes and Garden* editor, a landscape architect, and several horticulturists. A critical acquisition was Andy Martin. Andy designed computer software and a database system to deal with the supplier extranet and the e-commerce for Garden. His technological contributions played a key role in Garden's early success.

The company mission was to make the "Garden.com brand synonymous with the delivery of high-quality gardening and gardening-related products and services." The product offering included low-margin items such as live plants, shrubs, trees, bulbs, seeds, organic fertilizers, and pesticides as well as high-margin items like tools, furniture, garden ornaments, clothing, garden accessories, and a garden-inspired gift line.

The Online Gardening Opportunity

Gardening was one of the fastest growing hobbies in the US. According to the National Gardening Association (NGA), more than 67 million U.S. households in 1998 spent $46.8 billion on garden and lawn products and landscaping services - $30.1 billion spent on garden and lawn products alone (an increase from $26.6 billion in 1997). More encouraging was the fact that this growth stemmed from both an increase in the average consumer's spending from $418 annually to $452, and 3,000,000 new consumers to the industry.

The gardening industry's growth was led by the affluent baby boomers. These consumers expected high quality, variety, personalized service, and information in all of there retailing experiences. They were comfortable with shopping on the Internet and had little time to waste driving to traditional garden centers. Research had shown that online shoppers in such segments were attracted to convenience and were not very price sensitive. Women were a leading consumer demographic of garden and lawn goods. Women influenced 80% of all household purchases, and as women became more common adoptors of the Internet, their online buying levels were expected to grow.

Competition

Although online garden retailing represented an innovative approach for selling plants and specialty items, becoming a player in this fertile field was challenging given that large format home improvement retailers had already uprooted many of the 60,000+ commercial retail nurseries in the United States during the past decade. This shift from the local nurseries to home improvement superstores had left many in the industry questioning their future.

Traditional Local Nurseries

Traditional local nurseries had mixed results over the past few years. Although the industry's 50 largest lawn and garden specialty retailers reported an overall 4% increase in sales from 1997 to 1998, many nurseries liquidated their stores. When the 4% increase in sales for these traditional nurseries was placed in the context of the 21.7% increase for the total industry during the same period, it was apparent that the momentum was rapidly shifting to larger players. To compete, some nurseries drastically increased store size, while others added extensive Christmas merchandise to increase revenue during traditionally slow months. Other nurseries focused on the high-end garden market by stocking unique plants and supplies not found at the superstores. While this niche strategy worked for some, Exhibit 3 shows that it did not work for many nurseries.

Most local nurseries and gardening centers lacked the financial resources and volume to justify their own distribution network. Instead they relied on third-party suppliers for product offerings or grew their own stock. Suppliers tended to be small, geographically dispersed, and limited in their ability to distribute to a broad retail base. They typically had unsophisticated marketing and tracking systems, restricting their ability to make good supply decisions to match changing consumer tastes. These upstream inefficiencies inhibited local nurseries from offering the breadth and depth of products and services that could be obtained through the more efficient, integrated supply networks of the superstore. As a result, local nurseries and garden centers often had difficulty meeting gardeners' demands for product line breadth, accessibility, and price competitiveness.

Home Improvement and Discount Superstores

The Home Depot and Wal-Mart Stores together accounted for more sales of Lawn and Garden (L&G) supplies during 1998 than the remaining top-10 retailers combined (see Exhibit 4). Several factors led to this dominance, but the most important was price and convenience. Few nurseries could match the prices offered by high volume sellers and with new stores popping up daily in the middle of middle America, customers found it convenient to move their gardening purchases to the big format stores. Besides price, the largest competitors were all honing their marketing message. Home Depot benefited from hiring seasoned lawn and garden professionals along with its promotion of captive brands such as Vigoro fertilizers and Scotts lawn mowers. Likewise, Wal-Mart Stores had success with its licensing deal with Better Homes and Garden. Many customers visiting Wal-Mart focused on the Better Homes and Garden products, buying everything from water hoses to bulbs, flowers and seedlings. Better Homes and Garden also helped Wal-Mart with merchandising plans for each store ensuring that the types of plants and gardening accessories were well matched to the store location and climate.

Wal-Mart was not the only discounter to leverage licensing deals. K-mart, the number one L&G retailer five years earlier, had aggressively extended its Martha Stewart line from housewares and domestics to an impressive offering of outdoor furnishings and tools. Even Sears, which did not have outdoor garden sales areas, racked up impressive sales of its gardening tools. Lowe's benefited from a sponsorship with the HGTV cable network. Overall, home-improvement superstores and discount stores were formidable if not dominant players in the L&G arena.

The large bricks and mortar competitors all ran significant distribution systems. For example, Home Depot owned four traditional DC's located in Savannah, GA (approximately 1.4 million square feet); Cranbury, NJ (approximately 812,000 square feet); Ontario, CA (approximately 317,000 square feet); and Ontario, Canada (approximately 135,000 square feet). Home Depot also built a cross-docking facility in Philadelphia during fiscal 1998, where merchandise was received from manufacturers and immediately loaded it onto outbound carriers for store delivery. Most of Home Depot's high-volume vendors participated in their EDI program, representing over 75% of the superstore's total volume. Home Depot's EDI systems were used by the retailer to process orders to vendors, notify stores of expected product arrival times, and transmit invoice data from vendors and freight carriers to the Store Support Center.

Mail-Order Catalogs and Multi-Channel Online Retailers

During 1998, catalog sales accounted for approximately 10% of the $30 billion in total sales for the L&G industry. Although this segment had historically been dominated by established mail-order gardening catalogs such as Foster & Gallagher, Smith & Hawken, and Gardener's Eden, hotshot upstarts such as Martha Stewart Living Omnimedia had proven successful at broadening their offerings into the garden arena, pressuring traditional mail-order catalogers to implement web-savvy approaches to their current business models.

Gardener's Eden, a leading garden retail cataloger, believed it could expand into stores and online to grow their brand. According to Steve Strickland, Vice President of Marketing, "The web site and catalog drive people to the store, to touch it and feel it…. it offers a different service.adding stores and a web site are a way to add legs to our Gardener's Eden brand." An online presence for this type of retailer was a natural extension from their current capital resources – distribution centers and corporate infrastructure – and these resources were an advantage that Internet startups did not share.

It would take more than an Internet strategy and a Web site to compete against companies with mass appeal, such as Martha Stewart Living Omnimedia. Slated to go public during the fall of 1999, Martha Stewart boasted two magazines that reached nearly 10 million readers, an Emmy-award-winning TV show, 27 books that sold more than 8.5 million copies, a radio show, and a column in 233 newspapers. Her web site, marthastewart.com, hosted approximately 627,000 visitors monthly. Given that her company took in revenues in 1998 of $180 million and posted operating income of more than $27 million, competing with Martha was a challenge.

Other online retailers, such as 1-800-FLOWERS.COM and FTD, continued to expand their product offerings by venturing into the online garden industry. 1-800-FLOWERS.COM, which went public in summer 1999, signed an exclusive alliance with America Online to extend its agreement as the exclusive marketer of fresh-cut flowers and third-party marketer of garden products across all key AOL brands, including Netscape NetCenter and CompuServe. This $37 million four-year agreement was one of the longest running e-commerce partnerships in the industry.

1-800-FLOWERS.COM's product offerings included an extensive array of fresh-cut and seasonal flowers, plants, floral arrangements and gift baskets, gourmet foods, garden accessories and casual lifestyle furnishings.

1-800-FLOWERS.COM had a conventional supply chain built on bricks-and-mortar partners (see Exhibit 5). Though it used the Internet to receive and attract customer orders, the company relied on local florists to fulfill orders. These florists in turn relied on several layers of wholesalers and importers for a supply of flowers. "The florist that takes the order gets a percent, the florist that fulfills gets a percent, and very often a wire service serves as a facilitator and they take a cut for handling the bookkeeping," said Ken Young, 1-800-FLOWERS.COM director of communications. The recent acquisition of garden-equipment catalog seller Plow & Hearth – who also relied on a conventional supply chain – put 1-800-FLOWERS .COM head-to-head against Garden.com.

Smith & Hawken was an upscale home and garden retailer that sold its products through retail stores, catalogs, and online. While primarily a home interior company, Smith & Hawken was a significant competitor because it sold similar products as Garden.com, and distributed over the three channels. Smith & Hawken used the Internet in its supply chain by using smaller vendors to supply niche products. However, Smith & Hawken used the same warehouses to distribute to online customers and its catalog buyers and did not ship directly from suppliers like Garden.com.

Of all competitors, Calyx & Corolla's (C&C) supply chain was most similar to that of Garden.com: C&C did not keep inventory, instead, it ordered directly from growers in California, Florida, and Hawaii. The orders were electronically transmitted two or more times daily. The C&C account manager at each grower supervised the printing of orders, selection and packing of orders, handwriting of gift messages, and preparation of Federal Express shipping manifests. The orders were shipped directly to customers. In addition to educating growers to execute their retail responsibilities accurately and quickly, C&C provided growers with shipping boxes, cards, labels, vases, etc., and also demand forecasts. Growers, in turn, notified C&C of low or excess stock positions.

Though C&C used catalog marketing, it had slowly developed a retail web presence and had also begun to connect to its suppliers over the Internet. Customer phone orders were manually entered into C&C's proprietary order management software, while Internet orders were piped into the legacy system. The growers and FedEx then downloaded these orders through a secure electronic link. However, the web-enabled supply chain had not fully permeated the culture at C&C.

Despite its virtual supply chain, C&C was not a big threat because it competed with Garden.com only in a narrow segment (flower preparations). Diversifying into garden equipment would have required major realignment of market focus, brand image, and supplier base. Its customer database, too, would require expansion. There was no indication that C&C was willing to invest in such a change.

The Garden.com Shopping Experience

> "Their web site is colorful and fun," said Kerry Weiss, a new member of Garden.com. "I love all the information they give me – I want no-nonsense information in a quick manner and garden.com gives that to me."

Garden.com's site was easy to use and full of friendly information that was for the novice gardener, but still useful for the more experienced consumer. When visitors entered the garden.com site they were presented with a bright, collage of flower photos and were invited into four areas: Shop, Design a Garden, Our Community, and Magazine. The top half of the page was devoted to the garden.com banner, four primary destinations, and lead-ins to security and membership links, giving the site a consistent feel throughout the entire visit. Another advantage of the design was easy navigation. Exhibits 6-9 illustrate the web design.

If a consumer wanted to buy a plant but wasn't sure what type, after filling out a small online survey on conditions and preferences (sunlight, care, flower color, leaf type, and soil type) a list of recommendations was displayed. Each plant description also provided required care, and delivery details. Garden.com would not ship plants out of season. If Garden.com recommended the plant for a certain climate, it gave a disclaimer like, "This xeric plant is best adapted to and will thrive in the more arid climates of the <u>Western U.S.</u> If you would like to ship this plant to a state outside of the Western U.S.…it will not be guaranteed." Additional information was offered, "Learn more about this rose – how it's <u>packaged and shipped</u>, how to <u>plant it</u>, <u>care tips</u>, and <u>tools</u>." Unfamiliar words in the description, such as xeric, were linked to a definition.

A visitor to the site could gather lots of information. Under <u>Design a Garden</u>, the visitor had a range of options, from designing a garden with free garden-planner software to visiting predesigned garden plans. Or the visitor could see past "garden of the months" like: "Learn how to design a shade garden; Grow your own bouquet; Borders of annual bloomers; Plant a garden path filled with fragrance; and Learn the basics of interplanting." On every page the option to buy was presented.

For more information, the visitor could enter the Our Community interface for 24-hour live chats with gardening experts, a "garden doctor," or exchange photos and advice with other gardeners in the Gardeners' Forum. Popular with many web sites, the visitor could send a digital postcard of beautiful flowering plants. The Magazine offered a large collection of articles from *Garden Escape*. Garden.com also offered links to two other garden.com sites: Virtual Garden (ww.vg.com) and *Horticulture* magazine (www.hortmag.com). Virtual Garden was dedicated to building the premier gardening community and research space for today's gardener and *Horticulture* featured many legendary names in gardening.

As visitors saw items to purchase, they could add the item to their wheelbarrow. Upon check out, the wheelbarrow listed the items, description, price, often a significant discount, and tallied up the total cost, including shipping. An online buyer had the option of paying online or calling in a credit card number. The buying process brought three secured screens soliciting billing, shipping, and payment information. Garden.com was very explicit in reviewing the order, indicating again if any purchases were not recommended for the buyer's zone, and the expected delivery date. Depending on the season and availability of a certain plant, an order could take from 3 days to 3 weeks.

Marketing and Building Customer Relations

Garden.com's S1 stated, "Our marketing and promotion strategy is designed to build brand recognition; increase consumer traffic to our web site; add new customers; build strong customer loyalty; maximize repeat purchases; and develop incremental revenue opportunities." Initially, to heighten awareness, Garden.com bought advertising on portal sights like Alta Vista and Yahoo, but tracking software revealed that this was an inefficient use of funds. So, garden began aggressively pursuing more traditional forms of advertising. While Garden did not fall into the dot.com super bowl frenzy, they did produce TV adds which ran on CNN, Headline News, A&E, Lifetime, ESPN (when figure skating was on), and Home and Garden TV.

One of their most innovative efforts was the Garden Escape magazine. Published four times per year, the paper and web-based magazine was heavy on content and carried advertisements from other businesses. Nevertheless, some argued the magazine was Trojan catalog, since articles were linked directly to Garden.com products. For example, an article on caring for heirloom apple varieties carried links to Garden's apple offerings, care equipment like tree pruners, and related gifts like apple bowls. Nevertheless, the content was significant and powerful. Garden distributed 250,000 magazines a quarter to both paid and unpaid subscribers. On top of the magazine, Garden produced a holiday 1999 and 2000 catalog for direct mail solicitation. About 1M were distributed in 1999 and Garden planned to distribute 2.2M during the 2000 holiday season. Only about 1M were distributed before funding shortages stopped further mailing.

Direct e-marketing was also used: through Bloom Times, a monthly email newsletter distributed to members, and the Shopper's Preview, a weekly email sent to preferred customers notifying them of special offerings and providing content on gardening. Both of these also generated advertising revenue. Garden.com also engaged in some creative marketing relationships with the Virtual Garden Network, a group of selected gardening web sites, including gardenguides.com, gardens.com, Garden Launch Pad and backyardgardener.com. The Virtual Garden Network was set up to collectively offer advertising inventory for sale to lifestyle advertisers and to other members of the network.

Garden.com hoped that by leveraging the capabilities of the Internet not only for operational efficiencies, but also to provide value-added services, they could carve an advantage over traditional retailers. One such service was the horticulture database, which included thousands of pages of content and over 16,000 products. Plant Finder, another data-driven service offering, provided plant selection suggestions according to customer preferences, geographic location, and garden conditions. Other value-added services included a gift reminder and a gift registry service.

Garden.com built its service model around superior customer service, as customer service was an order winner in the virtual industry. Product variety and accessibility, responsive communication, reliable delivery, a concise and easy to navigate web design, 24-hour usage, and ease of returns defined Garden.com's virtual customer service. For example, before and after the Christmas season, the company staffed its customer service hotline 24 hours a day and personally answered over 1,500 emails daily. One customer remarked that not only had Garden.com replaced the entire order, but she received a follow-up phone call and email within 24 hours of her initial call to customer service. By forging these types of strong customer relationships, Garden.com attracted and kept buyers willing to pay a premium for gardening supplies. As stated in the Company's S-1, "We believe that by empowering gardeners to make informed decisions that yield results, we [created] a sense of connection to our web sites and the result [was] a loyal customer base that [looked] to us to satisfy their gardening needs."

Garden.com also earned revenues from selling advertising space on its web site. Garden.com sought promotional and distribution arrangements that could bring higher dollar value than banner advertising. Advertising sales accounted for approximately 8% of revenues in the FY 1999 growing to 12.5% in FY 2000.

Garden.com's Virtual Supply Chain

Through relationships with over 60 suppliers offering over 20,000 items, Garden.com provided a broader product selection than was available through any other retail channel. Where a local nursery might have carried one or two variations of an item, Garden.com offered as many as 200 varieties, and where a superstore may have offered 50 different perennials, Garden.com provided customers with a selection of over 2,000. Competing brick-and-mortar retailers' product offerings were constrained by finite store space. Garden's goal was to exploit the operational efficiencies of a virtual supply chain to capture industry advantage through product variety and the convenience of one-stop shopping.

To sustain this advantage, Garden.com entered into mutually exclusive online relationships with each supplier. Many suppliers were small, privately held growers. The suppliers were not permitted to sell through other web sites and Garden agreed not to use another supplier for the specific products sourced through the relationship. To join the Garden network, suppliers had to show they had order fulfillment capabilities. Many already had their own catalog operations that they were permitted to continue. In fact suppliers were permitted, and even encouraged, to conduct commerce on their own web site. Garden felt that suppliers who had their own site would further appreciate the value of Garden when they saw how expensive it was to acquire customers and keep up with technology. Suppliers were only prohibited from joining other etailers that competed with Garden. In most cases, Garden did not invest directly in the suppliers, but in some rare cases where demand growth overwhelmed a small supplier, Garden would prepay for a portion of the product forecast to help ensure product availability.

Because Garden.com sought to capture serious gardeners who were willing to pay a premium for quality products, suppliers were largely selected based on ability to supply very high quality products. The idea was to assemble the world's best growers for each category. During the contract period, suppliers were the sole providers of specified product lines, barring any stock-outs. In return, suppliers agreed Garden.com would remain the exclusive online source for their products throughout the term of the contract. Garden.com believed these relationships with high-quality manufacturers and growers erected barriers-to-entry to defend against new competitors and established brick-and-mortar firms from successfully entering the e-commerce space. Garden.com also remained cognizant of the many potential risks of relying too heavily on a single supplier. To minimize these risks, Garden.com's purchasing was balanced across key suppliers as evenly as customer-buying patterns allowed. The goal was to ensure that no single supplier accounted for more than 10% of revenue throughout the 1998 fiscal year; however, for the fiscal year ended June 30, 1999, one producer supplied products accounting for more than 14% of revenue. 25 key suppliers accounted for roughly 80% of Garden.com's revenues during the fiscal year ended June 30, 1999.

To prevent key suppliers from switching to other online outlets, Garden.com provided them with several supplier services: 1) Co-branding and channel access; 2) Consumer demand management, and; 3) Improved forecasting capability; 4) Fulfillment consulting; 5) Packaging consulting. Products were shipped to customers with both Garden.com's brand and the supplier's brand displayed prominently. In fact, Garden.com advertised the names of many of their suppliers on their web site, but without links to that supplier. In this manner, Garden.com acted as a consolidator - providing customers with a convenient location to purchase quality products from a myriad of sources while delivering visibility and a branding opportunity to suppliers. Furthermore, Garden.com gave suppliers access to the burgeoning electronic retail channel without them dedicating resources to build an online presence. By increasing revenues from products provided by key suppliers, Garden.com believed they made themselves a more vital component of their suppliers' customer portfolios.

Trellis and the Product Supply Process

To address the industry’s fragmented supply base, geographically dispersed suppliers, and the perishability of live planting material, Garden.com developed an information-driven virtual warehouse model for is gardening products. Garden.com leveraged Federal Express’ information-systems capabilities to link itself with suppliers and customers through Trellis – a proprietary shipping module co-developed with FedEx. Fluid information flow between members of the extended supply chain automated the updating of the order status from order entry to fulfillment and freight payment. Through their web site, Garden.com provided customers with visibility into current and future product availability, order status, and package tracking. As illustrated in Exhibit 10, the virtual warehouse model minimized Garden.com’s physical involvement with order fulfillment. Instead, the company was a consolidator of information. Garden.com focused on the capability of receiving and transmitting data throughout the supply chain, allowing other actors to concentrate on the physical transfer of goods.

Over 90% of Garden.com product shipments were processed through Trellis. By avoiding the expense and overhead of centralized, multi-tier distribution models that superstore garden retailers utilized, Garden.com believed they had established a competitive advantage. Suppliers were asked to update inventory in real-time, track perishable products, and modify Garden.com’s retail pricing through supplier sites built into their web page. To insure the relationship remained profitable for both parties, Garden.com negotiated pricing with suppliers using a discount from the supplier’s retail price. Nearly all customer orders shipped directly from suppliers, allowing Garden.com to maintain only a nominal inventory of specialty gifts, promotional items, and some safety stock for high-volume products. At least that was how the virtual warehouse model was supposed to work. Theoretically, suppliers could use Trellis to manage their inventory. However, those who had existing systems resisted adopting Trellis – so they would transfer (manually in most cases) the information. Few were willing to invest in integrating Trellis to their existing systems. Those who had no inventory system were so small that they were usually poor at inventory management. Complicating product supply management, live plants grown in greenhouses were susceptible to widespread diseases that could wipe out inventory. In the end, stockouts of hot items occurred frequently. In those cases, Garden’s customer service representatives would email or call the customer and try to find substitute products.

Pleasant View Gardens in Loudon, NH was typical of many Garden.com suppliers. A small family owned business, Pleasant View supplied a range of Proven Winners® hybrid forms of popular flowering plants. These plants were created by crossbreeding plants with gardeners' favorites like petunias or verbenas to achieve disease resistance and extraordinary blooming. The plants were propagated using a vegetative approach where cuttings from mother plants were planted in pots and grown to the desired size and maturity. Pleasant View supplied both other greenhouses and retail stores like Shaws and Home Depot. About 65% of their business was with other greenhouses. Pleasant View would sell them cuttings in 84-cell flats that the greenhouses would grow for sale to gardening centers. Garden View would also pot-up their own cuttings, growing them in their own greenhouses for retail sales at private gardening centers, grocery stores like Shaws, or super stores like Home Depot. Carol Huntington, the marketing manager, recalled the exciting early years working with Garden.com. "It was neat becoming part of the web phenomenon. We would see articles about them in magazines and say – wow!" Up until that point, Pleasant View had done little direct retail business, although they had been experimenting with direct shipments through a partnership with a mail-order gardening company. Pleasant View saw Garden.com as a true innovator in the direct gardening space and signed on four years ago as a supplier. Carol was particularly impressed with the deep marketing content Garden.com produced and the dedication to the segment. However, working with Garden.com wasn't always easy. "The hard part of our business is timing. You can sell books or CDs any time of year, but live plants are a little different."

Pleasant View would grow cuttings into small plants that were shipped to Garden.com customers in 3-packs of 3½-inch plants. Through experimentation, Pleasant View had perfected a clamshell plastic shipping container that protected the small plants in shipping. Cuttings were planted in late winter and were ready for shipment in April, with the shipping window lasting about 8 weeks. Garden.com would start accepting orders for the plants in the winter and continue accepting orders through the spring. Since most customers did not order the plants until late winter and spring, Garden.com would forecast the total sales and then commit to that quantity at the time Pleasant View planted the cuttings. The problem was always the forecast. When the forecast was too high, the perishable plants would keep growing in the greenhouses becoming "leggy" and unsellable. In those cases, Garden.com would run late spring fire sales, but to make the plants sellable, Pleasant View would have to invest in manually cutting the plants back to size. When the forecast was low there would be large shortages.

Like many suppliers, Pleasant View could not afford to truly integrate with the Trellis systems and there was often large-scale confusion about physical inventory. Garden.com would oversell the physical inventories and continue passing orders to Pleasant View long after there were no plants to ship. Sue Hanlon, the Pleasant View customer service manager, recalled many stressful times when she was left to try to sort out the customer orders. Each week, Garden.com would send batches of orders on Saturday to be shipped on Monday through Wednesday of the following week. Running the reports on Saturday morning was like playing a slot machine. Some weeks there was "massive over selling." There were also communication mistakes that plagued the relationship. For example, all of Pleasant View's 64 different skus were sold and shipped in three packs. However, last year marketing folks at Garden.com who did not understand the business made a simple change on the website allowing customer to buy plants individually – and never told Pleasant View. By mid April, Pleasant View was desperate, selling out of many products with more and more orders flowing in. Sitting in the shipping area one Saturday morning, Sue was puzzled by the pricing information on a customer invoice and suddenly realized the mistake. "I was shaking all over as I called my partner at Garden.com. I told her, 'you have now sent free material to hundreds of people and you don't have any plants to send to these orders sitting in front of me.' " Garden.com realized it was their mistake, but it was too late. Thousands of dollars of plant material was wasted and there were many unhappy customers who had to

be contacted. Likewise, when Garden.com over committed to inventory, they would be forced to pay for plants that were scrapped at the end of the season.
Yet with all the problems Pleasant View was still very excited about the Garden.com relationship and wanted it to succeed. Garden.com had helped Pleasant View onto the web and had even provided shipping equipment and computers to make direct shipping more efficient. As it became clear that Garden.com would fail, Sue and others felt lost. "There were so many times that I was so angry… I really liked the people – those are people who I have worked with for four years. They visited our operations in New Hampshire and we visited Austin. Yet, we were always sopping up the mess. You can have as many fancy web pictures and catalogs as you like, but you cannot ignore the nuts and bolts of the business. I am going to miss that outfit. They could have been on top and they blew it."

For gifts and hard goods, Garden.com maintained inventory in its Austin warehouse and conducted its own order fulfillment. Besides gardening hardware such as trowels and pruning shears, Garden.com found that its customer demographic was interested in buying a range of non-garden products from personal care items such as body wash and soap to home decorations such as candles and ceramics. Gifts represent about 15% of revenue and approximately 12% of skus. However 35% of the skus in the warehouse were seeds that generated little revenue and took up very little space and inventory dollars.

110% Guarantee – The Return Chain

Garden.com had identified difficulties in returning or exchanging orders as a significant threat to widespread customer acceptance of their solution. Thus, Garden.com offered customers an exchange, refund of the full purchase price, or 110% store credit for the full amount of the original order. The product return policy was divided into two categories: 1) Supplies, Tools, and Accessories and 2) Live Plant Materials. In the case of Supplies, Tools, and Accessories, the refund, replacement, or credit would be issued only upon return of the defective product. This implied a lot of inconvenience to the customer, especially if the product was garden furniture, which needed expensive shipping and handling. The Live Plant Materials did not require the customer to return the product for reimbursement, and hence the customer was insulated from the cost and inconvenience of return shipping. If the customer reported dissatisfaction with a plant or live material, Garden.com would simply apply a refund or replace the item.

While the return policy was effective for the customer, it was expensive for Garden. Items returned often were piled into the corner of the warehouse and rarely could be effectively resold because of damage or seasonal issues. To reduce these costs, Garden planned to outsource the entire returns process to Newgistics. Newgistics would handle the returns through their own claim centers of licensed mailing centers and liquidate the returned mechanize with Garden paying a per item charge to handle everything.

End of the Runway

At 3PM, Cliff and Lisa Sharples finished their meetings and hurried out the back exit of the building into their Toyota hatchback. Many of the employees were gathered in the kitchen, sipping on coffee-drinks and wondering what would happen next. As many times over the six months, the group began debating the viability of Garden's business model. Many argued passionately that the model was sound and could succeed with just a little more time. The key was growth. Everyone agreed that they had to grow quickly past their current $15-20M in sales to $100M. While the overall garden market was huge, the premium market was not as large as earlier expected. Many felt that Garden had to reduce costs enough to begin gaining inroads on the sales now held by large format stores. That meant getting into the very large low-end segment of mums, petunias, and impatiens sold every year to casual gardeners. But with their current upscale business model, Garden's costs were too high.

Another issue was the suppliers. If Garden grew, many wondered if suppliers would be able to keep up and reduce costs? Already Garden represented 70-80% of some of the suppliers' capacity. Could individual suppliers and the overall network be scaled? Since suppliers of live products had to ship all the demand early in the week to prevent plants from sitting over the weekend in FedEx facilities, order fulfillment capacity was a real issue in the highly seasonal business. Additionally, some of the suppliers were not so concerned with carefully managing the Garden.com business. For some of the small family businesses, Garden was simply another channel to move items that might otherwise be lost. When Garden grew past their expectations, they were reluctant to invest in more capacity. Running out of product didn't seem like a big problem to them – they were happy to sell out and avoid excess inventory that would become worthless.

Finally, there were those stubborn costs of customer acquisition. Would they go down? Garden was experiencing some of the issues faced by other etailers – brand recognition and customer loyalty required constant exposure. How could they stay in the consumer's consideration set when the consumer only needed to visit one month a year? Some thought that marketing should focus the offerings and concentrate on a few key segments. For example, abandoning the tough fresh-cut flower market that was rife with on-line competition. With more focus and fewer suppliers, Garden could concentrate on scaling a few areas without being spread so thin. As it stood, customers with many different line item orders were expensive for Garden since each had to be shipped from separate suppliers scattered around the country.

After an hour of heated debate the room grew quiet as one-by-one people returned their cubes realizing that regardless of who was right or wrong, it was probably far too late to miss the trees at the end of the runway.

Exhibit 1: Garden.com Stock Performance

Exhibit 2: Garden.com Financial Performance

	Quarter Ended		Twelve Months Ended	
	June 30, 2000	June 30, 1999	June 30, 2000	June 30, 1999
REVENUES:				
Products	$6,489	$2,637	$13,564	$4,952
Advertising	838	247	1938	442
Total Revenues	7,327	2,884	15,502	5,394
COST OF REVENUES:				
Products	5,651	2,446	11,416	4,466
Advertising	49	20	205	74
Total Cost of Revenues	5,700	2,466	11,621	4,540
GROSS PROFIT	1,627	418	3,881	854
OPERATING EXPENSES:				
Marketing and Sales	10,616	6,239	26,654	13,305
Technology, Content and Product Development	2,095	1,001	6,981	3,167
General and Administration	2,037	1,061	7,014	2,941
Depreciation and Amortization	719	233	2,107	610
Amortization of Deferred Compensation	252	370	1,174	674
Restructuring and Other Activities	888	---	888	---
Total Operating Expenses	16,607	8,904	44,755	20,697
OPERATING INCOME (LOSS)	(14,505)	(8,486)	(40,874)	(19,059)
Other Income and Expense	475	220	2,151	784
NET LOSS	$(14,505)	$(8,266)	$(38,723)	$(19,059)
less: Beneficial conversion feature and insubstance dividend	---	(2,700)	---	(2,700)
Net Loss applicable to common shareholders	$(14,505)	$(10,966)	$(38,723)	$(21,759)
Basic net loss per share	$(0.82)	$(9.58)	$(2.74)	$(20.48)
Pro forma basic net loss per share	---	---	$(2.33)	$(2.15)
Shares used in computing basic net loss per share	17,632,558,	1,144,536	14,149,167	1,062,696
Shares used in computing pro forma basic net loss per share	---	---	16,584,166	10,141,592

Exhibit 2: Garden.com Financial Performance (continued)

Condensed Balance Sheets
(in thousands)

	For the period ended June 30, 2000	June 30, 1999
ASSETS		
Current Assets:		
Cash and cash equivalents	$9,047	$15,340
Investments	18,612	3,710
Prepaid Advertising	1,869	988
Other prepaid expenses and current assets	2,143	1,086
Inventory	898	522
Total current assets	32,569	21,646
Property and equipment, net	9,146	2,659
Other assets, net	780	917
Total Assets	$42,495	$25,222
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	$4,282	$2,052
Accrued expenses and other liabilities	3,057	956
Unearned	187	188
Current portion of long-term debt	20	127
Total current liabilities	7,546	3,323
Long-term debt, less current portion	---	20
Commitments and contingencies:		
Redeemable convertible preferred stock	---	48,215
Warrants to purchase redeemable convertible preferred stock	---	24
Stockholders' equity/(deficit)		12
Common stock	177	5,768
Additional paid-in capital	104,499	5,768
Deferred stock compensation	(1,169)	(2,305)
Retained deficit	(68,558)	(29,835)
Total stockholders' equity/(deficit)	34,949	(26,360)
Total liabilities and stockholders' equity	$42,495	$25,222

SOURCE: Garden.com, Inc.

Exhibit 2: Garden.com Financial Performance (continued)

BALANCE SHEET

ANNUAL ASSETS (000s)	6/30/1999	6/30/1998	6/30/1997
FISCAL YEAR ENDING			
CASH	15,340	19,042	4,948
INVENTORIES	522	159	24
OTHER CURRENT ASSETS	5,783	425	59
TOTAL CURRENT ASSETS	21,646	19,626	5,032
PROP, PLANT & EQUIP	3,487	928	506
ACCUMULATED DEP	828	328	124
NET PROP & EQUIP	2,659	600	382
DEPOSITS & OTH ASSET	917	262	9
TOTAL ASSETS	25,222	20,489	5,423
ANNUAL LIABILITIES (000s)			
ACCOUNTS PAYABLE	2,052	910	236
CUR LONG TERM DEBT	128	175	123
ACCRUED EXPENSES	956	137	81
OTHER CURRENT LIAB	188	96	25
TOTAL CURRENT LIAB	3,323	1,319	464
LONG TERM DEBT	20	154	123
TOTAL LIABILITIES	6,666	1,473	586
STOCKHOLDERS' EQUITY (000s)			
PREFERRED STOCK	48,239	26,999	7,902
COMMON STOCK NET	15	13	15
CAPITAL SURPLUS	7	6	26
RETAINED EARNINGS	-29,705	-8,002	-3,106
SHAREHOLDER EQUITY	18,556	19,015	4,837
TOT LIAB & NET WORTH	25,222	20,489	5,423

INCOME STATEMENT (000s)

FISCAL YEAR ENDING	6/30/1999	6/30/1998	6/30/1997	6/30/1996
NET SALES	5,394	1,339	316	8
COST OF GOODS	4,539	1,107	246	5
GROSS PROFIT	854	231	70	3
R & D EXPENDITURES	3,167	1,213	858	161
SELL GEN & ADMIN EXP	17,530	3,822	1,692	529
INC BEF DEP & AMORT	-19,843	-4,804	-2,480	-687
DEPRECIATION & AMORT	0	0	0	0
NON-OPERATING INC	804	226	62	25
INTEREST EXPENSE	20	33	22	3
INCOME BEFORE TAX	-19,059	-4,611	-2,440	-665
NET INC BEF EX ITEMS	-19,059	-4,611	-2,440	-665
NET INCOME	-19,059	-4,611	-2,440	-665

Exhibit 3: The Top 50 Traditional Nurseries

Rank	Company	Sales (in Millions) 1998	1997	Percent Change	1998 Store Count	Sales Per Store
1	Frank's Nursery & Crafts	$250.00	$257.40	-2.90 %	254	$0.98
2	Agway Retail Services	224	238	-5.90 %	481	0.47
3	Smith & Hawken	110	88	25.00%	37	2.97
4	Bachman's	75	71	5.60 %	24	3.13
5	Pike Family Nursery	75	71	5.60 %	27	2.78
6	Stein Garden & Gifts	56	56	0.00 %	12	4.67
7	Armstrong Garden Centers	48	45	6.70 %	36	1.33
8	Earl May Seed & Nursery	47	56	-16.10 %	53	0.89
9	Calloway's Nursery	28	27.6	1.40 %	16	1.75
10	S.K.H. Management	27	26	3.80 %	3	9
11	Meadow's Farms	26	24	8.30 %	21	1.24
12	SummerWinds Garden Centers	25.1	NA	NA	16	1.57
13	Waterloo Gardens	25	24	4.20 %	2	12.5
14	Green Thumb International	22.8	22.8	0.00 %	6	3.8
15	Mahoney's Rocky Ledge	22	19	15.80%	7	3.14
16	English Gardens	21	25.3	-17.00 %	5	4.2
17	Wolfe Nursery	20	20	0.00 %	11	1.82
18	Molback's	18.6	16.7	11.40%	3	6.2
19	Bordine Nursery	18.5	18	2.80 %	4	4.63
20	Adams Fairacre Farms	16.3	15	8.70 %	3	5.43
21	Stovall & Co.	15.6	15.6	0.00 %	12	1.3
22	Rowland Nursery	15	15	0.00 %	6	2.5
23	Chalet Nursery & Garden Shop	14.7	14	5.00 %	1	14.7
24	Kasch's Garden Centers	14	12	16.70%	9	1.56
25	Porter's Nursery & Crafts	13.5	13	3.80 %	5	2.7
26	Amling's Flowerland	13.5	13.5	0.00 %	13	1.04
27	Cornelius Nurseries	13	10.3	26.20%	4	3.25
28	Homestead Gardens	13	11.7	11.10%	1	13
29	M. Goldfarb My Florist	13	13	0.00 %	4	3.25
30	Country Market Nursery	12.4	11	12.70%	2	6.2
31	Sloat Garden Center	12	7.2	66.70%	9	1.33
32	Lyndale Garden Center	12	11.2	7.10 %	3	4
33	Roger's Gardens	11.9	9.9	20.20%	1	11.9
34	Pettiti Enterprises	11.6	10	16.00%	6	1.93
35	Strader's Garden Centers	11.5	11.5	0.00 %	4	2.88
36	Behnke Nurseries	11.3	11	2.70 %	3	3.77
37	Valley View Farms	9.9	9.9	0.00 %	1	9.9
38	Green Arrow Nursery	9.5	9.5	0.00 %	2	4.75
39	Hicks Nurseries	9.2	9.2	0.00 %	1	9.2
40	Watson's Garden Center	9	9	0.00 %	1	9
41	Houston Plants & Garden World	8.7	7.2	20.80%	3	2.9
42	McDonald Nurseries	8.6	8.6	0.00 %	3	2.87
43	Capital Nursery	8.6	9	-4.40 %	3	2.87
44	Vinny's Home and Garden	8.5	8	6.30 %	2	4.25
45	Young's Nurseries	7.7	6.3	22.20%	2	3.85
46	Paulino Gardens	7.5	7.5	0.00 %	1	7.5
47	Dundee Nursery & Landscaping	7.5	7.5	0.00 %	2	3.75
48	Village Green Nurseries	7.4	6.4	15.60%	3	2.47
49	Teas Nursery	7.3	7.3	0.00 %	6	1.22
50	Prairie Gardens	7.2	7.2	0.00 %	1	7.2
	Totals and Averages	$1,479	$1,423	4.00 %		

The information in this table was gathered by Tampa, Fla.-based CSG Information Services.

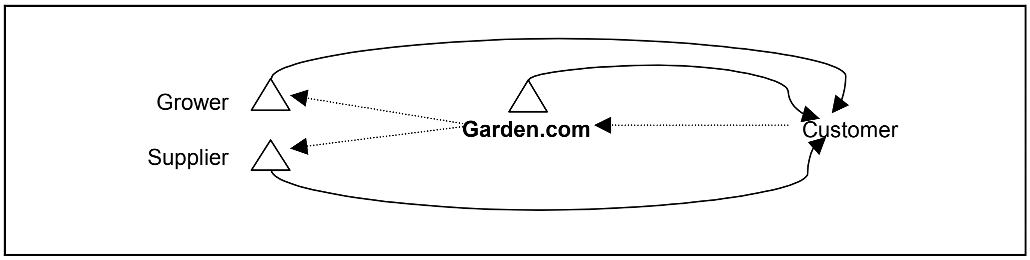
Exhibit 4: Revenue from U.S. lawn and garden product sales

Rank	Company	1998 Sales (Millions $)
1	Home Depot	$4,080
2	Wal-Mart	3000
3	Kmart	1311
4	Target	743
5	Lowe's	667
6	Sears	486
7	Hechinger	420
8	Menard's	400
9	Frank's Nursery	250
10	Agway	224

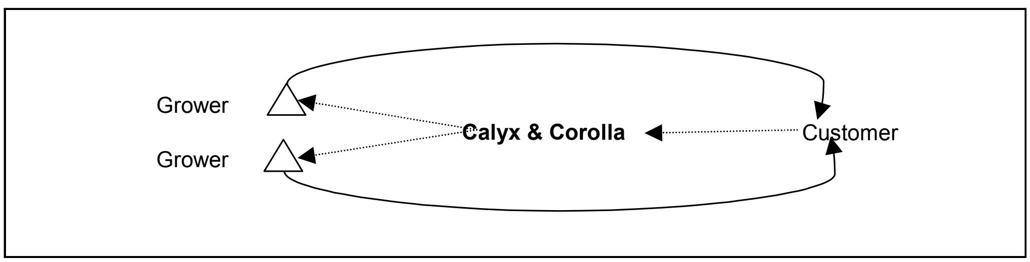
Source: NHCN research.

Exhibit 5: Supply Chain of Garden.com and Competitors

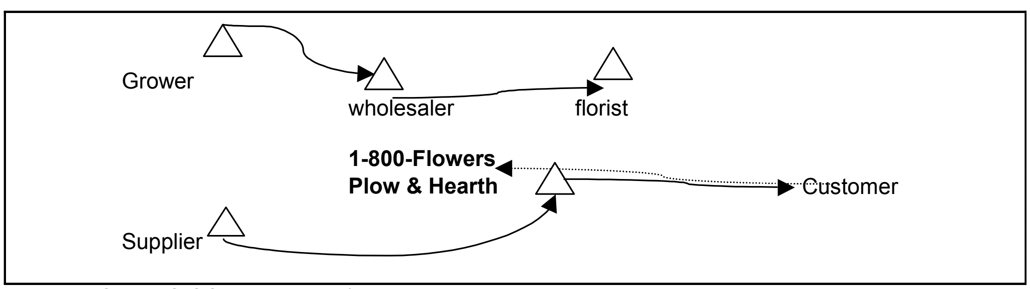
Flow of physical goods
Flow of information



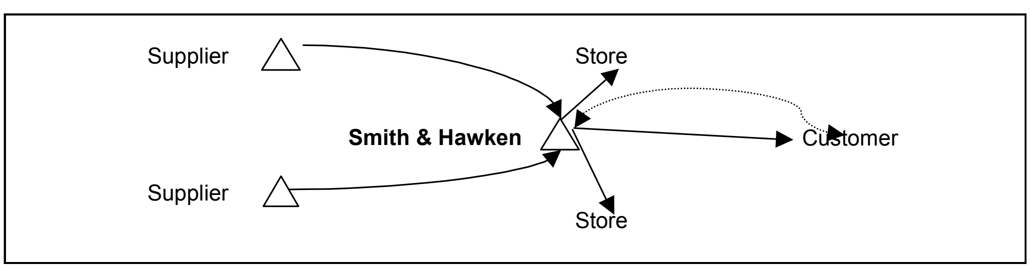
Garden.com has products shipped directly to customer from suppliers. It also shipped from its warehouse for high volume/margin items. Suppliers were connected over extranet (Trellis).



Calyx and Corolla (C&C) shipped orders directly to customers from growers. Suppliers were connected to C&C over the Internet.



1-800-FLOWERS.COM and Plow & Hearth accepted orders over the Internet, but did not use the Internet to connect to suppliers. Florists were connected to 1-800-FLOWERS.COM by an intermediary wire service.



Smith & Hawken accepted orders over the Internet, and also sent customers catalogs; they also used the Internet to connect to smaller suppliers using the Internet.

Sources: Garden.com S-1 and Harvard Business School, "Calyx and Corolla," Harvard Case, 1990.

Exhibit 6: Purchase option from garden.com

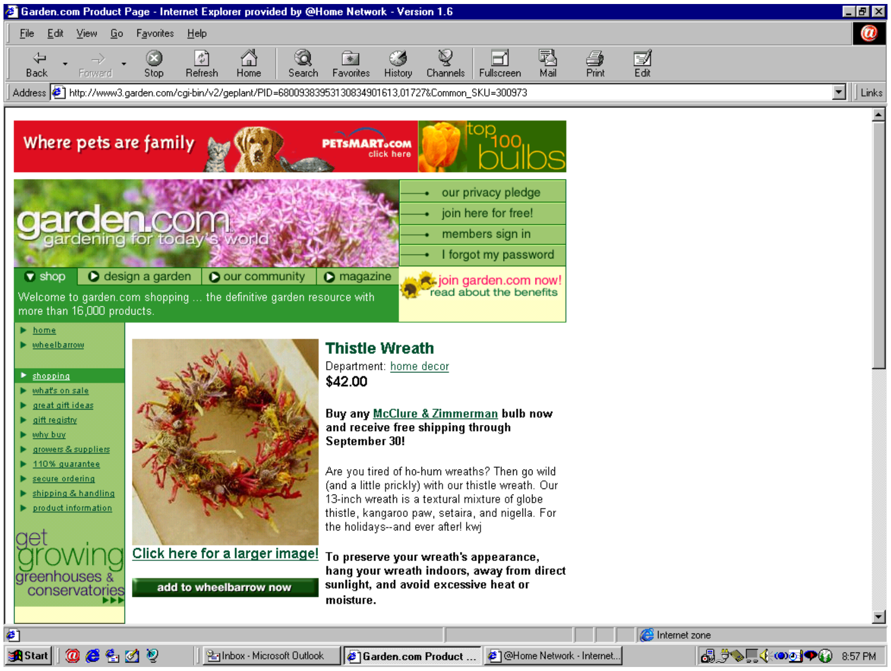


Exhibit 7: The Wheelbarrow from garden.com

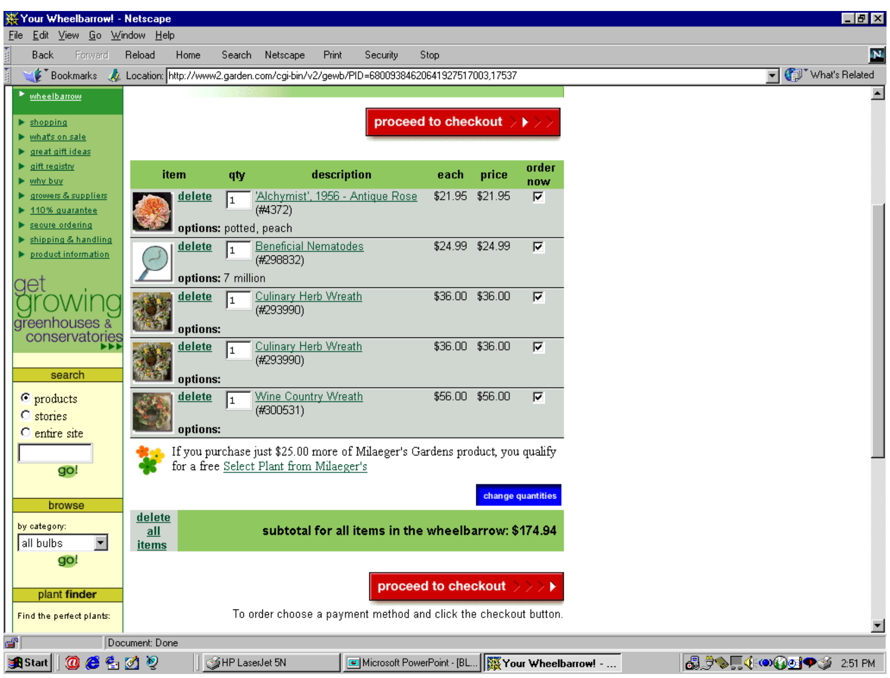


Exhibit 8: Designing your own garden from garden.com

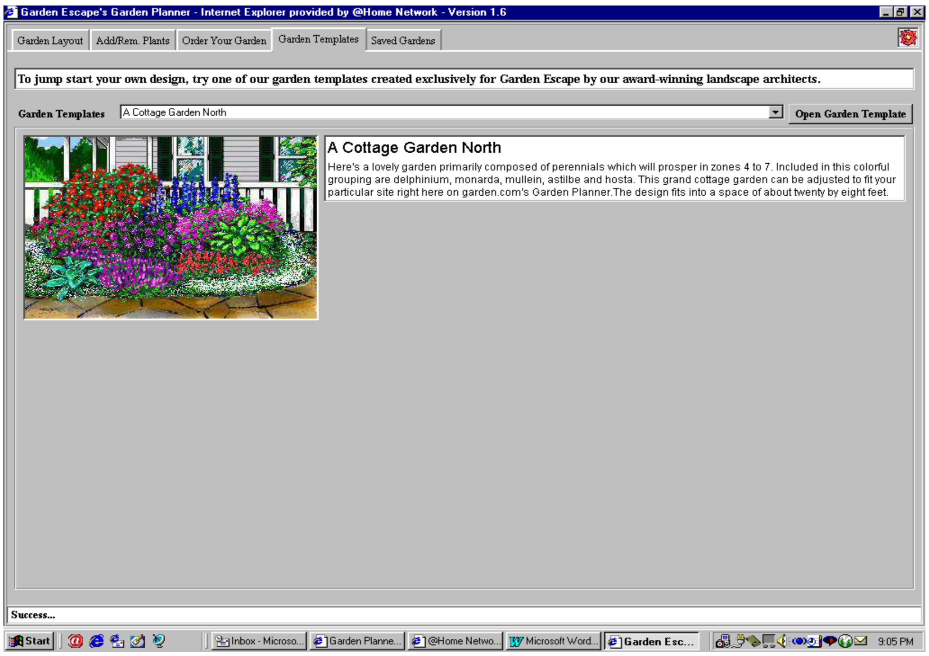


Exhibit 9: Email to new subscriber from garden.com

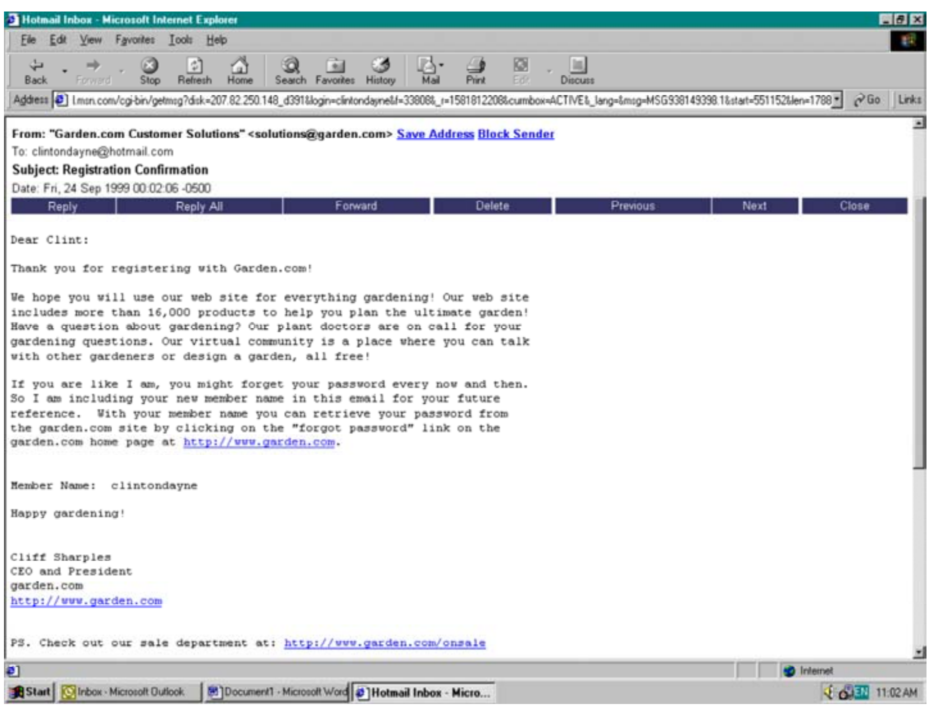


Exhibit 10: The Product Delivery Process

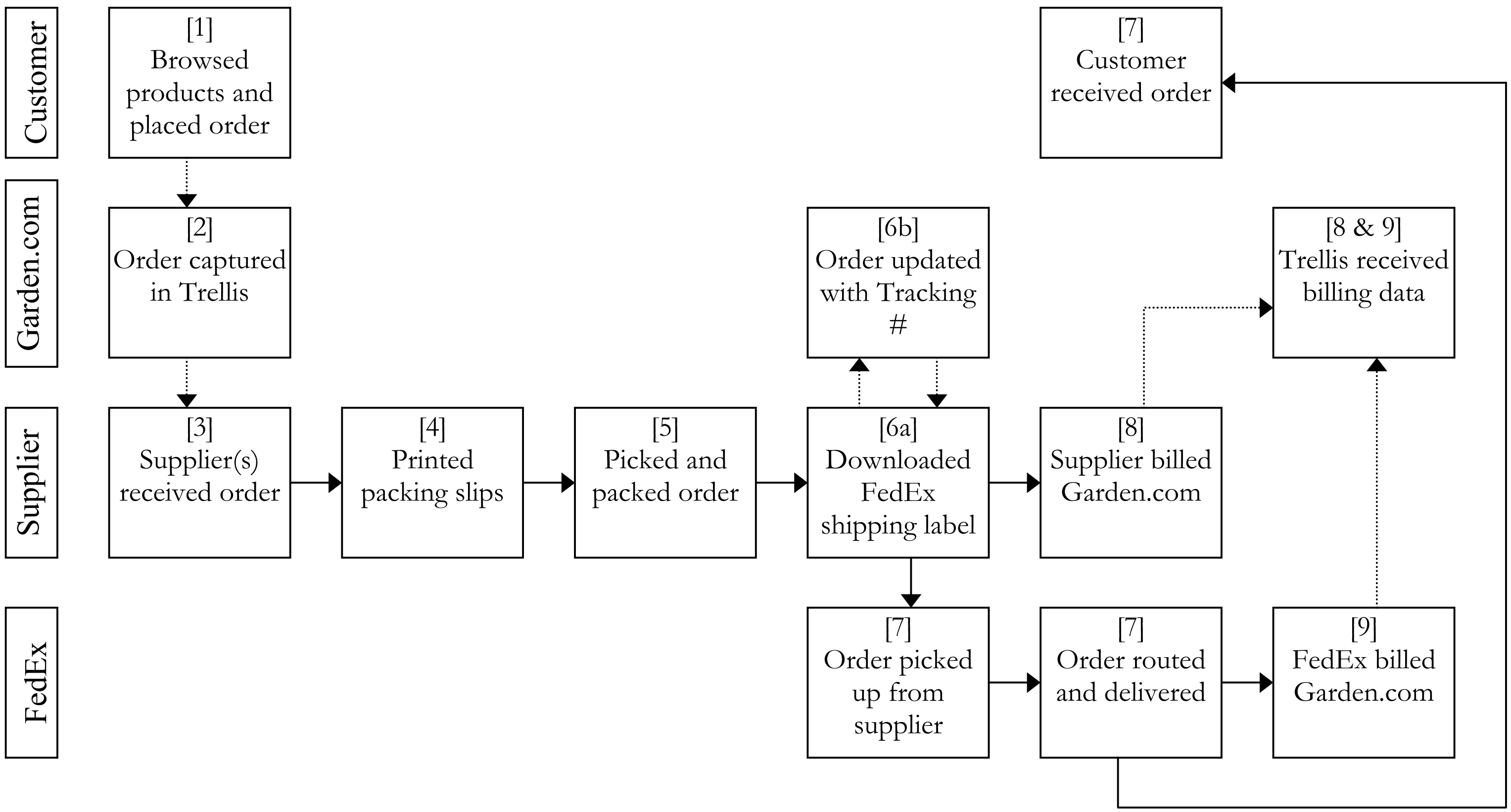


Exhibit 10: The Product Delivery Process (continued)

1. A customer visited the garden.com Web site, browsed for products, selected one or more items for purchase, and completed the order online or by calling Garden.com's Customer Solutions 800 telephone number.
2. Trellis captured all order data including customer information and product information.
3. Trellis routed order data to the appropriate supplier or suppliers for processing. Suppliers could access a special supplier-site of the garden.com Web page to view orders that contained one of their products.
4. Suppliers printed packing slips from Trellis or the Web site to prepare the order.
5. The supplier picked the items specified on the packing slip from its warehouse or growing field and packed the items.

6a. The supplier then downloaded a Federal Express shipping label from Trellis and placed the label on the exterior of the box.

6b. Trellis automatically updated the customer's order record with the Federal Express tracking number. From this point until delivery to the customer's location, both Garden.com customer-solutions representatives and the customer could track the shipment status through the garden.com Web site.

7. Federal Express picked up the processed orders and delivered the orders to the location specified by the customer.
8. At the end of each day, suppliers used Trellis to print a summary of all items processed and used the summary to invoice Garden.com on a weekly or monthly basis.
9. Federal Express billed Garden.com directly for the shipping costs incurred for all orders.

Source: Garden.com S-1.