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COOKING.COM

Tracy Randall, president and founder of Cooking.com, finished reading an article in *strategy+business* magazine and reflected on the advice in the article in regard to her recent efforts to drive profitability with a more in depth cost-to-serve analysis of her company. The need for continued sales growth, coupled with the necessity of keeping costs down, put pressure on Randall to make sure that the company's capacity-constrained fulfillment center carried products that offered not only the potential for the highest gross margins but also the greatest potential for profit. The company was already operating with a variety of fulfillment models, but she was not sure if Cooking.com had an optimal mix.

The company already offered cookbooks through an outsourced fulfillment model in partnership with Jessica's Biscuits, an online retailer focused exclusively on cookbooks. Some suppliers also provided direct customer shipment of certain items, saving the company the cost of handling and storing product inventory. Although Cooking.com already offered 35,000 products and 8,000 recipes, the largest selection among Internet retailers, Randall knew that the company had to continue expanding its offerings to customers in a profitable way. Even though the Internet retailing model theoretically offered unlimited shelf space in its virtual store, inventory still had to be held somewhere in the system and doing so was certainly not free.

Company History

Founded in 1998, Cooking.com emerged from a collaboration among co-workers at the Disney Store in Glendale, California, and Idealab!, an incubator in Los Angeles. On the heels of a few successful e-commerce start-ups, Idealab! was interested in funding several vertical e-commerce businesses. Excited about the promise of Internet retailing, the founders and Idealab! settled on the idea of kitchenware products for cooks. The retail category offered strong margins, a healthy average order size, and only a few serious competitors. Consumers seemed to have a strong connection to content, which would drive down marketing costs over time. The founders established the following four company goals for Cooking.com:

- To offer a complete assortment of products that included every top brand
- To create a shopping experience that was extremely intuitive and simple
- To provide dependable and affordable delivery
- To assist customers quickly and efficiently by offering highly responsive customer service

The company grew quickly by aggressively pursuing the opportunities offered in the Internet boom and raising several million dollars in 1999 and 2000. As the Internet hype began to subside in 2001, Cooking.com, like most Internet retailers, shifted its focus from revenue growth to profits. Unlike many competitors that folded after the bubble burst, Cooking.com successfully restructured its business to eliminate the need for further cash infusions and survived the crash. In 2004, the company realized a small profit, but its sales growth was stagnant. Nevertheless, having established a stable base, the management team returned its focus to expansion during 2005 and projected further growth for 2006 (**Exhibit 1** provides key financial metrics).

By the end of 2005, Cooking.com had cemented its position as a leading Internet retailer of kitchenware. With sales of $40 million, Cooking.com was ranked 176 in the *2006 Internet Retailing Top 500 Guide*. Although much smaller than most of its on-line and traditional retailing competitors, its large selection of kitchenware made it a substantial player in a fragmented industry.

Overview of Kitchenware Industry

The seven product categories offered by Cooking.com—table and barware, small appliances, cookware, cooking tools, storage, bakeware, cookbooks, and cutlery—constituted a $15.4 billion market in the United States. As of 2005, the Internet accounted for about 5% of sales of these products. As shown in **Exhibit 2**, Cooking.com accounted for a measurable but variable share of these online sales.

Historically, department stores such as Macy's, Rich's, and Hecht's dominated the retail market for kitchenware. Over time, however, the department-store channel declined in the face of growing competition from such mass merchants as Wal-Mart and Target. Specialty retailers like Williams-Sonoma also played an important role in this market as 43% of its sales were direct to the consumer via catalog and web operations. Amazon.com also played a major role, with kitchen and housewares ranking as one of the largest of its 34 categories of products at the time. As seen in **Exhibit 3**, Cooking.com garnered a significant level of online sales of cooking products relative to other retailers but was dwarfed by larger retailers with broader product lines and by those with traditional retail stores.

The manufacturers of cookware (also referred to as food-preparation products) included such global giants as Korea's Samsung and Japan's Matsushita, both significant producers of microwave ovens. Large U.S.-based companies included the Whirlpool Corporation, which sold a variety of small appliances and cookware under the KitchenAid brand, and Newell Rubbermaid, with 25% of its sales in cleaning and organizing products used mostly in the kitchen. Smaller domestic companies such as World Kitchen, a manufacturer of cooking and bakeware products under the Revere, Corelle, Chicago Cutlery, and EKCO brands, operated at the other extreme, with a broad nonappliance product offering and focus on the U.S. market. Other American companies, such as Sunbeam and Hamilton Beach/Proctor-Silex focused on such small appliances as mixers and toaster ovens. No company produced products for all segments of the industry, leading to the relative fragmentation shown in **Exhibit 4**. Regardless of the location of the company's headquarters or its particular segment of focus, most companies involved with food preparation products produced or sourced a large proportion of them in or from Asia.

Cost-to-Serve Drivers

Cooking.com stocked more than 5,000 of the 35,000 items offered on its site in its own fulfillment center in Ontario, California. As shown in **Exhibit 5**, the average prices and gross margins varied significantly across the seven product segments. Small appliances generated the second-highest average price per unit, at $78, but the lowest gross margin, at 34%. Cooking tools and storage priced much lower, at $18 and $23, respectively, but produced a higher gross margin, at 50% and 49%, respectively.

But prices and gross margins did not tell the whole story. Although the company generated 42% gross margin on the $27.8 million in sales channeled through its fulfillment center, operating costs for the facility ran around $2.8 million, leaving an operating margin of about 32%. Cooking.com also offered several shipping options, with charges based on the order value. The shipping fee generally exceeded the out-of-pocket cost paid to the carrier by 15%, which helped to offset the costs of the facility and also funded the occasional free-shipping offer.

Tracy Randall realized that continued profitable growth required fully understanding the true profitability of the offered products based on a deeper understanding of the operational cost drivers. To tackle this issue, she formed a task force spearheaded by Laura Shaff, vice president of finance, with the blessing of COO Bryan Handlen. Working with some outside experts, the team identified six major operational cost categories and developed some insight into the drivers of each.

Inbound shipping

Inbound shipping costs to the Ontario facility ran $625,000 a year, based on receipts of nearly 3 million pounds of product. All suppliers shipped from a facility—a manufacturing plant or, more typically, a distribution center—located within the United States. Most Asian-produced goods came from distribution centers located near a West Coast port like Los Angeles, but shipments were received from the Midwest and East Coast as well. One of Cooking.com's