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Pets.com 2.0

New Sites Strive to Prove That Economics of Selling Pet Food Online Have Changed Since Dot-Com Bust

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By [STU WOO](#)

The economics of Internet commerce have changed so much that Alex Zhardanovsky is now taking on the once-seemingly impossible challenge of selling pet food online.

Mr. Zhardanovsky in 2010 co-founded PetFlow.com Inc., a Manhattan start-up that has raised \$10 million in venture capital and that now ships one million pounds of pet food a month.

"We want to prove that the pet category can be successful online," said the 34-year-old entrepreneur, who said he expected his company to break even by the second quarter and have sales of \$30 million this year, up from \$13 million in 2011.



Enlarge Image

Ramin Talaie for The Wall Street Journal

The co-founders of PetFlow.com, Joe Speiser, left, and Alex Zhardanovsky, who have raised \$10 million in venture capital.

PetFlow is part of a new litter of Web-only pet-supply stores that have emerged in recent years, with some such as MrChewy.com and Wag.com sprouting just in the past few months. Backed by top venture-capital firms as well as by tech heavyweights including [Amazon.com Inc.](#), [AMZN -0.41%](#) the start-ups illustrate how the economics of selling heavy bags of pet food over the Internet have evolved since the Web's early days.

Traditional retailers such as [PetSmart Inc.](#) [PETM -0.12%](#) and [Wal-Mart Stores Inc.](#) [WMT +0.64%](#) are also heading to the Web. Wal-Mart started selling animal food online in fall 2010 so that it could expand its selection. "Online, we have an expanded assortment of pet products that complement the pet supplies in your local Wal-Mart store," said spokesman Ravi Jariwala.

But pet-food start-ups cite the cautionary tale of the now-defunct Pets.com Inc., a publicly traded company that sold pet supplies online and then became the poster child of the dot-com bust more than a decade ago. The San Francisco start-up, founded in 1998, raised \$110 million and went public in 2000. Pets.com then spent millions on marketing with its famous sock-puppet mascot. After

PetFlow and other Web-only pet-supply stores say changes in the economics of internet commerce make it possible to sell pet food successfully online. Traditional retailers are also taking to the web. Stu Woo has details

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burning through its cash, it laid off more than 250 employees and shut down in late 2000. Julie Wainwright, the Pets.com former chief executive, said her company could have survived if it had secured another round of venture-capital funding in 1999, as companies such as [Google Inc.](#) GOOG -0.59% did.

Now, while pet food remains heavy and expensive to ship—one reason that Pets.com failed—the cost of almost every other aspect of starting an online-retail business has plummeted.

A big part of that comes from the growth of a cottage industry that takes care of the grunt work of storing and shipping products. The rise of businesses such as Amazon's Web Services division, which rents computing power and storage, has also reduced the need for companies to buy their own computer servers, which Pets.com did. Using what are known as cloud-computing services costs hundreds of dollars a month or less, compared with servers that can cost thousands of dollars.

Overall, it cost an online retailer three to five times as much to launch a decade ago, said Brian Walker, an online-commerce analyst for Forrester Research. Back then, "the technology to run the site, the physical warehouse, site hosting, and staff would require a significant investment before you were even live with the site," he said.

Ms. Wainwright said it had cost between \$7 million and \$10 million to get Pets.com running, before acquiring inventory. Now, said Ms. Wainwright, who last year founded an online luxury-clothing marketplace called TheRealReal, it costs about \$25,000 to \$30,000, eliminating risks for potential investors.



Getty Images

The sock-puppet mascot of now-defunct Pets.com

In addition, "the world's changed," Ms. Wainwright said. There are now 232.1 million Americans with access to broadband Internet at home or in the office, compared with 48.5 million in 2000, according to Forrester Research. Only 1.2% of overall commerce was online in 2000, compared with 7.2% today, Forrester said.

Ms. Wainwright said she had two people on call at all times to maintain Pets.com computer servers. She had dozens of call-support employees, she said, because a third of orders came in by phone from wary customers afraid of putting their credit-card information online. By contrast, she said only 0.1% of orders at her new start-up are placed over the phone.

At PetFlow, Mr. Zhardanovsky estimates it took only about \$50,000 to launch the

company, excluding buying pet food and other inventory. PetFlow hired outside tech engineers for \$50,000 to create the website and online shopping-cart system and paid a few hundred dollars a month for Internet service.

Instead of setting up its own warehouse, which Mr. Zhardanovsky said would have cost \$1.5 million to \$2 million, PetFlow also hired a third-party company, Capacity LLC, to store and ship its products. Mr. Zhardanovsky said Capacity charged a storage fee and per-shipment fee, which amounts to between \$4 and \$5 per order.

One advantage PetFlow has, Mr. Zhardanovsky said, is that it works on a subscription model. He said 50% to 60% of customers automatically enroll to have pet food delivered to them on a regular basis, such as once a month. "Dogs need

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the exact portion of the exact same food every day," he said. "It's one of the only industries that lends itself to a subscription-based delivery system," he said.

Today, PetFlow has 65 workers, compared with Pets.com's 320 last decade. Marketing costs are also lower,

with PetFlow spending about \$200,000 to \$250,000 a month on Internet search ads and other marketing, while Pets.com spent more than \$25 million on advertising, including a Super Bowl commercial and banner ads on sites such as [Yahoo Inc.](#), YHOO -0.39% before shutting down.

That lower-cost model has enabled others to jump into the pet-food space online. Mr. Chewy, based in Miami, launched in September and expects to record \$5 million in sales for the month of December, up from \$1 million in January 2011, said co-founder Michael Day.

Wag.com, run by Amazon subsidiary Quidsi Inc., launched last July. David Zhang, site manager for Wag.com, said the company uses robotic technology to quickly move around cat or canine kibble, which helps reduce labor costs. "Would we have been able to do this a decade ago?" said Mr. Zhang. "Probably not."

The online pet-supply stores also say they are taking a different approach than Pets.com, which sold low-end food as well as higher-end products. PetFlow, Mr. Chewy and Wag said they all focus on convenience over price, and they carry mainly higher-end, gourmet dog food because the more expensive products are higher-margin. Even Wal-Mart doesn't carry much of the cheap stuff online.

"There are going to be some 99-cent cat food, dog food, lower-price-point items that may not make sense for us to carry online," said Mr. Jariwala, the spokesman. "We'll bundle them together, so you might buy a six pack."

Still, PetFlow and Mr. Chewy are losing money, while Wag.com declined to disclose its financial data. Many online-retail experts say the online pet stores can be profitable, but are skeptical they will ever become booming businesses. Forrester Research estimates U.S. online sales of pet supplies will reach \$4.8 billion in 2015, up from \$2.5 billion last year.

Michael Rubin, CEO of Kynetic, which runs an online-shipping consortium called ShopRunner Inc., said the three pillars of a good online-retail business, are "high margin, high price and low weight." The pet-supply industry meets none of the criteria, he said.

And the lower start-up costs only help up to a point. Last year, Mr. Zhardanovsky said PetFlow.com couldn't keep up with its orders by using a third-party warehouse. In August, PetFlow stopped using the outside party and began leasing its own 65,000-square-foot warehouse in Cranbury, N.J.

Mr. Zhardanovsky, who plans to seek another round of venture funding in the next year, said he calculated that in the long run, continuing with a third-party warehouse provider would be more expensive than having PetFlow operate its own warehouses once it started shipping a great volume of orders.

Mr. Zhardanovsky acknowledges the online pet-supply business remains hard—something he's reminded of every day by the Pets.com sock puppet that he put on the shelf across from his desk. Still, he said the idea behind Pets.com wasn't wrong. Pets.com was "ahead of the time," said Mr. Zhardanovsky.

Write to Stu Woo at Stu.Woo@wsj.com

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