

## From dot com to dot bomb

### LEARNING OBJECTIVES

- To understand the 'dot com' phenomenon.
- To identify the reasons for the rise and fall of the dot coms.
- To be able to summarise the lessons learnt.

### INTRODUCTION

This chapter is an epilogue to Chapter 5. We will investigate the dot com phenomenon, and identify the catalysts of its rise and fall and the lessons that can be learned.

### 'THERE'S GOLD IN THEM THERE DOT COMS'

In 1997/8 the dot com gold rush began in the USA, followed by Europe 12–18 months later. The received wisdom at the time was that businesses either went 'on-line' or went out of business. There was a frenzy as companies and individuals rushed to get involved with Internet businesses. The Chairman of Intel, Andy Grove, was 'widely quoted as saying that in five years' time all companies will be Internet companies or they won't be companies at all'.<sup>1</sup> In the UK, the Prime Minister, Tony Blair, was also 'vigorously urging business to embrace the Internet or risk bankruptcy'.<sup>2</sup> And so the dot com gold rush came to the UK.

Forecasts and predictions for the growth of e-commerce were of lofty proportions. Although there was no common agreement by researchers on



**Figure 6.1** The early dot com phenomenon

the exact figures for the total revenue worth of e-commerce, there was agreement that there would be exponential rates of growth, with some anticipating ten-fold annual compounded growth year on year. Surveys were forecasting the growth of e-commerce for home shopping, banking and other services in Western Europe to grow to around US\$223bn by 2002 from its estimated US\$19bn in 1999, with the US e-commerce market rising to US\$843bn (nearly 10 per cent of its gross domestic product [GDP]) from US\$109bn in 1999. Management consultants Datamonitor estimated worldwide revenues of more than US\$1,000 billion by 2003, while other studies by US IT research consultancy Forrester and accountants KPMG suggested even higher figures. Research carried out by the Henley Centre for Forecasting suggested shopping in cyberspace was growing six-fold every month.<sup>3</sup>

For the UK, estimates of consumer spending on the Internet soared to similar lofty heights with Verdict Research<sup>4</sup> estimating consumer spending on the Internet rising to £7.3 billion in 2004 from its estimated £581 million in 1999 (see Table 6.1). Predictions and forecasts for the potential revenue opportunity of e-commerce were coming from all quarters, Robert Conway of PricewaterhouseCoopers stated that 'E-business will be mega for the next five years',<sup>5</sup> while Intel's executive Craig Barrett, addressing the *Wall Street Journal Europe's* conference on converging technologies in 1999, said: 'I think all of the forecasts are underestimates. (E-commerce) is going to be a bigger phenomenon than any of us estimate'.<sup>6</sup>

Growth in the number of Internet users gave fuel to the predictions of the growth in e-commerce and raised the profile of dot coms. The number of users was growing exponentially mainly due to the growth of 'free'

**TABLE 6.1** Projected Internet shopping in the UK by 2004

<i>UK Internet Shopping for</i>	<i>1999 £ million</i>	<i>2004 £ million</i>
Groceries	165	2395
Clothing	5	1210
Computer software	122	934
Music	85	575
Books	106	430

*Source: Verdict Research*

Internet access pioneered by the British ISP Freeserve, where only costs of the Internet calls were charged. During 1999, net use was estimated to have risen by almost a third in Europe, compared with less than one-tenth in the USA. However, in the USA they had a good two or three years head start and so had achieved a critical mass of users. In the UK, an ICM poll for the *Guardian* newspaper found that 37 per cent of adults used the Internet either at home or at work, and that almost half the adult population – 21 million people – are ‘likely to be online by the end of next year (2001)’.<sup>7</sup> With the growing number of on-line users, a survey by Datamonitor<sup>8</sup> in 1999, found that shopping and financial services were the most popular uses. More than one in five consumers with access to the Internet ordered products on-line and 8 per cent used it to monitor their finances.

Development of improved technology (broadband) meant higher bandwidth would be introduced, enabling higher-quality and faster Internet access. This, coupled with competing telecommunications companies offering unmetered single monthly fees for accessing the Internet, meant that the growth in the number of Internet users forecasted would become a reality. ‘If 1999 was the year of the online retail explosion, 2000 will be the year of the online media explosion’ (Toby Strauss, Internet analyst at mortgage brokers John Charcol).<sup>9</sup>

Established high-profile companies were publicly sharing experiences of their e-commerce success, giving credence and legitimacy to the ‘power’ and attraction of e-commerce. Intel, the world’s biggest computer chip maker, at the Wall Street Journal Europe’s conference in 1999, revealed that it expected its e-commerce related revenue to generate about half of its total sales (around US\$15 billion); having started from zero nearly a year ago, they expected e-commerce transactions to represent 90 per cent of their total revenue by 2001/2002. ‘Essentially all of our businesses will be conducted in this fashion’,<sup>10</sup> claimed Intel’s Chief Executive.

Sun Microsystems introduced the concept of the on-line three A’s ‘Anything, Anywhere, Anytime’<sup>11</sup> explaining how Sun had created ‘MySunCentres’, which personalised websites for customers and partners,

giving them access to rich and dynamically changing information to match each visitor's profile. This was a way of improving stakeholder relationships, which improved the efficiency of the organisations and impacted on its revenue stream.

Leading consultancy firms were directly helping the start-ups and indirectly contributing to the hype with more forecasts and reports. Many of the top consultancies believed they could cash in on the potentially lucrative innovative ideas emerging from on-line start-ups. Many were offering a range of expert financial services, management skills and even premises for a fee or an equity stake in the new dot com companies. One of the global consultancies, Bain & Company, launched Bainlab, a subsidiary devoted to developing and funding Internet projects. Many of the top consultants were tempted away from their lucrative and 'safe' jobs to become CEOs and sit on the board of directors of some of the new start-ups. One the executives from Andersen Consulting left his position to join on-line grocer WebVan.

Expectations of high profitability from the dot coms were based on the number of site visitors, operating costs and the growth of advertising revenue. In 1999, these profit expectations fuelled a demand for shares in Internet companies that could not be met. Demand exceeded supply of shares and so many Internet companies were overvalued even though they were making a loss. With few Internet companies actually making money, it was hard for analysts to work out how to value them except by looking at the long-term growth potential. The numbers on the Web continued to increase rapidly, building strong brands and unique products.

#### CASE STUDY

Jelly Works, a UK Internet investment company, was floated on London's Alternative Investment Market, offering 10 per cent of the company within two months of its incorporation. Jelly Works's website has an on-line process for entrepreneurs to make their bid for cash to help their start-up or expansion. Its shares rose 2000 per cent within three days of floating from an initial 5p, to 99.5p per share, increasing the company's valuation from £10 million to £200 million. That company had a host of well-known business figures on its board, including Jonathan Rowland, founder of and investor in a number of Internet firms, such as 365 Corp and Demon Internet.

Flightbookers, the long-established London-based bricks and mortar travel business with annual sales of about US\$50 million,<sup>12</sup> launched Ebookers, the on-line spin-off. Ebookers offers travel products and services on-line, including negotiated discount airfares, hotel and car rental bookings. The on-line business had sales of about £10 million a year and reported a loss in the first six months of 1999, but floated on the New York Stock Exchange at a price of US\$18 per share, which had risen to US\$43 before finally closing at US\$26.5 per share by the end of the first day's trading.

In September 1999 the rival UK on-line travel agency, Lastminute.com, announced it was considering a flotation.

In the USA the phenomenon was even more pronounced. One of the first dot coms, and often seen as the blueprint for the 'dotconomy', Amazon.com was making losses despite its 4 million customers and sales approaching US\$1 billion a year. However, at the time (January 1999), its shares could virtually double in a week because of news of a share split and an announcement of a new warehouse to speed distribution. Amazon shares rose from US\$14 to US\$187 a share within 6 months<sup>13</sup> and the market valuation of the company reached US\$30 billion – more than leading US retailer Sears Roebuck. However, Jeff Bezos, the owner of Amazon.com, whose personal stake was worth US\$15bn, had the sense (lacking in some investors) to cash in more than US\$60m in stock along with his fellow Amazon.com directors at the height of the frenzied prices.

Headhunting was rife in an environment where there was a severe shortage of personnel who could understand and use the technology. Coupled with shortages came high salaries. Some companies would offer a bounty of up to £5,000 for finding and recruiting an employee in their organisation. Traditional bricks and mortar companies with old-fashioned pay scales were unable to compete with the 'sexy young dot com scene' which offered high salaries and a stake in the company through stock options. The pull of the stock market flotations, with millions of pounds available and the promise to 'make a million', attracted many high-flying employees away from their relatively lucrative and 'safe' jobs. As in the case of 30-year-old Michael Ross, who quit his £100,000-a-year job at McKinsey management consultants to head up Easyshop, an on-line retailer selling lingerie.

There was also growing resentment amongst the old staff because new staff were often rewarded with higher salaries and allowed to work in a separate and more modern environment than their traditional co-workers. However, the argument was that these talented people made things happen and so they would have to compete. One executive put it bluntly, 'Fuck the pay scales and pay the market rate.'<sup>14</sup> Other companies offered stock options in the parent company. Others were thinking of spinning off their Internet businesses, to create 'valuation currency' in which key staff could share. One Wall Street analyst with the reputation of being a dot com guru was supposedly enticed to change companies with a deal worth about US\$7.5 million.<sup>15</sup> In the fast moving environment, loyalty was rare and incentives were in abundance to try and buy that loyalty.

A groundswell of contemporary folklore, legend and hype was created about teenagers, school dropouts or ex-corporate high fliers emerging from the chrysalis of garages, bedrooms, squats or cramped offices in Manchester, Birmingham and London, having come up with a simple idea,

designed a Web page and attracted investors, to become the dot com millionaire butterflies taking the stock exchange by storm. An *Observer* study<sup>16</sup> of Britain's new rich in 1999 revealed that there are 90 British multimillionaires aged 30 or under, most having made their money in the new cyber economy of the Internet, telecommunications and computers, overtaking more established industries.

#### CASE STUDY

Jason Drummond created a business registering names on the Internet and estimated to be worth £24m. Adam Twiss and Damien Reeves, Cambridge University graduates, started Zeus Technology, a company that develops Internet software, valued at £30m. Adam Laird, 27, left Boston Consulting to run Magicalia, after lining up £1m of venture capital to back its string of hobby-focused websites. Tim Jackson's on-line auction house, QXL, was about to float for an estimated £400m. This, however, was only small fare compared to their US counterparts – 29-year-old Jerry Yang, founder of Yahoo!, was reckoned to be worth nearly US\$1bn and Jeff Bezos, founder of the on-line bookseller Amazon.com, was worth US\$7bn. 'Everyone's looking to do something on the Internet and make money. It's a combination of the gold rush and the Wild West. It is nice to be in a room where everyone thinks they are going to be millionaires'<sup>17</sup> (Nick Denton, First Tuesday,<sup>18</sup> a business networking and matchmaking company).

The Internet stock surge was being led by people who traded shares on the Web. The growth of e-commerce was a catalyst for the growth of on-line financial services such as stock brokering and banking. Stock trading service companies like E\*trade and Charles Schwab set up low commission and simple on-line trading facilities, enabling anybody to become a day trader trading in and out of shares several times a day. Many people signed up to the notion of becoming shareholders at the click of a button and were investing in shares in the very short term. It was estimated that the average investor in Internet stocks only held that company for less than a week.<sup>19</sup>

#### CASE STUDY

Nicholas Birbas, a 25-year-old former waiter, gave up his day job making US\$500–600 dollars a week and is now making around US\$50,000 a month trading on the Internet. He epitomised the day traders who knew nothing about the companies in which they invested, did not examine balance sheets or financial statements but spent all day in internet chat rooms like Tokyojoe or Silicon Investor swapping tips and gossip. They then traded stocks hour by hour, watching for every small movement in the price. "I just play on momentum . . . When I see the volume taking off, fundamentals don't mean anything at that point. I get in and get out and just keep doing that," Birbas says. His ideal trade is around 2000 shares at \$20 (for an investment of \$40,000) then he waits for the stock to rise \$3 or \$4 and sells: An instant profit of around \$8000.<sup>20</sup>

E-trading contributed to the overall volatility and inflation of dot com stock. The increased numbers of 'day' traders led to a shortage of some shares, such as E-bay, and fuelled the inflated stock prices since supply could not meet demand.

Trading on the Internet also meant that rumours and speculation spread more quickly, through the use of the Internet and the numerous press releases or news stories about companies. A tip posted on a popular bulletin board, or broadcast by a particular analyst with little or no justification, was sending share price rocketing or plummeting. In the UK, a Channel 4 gameshow, *Show Me the Money*, had analysts making stock tips on the programme, leading to a number of companies experiencing a rise in their shares following the tips.<sup>21</sup>

In a couple of incidents, companies inadvertently benefited from the dot com fever rumour mill. Osprey communications, a London-based advertising and marketing company, experienced a rise in their share price (which had been stable for the past month) from 7p to 15p owing to mistaken identity, leading to the valuation of the company to almost twice what it was only a week previously. The Chief Executive of Osprey explained:

We hear someone was looking down a newspaper listing of media stocks, misread Osprey Comms as Osprey.com, assumed it was an internet stock and took a punt without really thinking why . . . It is very nice to see the jump in the company's share price but it is nothing to do with us. We do have an e-commerce division that is performing very well but nothing has changed at the company to explain the movement in the share price.<sup>22</sup>

Similarly a company called Rodime, a floppy-disk-making company based in Edinburgh, which was suffering losses, saw its shares double rising from 6.5p to 12.75p on the mistaken assumption that it was being merged or taken over by an Internet company. The same thing happened with a company called Ultima Networks, which enjoyed a 36 per cent rise in shares because of rumours of mergers/acquisitions.

An environment of information symmetry was created by the growth in the number of sources of financial information that was available to both professional and home shares traders. With the growth of the Internet came the growth of cable, digital and satellite television, which began broadcasting 24-hour programming. A variety of national and international television stations were broadcasting special programmes where financial information was available 24 hours a day and covered all the financial and business markets and economies of the world. Traders could instantly access a whole range of information delivered through the mass availability of financial information websites, television and radio, and make a decision to buy or sell and complete the transaction within seconds and at the click of a button.



And so the late 1990s witnessed this dot com frenzy on both sides of the Atlantic. The prediction for the new millennium was that it would continue. Ivo Philipps of Screentrade, the on-line stock brokers, predicted that 'There will be numerous internet launches and flotations in the first quarter of 2000, with further "phenomenal" growth over the next two years'.<sup>23</sup> But Nancy Smith, the head of investor education and the US Stock Exchange Commission, warned: 'What is happening is that investors are pouring their money into anything that has "dot com" after it. Nobody knows where it is going to end, who is going to be standing at the end of the day'<sup>24</sup>

### 'ALL THAT DOT COM GLITTERS IS NOT GOLD'

There is no doubt that the advancement of electronic commerce, and the birth of the dot coms that ensued, was a phenomenon that characterised the revolution in technology and the reaction of business and society to it. As with all revolutions there is a period of euphoria and optimism that drives the revolution onwards into the mainstream. With this move into the mainstream, reality reasserts itself, and where previously ignorance, naiveté, innovation, novelty and enthusiasm obscured the facts, a time for consolidation, reflection and analysis replaces the initial frenzy of euphoria. And so this was the case with the dot com boom. The following section will examine some of the high-profile dot coms that 'bombed' as a result of investors returning to sanity and sound practices of business analysis.

In mid-2000, the demise or takeover of a number of high-profile sites signalled the beginning of the dot com shakeout. Forrester Research published a report by David Cooperstein, 'The Demise of Dot Com Retailers',<sup>25</sup> predicting that the shakeout would be dramatic and bloody. The report predicted that of the hundreds of e-tailers in some market segments, at most only three would be left in each niche after the shakeout. It also predicted that a similar shakeout would occur in the business-to-business sector. Already B2B stock values have fallen dramatically (the share price of Freemarkets fell by 89 per cent) a trend which others are following. Forrester predicted that low profit margins, competition from established traditional businesses and lack of investor capital would drive most of the dot coms out of business by 2001.

PriceWaterhouseCoopers commissioned a report<sup>26</sup> to examine the 'burn rate'<sup>27</sup> (the length of time a company can continue to operate before needing to raise additional cash) of 28 Internet companies listed on the Stock Exchange (including techMARK)<sup>28</sup> and AIM.<sup>29</sup> The report's findings revealed that 25 of the 28 companies had short burn rates – the average being 15 months – but ten of the companies had a burn rate of less than



12 months and one in four had a cash burn rate of six months. This meant that 25 companies would have spent their cash reserves by August 2001, well before they could break even. They identified marketing and technology costs as being responsible for the fast rate of 'cash burn'. It also said business-to-business companies were far more likely to get extra funding than business-to-consumer companies.

Since 2000, there have been some very high-profile closures of dot coms resulting from cash burn out, fraud, overspending, inability to attract more funding and a range of other reasons. For example, Clickmango.com attracted £3 million investment, including investment from the English actress Joanna Lumley. The site sold natural healthcare and beauty products on-line and employed 18 people, but closed five months after its launch having only achieved £100,000 of sales. Other closures include Furniture.com and etoys (later bought for some US\$3 million and revived by bricks and mortar company KoB Toys, with an 80-year history of selling toys in the USA). So what is the reality of the dot bombs? Table 6.2 has been compiled to give a flavour of the kinds of Internet companies that have closed down and the reasons for it.

### Boo.com to Boo.bomb within six months

One of the earliest high-profile and often-quoted examples of a failed dot com is Boo.com. Boo.com, a European on-line clothing retailer, was finally launched on 3 November 1999 to a loud fanfare of publicity after overcoming five months of technical delays. The Swedish founders were Patrik Hedelin, a corporate financier, Ernst Malmsten, a poetry critic who dropped out of studying history, and Kajsa Leander, a former Vogue model. The trio originally came together to launch a Swedish on-line bookstore (bookus.com), which they sold to fund Boo.<sup>30</sup> Their ambitious aim was to be the first truly global shop selling a selection of branded sports and fashion goods in seven different languages and several currencies, using a virtual shop assistant (Miss Boo) to guide customers through the whole shopping and buying process. *Fortune* magazine featured it as one of the 'coolest' companies of the year.<sup>31</sup> Investors and shareholders in Boo included the French billionaire owner of the LVMH (Louis Vuitton Moët Hennessy) luxury goods group Bernard Arnault; the Italian clothing family Benetton; and US investment banks Goldman Sachs and JP Morgan. Investing an estimated £80 million, the company had offices in London, Stockholm, Paris, New York and Munich employing some 400 people.

Sales for the Christmas period were valued at over US\$100,000<sup>32</sup> when a report from investment bank CSFB ranked it as the number one retail site in the USA in overall e-commerce terms.<sup>33</sup> But this was not enough to save 100 jobs, which were axed in January 2000. It was later revealed that despite the five-month delay in the launch of the website, the management had ordered a whole season's worth of high-fashion sportswear, which it later had to sell at a discount as outdated stock. When the website was

**TABLE 6.2** A selection of dot coms to dot bombs

<i>Name of site</i>	<i>Details</i>	<i>Date of closure</i>
DrKoop.com.	A website based on the vision of Dr C. Everett Koop, the former US Surgeon General, who believed that people should be empowered to better manage their personal health with comprehensive, trusted information. drkoop.com provided users with comprehensive healthcare information, access to medical databases, real-time medical news, interactive communities and opportunities to purchase healthcare-related products and services on-line. Investors put in over US\$100 million.	17/12/2001 filed Chapter 7 <sup>a</sup> bankruptcy and is shutting down.
iPublish.com	Electronic book publisher part of Time Warner, selling electronic reprints of books and original e-books from new authors. At its demise, it had US\$10 million losses and axed 29 employees.	5/12/2001
Net2000 Communications Inc	Telecommunications company offering telecommunications services, videoconferencing and a range of other services. At their peak their market capitalisation was US\$1.5 billion and offered BMW cars to employees for signing on. They had already gone through consolidation processes by selling off different parts of the organisations and paring down the 900 employees to 200. The company is US\$115 million in debt.	20/11/2001 filed for Chapter 11 bankruptcy <sup>b</sup> and was selling off its assets. Ten of its affiliates also filed for Chapter 11.
allmybills.com.au	A major Australian dot com start-up received initial seed capital of US\$2.5 million and offered consumers a consolidated on-line bill-payment service. Six months later it closed, losing its 25 staff whom they still owed some US\$100,000 and owing creditors US\$1.2 million. No other funding was forthcoming. <sup>c</sup>	7/17/2000
Pixelon.com	The founder and CEO of Pixelon, Michael Adam Fenne, a computer programmer, was really David Stanley, an ex-con running from the law. He claimed to have invented a new way to broadcast video on the Internet, and was reported in the media to have 'developed the industry's most advanced proprietary system for compressing analogue media sources into digital multimedia files viewable by personal computers worldwide. The company holds eight patents surrounding its technology, and has an array of specialised delivery systems for its clients in the entertainment, advertising, sports, corporate and live broadcast industries'. <sup>d</sup> He raised around US\$30 million but this information was untrue. It was	27/6/2000

**TABLE 6.2** Continued

<i>Name of site</i>	<i>Details</i>	<i>Date of closure</i>
giftemporia.com	reported that he spent the money lavishly and even spent US\$16 million on a launch party which featured a performance by Kiss and The Who (in a very rare reunion gig) in Las Vegas. This high-end shopping destination had the backing of former President Bush (senior). Nine months later the site ceased to exist.	28/6/2000
somerfield.co.uk	British supermarket chain Somerfield announced it was shutting down its 9-month-old on-line shopping service on 25 June. 228 jobs will be 'affected'. This, however, was revived in 2001.	19/6/2000
PlanetAll.com	A Web-based address book/community site, which was acquired by Amazon. The Web page's excuse was that Amazon has 'succeeded' in integrating its services into Amazon.com.	20/6/2000
Flake.com	A portal for breakfast cereal. 'I'm discouraged, and I'm essentially broke', says the founder	16/6/2000
Surfbuzz.com	The on-line auction site informed its customers that it 'will no longer be operational nor continue to exist'. After burning through its cash.	7/6/2000
Toysmart.com	The Disney-owned retailer said it was going out of business after burning through most of its cash and being unable to raise more. Walt Disney Co. bought majority interest in 1999, six months before it went bankrupt. It had 170 employees at shutdown.	29/5/2000
Digital Entertainment Network (DEN)	Provided original Web videos for young people. More than 300 workers were laid off. DEN raised more than US\$68 million from Dell, Microsoft and others.	May 2002

*Sources:* This table has been compiled from a number of websites that have logged the failed dot coms, giving irreverent and sometimes obscene views of their failure<sup>e</sup>

*Notes:*

<sup>a</sup> Liquidation bankruptcy

<sup>b</sup> Under the bankruptcy code, a Chapter 11 filing allows a company to continue operating while it works with creditors to reorganise and develop a plan to keep the company in business.

<sup>c</sup> K. Nicholas, 'Allmybills runs out of Cash', Biz.com: [www.smh.com.au/news/0007/14/bizcom/bizcom03.html](http://www.smh.com.au/news/0007/14/bizcom/bizcom03.html)

<sup>d</sup> 'Actual Results May Vary . . .', The Industry Standard, 26/6/2000: <http://www.thestandard.com/article/0,1902,16361,00.html>

<sup>e</sup> Such as: 'dot com graveyard', Washington Post Online: <http://www.washtech.com/news/dotcom/6547-1.html>; 'Dot com doom', News headlines from Moreover: <http://www.moreover.com/cgi-local/page?o=portal&c=Dot%20com%20doom%20news>. Also, the archives of f\*\*\*kedcompany.com (the \*\*\* indicate the letters 'uck'), but be warned this website contains obscene and sometimes libellous material. Another site, which actually preserves the home page of the now defunct websites, is <http://www.disobey.com/ghostsites/> (compiled by Steve Baldwin, who keeps a museum of e-failures).

launched, it was too technically demanding for the target audience who were either unable to load it because it 'crashed' their PCs or because it took over an hour to place an order. Apple Macintosh users were totally unable to use the site, and complaints from potential customers were either ignored, or received a response that the site only catered for people with fast connections and the right equipment.<sup>34</sup> Despite website improvements that enabled an easier and faster ordering process and access for Apple Mac users, prices more competitive than high-street competitors and an increase in revenues to US\$657,000 for the month of February compared to US\$680,000 for the three months from November 1999, it seemed disaster was imminent.

In February 2000, Patrik Hedelin (aged 30) decided to return to Sweden to 'spend more time with his family' and took a non-executive role at Boo. He was replaced by the new finance director Dean Hawkins who used to be second in command at Adidas.<sup>35</sup> Hedelin stated that he may pursue other Internet opportunities as long as they did not conflict with his commitments to Boo, but denied there were any problems with the company, stating that it was normal for a start-up to have teething troubles in its early life. Hawkins and the technology manager (recruited from BSkyB) left to join other Internet firms very soon after. Rumours were rife that Boo were burning cash at a faster rate than expected and were attempting to raise an additional £20 million to keep afloat.

Pressure from their investors and shareholders finally led to the directors at Boo.com calling in liquidators from the accountancy firm KPMG after existing investors refused to add to the estimated £80 million and no other source of funding to keep the company afloat was forthcoming. Although those losing their jobs 'were obviously very angry', it was reported that recruitment agents were seen handing out cards to staff leaving the building. KPMG received 30 offers for the company within days of the announcement and expected to sell it within one week. The Boo.com era – associated with high prices; luxury expenses (including Concorde flights, entertaining at top restaurants and a champagne lifestyle); being dubbed 'the most expensive call centre in the world' by one analyst for employing 80 people in London's fashion centre, Carnaby Street, instead of the more typical call centres sited in industrial estates on the edge of medium-sized towns<sup>36</sup>; and a burn rate of nearly US\$20 million for each of the six months it traded – had come to an end.

Boo.com was sold to the US fashion Internet portal fashionmall.com for an estimated £250,000. This was mainly for the brand, the logo and the right to use the domain name that was established by Boo. The CEO of the company admitted to feeling fortunate that the original Boo team spent so much money on marketing. It expects to spend a maximum of US\$1m on marketing, compared to the US\$40m the original Boo spent. However, the high level of awareness they created is now helping her cause: 'Retaining the name Boo uses this awareness of the name to bring people to our site so they can see how great our product is . . . We have the same sort of irreverent sense of humour as our predecessors.'<sup>37</sup>

The new Boo is very different from its predecessor. They believe they have learnt many lessons from the original Boo. The new company has only nine employees compared to original Boo's four hundred, and is also financially secure with about US\$27m in the bank, which is estimated to last ten years based on the current burn rate. The new Boo also has a different business model, which the CEO explained:

We do not own and sell our own inventory, what we do is connect people to great e-tail sites and product. So our value to the visitor is about connecting them to interesting places through Boo . . . We have a very long-term view about this. We're not trying to take over the world in a year, we're trying to take over the world in a series of years.

We will have some of the same brands the original Boo had but when they are on our site it is not because of the brand, it is because the product is really cool.

It will work because we are applying the lessons of the original Boo to a new business model and retaining all of the positive elements of the Boo brand.<sup>38</sup>

Fashionmall.com focuses on the 18–30 American and British markets, and specialises in beauty products, clothes, gifts and toys – from hi-tech gadgets to motorcycles. There is also a community aspect to the site: users can talk to each other in the party section. The new Boo.com plans to make money through advertising and sponsorship on the website and is also developing a database that can be sold to companies that want to know about and target the people Boo.com attracts. Expectations were that the company would achieve profits within two years. In fact, the company broke even in the second quarter of 2001 and began to make a small profit (after reducing its staff to 3) in the third quarter of 2001.

In an epilogue to the Boo.com story, the founders were interviewed by the *Guardian*<sup>39</sup> 18 months later (October 2001) and answered charges of extravagance and inexperience, which they were in the process of reflecting upon in a book they were writing of their experience:

We made mistakes. I'm not denying that but a lot of the time I felt very isolated. I was left by myself and should have had a strong chairman who had been there before and could tell me 'Ernst, you can't do that, do this instead'.

I was quite young and inexperienced. I was only 28. The company was too ambitious. We tried to do everything in too many areas and too quickly and it was just unrealistic.

The structure was so complex that sometimes neither us nor the investors knew which of the holding companies we were supposed to be putting money into.

Everyone got caught up in the hype. It's easy to forget what people were saying at the time.

In response to the stories of their Concorde travelling (where tickets are around £5,000–£10,000 each), caviar eating and champagne quaffing extravagances that were part of the process of cash burn, Ms Leander said:

I only flew Concorde three times and they were all special offers . . . Some people might think it's glamorous to fly to New York every other week and have dinners with investors but I have a young child I hardly ever saw and I'd have rather been at home with her.

And that stuff about the free coffee and fruit. I mean doesn't every office have free coffee and fruit?

We only had two [parties] and they weren't as extravagant as people said.

Mr Malmsten adds:

We went out a lot because it was a new company with a good spirit but it wasn't charged to boo. Yes, I went to Nobu for dinners and yes it was glamorous but fashion is a glamorous business.

When boo closed it was the worst day of my life. It was so sad seeing all those people lose their jobs. A lot of them had become very good friends. I cried a lot.

If I do something else I need a mentor, someone who is a wise person who can in some way look after me. I felt quite alone at boo.

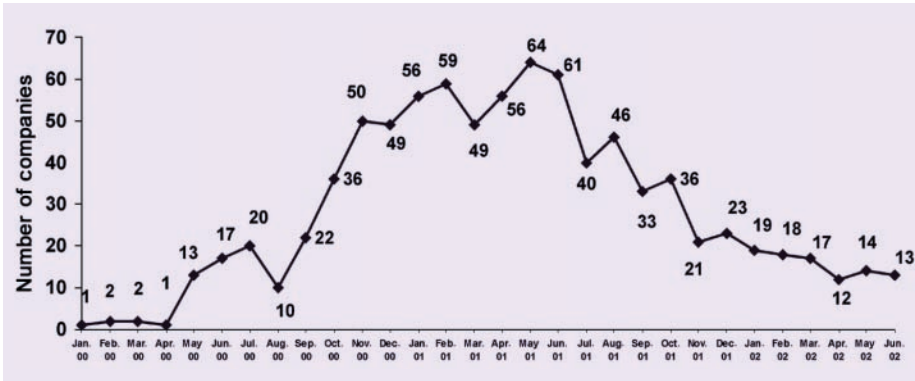
As well as the book being written by co-founders Ernst Malmsten and Kajsa Leander, the third partner, Patrick Hedelin, also wrote a book about the time at Boo.com which the other two refute as being in some instances exaggerated and untrue. A film production company has an option on the rights to the book *Boo Hoo: A Dot-com Story* and are planning to produce a film starring Richard E Grant and Famke Jansen, depicting the story of Boo.com in autumn 2002.

#### CASE QUESTIONS

- 1 What are the lessons that can be learnt from the experiences of Boo.com?
- 2 If you had been CEO of Boo.com how would you have done things differently?
- 3 Design a strategy for Boo.com to succeed today.

#### THE DOT COM SHAKEOUT

Webmergers.com is one of the leading providers of research and services for buyers and sellers of Web and technology properties, producing regular reports on the state of mergers, acquisitions and bankruptcies of Web-based companies. In a report by Webmergers in 2002, they estimated that in the period 2000–2001, there were around 762 closures – 233 in 2000 and 537 in 2001.<sup>40</sup> The chart in Figure 6.2 plots the monthly shutdown or declared bankruptcies of Web-based companies. The research is based on surveying published and personal sources, tracking shutdowns and bankruptcies of 'substantial' Web-based companies around the world. Substantial is defined as those that have received significant funding from venture capitalists, business angel investors or other formal investors.



**Figure 6.2** The number of Web-based company shutdowns (2000–2001)

Source: [www.webmergers.com](http://www.webmergers.com)

The height of dot com closures peaked between November 2000 and August 2001 and seems to be slowing despite the economic slowdown in the USA and some European countries in late 2001. It is broadly estimated that nearly two-thirds of the closures are US-based companies, around 10 per cent are Western European, around 2 per cent are from the Asian-Pacific region and one-quarter come from the rest of the world. The kinds of companies that were largely affected were those with a higher cash burn rate, mainly in the business-to-consumer sector, and nearly half were e-commerce based businesses (i.e. conducting transactions such as e-marketplaces and e-tailers), followed by a quarter that were content providers such as news and entertainment websites. Some argue that the closure and bankruptcy rate of dot coms is slowing because there are no dot coms left. Webmergers believe this is like saying ‘a decline in rabies rates is due to the fact that all dogs are dead’.

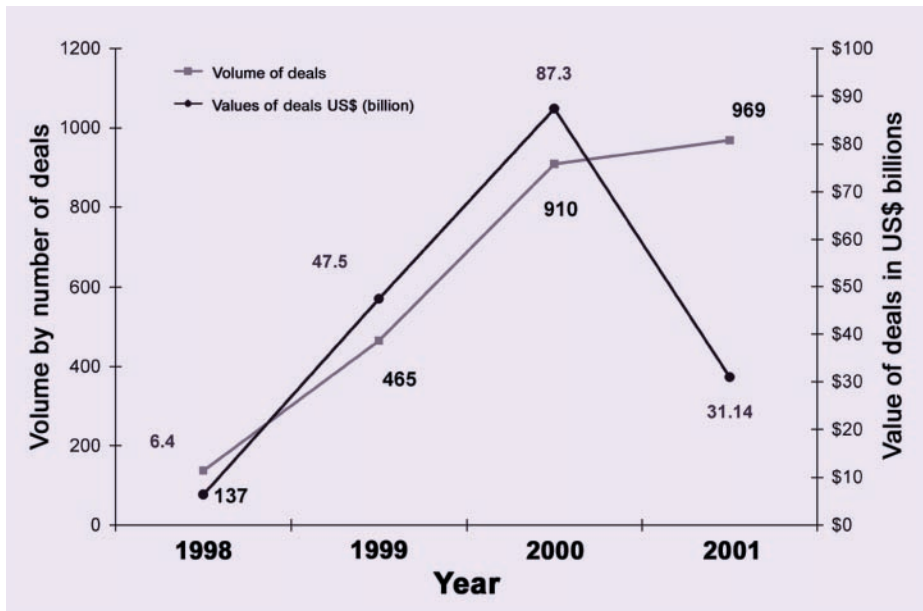
If these figures are put into perspective a different picture emerges. Webmergers conservatively estimate that there is a total of between 7,000–10,000 funded Web-based companies. This makes their failure rate around 8 per cent within the first 2–3 years of start-up. If this figure is compared to the average failure rate of ‘bricks and mortar’ start-up companies, most studies show that over 90 per cent fail within the first three years. The primary reason for such a high failure rate is that owners have to go through the learning curve of operating a specific type of business.<sup>41</sup> These figures suggest that there is more hype than substance in the reported failure of Web-based businesses. Far from being a failure, Web-based business on the whole has been a success (to date), with the stock market crash and the reporting of the high-profile failures (such as Boo.com) overshadowing the reality of the situation.



As well as the much reported closures of the dot coms, there has been even more activity in their mergers and acquisitions (M&A). For every closure in 2000 Webmergers found that there were almost four times as many Web-based companies being merged or acquired. This slowed in 2001, where for every closure there were nearly two Web-based companies that were merged or acquired. Figure 6.3 charts the volume and value of mergers and acquisitions over four years since 1998.

At the peak of the dot com frenzy, as cash burn rates reached unsustainable proportions, investors were reluctant and unwilling to invest any more funds in these companies. Web-based companies saw mergers as an alternative way of obtaining funding. In 2000, the time frame to get the deals done quickly for fear of being outbid was weeks, and often the merging and acquiring companies were not fully aware of what they were buying and how they were buying it. At the height of the frenzy, AOL (the Internet service provider) and Time Warner (the multimedia empire) merged in one of the biggest deals of the period valued at around US\$157 billion in early 2000. It has since had to make a one-off write-down of between US\$40bn and US\$60bn of goodwill in its accounts for the three months to March 2002 to reflect 'overall market declines'.<sup>42</sup>

As time went on, the dot coms consolidated their finances in the face of more realistic and reluctant investment making the companies



**Figure 6.3** Mergers and acquisition activity of Web-based companies (1998–2001)

Source: [www.webmergers.com](http://www.webmergers.com)

'cheaper'. The average deal fell from US\$10.2 million in 1999 and US\$9.5 million in 2000 to US\$3.2 million in 2001, its lowest level over the four years and the timeframe for closing the deal became longer. The stock-market crash further eroded the valuation of the Web-based companies, making them cheaper still. The majority of mergers and acquisitions activity (over 90 per cent) originated from US companies in 1998–9, underlining the US advancement in e-commerce the lifecycle. By 2000, the rest of the world was catching up and was responsible for nearly 75 per cent of Web-based company M&A spending.

The pattern in the types of companies merging and being acquired followed that of the closures. Initially the major interest was in the business-to-consumer content provider websites, slowly changing more to the transaction and e-commerce websites and more recently concentrating on business-to-business related websites such as e-marketplaces. In 2001, there was a further shift towards acquiring Internet infrastructure companies that provide such infrastructure as e-business software, network tools and other 'e-business enabling' technology, which facilitates core Internet applications such as customer relationship management (CRM), e-procurement, on-line payments, supply chain management, collaboration and enterprise resource planning (ERP). Technology companies like IBM, PeopleSoft, Siebel Systems, Microsoft and SAP began taking advantage of the low valuations to fill gaps in their product lines cost effectively. The acquisition of content and e-commerce sites was extremely small by the end of 2001, reflecting the rock-bottom valuations. However, these kinds of deals were not entirely dead, as in the case of the record-setting deals of Cendant's (a travel/finance/re-location/real estate services conglomerate) US\$2.9 billion acquisition of travel services provider Galileo International and Vivendi Universal's (the global media and communications corporation) US\$373 million bid for on-line music property MP3.com.<sup>43</sup>

As more Internet companies got into difficulties, the bricks and mortar retailers acquired complete fully functional websites at a fraction of the set-up costs – they cashed in on the brand, the technology and the existing customer databases without the risk of the dot com start-up. For example, Great Universal Stores, the UK's largest home-shopping group (who own Argos and Burberry amongst others), bought jungle.com<sup>44</sup> in September 2000 for £37 million, which was thought to be well below the suggested stock exchange floatation valuation of £750 million. Jungle, one of the most recognised on-line-brands in the UK, had already spent £2 million on developing the website and £5 million on a high-profile marketing campaign, and had 370,000 registered customers and recorded sales of just over £75 million, but still made losses before tax of £11.4 million.

In March 2000, Kingfisher (owners of high-street retailers Comet, B&Q, Superdrug and Woolworths) bought a minority stake in the thinknatural.com website (Europe's leading on-line retailer of natural

health products) for £3 million. As part of the deal, ThinkNatural would gain high-street promotion through Superdrug's 704 UK stores, and access to the supply chain and buying power of the health and beauty giant.<sup>45</sup>

## WHAT ARE THE LESSONS LEARNT FROM DOT COM SHAKEOUT?

We have discussed the dot com phenomenon – its rise and fall. The reasons why the dot com phenomenon began and ended can be divided into three core factors – the macro-environment, the impact of the technology and the micro-environment at the level of the firm.

### The macro-environment

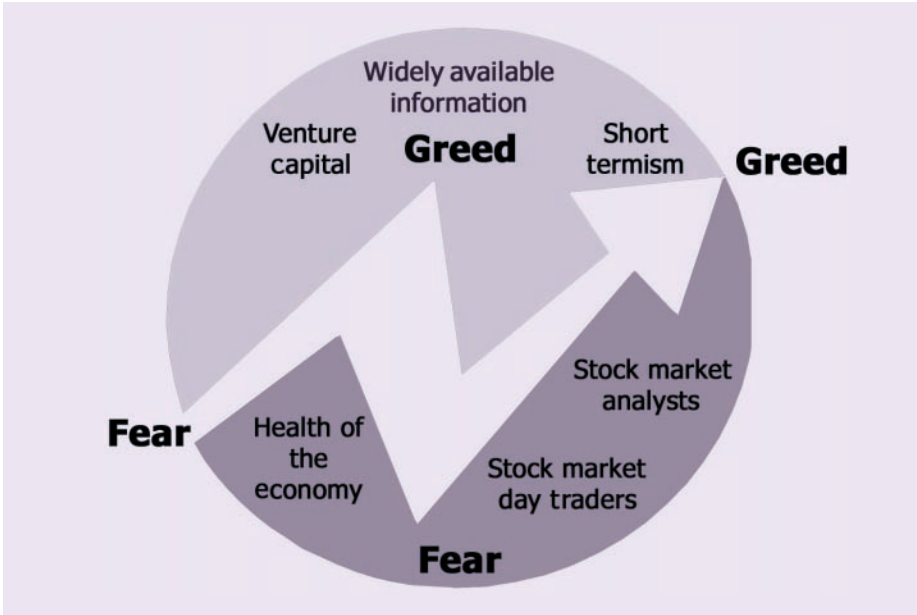
Initially the technology and capabilities of the Internet were understood by very few. In this climate, demonstrations of Web pages and their ability to capture, manipulate and present information was very attractive. Hit counters would show the number of visitors reaching millions in a month and so financial projections were based on these volumes of visitors being translated into potential sales.

*Venture capitalists* were swayed by the projections, and the real world business sense of many hardened analysts was obscured by the new technology. Similarly with stock market and equity analysts. They were influenced by the amounts of capital investment the business plans could attract and the keen interest from potential investors.

Not only this, but the *sports-style coverage of the equity markets* created a hype machine fuelled by 'star' research analysts like Henry Blodget of Merrill Lynch & Co.<sup>46</sup> There were also suggestions and accusations of a clash of interests, where the large investment banks giving advice on the performance of stocks and equities were the same banks that were handling the flotation of the dot coms on the stock exchange and so were far from impartial advisors – but either way they were benefiting.

Another macro-environmental factor was the introduction of *Web-based stockbrokers* that enabled *individual non-professional traders* to buy and sell shares instantaneously and as many times a day as they required for a minimal commission fee (around £10). This, along with the *widely available company, market and economic information* on the Web and through other media, fuelled the *short termism*, which drove demand for dot com shares.

The growth of *the world economy* meant that vast quantities of funding were available from both institutions and individuals to invest in the new technology ventures or dot coms.



**Figure 6.4** The dot com greed/fear spiral

All these events conspired to create a *greed spiral* upwards (see Figure 6.4), drawing in more investors and creating more of a demand for shares that were increasing in value by multiples of ten within days of issue. However, the failure to realise the projected levels of sales and profits and the inordinate rate of cash burn, coupled with the downturn in the economy, meant that further funding for investment was not forthcoming. Thus without further cash injections and with the heavy losses being experienced, the high-profile new start-ups were unable to continue and were either acquired or ceased to trade. The same factors that drove the greed spiral upwards now initiated the fear spiral downwards. The fear of losing further capital and any potential returns on investment exceeded the greed, which resulted in the different macro-environment factors impacting on each other compounding the slowdown further.

### Impact of the technology

This relates directly to a number of issues relating to the use and access to the technology. For example, the *Internet penetration rates* during the period were still relatively patchy, and so a large number of potential users could not yet access the Internet and the boast of global reach was limited to certain regions and countries. Not only this, but the cost of connecting to the Internet was still relatively high and dependent on a 'pay as you go'

basis rather than a flat rate. Penetration rates of *Internet-compatible computing equipment* were also overestimated and so again the number of potential users was much lower than projected. In the case of Boo.com the website was far too sophisticated for the computing equipment of the majority of its users and so it became inaccessible. Boo.com were adamant they were not going to cater for the lowest common technical denominator.

As time went on, more users came on-line, so there was an increase in user 'Web savvy'; people became more familiar with the World Wide Web, and no longer clicked on everything on a Web page to see what it would do. This in turn reduced the impact of Web advertising and so *Web advertising revenues* almost halved in early 2001. These revenues fell even further later on in the year, causing many dot com businesses that relied on advertising as an integral part of their revenue stream to collapse.

The dynamics of the Internet and World Wide Web mean that there is almost *infinite space on the Web*. With the increasing number of start-ups that transferred an existing business model onto the Web or, even worse, copied other companies (largely because funding was available), the advantages of the power of the Internet were not harnessed by many and so *too many sellers were seeking too few buyers*. Many of the business models required both a critical mass of buyers and a critical mass of sellers at the same time. Many of the e-marketplaces fell into this category and many failed because it was impossible to create the same level of critical mass at the same time.<sup>47</sup> The more creative start-ups leveraged Internet tools to produce such innovations as collaborative buying, price comparison facilities, e-procurement and bidding systems for a number of different products or services rather than just duplicate a mail-catalogue on the Web.

Because of the early stage of adoption of the Internet there was no empirical evidence or precedence of how to measure or interpret the success of websites. Different metrics, such as visitors to the site and number of page downloads, were used but there was a question mark over how effective they were in representing success. So as the general economic slowdown continued, advertisers and Internet sponsors were increasingly unsure of the wisdom of investing large amounts in websites.

### Micro-environment – the business

As with any business since the beginning of the history of commerce, a well thought-out and realistic business plan is crucial to its success. In the case of the failed dot coms, the *business plans and the business models were not thought through properly*. They were put together on the back of the dot com hype and were largely implemented by *inexperienced managers* and executives who were young, IT literate and understood the technology, but

who were unable to manage the large sums of venture capital. This led to a large amount being spent on technology which was largely put before the business, the revenue streams were overestimated, the salaries were over inflated, the borrowing was far too high and the cash burn rates were obscenely high (relative to other businesses). There was also a problem with the technology because, as one commentator said, 'we would get the orders for the website first and then figure out how to deliver it'. The bad planning not only extended to the revenue streams but also the logistics streams. In the case of etoys.com, they were too successful and could not cope with the logistics of delivery – which involved more frequent, geographically disparate deliveries of small packages to customers.

### WHAT ABOUT THE SUCCESS STORIES?

The story of successful Internet start-ups is largely as a result of doing the opposite of the failed dot coms. These Internet start-ups concentrate on a specialist or niche area of a product or service. Some initially involve home working to minimise costs. This is a crucial part of competent financial management needed to drive a successful business start-up which means reduced *not* inflated salaries and very little or no debts or borrowing.

With the lack of loans and borrowing, there will also be limited outside involvement, which for the entrepreneurial and competent management team would be more of a hindrance than a benefit. Advertising and promotions budgets are also minimised. It was estimated that the average dot com spent some £3–5 million on promotions and advertising. In the case of the successful start-up, advertising is initially mainly through word-of-mouth (or viral marketing) and electronic means (such as newsgroups), which has been found to be the most effective means of promotion over the Web.

Another factor is in-house technology or website-development skills. The profile of the management team should, if it is an Internet or Web-based business, consist of at least one member of the team with the necessary IT skills, otherwise there will be problems attracting and maintaining loyal IT staff critical to operations.

Finally, those Internet companies who have succeeded have projected and realised modest profits which grow at a steady rate year on year. There should also be no immediate plans for flotation on the stock exchange in order to make a 'quick buck', cash in the shares and retire on the proceeds, as was the intention of large number of people involved in the initial wave of dot com start-ups. Some examples of successful Internet start-ups that are still in existence in 2002 and have been so for over two years include:

- *Tesco.com* ([www.tesco.com](http://www.tesco.com)) – the retail supermarket giant’s on-line shopping service is one of the most successful in the food retailing sector.
- *Hard to find records* ([www.htfr.com](http://www.htfr.com)) – a specialist site that locates vinyl records and sells equipment for DJs.
- *The Alternative Gift Company* ([www.alt-gifts.com](http://www.alt-gifts.com)) – a specialist site that provides a service to locate gifts for specific occasions and people and also supplies and ships those gifts.
- *Jobserve Recruitment* ([www.jobserve.com](http://www.jobserve.com)) – the on-line recruitment agency is still privately owned and has won numerous accolades and awards as one of the most successful and fastest growing Internet start-ups since its inception and is only recently moving into multi-million pound premises to accommodate the growth in the company.
- *Online medical consulting service* ([www.med4u.co.uk](http://www.med4u.co.uk)) – the on-line medical consulting service run by a couple of qualified medical experts and practitioners who offer a fee-paying consultancy on-line, giving patients piece of mind and advice on their conditions and medication.
- *Internet estate agent* ([www.findaproperty.com](http://www.findaproperty.com)) – has also grown from strength to strength and is a website where agents can post the properties for sale or let and potential buyers can then contact the agent themselves around the world.

All of these sites not only offer the basic goods or services but also include information relevant to the visitor and the industry sector in which they are operating.

## SUMMARY

The dot com boom was fuelled by the introduction of new Web and Internet technology into the world of business. The Internet’s ability to reach a global audience, and so access global markets across time and geographical barriers cheaply and effortlessly, was the basis of many business plans that attracted hundreds of millions of pounds of investment and funding. Conventional wisdom was that the first to grab a substantial market share would win and retain their position as market leaders. The unrealistic projections of the business plans fuelled a frenzy amongst investors, stock markets, the media and the business community to get in on the act and benefit from the bonanza. The demand for shares in Internet and Web-based companies far exceeded supply and companies that were only weeks old, with little or no information on their actual financial performance, were valued at hundreds of millions of pounds. This made them bigger than the ‘traditional’ multinational corporations and



institutions that had been in existence for decades with a successful financial history. The spending on marketing and technology (seen as core to the strategy for capturing market share) spiralled out of control with some companies paying 400 per cent of their revenues on advertising. The dot com entrepreneurs were chasing growth at all costs – ‘It’s too soon for profits – they’re just not important,’ Forrester reported one dot com executive as saying.

The ‘burn rate’, the term analysts gave to the frenetic rate that firms spent money, was unsustainable and venture capitalists were unwilling and unable to pump more funds into ventures that were showing no financial returns. As more and more websites were launched, the market became overcrowded and it became difficult for consumers to differentiate between different sites. Companies like Boo were unable to build up numbers of buying customers fast enough to generate revenues to offset the high set-up costs and exceedingly high cash-burn rates. Since the high stock prices were based on unrealistic estimates of how fast profits and sales could rise, when losses began to mount, share prices plunged, which in turn hit confidence in the corporate sector. And so there was a return to rationality, which led to the demise or acquisition of many unsustainable dot coms.

With the consolidation of the dot com sector, so the economy returned to a semblance of stability with wages becoming more realistic, alleviating fears of potential inflationary effects and subduing the greed spiral. But just like the exaggerated and over-hyped report of the dot com bonanza, its demise has similarly been over-hyped and exaggerated.

Boo, and companies like it, taught many people some very hard lessons about remembering that a business plan is based on achievable and sustainable financial objectives.

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#### DISCUSSION QUESTIONS

- 1 What were the major catalysts for the rise of the dot coms?
- 2 What were the major catalysts for the fall of the dot coms?
- 3 Explain how the same factors worked together to first create the rise in the dot coms and then lead to their downfall.
- 4 Where do you think the dot coms of today will be in 2 years time and where will they be in 5 years time?

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