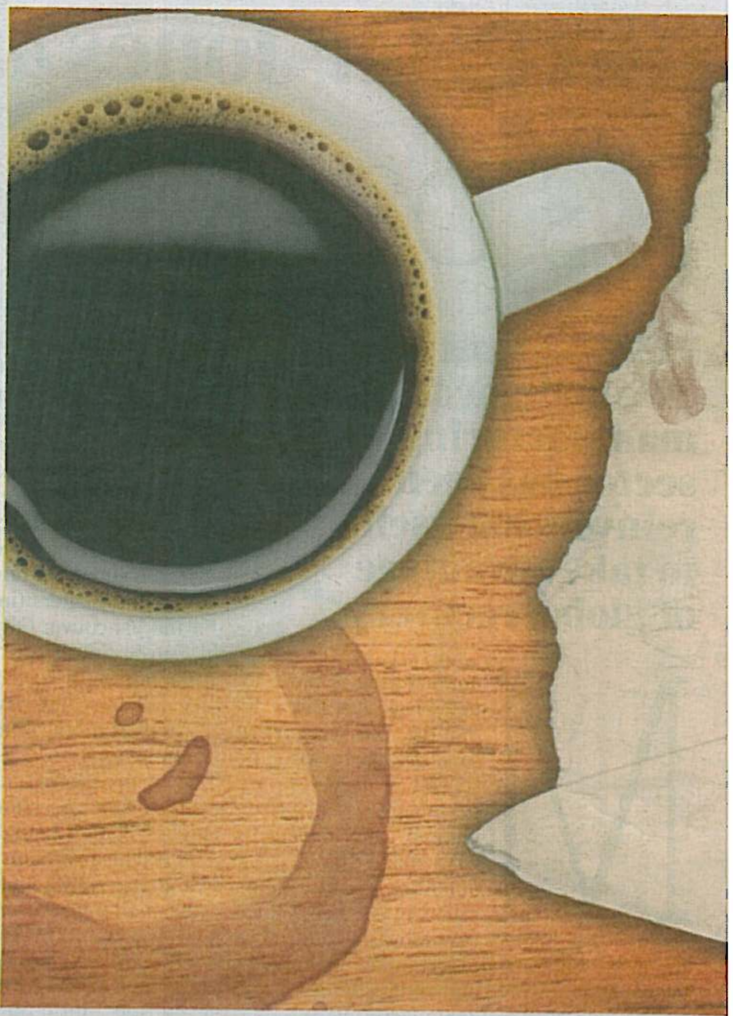
Legacy of the dot-com crash



It is easy to dismiss the era of fanciful business plans on the back of an envelope but, ten years on, Scotland is a more inviting place for budding entrepreneurs

by John Hatfield

Technology changes but people don't. A decade after the dot-com crash a whole new generation of social media entrepreneurs are speaking in tongues eerily reminiscent of their internet forebears in the heady days before the high point of the dot-com boom in March 2000. In both cases, the greatest danger lies in thinking that the rules of business have been rewritten.

Edmund Burke, the great political thinker, famously pointed out that those who don't know history are doomed to repeat it. The brief history of the dot-com crash proves a salutary, cautionary tale in this respect.

Back in the heyday of dot-com mania, businesses were falling over themselves to add an 'e' prefix to everything they did (e-business, e-commerce, e-tailing) or attach a .com or .co.uk suffix to their names. Today it is all about harnessing Web 2.0 and social networks, leveraging Twitter, Facebook. YouTube and blogs. The words to drop today are collaboration, mobile platforms, mashable content, and apps (as in applications).

Polly Purvis, executive director of Scotland IS, confirms the impact of Web 2.0. "The use of social networking and digital marketing is now an essential part of the marketing mix and companies ignore these new tools at their peril. Ten years ago it was inconceivable that social networking would be so firmly embedded in our daily lives as it is today," she says.

At the height of the hype, pundits, venture capitalists, analysts and entrepreneurs were queuing up to tell us that the rules of business had changed. Old models were obsolete. Traditional, battle-tested business plans were out and fundamentals like profitability and return on investment were ignored. A Klondyke mentality took hold, one which briefly ushered in a whole new set of values.

Suddenly, the plan for getting rich quick was to raise huge amounts of money from venture capitalists for an untested, novelty idea as long as it was based on the internet. These were sometimes literally written on the back of an envelope; Peter Wilkinson is reputed to have sketched out the idea for ISP company Freeserve on a napkin.

Indeed, mission statements such as the famous "Have fun, do cool stuff, get rich" were often indistinguishable from the business plans. Sand Hill Road and Menlo Park, home territory of the US tech venture capitalists, attained a Shangri-La like lure for budding e-business millionaires.

But everything reverts to the mean and dot-commers learned that they couldn't escape the fundamentals: If initial public offering (IPO) prospectuses were wish-lists then profit was the reality check. Most dot-coms had absolutely no idea how to monetise their ideas. A new set of investment indicators and terms entered the vocabulary. In pursuit of the fabled 'killer application' (Apple take note), burn rate became the main metric. This was effectively the rate at which loss-making companies with unviable business plans used up their capital.

Everyone was obsessed with exit. Sometimes this happened through IPO — selling a first tranche of shares to investors for large sums without having made very much, or even any money. E-Toys, for example, had an IPO at \$80 a share in 1999. It went bust 18 months later with its shares valued at less than \$1.

Notoriously, Sweden's Boo.com spent \$188 million in just six months trying to create an online fashion retailer. The problem? It was much easier for an established fashion retailer to graft on a web channel than for an internet start-up to create a trusted brand — and supply chain — from scratch. Long established catalogue retailer Great Universal Stores (GUS) bought Glasgow-based e-commerce solutions provider, Reality, in a £35 million deal.

GUS was superficially an old economy stock, specialising in the catalogues popular with mums, such as Kays and Choice.

But it had been a proto e-tailer, in all but internet access, for decades. It had enviable logistics and expediting experience, a proven financial services infrastructure, a valuable database of active customers and track record in providing the products that the market wanted. Adding an end-to-end fulfilment online to this was much easier that doing the whole process back-to-front.

The GUS purchase of Reality was a classic instance of the alternative to exit by IPO; a trade sale to a well-established traditional player who was under pressure from investors and analysts to graft on some sexy dot-com aspect in order to boost the share price. This reached its apotheosis when AOL bought Time Warner in a deal that proved a fiasco.

Internet companies were paying hundreds of pounds to acquire customers who would then only spend a few pounds on the site. Hard business sense was replaced by voodoo economics.

This manifested itself in the land-grab fixation with market share as 'growth now, profits later' became the mantra. Entrepreneurs could tell you how many hits they received on their site but not how they were going to monetise that traffic. One of the legacies of the dot-com boom is that a whole generation now expects everything for free on the web and has scant regard for intellectual property rights.

How it all adds up

5,048.62 The all-time high point of the Nasdaq stock market index on March 10, 2000.

\$5 trillion Fall in market value of Nasdaq technology companies from March 2000 to October 2002.

March 1985 Symbolics Computers of Cambridge, Massachussets, becomes the first company to register a dot.com internet address.

1997 Registration of the one millionth dot.com.

\$99 billion The loss made by AOL-Time Warner in 2002, following the bursting of the Internet bubble.

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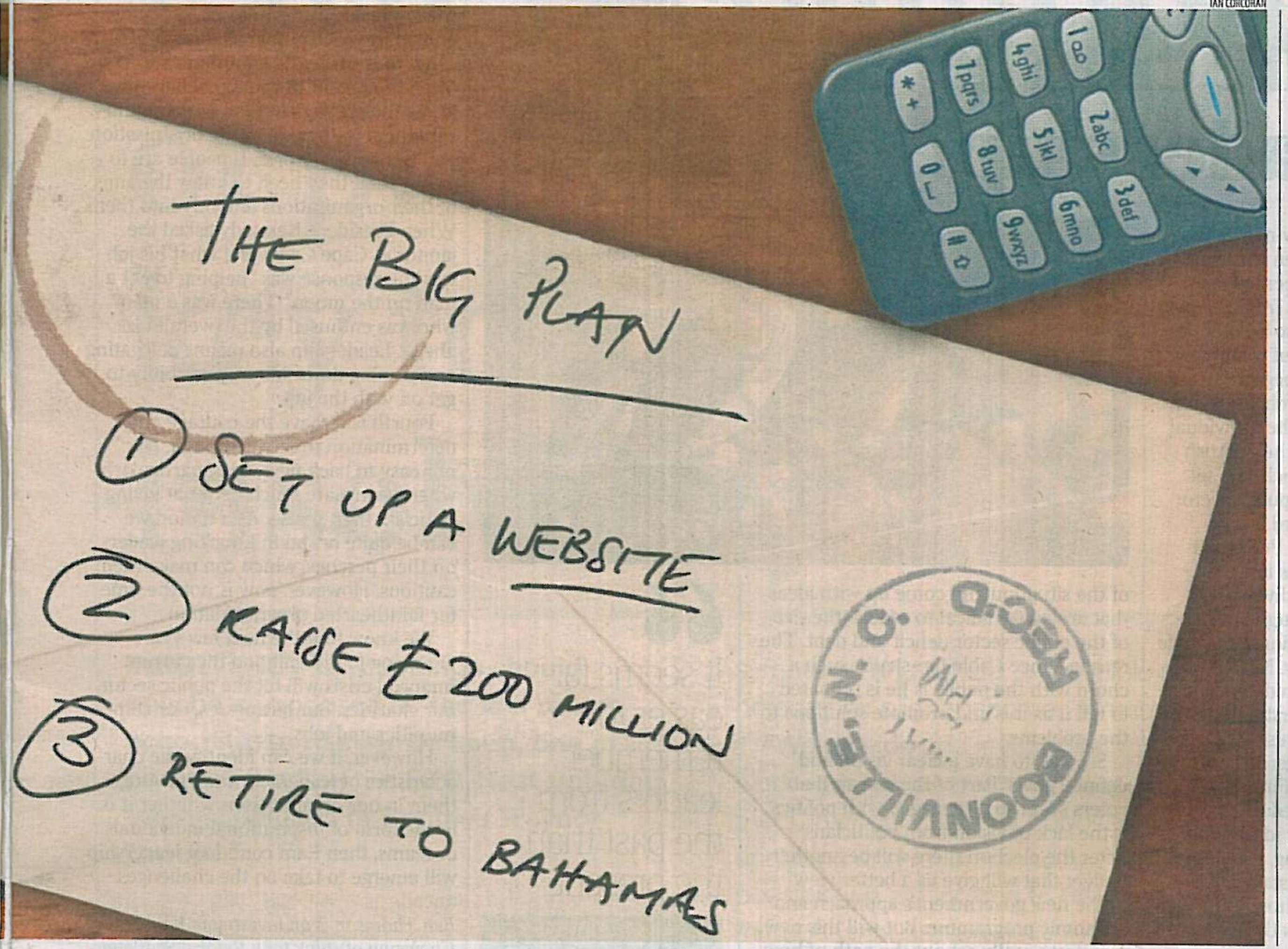

Winner on the Web

Self-confessed IT geek Gareth Williams, chief executive of Edinburgh-based Skyscanner, created what is now the biggest flight search engine in Europe during the dot.com boom.

Starting with an Excel spreadsheet of destinations and prices, Skyscanner began as an underground project which grew by word of mouth. As hits to the site rose exponentially Mr Williams and co-founders Bonamy Grimes and Barry Smith realised they might have a winner and gave up their day jobs. Putting their own money into the start-up they launched the site officially in 2001.

It proved to be a shrewd investment and attracted backing from leading Glasgow-based SEP, which itself has become Europe's leading venture capital firm in the past decade. The company's latest accounts show the firm grew revenues by 75% from £2m to £3.5 million. Even in depths of the recession, the year-on-year growth is 80%.

It is now a global brand and offers flight searches in 20 languages and 64 currencies receiving about two-thirds of its business from outside the UK. Traffic currently comes to the site from 233 countries around the world, with 7.5 million people performing 50 million searches on the site each month.

However, despite everything, the dot-com era was largely a success. Many great companies emerged that now dominate the economic landscape: Amazon, Google and eBay. The boom also produced a slew of incredibly successful Scottish dot-com entrepreneurs such as Mick Jackson of WildDay, now Europe's largest online outdoor store; Mike Kinsella, who founded Saw-You (now WeeWorld) and pioneered social networking in the process; and Skyscanner (see panel, right.)

Despite the doom-mongering, a major US study found that found that 48 per cent of dot-com companies founded since 1996 were still around in late 2004, more than four years after the crash. Far from being the wipe-out that everyone imagines, the dot-coms have been more resilient than the players in previous booms from automobiles to television and radio.

Lessons have been learned from the dot-com era as Gary Ennis, managing director of Glasgow-based business web specialists, NSDesign points out: "The web has essentially come of age since the dot-com boom and bust that crippled organisations like boo.com. User generated content, comments, reviews, and recommendations are now what sell products online, rather than traditional advertising.

"Online advertising with social media provides highly-targeted marketing to niche audiences and specialist groups. It's early days in the monetisation of social media. Better to remember to always listen to your customers, rather than simply be hypnotised by the 'numbers' and the lure of profit that these volumes might suggest."

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And the landscape for the current generation of social networking entrepreneurs' is radically different today. Online delivery is as good as desktop applications. The cost of entry is much lower with open source and cloud technology available to start-ups. Finally, the population as a whole is much more web savvy than it was ten years ago.

One of the greatest lessons from the survivors is that niche is best. While the headline-grabbing strategy during the bubble was to become a category killer, completely dominating an entire market, those that have thrived tend to be in micro-niches.

One such example is Scottish online retailer, Vacuum Cleaner Bags. Rob Beer, director, set up vacuumcleanerbags.co.uk at the height of the dot-com boom and was an early adopter of the e-commerce channel. He believes that the model has now come of age: "Advances in technology over the last ten years have allowed our Scottish based business to compete effectively on a global stage. While specialist stores are disappearing from our high street, they are appearing in ever-increasing numbers on the internet.

"Small businesses no longer need to be local businesses. Vacuum C=leaner Bags has the ability to stock hundreds of different types of bag — something that high street competitors could never do. We're also able to outsource our fulfilment functions in a way that only large firms could have contemplated 10 years ago."

The greatest lesson of all was that the internet is a channel and not a sector. That goes for social media as well. Companies that realise this simple truth are the ones that thrive. The company with the fastest growing web presence, globally, at the height of the dot-com boom was not a funky internet start-up or even a big ISP or search engine. It was Tesco.