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PORTALS
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The Dot-Com Bubble Is Reconsidered -- And Maybe Relived

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The traditional history of the dot-com bubble has been told many times: Too many companies rushed into the market in defiance of all known business fundamentals, and when the crash came, all but a tiny fraction of them just as quickly imploded and went away.

That received wisdom, though, is now getting a going-over by economists, business historians and others, some of whom are coming to new conclusions about what precisely went wrong during the bubble years, normally dated from the Netscape IPO in August 1995 to March 2000, when Nasdaq peaked at above 5100.

A recent paper suggests that rather than having too many entrants, the period of the Web bubble may have had too few; at least, too few of the right kind. And while most people recall the colossal flops of the period (Webvan, pets.com, etoys and the rest) the survival rates of the era's companies turns out to be on a par, if not slightly higher, than those in several other major industries in their formative years.

The paper is being published in a coming issue of the Journal of Financial Economics. As noteworthy as the findings are, even more interesting is the process that led to them. The work is an outgrowth of the Business Plan Archive at the University of Maryland. Its goal is to become a kind of Smithsonian Institution of the Internet bubble, saving for posterity every business plan, PowerPoint presentation and venture-capital term sheet -- the more frothy and half-baked, the better -- that it can get its hands on.

David A. Kirsch, a professor of management at the university's business school and one of the authors of the study, said it relied on a thorough examination of one particular treasure trove at the archive: every business plan, roughly 1,100 in all, submitted during the period to an East Coast venture firm.

The VC office later closed and donated the papers to the archive on the condition it remain anonymous. Prof. Kirsch said that while the office would be considered second tier when compared with the famous names in Silicon Valley's Sand Hill Road, the 1,100 firms he studied were representative of all of the companies started during the period.

Looking through those business plans, and contemporary press accounts, the study identifies a defining business strategy of the bubble era: Get Big Fast. A business was supposed to grow as quickly as possible because the first successful entrant in a category could keep out challengers. If a company was able to successfully get big, it could use that position to later finesse other questions, such as how it might one day actually make money.

Belief in this "first mover advantage" is today tempered by a new awareness of the risks of being the first out of the chute. Back then, though, VCs used Get Big Fast as their basic investing strategy, despite the absence of any evidence that it worked. By the spring of 2000, however, the world was beginning to wake up to the fact that it didn't work. The crash followed soon thereafter.

The study suggests, though, that the dimensions of that crash might be misunderstood. Nearly half of the companies they studied were still in business in 2004. Prof. Kirsch says that most people believe just a few percent made it through.

The study found that the attrition rate for dot-com companies was roughly 20% a year, which is no different from what occurred during many other industries, such as automobiles, during their early boom periods.

Most of these survivors, though, aren't the titans like Amazon or eBay, but much smaller efforts such as wrestlinggear.com, which sells equipment to high-school and college wrestlers, what Prof. Kirsch called precisely the sort of demanding niche market for which Web shopping was invented.

The fact that so many dot-com companies survived suggests that even more could have started. But that didn't happen, says the study. Investors following conventional wisdom of the day were interested only in companies that could dominate an entire industry. In looking for these, they ignored smaller niche opportunities that had the potential to become modest but profitable enterprises.

"It turns out there were lots of nooks and crannies for entrepreneurial action," says Prof. Kirsch. "But those nooks and crannies might have been $5 million or $10 million businesses -- well worth doing, though not necessarily for VCs."

The paper's other authors were Brent Goldfarb, a University of Maryland economist, and David A. Miller, of UC San Diego.

While they didn't deal with the current Internet bubble involving "Web 2.0" companies, it's clear that a variation on Get Big Fast is alive and well today, just a few years later.

Companies like Interactive, eBay and Google are spending hundred of millions, often billions, on start-ups such as MySpace, Skype and YouTube, which have developed a commanding market presence but without actually making money. Some of the explanations for these purchases have a certain logic; others seem like dot-com déjà vu.

It will take awhile to know whether things will turn out differently this time. But bubbles always have happy endings, don't they?

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