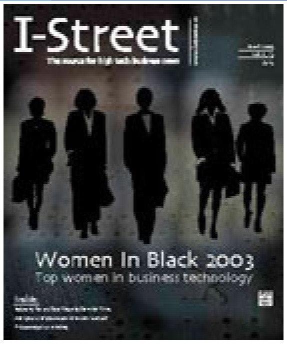

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The School of Red Herrings
by Christopher Rollyson

Market analysis and commentary

The current uncertainty in the investment climate reflects pessimism regarding technology and Internet companies as well as a collective inability to value technologies that are imbued with discontinuous change. This uncertainty contains numerous false assumptions—red herrings—that serve to mislead the markets and prolong the mood, discouraging investment in technology companies for the wrong reasons.

Moreover, these herrings underpin many of the decisions that companies, investors and individuals are making, which will cause these decisions to have less than optimal results. By exposing some of the assumptions here, I hope to challenge what has become conventional thinking and to awaken some members of the market from their slumber.

The School

Herring One: "The markets proved that the New Economy was largely hyped—and that Internet technology actually carried little value."

This assumption contains two parts. First, depending on how one defines the "New Economy," it can be partially right. If the New denotes constantly rising stock values, overnight millionaires, and huge marketing budgets spent vying for first mover advantage, I certainly agree that it was hyped and represented relatively little durable value.

Second, roping Internet technology with the "New Economy" is wrong because the basic value proposition offered by Internet technology in general remains valid (changing the economics of communication).

In fact, the words "New Economy" epitomized the hype around the Internet and technology and carried little value other than mass awareness; it also served to divert attention from the real story, that Internet applications could significantly reduce transaction costs and improve customer satisfaction.

Approached from the perspective that the global economy is a jungle of transactions (interactions), anything that significantly reduces these costs would have a tremendous impact on the economy's efficiency.

The rub is that "applying the Internet" to the global economy's Zillions of transactions is an extremely ambitious undertaking, and realizing this value will take time. Success will come in pockets and isolated spurts, hardly the stuff of which legends are made. The markets and investors in general haven't caught up with the distinction between the "New Economy" and Internet technology yet.

Herring Two: "The number of layoffs and VCs' and corporations' losses show that it was all a pipe dream."

To be sure, most VCs are smarting from some of their investments, but this is a game that they know well, and they are busy doggedly scrubbing their portfolios. They see it as a business cycle, a necessary exercise that "comes with the territory."

That said, there is an interesting wrinkle this time: traditionally a cottage industry known to only a few financiers and entrepreneurs, venture capital has exploded into the limelight during the past five years, and their funds increasingly come from mutual funds, a trend which impacts average people, who may well harbor this assumption.

The VCs may experience a backlash because some mutual funds may not have the stomach for serious risk. No VCs who are worth their salt fail to understand the value proposition offered by the Internet or technology; rather they are constrained by the realities of their portfolios.

Likewise corporate losses have a mixed impact because most corporate executives have been educated enough to understand at least some elements of the value proposition of Internet technology, and by now they appreciate the difficulty in transforming their enterprises. They can also understand their considerable losses as an unfortunate but certainly not catastrophic cost of learning how to improve their business. As a group, they do not believe it was a dream; they are more likely to harbor the third assumption.

Herring Three: "We suspected all along that the momentous change proposed by the Internet was exaggerated, and we accelerated e-business projects reluctantly to the tune of stratospheric IT budgets. Now we're happy to go back to business as usual and approach it incrementally."

This is the corporate cop out and, from the enterprise perspective, it is especially dangerous because it also contains the first false assumption, and corporations take so long to implement profound change within their organizations that they haven't a moment to lose.

Since one of Internet technology's key value propositions is reducing transaction costs, we can see that corporations, since they contain a large number of transactions, have the most to gain from implementing Internet applications and e-business strategies.

However, they are also subject to the complexity that profound change represents, and success won't come overnight. It will take a sustained, committed effort, mistakes can be difficult to correct, and sidelining themselves now may have very unfortunate consequences.

Herring Four: "Do you mean that I'll have to run this company for seven years before maybe realizing a windfall? No way!"

The entrepreneur cop out. There is no question about it, the funding climate has changed drastically and may never be the same again. Many entrepreneurs launched ventures in an era of relatively easy money, and the change can be hard to accept. The thrill of creating and selling a company within two or three years was so exciting, and it became an attainable goal in the minds of some entrepreneurs and VCs.

It's difficult to say what the timing of exit strategies will look like in the next several years. Count on longer! The emotional downside for some entrepreneurs is that it begins to look like a "regular job" with its slower progress, sustained effort and returns that may have less perceived upside. Not quite as tasty as the "New Economy" idea ;-(and tough to take sometimes.

Herring Five: "Once investors wake up, it will be business as usual, and I'm going to wait it out."

The individual cop out, which parallels the corporate cop out, is much easier to understand and correct. The main danger that it holds for the individual is that it can lead to sidelining oneself during the current turning point.

People who have robust career plans can make serious gains during the current period in which the market is sluggish. Because many people are stalled, wondering what to do and where things are going, it's possible to move ahead by acquiring the knowledge that will be useful during the current transformation.

Use an old consulting trick and assume a transformation: pick an industry area, reflect on how web applications will impact a bricks and mortar "industry." Picture all the transactions (interactions) that take place in that "industry" and what it will mean as they are increasingly conducted digitally at a fraction of the cost. Build knowledge of the transformation, and pursue work that helps to increase that knowledge.

Herring Six: "I don't know if I want to play in this game if the upside isn't in the triple digits."

The investor cop out usually harbored by people who haven't been in the game very long, which includes the majority of the population that came into the tech market in droves during the past five years. As we've all heard by now, sustained triple digit returns are always short-lived, and this time was no exception. Part of the "New Economy" hangover is accepting that, although it's by no means business as usual due to the transformation that's taking place, more modest returns will be the order of the day. Take a look at the experts: VCs have been in the game of investing in high tech companies longer than almost anyone, and as an industry, [illegible] average 15-25% over long periods.

Conclusion

The rapid change in the market for technology and the Internet during the past year represents the aggregate of numerous factors, some of which have changed and others that have not. While no one can change market conditions, it is possible to profit from the opportunities and threats that they present. For example, using technology to reduce transaction costs is valid and will prevail in the market, so positioning oneself, whether as investor, employee or corporation, within the market to build knowledge around that fact will pay off as an investment.

On the other hand, it's probably a good idea to throw the "herrings" overboard: they're more than three days old!

About the Author:Christopher S. Rollyson specializes in e-business strategy for bricks and mortar as well as business strategy for start-ups, most recently for PricewaterhouseCoopers Management Consulting. Since 1994, he has had numerous strategic, managerial and analytical roles relevant to e-business transformation. He can be reached at http://www.rollyson.net.