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*Spanning the Chasm from Thought to Action*

**DigitalBridges2004**  
**January 24-25 2004**

## **Dotcom Déjà vu – Why Not Buy Google?**

### **Facilitators**

Peter Garcia-Sjogrim '03.5

John Schirm'05.5

### **Panelists**

John Davidson '68, Silicon Valley private investor, serial entrepreneur

Jim Robinson '84, Principal, Middlebury Capital LLC

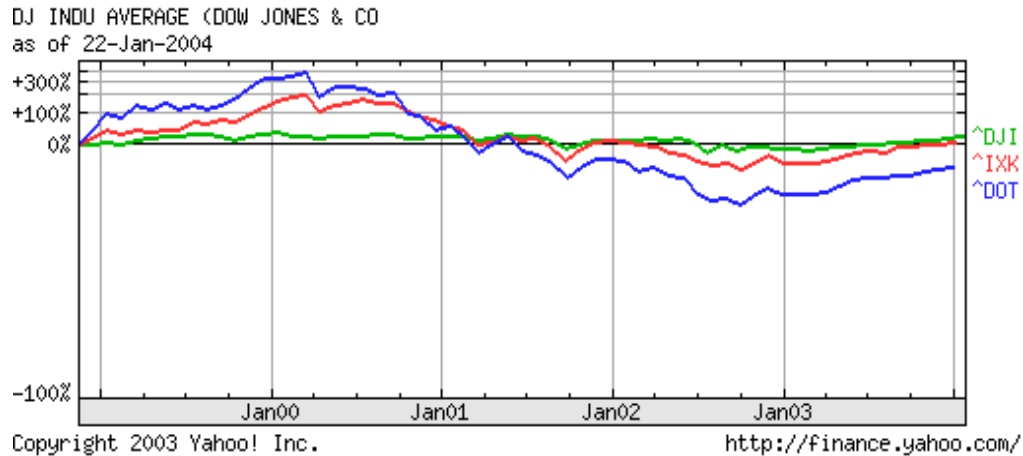
Jed Smith '88, Managing Director, Catamount Ventures LLP

Dotcom Déjà vu examined the burst of the dotcom bubble in 1999-2000 and its aftermath. Central to the discussion was what many see as the question of the day, “Is the technology market back, or has it disappeared like betamax?”

First on the agenda, however, was defining the notion of a market “bubble.” While somewhat cumbersome, the panel took the Fed’s definition as its working premise, “A sharp rise in price of an asset or a range of assets in a continuous process, with the initial rise generating expectations of further rises and attracting new buyers – generally speculators, interested in profits from trading in the asset rather than its use or earning capacity”<sup>1</sup>. In other words, a bubble is caused when traders are buying on price speculation alone, and disregard the standard metrics: the company’s earnings potential, or even if the company has earnings at all. Under these circumstances, price inflation and the ultimately bursting bubble can be blamed on overzealous investors and is not the fault of the technology or the companies.

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<sup>1</sup> (Federal Reserve Bank of Chicago: Conference on Asset Price Bubbles, 22-24 April 2002)



Jim Robinson '84, Principal, Middlebury Capital, who drilled deeply into the ideas behind a bubble, believes that bubbles are good for an economy. "Bubbles are useful for defining a new space and attracting talent to this space... and industries that create bubbles often are good spaces for people to enter because they can create their own niches and redefine business plans."

The panelists agreed that the 90's bubble was a hyperactive time for the market, and that it was indeed inflated by equity markets investors, rather than by the tech companies or the largely young and somewhat inexperienced people who led them. The emerging companies were alien to investors, which translated into replacing traditional (proven) valuation methods with those based on Website hits and eyeballing measures because "a growing proportion of a firm's assets--brands, ideas, human capital--are intangible and often hard to identify, let alone value."<sup>2</sup> Investors were also new to the Internet and computers, and were excited over the potential that each seemingly had for ushering in a totally new business paradigm; it was even touted as The New Economy.

Investors also mislabeled many companies as "technology" when they were actually traditional companies that were changing their business models by introducing technology into supply chains and operations. Amazon.com, Google.com, and Drugstore.com, for example, were delivering traditional services --books, advertising, and health and beauty supplies. Internet and computer technology did make these company's new business models possible, and they did lower distribution costs, but new technology was not being created or innovated.

Putting this new spin on traditional businesses totally redefined the way investors thought about commerce, and posed a large problem for valuing companies. These things combined with the large purchasing power of institutional investors, and the frenzied nature of the investors helped run the market up and caused further speculation.

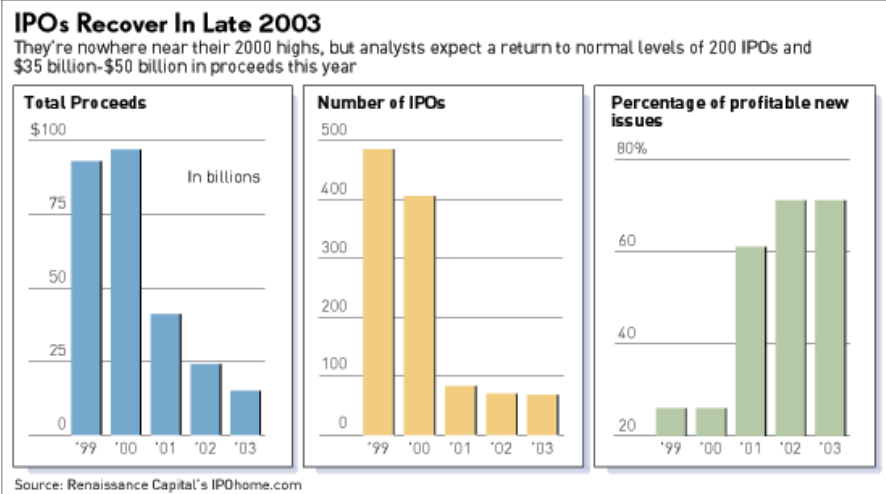
<sup>2</sup>(Bubble Trouble: <http://tiger.berkeley.edu/sohrab/politics/economist.6.html>)

John Davidson '68 a technologist who helped build the Internet gave his worm's eye view as to what he believed caused the bubble to burst. He believed one factor was that companies receiving venture money were given too much. This drip feed of funds kept them too comfortable, and eventually they lost their innovative edge. John also felt that Microsoft helped to cause a great deal of the market's downturn, because their monopoly on operating systems allowed them to bundle software. Because Microsoft could put Internet Explorer and other Windows utilities in every version of Windows, they were able to force small companies out of business. Microsoft software worked much better because it used Microsoft packets, and protocols that fit perfectly with the operating system. This lowered the demand for third party packets, protocols, and software, driving many smaller companies out of business. With the disappearance of these smaller companies there was less demand for products such as network hardware and computers, this in turn dragged the whole computer and Internet technology industry into a downward spiral.

The question of the day, "is tech back," was answered with each panelist giving his best forecast for the future. No absolutes were established, but each panelist had an interesting prediction for the future.

Jed Smith '88, Managing Director of Catamount Ventures, started his discussion by using parking prices as an indication of the economy. He explained how they peaked at the pinnacle of the bubble, bottomed out when the market crashed, and have appreciated since the trough. The upward trend was not just a phenomenon seen in the computer and Internet technology industries; it reached all the way down to parking, moving into all areas of the economy.

Jed and Jim pointed to the increase in the number of IPO's for 2004. The IPO market during the bubble was unlike anything investors had ever seen. Companies that were not fundamentally sound were able to float enormous amounts of equity without producing earnings. After the number of IPOs coming to market dropped, there was a shift back to traditional fundamentals. Companies that were going public had to prove that their business models were sound by posting profits or near profit levels. This was a drastic change from 94-99. 2004 is already experiencing an IPO buzz with profitable big name companies such as Google and Salesforce.com coming to market.



Jed also cited his own venture portfolio showing a decrease in employees during the crash, but an expected increase in employment for 2004. Like the market this increase in employment was not a return to the peak, but it was a correction and would lead one to conclude that the market was moving towards a proper valuation of the new industries.

### Jobs

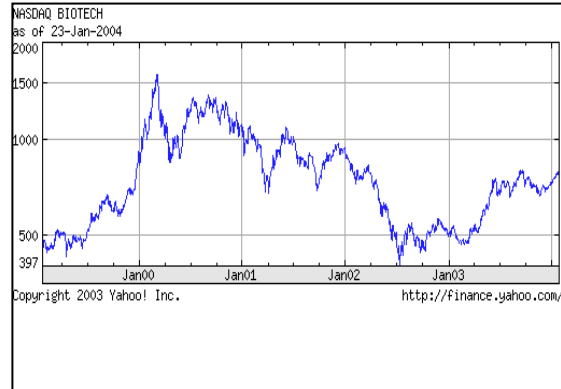
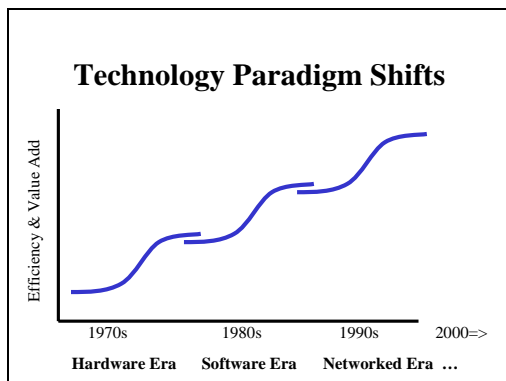
- CNN estimate that there are 6,500 tech firms that are among the walking dead
- Employees in Catamount Portfolio
  - 2000 Employee count - 525
  - 2001 Employee count - 450
  - 2002 Employee count - 275
  - 2003 Employee count - 250
  - 2004 Employee count - 325 estimate
- 85% of Silicon Valley CEOs expect to be hiring in 2004
- High tech layoffs accounted for 17% of 2003 layoffs. 33% in 2002

Technological advancement will continue to drive the market, as both Moore's<sup>3</sup> and Metcalfe's<sup>4</sup> Laws hold true. As society's computing demands increase users will demand more power and greater networking capabilities especially in the their homes.

Given that technological shifts come in waves, Jed showed that we are most likely on a plateau awaiting the next technological paradigm shift. There is a plethora of technologies which could lead to a technological shift such as new energy sources, nanotechnology, bioinformatics, and wireless technologies. Some of these have already experienced baby bubbles as Jim showed in nanotechnology and biotechnology.

<sup>3</sup> (Moore's Law: Every 18 months, processing power doubles while cost holds constant.)

<sup>4</sup> (Metcalfe's Law: The usefulness, or utility, of a network equals the square of the number of users.)



John Davidson also echoed the thoughts of both Jed Smith and Jim Robinson on the comeback of technology. He was able to give his perspective from “inside” the industry being involved in four technology start ups. He saw the industry emerging from a “nuclear winter,” with a few small companies surviving. But the ones that had survived, possessed good fundamentals, and were at near profitability levels. The lack of venture and angel capital due to the downturn of the market meant that these companies had to be relatively self sufficient. He compared them to the first drop of oil out of the Alaskan pipeline, they were not great in volume but they were a paramount event that signaled a turn around.

None of the panelists saw Google as a corollary to Netscape. They did not believe it would be the catalyst to set off another bubble. Rather, Google was more an indication of where the industry was going. It is a company with sound fundamentals leading the industry out of the crash. Google does not have a robust pipeline of new start-ups following it to trigger another speculative bubble. It will be followed by small companies based on sound fundamentals that are trying to innovate and created new technologies. There are possibilities for bubbles to form around other new technologies, but as stated these are good, and will help to define new industries.

The computer and Internet technology bubble seems to be over, but tech is back, and in reality it never left, it was merely shadowed by the bubble created by speculators. New technologies will emerge and create new bubbles, but these are necessary to take our economy into the future.