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OPINION

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Viewpoint

Internet: When enthusiasm gives way to disillusionment

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While the landscape is littered with dot-com obituaries, the Internet remains a transforming technology, vital to the future of business interests everywhere.

Like other transforming technologies, the Internet attracted investors like moths to a flame with its promise to rewrite the laws of competition, spawn new industries and create new sources of wealth.

And like other transforming technologies, unbridled enthusiasm gave way to disillusionment as the harsh realities of building and operating a successful business set in. The Internet has not "changed everything."

No silver bullets

In the 1850s, the railroads, another transforming technology, began a period of expansion not entirely dissimilar to the Internet's development. Obviously the drama unfolded far more slowly, but the railroads attracted huge sums of capital from American and European investors alike and laid new track at a phenomenal rate.

In 1916, the American rail network hit its peak at 254,000 miles, all controlled by eight to 10 groups rather than the 25 systems operating some 20 years earlier, and nationwide railroad employment reached 1.7 million.

Today, U.S. railroads operate a scant -- by comparison -- 132,000 miles of track and employ 200,000 people. Interestingly, total market capitalization for the U.S. railroads in 1916, adjusted for inflation, approached $35 billion, a number slightly less but close to the current industry total.

So what have we learned? New technology will always generate enthusiasm, encourage speculation and attract large sums of capital. And after a period of intoxication comes withdrawal and, in turn, efforts to rationalize the technology and weave it into our industrial fabric. Whether railroads or dot-coms, "old economy" or "new economy," there are no silver bullets. Businesses will rise and fall based on their ability to satisfy four fundamental needs:

1. To build a successful business, a company needs to find an attractive market. In assessing market opportunities, several questions come to mind. Specifically, is the market expanding? How is it structured? Is it dominated by a small number of powerful players or fragmented with many buyers and sellers? What are the entry barriers and switching costs? Do the sellers earn acceptable profits? Do buyers have unmet needs?

2. Companies must offer a compelling value proposition. What is the unique combination of products and services that will encourage trial usage, change buyer behavior and promote widespread adoption? As many have already discovered, it takes more than low prices.

3. Companies must come to market with a viable business model. They must create value for customers, suppliers and shareholders alike and the path to profitability must lead predictably to a meaningful return on investment.

Being first offers advantages and establishing a large user base creates potential but, in the end, how will the company achieve a critical mass of profitable customers?

The recent $363 million failure of Webhouse Club provides one of the more spectacular examples of a company closing its doors because it lacked a sound business model. Shoppers liked the low- cost groceries but manufacturers and suppliers never bought in and the company had to subsidize consumer transactions.

Online advertising sales, once considered a sustaining source of revenue for online ventures, have failed to materialize as hoped. Yahoo! realizes nearly 90 percent of its revenues from online advertising and the company expects its 2001 revenues to drop 30 percent from the $1.1 billion generated in 2000.

DoubleClick, one of the largest digital advertising/marketing firms serving some 2 billion banner ads per day, recently released first-quarter 2001 numbers and reported that its media revenues dropped 23 percent from the same period last year and 24 percent from the prior quarter.

Nor are transaction fees the answer. Assuming a transaction fee of 0.5 percent, a company wanting to return 25 per over a five year period on a total investment of $100 million must process billions in transactions per year.

Enabling technology

4. The new company must establish a sustainable competitive advantage. If a company wants to compete effectively on price, it had better establish itself as the low cost supplier. The Internet didn't change this.

In the end, the Internet is an enabling technology. Again like the railroads, the Internet cannot create primary demand for goods and services. It can, however, serve as a tool, allowing companies to better serve their customers, reach new markets and create efficiencies. The Internet will continue to attract attention and, for many companies, it will prove pivotal. Established companies like Grainger (B2B) and Walgreens (B2C) have deployed Internet technologies to strengthen their competitive position and it's working. Importantly, these companies have not changed their basic strategy or value proposition. Rather, they have embraced the new technology to increase their competitive advantage.

Looking forward, both established companies and startups will continue seeking ways to exploit new technologies, increase efficiencies and create value, but, unlike those who so quickly came and went, some will survive because of their ability to address these four fundamental needs. Perhaps there's no "new economy" after all.

John Forrester is a Jacksonville-based business consultant.