Now That We’re Still Here, Where Do We Go? 7 Answers

By SAUL HANSELL

Hundreds of millions of people surf the Web, hundreds of billions of dollars of stock market value have come and gone, and yet the burning questions posed by the Internet have cycled back to the same ones asked five years ago, when people first started to size up the Internet.

Can anyone make money with this? Will it be a viable medium for advertising? For shopping? Where is this all going, anyway?

Two years ago, it seemed as if there were answers to these questions. But there is nothing like a plunging stock market and a generation of pioneering companies teetering on collapse to sow new doubts.

To try to figure out what we have learned from the wild ride so far, this section convened a panel of seven people who have been taking chances through the ups and downs of the Internet:

Patrick Byrne, the chief executive of Overstock.com, a rapidly growing site that sells surplus merchandise, much of it bought from failed e-tailers.

Bill Gross, the chief executive of Idealab, which spawned companies ranging from CitySearch to Goto.com to eToys.

Vincent Caminiti, the senior vice president for e-business at Delta Air Lines.

Mark T. Hogan, the president of the e-GM unit of General Motors.

Ted Leonsis, the vice chairman and new products officer of the America Online unit of AOL Time Warner.

Roger McNamee, the general partner of Integral Capital Partners and Silver Lake Partners, two private investment firms that focus on technology companies.

Stephen Riggio, the vice chairman of Barnes & Noble and the acting chief executive of Barnesandnoble.com.

Earlier this month, the panel exchanged e-mail messages over one week.
Q. A year ago, companies that had anything to do with the Internet -- media, commerce, business to business, infrastructure -- were valued at hundreds of millions, often billions, of dollars. Today, most are worth fractions of those sums. Other than the market itself, has anything else changed?

Ted Leonsis: All truly large and scalable/profitable media businesses have multiple revenue streams. At AOL, we have subscription revenue, advertising sales, local classified like sales, eCommerce transactions and merchandizing. Newspapers and magazines have subscriptions, single copy, advertising and classifieds. Cable has sub fees; local and national advertising. So---most of the businesses that have blown up have had single revenue source models. When that singular source dries up---you are toast:-). So---multiple revenue streams is key. Secondly---most major media companies have multiple titles or enterprises to leverage their expenses and to cut their costs and cash consumption via cross promotion synergies. This is one of the motivators behind the AOL and TW merger. Building single title or singular focus enterprises without any leverage or synergy is a recipe for huge cash needs and hopes of patience from investors. Consequently, the industry is ripe for consolidation and a wave of mergers and acquisitions to weave more multitle; multi brand organizations with shared costs and infrastructure.

Vincent Caminiti: Some traditional companies have elected to form a separate e-subsidiary, setting up new compensation plans, tracking stocks, and removing themselves from their core business. This is problematic as the "hidden" assets are owned by the core, require functional areas’ participation, and therefore are integral to the online success. You cannot separate your online activity from the core strategy. Delta recently formed an e-Business unit that is still connected to the business of operating an airline, not a separate company. This e-Business has dedicated leadership, senior management support (from CEO level), and organizational alignment to the operating units. Our previous organization had functional areas that had their own online strategies and initiatives with little coordination, little accountability, and sub optimization of assets. Our new approach enables us to assign ownership, provide focus and accelerate implementation. Obviously, with the slowing of the economy, cost pressures grow. However, our e-business initiatives support the core business and promise a sound return on investment and will therefore continue to receive the necessary funding.

Patrick Byrne: Mistake #1: Overstock devoted only a tiny portion of its marketing budget to advertising on sites that deliver eyeballs and branding. The mistake was that we devoted ANY money to such sites. The proper amount to spend on branding on the Internet is $0. Mistake #2: As a startup company 18 months ago, we outsourced our fulfillment operations to an experienced third party warehouse company. It failed. We found another experienced third party fulfillment company. They also failed. Only last summer did we build our own warehouse to the special needs of liquidation and closeout purchasing. Since then, we have shot from oblivion to #4 on a recent Bizrate survey of total customer satisfaction (and one of the firms ahead of us is in its death-throes).
The lesson is that outsourcing mission critical operations to experienced 3rd parties can lead to ruin: when things are going wrong they don’t lose enough sleep. How are we preparing for the economic slow-down? Since we are in the business of buying failed businesses, we are keeping our own powder dry while we pray for rain.

Steve Riggio: What fast growth company doesn’t make mistakes? Let’s call this one a case of starting a new venture on one very large mistaken assumption. Like most companies that jumped into e commerce aggressively we believed that the Internet itself, from a purely transaction perspective - computer to computer- would be an extremely efficient way to process customer orders. In effect, lower than traditional catalog mail order, which would lead to a fast-growth, low cost producer model. Nice. In fact, the cost of physically processing orders - the picking, packing and shipping, is something we excelled at almost immediately and has steadily improved. We now have the most sophisticated and efficient direct fulfillment book distribution centers in the book industry. The higher than expected costs come before and after the order is created and this has nothing to do with marketing. In this respect, the Internet could be regarded as the most expensive way to do business in the history of civilization: large data centers and call centers were not what we expected and every e commerce (selling consumer products that are shipped from point to point) colleague I know shares this belief. The cost of building and maintaining an e commerce platform that could handle rapid growth as well as support a rapidly evolving technology environment has been substantial. Companies that jumped in early had the added challenge of creating application and technology work-around in the midst of fast growth. The call center situation is a curse and a blessing. Bill Gross is dead on when he says that successful companies are going to need "tight feedback loops with customers". The Internet has given our customers the controls as well as a voice and they certainly use it. The curse is the huge costs associated with handling the enormous volume of phone calls (yes, they call) and e-mails. The blessing is the powerful feedback customers provide. If that feedback is properly channeled back into the organization you have a market research arm worth its weight in gold. On the positive side of all this we are now getting leverage from our e commerce platform as our growth continues to be healthy. On the call center front, our inquiry to order ratios are rapidly declining as we learn the business and take action from our feedback loop. What e commerce, and catalog mail order for that matter, is missing is a "store manager" level of responsibility, authority and accountability. In a retail store, the buck stops with the store manager. They are the most important people at Barnes & Noble. In a large scale e commerce or catalog business, there is no similar individual. While feedback loops are important they don’t get close enough to the customer.

Bill Gross: Steve, What you say about store managers and commerce, let alone ecommerce, is so true. Think about an in-store situation. A line forms at checkout. A good store manager sees this, and either calls out some extra help at checkout, or opens a new window himself/herself and says "may I help the next in line?" A bad store doesn’t do this, and you stand in line and get madder and madder until you finally drop your merchandise and walk out. Maybe this
happens a few times a day, or maybe even a few times an hour - hopefully never in a great store. Online, very often, you have no one watching. Things like this and much worse are happening all day long, maybe hundreds of times an hour, sometimes thousands, and if you were to judge by abandoned shopping cart data, much much more. Now to be fair, you have a higher hurdle when you go to a physical store, you are up the commitment ladder in that you have already expended the energy to bring your body to that store, so you won’t "abandon your shopping cart" quite as easily. And online, you may have had to only type a few letters (if your url is a.com) and then a few clicks to fill your shopping cart - much lower time and energy investment. Nonetheless, the point I wanted to make was to say that still, often, no one is looking. Much better software needs to be created online for observing, tracking, improving, and optimizing the shopping experience online, to refine it and surpass, in the few ways that it can surpass (not in the tactile and other sensory part, but at least in the anticipatory and solve problems part) a physical world retail experience. Granted, it’s only been a few years, and it’s amazing what has been done, but I also feel there is a long way to go, and people should not write off the experience based on these first few years. It took mail order many more years to reach the same percentage of retail sales than the Internet. But we still have time, and a long way to go to both approach a great store manager, and then maybe in some respects pass that.

Roger McNamee: Bill Gross said "Over the past several years, some incredibly bad businesses were launched as people experimented to learn the differences between great, mediocre, and bad business propositions online." What mistakes have you made and learned from that helped you improve your own online business? What have you learned by watching the mistakes of others? Also, are you doing anything differently this year specifically to hunker down for the slowing of the economy? Experimentation is one of the most important attributes of our entrepreneurial economy. One of the great aspects of manias is that they enable massive experimentation at the time when that experimentation is most valuable... in the early days of a new industry. Although manias ultimately have painful consequences, historically these consequences have been outweighed by the benefit to U.S. society of dominating a new industry. Very little new has been learned. Most of the lessons of this mania have their roots on tablets handed down from on high in some distant epoch. Examples: * Cash is king. (Corollary: the difference between a business and a business plan is capital.) * Profits matter. * Stories that appear too good to be true usually are. One of the hard parts about Internet mania was that it lasted long enough to create its own set of rules. Well educated, hard working, rational people actually believed for a while that "Internet time" was real. For a time, Wall Street believed that the value of a start-up was proportional to the commitment it could make to buying eyeballs on Yahoo and AOL. More recently, investors believed that revenue growth greater than 100% per year justified whatever level of spending (and losses) were required to generate it. In the fall of 1998, an exceptionally highly regarded venture capitalist actually told his investors that his firm did 28 deals in one month because saying "no" to mediocre deals was costing more in terms of profits than the firm could possibly lose from saying "yes" to bad deals. Sadly, the collapse which inevitably follows a mania teaches
its own set of spurious lessons. The most popular of these on Wall Street today is that you "can’t make money in B2C." Inevitably some good ideas will get wiped out with the bad ones because no one cares to tell the difference.

Roger McNamee: Question 3 follow-up to Steve Riggio: The fulfillment side of e-commerce appears to be particularly challenging, both in terms of cost and complexity. None of the established fulfillment models -- hub and spoke (used by traditional retailers to replenish stores), mail order or infomercial -- works very well for Web retailers. One issue is single unit shipments. Another is the relatively unpredictable timing of orders. A third issue relates to customer expectations. For some reason, customers have huge anxiety about their on-line orders. They call early and often to check on order status . . . which completely destroys the economics of the sale. The economics of certain large retailers will support the creation of dedicated fulfillment infrastructure. Unfortunately, the cost and complexity of fulfillment centers is so high that I suspect most etailers will prefer to work with third parties, such as SubmitOrder.com in Columbus, Ohio.

Roger McNamee: Follow-up to Ted Leonsis: More is almost always better. That said, the economy is replete with examples of hugely successful one product companies. Intel is an example.

Ted Leonsis: I can give you a good example. I thought, back in 1994, that people could be entertained online. We experimented and failed. What I learned was that people wanted to PLAN their entertainment online. So--we oriented our local group--Digital Cities, Moviefone, and Mapquest--to this consumer need. This local group is now fastest growing area on AOL, and is very profitable. So--live and learn!

Bill Gross: Our lessons learned include these: 1. The CEO and the senior management team are probably the number one and two most important things to a company’s success. We look for incredibly talented, experienced, and adaptive leaders - adaptive so that the business can change to the signals its customers are telling it. 2. We look for higher gross margins, and higher barriers to entry. It’s not just about moving fast, but about making sure that the fundamental business proposition and strategy allow for building strong competitive barriers, so that your business can thrive for the long haul. 3. We are building businesses that can sustain a multi-year period of tight capital markets, and which set realistic spending levels and growth rates to get to its milestones of profitability. So the lesson is grow your company safely within the parameters of the money you’ve raised, and don’t expect to return to capital markets without significant progress. 4. We are accelerating, not contracting our growth of new businesses, because we believe that the long-term potential right now is terrific, so the lesson learned I guess, is, don’t pay attention to the stock market, but do pay attention to fundamental value creation and the markets will catch up to that eventually.

Steve Riggio: I agree that the retail fulfillment model does not apply to e-commerce. Most of our retail store shipments are composed of dozens of units
while consumer orders have a little over two units. That sets up entirely different requirements for handling product efficiently. I believe that e-commerce fulfillment models closely mirrors, if not precisely matches catalog mail order. In our case, we were able to locate an e-commerce fulfillment center literally yards away from the parent company’s distribution center, which is the largest warehouse in the book industry. So we had the goods at hand and were able to "ingest" those goods quickly into a direct fulfillment system. Early on, we built it "by hand" in order to learn the unique requirements & idiosyncrasies of orders from Internet customers. Once we had a good command over this and had established target service levels we invested in a completely state-of-the-art center. I believe it prudent for most retailers to outsource this function at the beginning. Until one knows more about the business & understand the costs associated with various levels of service you can’t make big capital investments or divert time & resources to functions like this. Once you decide to bring it in-house, there are more than enough good professional consultants in this arena - you don’t have to reinvent the wheel on materials handling or supply chain management. The disadvantage to outsourcing, of course, is that you are putting your customers in the hands of another company. The bigger one gets, the more one is exposed to that company’s performance and financial well-being. Yes, e-commerce customers call often and it is the straw that broke many companies and not just from the sheer cost of handling orders. Unresolved complaints, unanswered phones and poor service is the single best way to destroy customer relationships and lifetime value. One unique challenge of e-commerce has been giving customers unambiguous information about inventory status. It is the number one reason customers call and most of it is related to poor systems. Many companies claim "real-time" when it is really batch mode. Getting the inquiry to order ratio down requires a feedback loop leading to action. You have to draft top ten lists, whittle them down and draft them again.

Patrick Byrne: Some of the issues mentioned here, such outsourcing warehouse operations and investing in systems for one’s own warehouse, hinge partially on the type of product being sold. Setting up a warehouse that sells 1 million identically-sized CD’s/month is quite different from one that handles liquidation, we have learned. More specifically, we have products that vary in size from watches to big screen TV’s, which are rolled over constantly (the average closeout buy is 60 units), and which have to be sold from a pick-pack-and-ship facility. After dealing with two well-known 3rd party warehouses, both of whom failed miserably, we realized no one knew how to do this because no business before us (that we could think of) faced all three constraints. One of the most common mistakes I see on the Internet is over-investment in warehouse systems. If one has a dog’s mess of a warehouse operation, and one throws a bunch of systems on top of it, one gets a computerized dog’s mess.

Roger McNamee: In the fall of 1998, an exceptionally highly regarded venture capitalist actually told his investors that his firm did 28 deals in one month because saying "no" to mediocre deals was costing more in terms of profits than the firm could possibly lose from saying "yes" to bad deals. How did those 28 companies do? Was he right in retrospect? Many of you are being quite harsh to
the venture capitalists who fueled the mania. Have they paid a price, learned a lesson. (Bill who has much in common with a v/c did offer his lessons.)

Patrick Byrne: A year ago I spent two months meeting with venture capitalist, none of whom were in this group, and so what I say is intended with no disrespect to any of members of this forum. With the exception of perhaps 3 or 4 that I met last year, my experience of VC-land was acutely negative. I did not expect it to be so. I am an investor by background, and my sympathies are more with capital than with visionaries. I have heard people complain about their companies being "stolen" from them by VC’s, and always mentally said, "Fella, you sold a sliver of your firm, then another sliver, then another sliver: if you woke up one day and only had a few crumbs left you have no one to blame but yourself." That was my attitude going into it as I met with VC’s. Yet I received term sheets from three different VC syndicates who wanted to invest $20-30 million each, at pre-money valuations just under $100 million, and those term sheets were an embarrassment to capitalism. They read in essence, "I’ll put in $30 million with you but you have to promise to triple it (and if you don’t it comes out of your hide, Byrne); if you sell the company we get out $30 million back, another $30 million, then our share of what’s left; if we don’t like how you are running the company we can (for 5 years) put the stock back to you and get our $30 million back with interest, and if it all goes under we get our $30 million back first." That to me is not yous-knows-da-game-yous-takes-yours-chances capitalism. It is crybaby investing. I turned them all down because I did not want that kind of an investor as my partner: I wanted an adult who would study the business, study me and my colleagues, and decide whether or not to step up. I have met a very few, VC’s who are willing to play that way.

Ted Leonsis: That investment strategy was called "chuck and duck." Like all businesses--there will be two to three big winners that dominate the category and scale--and then get a disproportionate piece of the value creation. As a limited partner in 3 or 4 big VC houses, I have asked the partners how they will reinvent themselves? Their answers to date are as poorly conceived as many of their investments!!! I think we will see new approaches to investing including developing companies and products that fill niches in the offerings of major companies such as Cisco,Microsoft,Oracle,AOL/TW,etal.I believe we will see a real partnership develop between great vc’s and major companies to codevelop new things! In essence, VC’s wil be funding off income statement r&amp;d for these companies.These new companies will share teh partners infrastructure; and teh exit--more often than not--will be a planned acquisition.

Roger McNamee: Anyone who wants to understand how markets evolve should just study AOL. The company has been hammering away at the on-line market opportunity since the mid-80s, trying one thing after another, getting a little smarter every day. Great franchises -- and great industries -- do not emerge full grown from Zeus’ head. They evolve over the course of a generation. My guess is that we will be able to reconvene this panel every three or four years for the next twenty . . . and there would still be compelling issues to discuss.
Roger McNamee: I think Steve is right on target here. SubmitOrder.com has emerged as the leader in third party fulfillment precisely because it understood the need for facilities designed from the ground up for e-commerce. SubmitOrder’s systems are real time and its customer care solutions are an extension of the brands it represents.

Roger McNamee: My sense is that every investor who participated in the Internet mania - from VCs through the public market -- did some deals or made some investments that they would love to rescind today. The firm I mentioned has been a Tier 1 player for many years . . . and I am quite confident that their brand will survive whatever bad judgments they may have made in late 1999. Others will be less fortunate . . . and some big brands will be wiped out. C’est la vie

Steve Riggio: The Barnes & Noble Superstore concept didn’t grow out of "Riggio’s Head" in a flash of vision. In 1971 we were independent booksellers who bought the Barnes & Noble company (then a single store) that was mostly known for selling textbooks. The first modern generation "superstore" appeared almost 20 years later. The time between was spent experimenting with many bookselling concepts in a variety of environments (shopping malls, strip centers, urban downtowns). When we opened our first new generation stores they were 15,000 square feet and the NY publishers thought we would go bankrupt ("too big, nobody reads books in New Jersey"). Our stores today average 25,000 square feet. We’re still learning

Bill Gross: I think that all truly great companies are "adaptive" to the marketplace. It’s not so much that they have multiple revenues streams, but that they can "invent" new ones, and creatively grow existing ones when necessary. In the CEO’s of our companies, that skill, that adaptiveness we find as one of the most important traits, beyond integrity, leadership skills, smarts, and work ethic. In this era of near instant communication, adaptiveness like this is necessary to compete and survive.

Bill Gross: Saul, this is an old reply to your question on the mania that I had written but had remained in my drafts folder... Fundamental versus comparables - that’s what I would boil it down to in valuation and the Internet mania. Here’s my example - if you are trying to figure out what a new business idea is going to be worth, you can either try to figure out what it will generate, and what the fundamentals dictate the value should be, or you can make comparisons to "other similar" businesses. The fundamentals are sometimes hard to figure out, or estimate, but sometimes not. But comparables are sometimes a better way, or maybe an easier way to judge value. Similar to real estate, where you look at the houses next door, down the block, in the neighborhood, what they sold for, how often and when, etc. to get the comparable price for a house you might want to buy or sell. VC’s did the same, thing, and just like in a real estate boom, with a lot of demand for a neighborhood and not a lot of supply, the prices all went up, thus forcing comparables up in an ongoing virtuous cycle. As more and more companies came on the market, just like too many new houses in a market going
up for sale, and the demand dropping out without people wanting to move in, the comparables all change. I would put some blame on the press. I have found that the press is more interested in sensationalizing rather than working hard to tell the whole story, and this fuels the mania. The press was often as reckless with its presentation of the fact as the market it was covering.

Steve Riggio: Bill, I agree that much better software has to be developed to make online shopping more efficient. I do believe that the whole experience of finding, browsing and checking out online will dramatically improve in the coming years. (the Internet is particularly weak for browsing). Our goal is to make our web site function as if you were talking to the most knowledgeable bookseller in the company. Or let’s say, thousands of knowledgeable booksellers rolled into one. Its what excites me. Its going to happen. By having Internet Service Counters in our stores we get the bang in both places.

Patrick Byrne: Agreed. In fact, I think there is going to be a tremendous shift towards sites that add value to shoppers. No longer will a simple shopping frame encompassing hundreds or thousands of sites be seen as meaningful. Instead, sites are developing that actually ask the consumer, for example, what kind of camera she is looking for, and then leads her through her selection process, considering variables such as price, complexity, quality, consumer ratings, etc. In short, they affect the buyer farther up the decision tree. MySimon is a small step in that direction: there are bigger steps to come. This is an area where it seems to me portals have not done as good a job as they might, but could be a place where they could add tremendous value and gain customer loyalty.

Steve Riggio: The press certainly played its role in fueling Internet mania but they were not the ones setting the valuations. They covered what they saw. An individual investor who bases their decision on what they read in the press or see on TV has bigger problems than the money they might have lost. On the other hand, Internet analysts were the ones who set the pace and millions of people lost money based upon their calls. The fact that billions were made based upon those calls does not excuse the shoddy analysis that confused "metrics" with true measures of financial performance.

Bill Gross: Patrick, All of the terms that you are describing could be considered egregious, but might also be realistic when you say they all came along with a $100m valuation. At a $20m valuation, I bet they could have been negotiated away. Maybe even at $50m. So I would say that the whole package of terms need to be looked at together - price, protection, risk, management team, growth, potential, etc. I do agree that many VC’s have begun asking for terms that seem onerous and also seem to limit their downside and make them seem less like a partner in growing a business, but I think in great part that was due to crazy valuations, unrealistic investment timeframes (because of competition) that didn’t give them a chance to do due diligence or the time to build mutual trust and respect with the entrepreneurs. So maybe the "crybaby investing" you are referring to might have been in response to a complementary "overjoyed baby" valuation.
Patrick Byrne: Fair point. If I were investing with someone who wanted a $100 million valuation for a business with no fundamentals, I could see trying to win something back on the "hooks and latches" I built into the contract. At least, I could see why people would try that. In our case, however, we did repeatedly try to convert the offers we received to common stock investments at far lower valuation (for example, we calculated that what was ostensibly an $80 million valuation for preferred stock translated into a $37 million common valuation, and scaled down from there depending upon how deeply the hooks and latches ended up biting). No one was interested Ted Leonsis: the VC’s all said that they would only invest in preferred stocks. But I acknowledge your point has much merit.

Roger McNamee: Just as financial manias are part of the cultural fabric of this country, so too is the desire to place blame after the fact. It is easy to place the blame for Internet mania on analysts ... or investment bankers ... or venture capitalists ... or greedy investors ... or anyone else. The reality is that manias require willing participants at all levels of the investment food chain. Everyone who participated needs to accept responsibility for their actions.

Saul Hansell: Just after many of these giants admitted that they must change their businesses in fundamental ways, their challengers have run out of money. With David gone, how much will Goliath change? Bill and Mark: What have you learned from the experience Cars Direct? Will the process of buying a car really change much over the next few years: Vincent Caminiti: Do you think the Internet is letting you sell more tickets directly? Why, then, do you need to own a part of a travel agent, Orbitz? Anyone: Are the incumbent companies too smug at their apparent victory and still heading for a fall?

Steve Riggio: The whole idea of disinter mediation (did I spell that right?) was ridiculous to begin with. It was founded upon no empirical or financial data and investment banks sold the idea as long as they could. The Internet has the power to transform companies and extend their reach. It has created wonderful new companies, like Yahoo. The Internet is a vehicle to create not destroy (unless we are talking about the trillions of dollars of market cap that has gone down the tubes) and it will create value in the hands of good companies.

Mark Hogan: We’re not necessarily focused on the demise of the dot coms. You may say David is gone, but that doesn’t dilute the power consumers now have in the purchasing process. Goliaths of the world will continue to change because consumers will demand it. The car buying process will change in a number of ways over the next few years. For starters, the mystery of price will go away removing much of the anxiety consumers experience when purchasing a vehicle. Consumers should also expect a more seamless online to offline experience. As manufacturers transition to a locate to order business model, consumers should expect to get the exact car they want, when they want it and where they want it. It would be crazy to think that incumbents are becoming smug in the current environment. We’re all continuously shooting at a moving target. The market is more complex, the competitive environment is more fierce and satisfying
customers is more challenging than ever. I wish I could say we have the time to reflect on our current position, but we’re moving too fast to stay ahead of the pack.

Roger McNamee: The Internet was put forward as the cyber-slingshot that a David could use to topple the Goliaths of the Fortune 500. Someone could start a site that would sell cars, airplane tickets, books or stocks--to pick some examples that come to mind here--in ways that threatened to change the entire structure of those industries. Middlemen were cut out, prices slashed, customers empowered with new information. Just after many of these giants admitted that they must change their businesses in fundamental ways, their challengers have run out of money. With David gone, how much will Goliath change? Bill and Mark: What have you learned from the experience Cars Direct? Will the process of buying a car really change much over the next few years: Vincent Caminiti: Do you think the Internet is letting you sell more tickets directly? Why, then, do you need to own a part of a travel agent, Orbitz? Anyone: Are the incumbent companies too smug at their apparent victory and still heading for a fall? Despite the collapse of dot-coms, it seems very unlikely that the economy will return to business as usual. The economic incentives to exploit the real time nature of the Internet are just too compelling. It is instructive to study the industries that *have* been transformed. In the retail brokerage industry, the Web removed the human element from an error-prone process, creating a nirvana with both increased customer satisfaction and lower cost to the service provider. Any industry that can replicate this cost/benefit combination will be transformed in a big way. In travel, the airlines attempted to use the Web to disintermediate travel agents, whose fees had historically been bundled in the cost of tickets. Fortunately for the travel agents, some consumers have been willing to pay explicit fees to get help in navigating the complexities of travel reservations. While the impact of the Web is less dramatic in travel than in brokerage, the economic gains to the participants are still very positive. In retail, the message is also mixed. In a handful of categories (e.g., books and music), the Web has changed everything. In most others, physical marketplaces are as important as ever. That said, the success of traditional apparel vendors on the Web suggests that hybrid strategies can work nicely. The big unknown in retail is whether global brands can use the Web to bypass part or all of their traditional channels. The failure of Levi’s first Web effort provides a single data point. I expect a different outcome from Esther Lauder, Major League Baseball and others

Ted Leonsis: Disintermediation was going to kill AOL, too remember?:-). All I can say is that still -- in 2001 -- the best selling meal in America is Happy meal Number 1’!! Consumers wants packaged offerings, easy to find, high quality, and fairly priced value. Disintermediation, my butt!

Ted Leonsis: I am concerned that many of the old economy companies that were late to transform their business via the Internet have now been given tacit permission to avoid change by the slew of media hype about the so called dotcom mania fizzle. It reminds me of the tsunami in Japan where the water ran out of the bay--and all the townspeople slowly walked into the beach
area--unafraid--- and then the wave came back and killed them all:-).

Vincent Caminiti: Does anyone not believe the Internet has changed the way we do business dramatically and forever? Power to the people AND power to business. The Internet provides unprecedented information [power]to customers and, at the same time, allows business to break the compromise of richness and reach. Seems to me that companies must deal with both sides of this opportunity to be successful. Customers shopping Delta now have all the information [power] they need to make more informed decisions, AND they are in control. We, on the other hand, can make meaningful, more personal offers, designed to not only provide value to the customer but do it more profitably [avoiding middlemen]. Yes, Saul, we are selling more tickets directly on delta.com because some customers prefer the above. However not all customers are alike, so we plan on having a channel for every customer segment. Some leisure customers, for example, prefer the "independence" of online travel sites, which are expected to grow from $5.6 billion in online sales in 2000 to $7 billion by the end of this year. This arena is dominated by Travelocity and Expedia, and Delta’s foray into this segment is designed to both to mitigate that share dominance and, at the same time, provide a less expensive distribution channel. So, Orbitz is both a defensive and offensive initiative.

Bill Gross: The internet is about using the power of real-time two-way communications to solve big business and consumer problems extremely efficiently. While some Davids won (at least so far), for the most part the role David played was to force the Goliaths into recognizing and embracing the Internet as a tool to increase the efficiency of their basic business proposition. What we learned in our experience with CarsDirect is that people view car buying as a big problem, and that one can use a direct purchase web site, with clear information and pricing as one way to address that problem. The business has had success beyond our imagination, and now sells thousands of cars a month, and saves customers lots of hassle. It’s not that middlemen were cut out - the Internet in fact often allows the creation of lots of "new" middlemen - it’s that a process is made more efficient. In that sense, I agree a lot with what Roger said earlier, that the Internet is not so much about "sites" but about using this communication platform to enable more "turns" on "information inventory" per unit time, and thus making your organization more efficient in the same way that a company is more efficient when it has more "turns" on physical inventory. The Internet allows for something much close to "just in time" information in the same way that efficient manufacturing organization have powerful "just in time" inventory. Back to cars - I think the process of buying a car will continue to change over the next few years. Already, more than 50% of car purchases are researched on the Internet before the purchase is completed, and a growing percentage of sales are actually completed online. I believe that both of those will continue to grow over the coming years, to nearly 80% to 90% researched, and maybe as much as 10% to 20% completed online. Not 100%, but 10% to 20%, and that’s still huge, and similar to the % of commerce that is done online and through catalogs for say, books, music, clothes, etc.
Patrick Byrne: Ted, Good point. I think much of the thinking about the Internet has extolled the efficiencies of it, yet overlooked how hard it is to get consumers to change habits. Economists love auctions for all kinds of theoretical reasons (e.g., they make consumers reveal hidden preferences), but only geeks actually sit around and top the bid in the last nano-second. Most people want to see a price, decide to buy, and be confident that the product is on its way.

Ted Leonsis: I am concerned that many of the old economy companies that were late to transform their business via the Internet have now been given tacit permission to avoid change by the slew of media hype about the so called dotcom mania fizzle. It reminds me of the tsunami in Japan where the water an out of the bay-and all the townspeople slowly walked into the beach area--unafraid--- and then the wave came back and killed them all:-). Ted Does anyone see an area where that on new car prices with dealers. Do you agree with Bill that Tsunami is going to hit? In the car business market, what will the real effect be beyond giving buyers better ability to bargain a significant minority of cars will be purchased like they are sweaters from LL Bean? If state laws didn’t perpetuate the dealer system, would it survive? Bill, given the pushback you found from the car companies and dealers, do you think that the industry will change much beyond where we are now?

Ted Leonsis: I think another new wave of Internet growth will come from new and creative tweaking to existing industry business models. Let’s look at the Music business. Their last big wave of growth came when labels republished their catalogues on cds, and everyone traded in their vinyl for plastic. Now--everyone sees that Napster and Winamp etal show that consumers get what they want. And consumers like a wide range of options to get music fast, and more conveniently. Students love that it is free right now too:-). So--what is the next wave of growth? Business model stimulation--not deconstruction! When you look at the movie business, you see many windows of revenue stimulation: 1), theatrical release; 2) cable (HBO etc); 3) ancilliary (Spectavision etal); 4) Video (Blockbuster); 5) Network release; 6) International; 7) Tape sales; 8) DVD sales; 9) merchandise sales sales. Multiple revenue streams are GOOD!!!!. Music, for the most part now has only 3 revenue streams---1) cd sales; 2) concerts; 3), merchandising sales. So--if we can use the Internet to create NEW revenue streams for labels and artists, and make music collection even more convenient by using the Internet--everyone would win. By using the Internet--a consumer could get and pay for the right to hear tracks FIRST; then buy the CD in physical form and downloadable form; and get the entire artist library accessed via streaming; or downloading; and join a fan club; or hear the artists own personal play list; or buy tickets first etal. The Internet WILL MAKE for new revenue stream for the existing indusrtty players and EXPAND the market and revenue base. That is what is next! Industry by industry!

Roger McNamee: Great point, Ted. The record labels are addicted to mass merchandising -- selling 10 million units for some new 18-year old blond with high beams - and have very little interest in 99.9% of the artists that performs in clubs and arenas around the country. Standard record contracts basically
prevents today’s artists from fighting back. But the situation will eventually change. The web allows musicians to communicate directly with fans. Today’s artists don’t get much economic value from this, but tomorrow’s will. New bands have a huge incentive to work outside the system . . . and entrepreneurs have an incentive to help them do so.

Steve Riggio: I find it astonishing that the music labels were so resistant to music downloading. The technology has existed way before Napster was born. The labels failed to embrace the medium and failed to experiment with a wide range of tests at their disposal. Here was a new medium with a potential to create a new revenue stream for them as well as provide the best promotional tool to sell music in the history of the business (listen before you buy). A business model could surely have been built that would have increased the value of their artist’s intellectual property. Consumers would have embraced any number of ways to buy downloaded music, from individual songs to mix ‘n’ match collections to monthly subscription. The labels sat frozen and along came Napster. They got what they deserved and are now in reactive mode. Music labels and book publishers are middlemen between the artist/writer and the consumer. They are, in effect, content aggregators. So, too are music retailers and booksellers middleman. How we all serve artists and writers has been fairly consistent for decades. That is about to change. The Internet, particularly with respect to its ability to download music and digital content is going to be the catalyst.

Roger McNamee: When CDs came along, the average retail price of music jumped from $8 to $16. The labels kept the difference. They got very rich from doing so . . . and very reluctant to support any new delivery medium that didn’t offer comparable economics.

Patrick Byrne: At the risk of instantiating H. L. Mencken’s dictum, "To a man with a hammer every problem looks like a nail," I think that the best use of the Internet for the automobile industry is to run their closeout sales through it. I expect they will confront the same market dynamics and sales channel pollution problems other industries have, and realize that the Internet is a pretty lousy way to sell most physical products, especially when you already have a good distribution system in place. The exception is liquidation of excess inventory, for which the Internet is perfect. Overstock.com now has nearly 7 million unique monthly visitors (about 1/4 the size of Amazon), and to them we flush out the excess name-brand merchandise of over 100 manufacturers. They no longer are faced with slow-moving and marked-down inventory drifting around in and polluting their sales channels. Manufacturers who would not return our phone calls 18 months ago are now banging on our door to handle their products, so advantageous is this system. If you agree, Bill, please call collect.

Patrick Byrne: I respectfully disagree with Steve and question his "astonish[ment] that the music labels were so resistant to music downloading." Returning to my earlier tollbooth metaphor: is there a tollbooth business anywhere where the tollbooth owner exacts such a disproportionate share of the transaction for helping the transactors find each other? For helping a home-buyer
and a home-seller to find each other a real estate agent takes a 6% fee. When I buy a $10 CD the artist is seeing 10 or 20 cents of my money: the rest goes to the tollbooth owners (record publishers, distributors, and record stores) who stand between us. In an age of physical distribution that situation has two explanations: first, those tollbooth owners incur costs publishing and distributing music, and second, the capital tied up supporting the system has to eat as well. The cost of distributing digital products have become essentially 0, and the problems of micro-payments and copywrite protection have been technologically solved and will soon be widely adapted. Yet the tollbooth owners are still standing there expecting to collect their fat fees. They will be the first against the wall when the revolution comes.

Steve Riggio: Patrick and I actually agree and I should have articulated it better. My "astonishment" was meant to describe my feelings regarding the commitment of the music establishment to the rules of the past, which, I confess was said tongue-in-cheek. My last point was that music labels, book publishers & music and book retailers are middleman and the relationship between those groups and artists and writers will profoundly change. In its first phase of growth the Internet has served as a new means to process transactions, efficient for some, mostly expensive for others, particularly e tailers. The next great thing will be the Internet’s role as a delivery mechanism for content. True information portals. While the cost of delivering digital content is not exactly zero, it does strip out enormous costs. Thus, artists and writers deserve a higher share of the revenues from the sale of their intellectual property. Music labels & book publishers are clearly not of this belief, hiding behind the veil of concern over rampant distribution of "their" content. Thus Napster. A proactive approach to the sale of music over the Internet would have recognized its ability to build the market by its ability to create new demand, which I believe will occur. Because of the efficiencies from this new revenue stream it is only fair that a larger cut of the pie should go to the artist. So, instead of building a business model around a smaller share of a new market, they held firm ground and now Napster and its descendants are on the march. Even in the event that digital music sales negatively impact catalog music sales, the clock cannot be turned back. In the next few years music labels and book publishers will have to recognize that old business models & practices will not fly with respect to digital content. Bloated overheads, silly marketing departments and stone age warehouses don’t add value to distributing digital content. This is especially true of book publishers, who are in a unique situation. Publishing contracts prior to the early 90’s did not assign rights for digital distribution to the publisher. They remained with the author or are unclear. An online bookseller like Barnes & Noble.com simply needs a digital file of the content to sell it directly to consumers. Our newly announced imprint, Barnes & Noble Digital offers higher royalties to authors because the "publisher" is out of the picture. And we intend to create new ways to "package" digital books and enhance editorial content based upon our experience as booksellers, publishers and e tailors. We’ll even publish online royalty statements. We are close to the customers and the authors. I think artists and writers inherently want to see their intellectual property distributed. They want a fair share and more control.
Patrick Byrne: Thanks, Steve, and pardon my obtuseness for missing the ironic tone earlier. Been a long day. I do think that book publishers are not going to be hurt by digital distribution as badly as music publishers will be, because part of the enjoyment of reading has to do with the tactile experience of a book that would be foregone with an electronic version. This tactile experience is lacking in music. Except for real audiophiles (who stuck with vinyl anyway) nobody particularly cares about the pleasure of sticking a CD in a slot, as they do care about the thrill of opening a new book. The day will come, however, when monitors develop the same resolution as the printed page, and when they do electronic books will finally make some headway. When they do the changes Steve has described will become common. But I think these changes will not overrun the book industry as they will the music industry, because too many of us are tied to the physical enjoyment of books.

Steve Riggio: A CD is a consumer product, whose value, especially as a gift item, cannot be replaced by a digital download, which is a song. Shopping is a social activity and the sheer buying of physical product gives people pleasure, as does the thrill of downloading something for nothing. They are different experiences. CD’s are also relatively inexpensive consumer product and will remain as nice things to give and to own. They are also easy to use. Stick it in and it works. While kids are adept at Napster we are a still two or three years from the time when normal human beings can download a song and put it on an MP3 player. I think the enjoyment of buying retail goods applies more so to the latest Britney Spears CD than to an old Steppenwolf CD. Digital downloading that single song from an old album may cut into some artists catalog sales but it might also be a way to keep many artists alive. The book industry is much larger than the music industry. Digital downloading of content (eBooks, articles, research reports) will dwarf sales from music downloading. This will not hurt publishers because it will create new demand for content that is largely unavailable today. Traditional trade book publishers are simply not in a position to participate in this emerging market. Textbook and educational publishers are much better positioned as their content, author base and target customer(students, professionals) is where the market is going to happen. I believe that a book is about the best technology ever invented. Nevertheless, The eBook Readers that Microsoft will introduce this fall are quite impressive. The efforts they are putting into this arena are already beginning to produce a reading and tactile experience that nobody would have imagined three years ago. And they will get better and better. This clock does not turn back.

Roger McNamee: Amen to that, Ted! Disintermediation only happens to people who aren’t paying attention.

Roger: Ted Leonsis: Does this worry you? To me it has a certain morbid appeal. A bunch of Fortune 500 companies will go the way of the dodo.

Roger McNamee: A few industries will be overwhelmed by the tsunami, but others will only get their shoes wet. The reality is that our economy works pretty well and people are reluctant to abandon successful business relationships.
without compelling incentives.

Steve Riggio: Sales growth at Barnes & Noble stores has been healthy right through the growth of the Internet. In fact, our comparable store sales performance has been better than that of our competitors through this period. We think our Internet site has been a contributing factor. Six million unique visitors a month surely helps as more people than ever see our brand and are interacting with us.

Bill Gross: I don’t think the internet is going to eliminate car dealerships but I do think it is going to force dealerships to adapt to survive, and to be more responsive to what customers want. I think the internet is going to also force car manufacturers to make closer to what customers want as well. I think the two-way part, the dialog, the feedback loop, the low cost survey capability and data collection component and much more are going to allow much more efficient manufacture and retailing of cars - I should say all products, not JUST cars. But the car manufacturing process has historically been a highly one way process, make and sell, versus sense and respond. Sense and respond will always win with customers, and sense and respond is one of the huge not yet fully tapped powers of the Internet.

Saul Hansell: The hype about b2b has been at times as frenzied as e-commerce and e-media. Again, let’s look at what’s real, in your shops and in the world. Where do you see Internet technology actually changing how companies buy raw materials and sell their products. How many of these changes actually change the structure of industries or do they just marginally reduce transaction costs as e-mail replaces faxes (which replaced couriers) and so on.

Vincent Caminiti: The Internet and its B2B exchanges have brought buyers and sellers to the table that would never have readily sat down before (i.e. competitors, players from unrelated industries, etc.). Although they still are in infancy stages, airline-related B2B exchanges hold promise of significant savings for both buyers and sellers of airline goods and services. Sitting on the sidelines and not getting involved at this time is not an option for Delta. By not joining an exchange, we run the risk of losing control over how the marketplace develops and being shut out of leading edge technology, not to mention potential new equity opportunities. All of the top 10 airlines worldwide have joined one of the two major exchanges. For example, Delta is a founding partner in AirNewco, along with United, Air France, British Air, American Airlines, Continental, Iberia, Swissair and United Parcel Service. AirNewco has recently joined forces with MyAircraft.com - which is comprised of Honeywell, B.F. Goodrich, and U.T.C. -- and are expected to handle more than $45 billion of the partner airlines’ supply chain business annually. The exchange, which will be open to all industry participants, will use the Internet to offer buyers the ability to link with sellers in five key operational areas: maintenance and engineering, fuel and fuel services, catering and cabin services, airport support services, and general procurement. The biggest challenge will be integration of our back-office systems and processes to drive efficiencies and other benefits directly to Delta.
Patrick Byrne: The hype about B2B is not hype. The difference between B2C and B2B is that it proved extremely difficult to get consumers to change their patterns of behavior. For example, economists can talk to they’re blue in the face about the advantages of auctions, but not many of us really want to hang out by our computer until midnight trying to game an auction by submitting a bid in the last second for that Gameboy that we’ve just got to have. Our unwillingness to change personal behavior to be perfectly rational generates slight costs that we happily accept. But business people cannot accept such costs, and so they quickly change behaviors to acquire advantages, such as reducing transaction costs or maximizing yield. Competitive pressures force businesses to do so and those that do not become obsolete. However, competitive pressures will also ultimately force businesses to pass along these gains to consumers, just as they always have. Think of all the great technological improvements of the last 40 years in airplanes, automobiles, computers, etc. Have they allowed corporations to take the return they earn on their investors’ capital from 12% to 50%? Of course not. The new technology gives them a temporary advantage of higher margins or less capital, then everyone adopts it, margins get squeezed and the gain is passed to the consumer. Businesses won’t become better businesses, they will just become more efficient, and hence all these great new empowering technologies will just "empower" them to be able to charge consumers less money.

Ted Leonsis: This has been fun. I will answer the last few posts later today or over the weekend. So--here is my question.I cant help myself--I am sorry:-). In a world where Moore’s Law drives consumer’s expectations---what will the NY Times do to grow and remain relevant to consumers like my son and daughter who look at newspapers as foreign objects? In a world where we offer more and more for less and less--how will newspapers like NYT make it?I believe the NY Times has shown a loss of readers over the last 5 years--yet has increased its ad rates;its single copy price and its subscription price. What will the NYT look like 10 years from now? Thanks.

Roger McNamee: While all the early B2B buzz related to purchasing applications, that is not where the real value lies. Most companies do a decent job of purchasing, and some can enhance price and vendor discovery through net markets. The big win, however, is in the management of multi-step supply chains. Why? Because the winners in technology are the companies which can get new products to market (in volume) fastest, thereby capturing the easy profits and market share. Purchasing is an important factor, but by no means the most important factor. In the electronics industry -- where outsourcing is a way of life -- most OEMs have a supply chain with four to six levels. In this environment, the competition is not OEM vs. OEM, but supply chain vs. supply chain. Demand forecasts in the electronics industry are notoriously unreliable. Some observers suggest that 90-day forecasts are wrong 70% of the time. As a consequence, roughly 30% of the components purchased from distributors are returned within 90 days . . . at huge cost to everyone in the supply chain. The net allows supply chains to share demand plans, engineering change orders and other critical pieces of information in real time. Companies whose products facilitate
this communication include Agiles Software and eConnections.

Steve Riggio: "You have to draft top ten lists, whittle them down and draft them again" So what is at the top of your list of things to do in your shop in 2001 that will have the most impact?

Vincent Caminiti: This next year will be monumental for Delta. In 2001, the top priorities for Delta’s e-Business unit include focusing on opportunities that will deepen our relationships with customers, employees, suppliers and stockholders, while delivering value to the Delta brand. Additionally, we’ll move toward our goal of migrating customers from offline purchasing channels to online channels, achieving more than 20 percent of online share and more than $1 billion of annual ticket sales via delta.com. Some major hits that we will soon reach are the full launch of our new small business Web site, MYOBTravel, switching the on button for the new airline procurement exchange site, AirNewco, and getting the online leisure joint venture Orbitz off the ground. But our focus doesn’t only revolve around the commerce worlds of B2C and B2B. Our business-to-employee (B2E) initiatives (i.e. Wired Workforce home computer, eHR, and eLearning programs) will provide Delta with a clear, sustainable competitive advantage that will improve Delta’s 80,000 worldwide employees’ learning, communication, commerce, wellness and productivity.

Patrick Byrne: Blocking and tackling. We are entirely focused on execution. According to Bizrate’s holiday analysis of customer satisfaction, Overstock.com grew from oblivion one year ago to the #4 for total customer satisfaction (and one of the three ahead of us may be gone when this article runs). We have learned that just focusing on basics, like delivering orders on time and providing quick, efficient, bare-bones customer service, pays more dividends than marketing. The average customer tells 12 people about his or her transaction, good or bad, so just making your current customers happy is the best marketing you can do. This industry indulged so much “vision” over the last few years that some lost sight of that. Everything was a Hail Mary pass because the first few successful businesses were Hail Maries (e.g., eBay, Yahoo!). But as Woody Hayes said, "When you pass three things can happen, and two of them are bad." The only plays we are running these days are three yards and a cloud of dust.

Steve Riggio: In 2001 we will execute our vision of uniting our retail stores and web site with services and programs that keep customers in the B&N family. Connecting our stores, web site, e commerce infrastructure and direct fulfillment capability provides us a platform with greater reach than any of our competitors be they pure e tailer or clicks ‘n’ mortar. It enables us to build a "network" of customers whose demographic is perhaps, the very best in all of American retail. Between our online and retail stores that network now stand at over 30 million regular customers. By mid-2001 every single Barnes & Noble store will have Internet Service Counters, enabling customers to place orders from titles & products listed our web site right in the store. This new service brings the Internet to those who have not been inclined to make purchases online. Ordering in the store includes the convenience of paying by cash and being able to pick
orders at your local B&N. In the fall of 2000 we introduced a membership loyalty program targeted to our best customers that offers extra discounts both online and in our stores. We also intend to stay focused to our core business. We believe in the power of specialty retail and we think our intense focus on the book business has enabled us to leap frog all the competition with respect to selection. We now stock far more titles than any other online bookseller and our selection even surpasses that of the largest booksellers, quite laterally, almost every book in print. In conclusion, leverage everything we have built and provide customers with seamless access anywhere, anytime.

Ted Leonsis: Here is my list for AOL’s immediate future A -- remain consumer obsessed, post merger, and use the Internet to sense and respond to consumer needs and make subtle, yet significant changes to all our businesses to make our customers live’s better and more informed, entertained and convenient. b..Take immediate advantage of true synergies between AOL and TW--and drive more cost efficiencies into the company;cut costs thru cross promotion,and shared infrastructure,and beat Wall Street’s expectations on all metrics; c..Begin to transform selected industries and our businesses via the Internet ;with a focus on music,television,publishing,and telephony. d...Create a company where entreprenuers,general managers, and creative people of all types can flourish and make a difference!

Saul Hansell: Here’s where you get to make one or more predictions about the a significant occurrence in any corner of the world related to the Net. Feel free to consider consumer behavior, investor sentiment, regulations, mergers, products or broader social phenomenon.

Roger McNamee: The magic of the Internet is that it provides a backbone for real time commerce. The biggest investment opportunities will come from applications of the Internet to IT-based business processes that can and should be implemented in real time. I believe the next two or three years will be a period of consolidation. To the casual observer, it will appear that the Net is receding in importance. In reality, the Web platform will be bulking up - standards such as XML will be fleshed out and brought to market -- in preparation for the next big wave of growth. (The analogous period in the development of the PC occurred from 1984-1986, when IBM lost control of the PC platform and Microsoft/Intel took over.)

Vincent Caminiti: The Internet’s impact on consumer and business behavior is in its infancy. Undoubtedly, it will change the DNA of commerce and consumer behavior, and on top of this, the enhanced technology of mobile commerce will just add more fuel to the commerce fire. However, companies need to also be prepared for the changing paradigm of employer-employee relations. As Chuck Martin references in his book Net Future, "the ability to communicate rapidly and effectively within the organization can mean the difference between winning and losing." The future is extremely wide and bright for "business-to-employee connections", and therefore critical that we bring our employee force along for the e-ride. We at Delta do not intend to let this one get by us.
Patrick Byrne: One answer for each of government, business, and individuals. The largest organization to be disintermediated is government. A portion of the role of government in our society stems from high transaction costs among agents: because it would be prohibitively expensive for transactors to contract with each other, government forces fixed transactions upon us, then charges a hefty sum for their service. Yet nearly every kind of transaction cost is reduced via the Internet. Thinking out over a decade or two, I suspect that as the justification for many of government’s activities are eroded by the Internet, there will be less of them, and more discretion will return to individuals. American businesses in 2000 made an 8% return on the capital they employed. They leveraged that to 13% on common equity by paying less than 8% to those who chose to supply capital to business on safer terms (for example, in the form of debt). But overall, they made 8% return on the money that capitalists supplied them. In the coming years, capitalists are going to save and borrow and retain corporate earnings in order to invest in these new technologies, and sink trillions of dollars of new capital into them, and so will all their competitors, and everyone will get more efficient, and be able to charge less or use less capital in their supply chains, and when the dust clears businesses will be making 8% on the capital they use in their businesses. Individuals will benefit from the transfer of discretion to them from government, and from the willingness of capitalists to fund these improvements in the machinery of commerce.

Steve Riggio: In consumer e-commerce, customers feel they are in a real-time mode and expect that the information they are seeing on the screen is accurate, especially with regard to status of inventory. Creating a backbone that connects real-time inventory on the shelf with what the customer sees on the screen is no small feat. Most start-up e-commerce companies never got to first base on this. This situation is exacerbated by the fact that rates of movement are much more difficult to predict for e-commerce companies than for catalog mail order. You are "always on". When a company mails a catalog they can forecast their inventory needs fairly accurately once 10% of their orders are in. This enables them to bring the necessary goods in before their starting inventory runs out. Inaccurate inventory status is a principal reason why e-commerce companies get flooded with calls and e-mails. They are better off not taking an order rather than posting promise dates they can’t deliver on.

Ted Leonsis: For the industry -- 1. A big focus on open speech web. The telephone is the single most used device known to man--and it will be a big new gateway to the web.It is the best ecommerce device ever invented,and there will be tons of innovation blending the web with the phone during the next 12 months.AOL/TW will be a big player here. 2..Next wave of music services will be introduced---these new services will be good for mainstream consumers;artists and labels; 3..Bandwidth increases will rollout slower than people think! Narrow band will still rule for next 18 to 24 months. 4..The industry will consolidate with the big companies getting bigger and the small getting marginalized. 5.Wall Street and single investors will have a flight to quality, and blue chip earnings and cash flow based companies will capture an inordinate amount of share price value increasing the short to mid term.
Steve Riggio: The Internet will usher in a golden age of information distribution and publishing. While the Internet has proven challenging as an efficient means of handling transactions, it is very good at distributing information. To date, information on the net has largely been free. The lack of successful revenue or ad supported models for content distribution has temporarily stalled efforts to digitize, organize and make available vast amounts of valuable content. True information portals will emerge. The corporate marketplace will be first because that is where the foundation already exists (Lexis-Nexis) and where the most lucrative opportunity lies. It will then spread to the consumer sector. In a sense, the sum total of what has been written in hundreds of disciplines will be made available via subscription, premium subscription or by the piece. Back issues of thousands of professional and consumer magazines & academic and scholarly journals will provide new revenue sources for the owners of that content. New publishing companies will emerge (many are in formation already) that help writers get connected to readers by offering them the services they need (editorial) without taxing them for overhead that they don’t. eBooks will become adopted by the masses within ten years but they will be a small sub-set of a much larger market for digital content that can be stored in personal web libraries, downloaded and printed or sent to a portable device.

Roger McNamee: I look to the future of the Internet with only two firm convictions: (1) there is no limit to what the Internet can become over the next twenty years, and (2) I have no ability to predict how the Internet will turn out. The Internet eliminates barriers of distance, time and even politics. Already a powerful force for globalization, the Internet projects American ideas and values better than Hollywood ever did. With time, the Net should allow ideas and values to flow in all directions ... giving us access to the best of everything. Near term, I expect a consolidation period of two to five years, during which the bits and pieces of Internet infrastructure will evolve and stabilize, before finally becoming a truly solid platform for applications, content and commerce. (One could argue that the Internet is already a great platform, but my point is that there are still many potential users, applications and businesses that do not exist because the platform is too unstable, complex, etc.) You will know that the platform is solid when real time enterprise applications - applications that allow companies to interact in real time with suppliers and customers - are no longer exceptional. Like Ted, I believe the Internet will ultimately enable wonderful new forms of entertainment. How much further the platform (and the net itself) must evolve to support them remains to be seen, but the opportunities are limitless. I expect on-line retailing to improve steadily as retailers gain more experience on the Web. Third party fulfillment services such as SubmitOrder.com will open the up the Web for global brands that want to reach customers directly.

Saul Hansell: Steve and Ted seem to be saying that advertising, which was supposed to pay for so many of the nifty sites people made, is not going to produce the income people once hoped. Is there any future for advertising supported site? Ted, amid your subscription businesses, you have a lot of ad supported sites. Do these waste away? Besides Steve, others advertise online.
Any happy customers? Saul

Ted Leonsis: There will be one to two leading ad supported sites--per category. These will be nice size businesses--but NOT as big as Wall Street initially hype their promise. These sites will be resized to cut burn rate--or be acquired by a traditional media company that can leverage its infrastructure or cross promo inventory.

Bill Gross: One of the things that the Internet industry and the whole climate of the last few years spawned is a rich diversity of very subtle business models and propositions. Venture capitalists traditionally do extensive diligence and study of a business to understand fully its prospects, protectability, and profitability. That is always quite hard, and maybe even more so in the last few years because of the richness and diversity and pace of new business creation. Even in the best of times, venture capitalists who spend months studying a business before investing get it right less than 33% of the time - sort of like a VERY good batter in baseball. But in the last few years, venture capitalists made decisions in less than a week, sometimes less than a day or an hour, in one meeting, because of the race to win a deal. And individual investors, spending even less time, were all of a sudden in a rush to make decisions like this, on even less study, often on just a label, like b2c, or b2b, or advertising, or supply chain. This is what led to a lot of craziness. Businesses need to be evaluated on deep fundamentals, not on one-word or two word labels. Thus, writing off advertising as a model is ludicrous. Maybe ill-formed businesses based on advertising, but NOT ALL advertising. Advertising - or the education / shifting of consumers and businesses to make purchase decisions is huge. Because of the two-way nature and trackability of the internet a whole new era of advertising, including pay for performance, cost per action, etc. can be created and can have enormous implications. We believe that the shift to pay for performance in advertising has already begun, is accelerating quickly, and is going to be a huge part of all advertising in the coming years, and those who create businesses to capitalize on that can have terrific returns, if they are clever, adaptive, and provide proprietary value add to that education / shifting process. To write off "advertising" businesses would be ridiculous, and certainly simplistic. I feel that the press has a role to play in teaching investors - new investors that are coming to look at new companies for the first time - to search deeper into the fundamentals of a business and not pay attention to simple labels.

Steve Riggio: I did not mean to suggest that we should write off advertising. I do believe that the so called as revenue that supported most sites would drop substantially, causing many to disappear. Of course, this opinion is based mostly on my experiences on the paying side of the equation as well as hearing from colleagues in the industry. I know of some sites whose ad income in 2001 will be one-tenth of what it was in 1999. I equate advertising with rate cards that are usually based upon empirical historical data and competition: cost of a Super Bowl ad, full-page ad in the New York Times. In that respect there really has been no advertising per se on the web. The last few years has seen a whole bunch of wheeling and dealing in the guise of "strategic marketing alliances" and
pay per click deals. The CPM on rate cards that do exist usually drop by 50% after the first handshake. Online media is a valuable channel. It has just been tremendously overpriced.

Patrick Byrne: As another buyer of online media I heartily endorse Steve’s position. Of course online media is here to stay. The companies that provide it are not. For a long time they sold online media at inflated prices because at first no one knew what it was really worth, and more recently because buyers were locked into the contracts they had signed earlier. That is changing fast. Since we are all boasting a bit about our firms, I will claim the liberty of explaining where I am coming from. My colleagues and I (I am by ar the weak link on the team) took over Overstock.com in the September of 999, when MediaMetrix showed us as having about 50,000 monthly visitors, and ranked us site #7,000 on the Internet. We cancelled portal deals that ere already in place and adopted new below-the-radar-screen media (e.g.,Hotbar, Bargaindog, Coolsavings, etc.) By December MediaMetrix showed us as he fastest-growing site on the Internet with over 2 million monthly visitors. We achieved that growth on a total marketing spend of $1.5 illion: the shopping site just below us had spent $80 million on marketing that year (they are publicly traded, so I could check). Incidentally, our growth has continued: last month, January, we had just short of 7 million visitors (about 1/4 as many as Amazon), on a total marketing spend of about $300,000 for the month (a tiny fraction of what most sites spend). With that as background, I will describe what it looks like from the buy side. Two years ago the received wisdom was, "You have to have a portal deal: it is like getting a billboard at the onramp to the Information Superhighway." Portal-salesmen swarmed the lands reciting the same canned pitch to every VC-backed website they could find: "We think you have the greatest business on the Internet, and we want to be part of your success. We want to invest $10 million in your company (in the form of advertising credits). Of course, you have to commit to spending $40 million advertising on our portal over the next two years. Don’t worry, if it doesn’t work we’ll fix it because we have a vested interest in your success. Sign here, friend. You have 24 hours, and if you don’t, we will sign that deal with your competitor on Friday." People waited in line to sign such deals. They were often pushed to do so by their VC’s, which is ironic because these deals had the effect of draining the startups of all the cash those VC’s had invested and bankrupting their investment. Rough justice. Incidentally, if there are any Internet CEO’s or marketing guys reading this who are locked into an egregious deal with a portal and want to out, this is what you do: stop paying. They will call and threaten you. You say, "Look, we spent $X with you and got about $X/100 value. I will pay for what you delivered so far, but pull us off your site going forward." (Make sure you offer to pay for what they have delivered so far.) They will piss and moan and wave the contract in your face, to which you reply, "Go fish: I ain’t paying." Then they will send lawyers who will scream and yell and piss and moan and wave the contract in your face, and you say, "Go fish: I ain’t paying." And if they are publicly traded their accountants will start telling them they are going to have to reserve against any more revenue, and it is going to look ugly, and they will scream at you some more, and threaten to sue you, and you say, "Go fish: you’re publicly traded and you
are never going to sue a customer for revenue." And then they will piss and moan some more and take your offer, and you will have some of that VC money left with which to build a business.

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