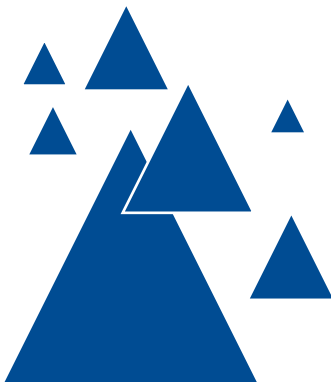




# The Boys in the Bubble: Searching for Intangible Value in Internet Stocks

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## Executive Summary



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# **E**XECUTIVE SUMMARY

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## **Introduction**

The Internet boom has now entered folklore as a speculative bubble on a massive scale. Throughout the late 1990s the dissemination of Internet access was seen as harbinger of an enormous societal and economic change, a new ‘weightless’ economy in which the sky was the limit for productivity and wealth.

In the subsequent stock market collapse, consultants and many academics lost interest in isolating and measuring the ‘intangible’ sources of value that had been used to justify the stock market values of Internet firms. The current report returns to this theme in the belief that while the stock market bubble has burst for the new economy its economic and social significance has not, and will not, go away. Indeed the recent stock market decline of the Internet sector might be seen as part of its maturation. As high profits to early innovators drew attention and attracted new entrants, the wealth created by the industry has now been re-allocated away from producers to consumers.

This report searches for intangible value amongst Internet stocks and, in particular, two possible sources of intangible value for Internet firms are examined:

- the visibility of a host’s site, or the number of ‘eyeballs’ visiting a site and hopefully buying from it; and
- the retention of the founding entrepreneur whose vision gave birth to a site.

This report looks at the value of on-line visibility in the UK and the value of retaining the founding entrepreneur for a sample of US firms. The first chapter discusses the applicability and implications of

the 'winner-takes-all' business model in the UK market (Hand, 2003). It was this model that resulted in the huge losses made by Internet ventures appearing acceptable because of the need to grab market share and so to assure the viability of the business. The report also provides some stories of E-entrepreneurs as a way of illustrating their centrality to Internet ventures and the mechanisms by which they added value.

## **Host site visibility and Internet stock value**

Web-traffic, or visits to host sites, is highly concentrated in the UK. This study uses data from Jupiter Media Metrix for the calendar year 2000 to investigate the degree of concentration of website visits. Just 100 sites attracted more than two-thirds of all estimated web-traffic each month in the year 2000 and the four hundred most popular sites accounted for over 90% of all traffic. Despite this concentration of web-traffic, only a minority of sites experienced persistent popularity. However, this report shows that, while popularity is rarely persistent in the UK, this fact is not well understood by investors and is so poorly reflected in Internet stock values. The study provides evidence of transient returns to being a popular site. Yet there appears no evidence of a premium, and some evidence of a discount, to being a persistently popular site. This finding somewhat undermines the claims made by both business consultants and academics that web-traffic constituted a more reliable financial performance metric than traditional accounting-based measures such as earnings and book value. The proposed benefit of web-traffic as a valuation yardstick presumably derived from its ability to predict future revenues to the host of the site and hence future profits. But if web-traffic could not be predicted with any regularity, then its usage as a valuation technique should have been in doubt. The failure to uncover a systematic relationship between consistently high streams of web-traffic and Internet stock returns may be due to many other factors not studied here. These may include business alliances with web-portals, such as AOL and Yahoo!, and leading E-tailers such as Amazon.com and eBay. Internet access and use is an inherently social activity where it is considered that first mover advantages, lock-in effects and cross-fertilisations abound. Thus, the search for a summary 'number' that indicated performance may have been misplaced.

## The founding entrepreneur and Internet stock value

A major part of the entertainment value of the Internet boom was the swathe of larger than life characters it threw up. College drop-outs, too 'geekish' to be rock stars, could, in a brief window of opportunity, log on, launch an initial public offering and retire rich at 30. Each Internet venture in many ways constitutes a bundle of intangibles, with patents and brand positioning often being the only clear assets. In such conditions there is clearly a role for a face to make these intangible assets congeal into a viable firm. Familiarity breeds investment and the presence of a captivating entrepreneur can be crucial to the success of an Internet venture.

Chapter three of the report looks at three examples of E-entrepreneurs, Steve Case of AOL, Pierre Omidyar of eBay and Ernst Malmsten of Boo.com. It does so using the stream of popular literature which sprouted up in response to the Internet boom, much of it in the form of uncritical biographies and autobiographies. While these three men fared with different degrees of success, each share some important characteristics. The first is an ability to combine great personal creativity and initiative with continuous networking and a desire to achieve consensus on key organisational goals. More than anything these individuals were survivors, capable of enduring an unusually high degree of uncertainty regarding both personal and corporate well-being. Interestingly, none of the three examples now remain with the company they founded. Whatever value they brought to the enterprise was clearly not judged as being central to their creation's longer-term survival.

The anecdotal evidence sets the background for the empirical study of the impact of retaining the founding entrepreneur upon firm value. For this study, a sample of 50 'pure-play' Internet firms in the US is used. The effect of the retention of the founder on company value by reference to stock prices alone is not used, but the Entrepreneur's valuation impact is measured using two traditional accounting metrics, earnings and book value. While stock price measures of Internet firm value may be dismissed as 'irrational', the same cannot so easily be said of accounting measures of performance. Regardless of the performance metric used, the results

clearly suggest that retention of the founding entrepreneur after the initial public offering adversely affected firm value, or at least added no value. This concurs with research which suggests that new start-ups follow a trajectory from high uncertainty/high profit to low uncertainty/low profit as they grow. The ability to handle uncertainty, so vital in the start up phase, is dismissed by financial markets in favour of a more risk-averse style of management later on.

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