

DOT COM BURST

What is Dot Com?

Dot-com is a common way of referring to companies that were a collection of start-ups selling products or services using or somehow related to the Internet. The dot coms peaked in the later part of the 1990s. The name comes from the fact that many of the companies had a suffix “.com” (DNS suffix) built into their company name.

Dot-com companies were stereotyped as having extremely young and inexperienced managers with lavish offices. Companies frequently held parties or expositions where free pens, t-shirts, stress balls were given away. The companies also required extremely long work hours and high pressure.

What is Dot Com Burst?

The late 1990s saw a speculative frenzy of investment in the Dot Com companies – both by the venture capitalists and individual investors in the stock market.

This created a stock market bubble (a financial markets term applied to a rise or boom in the share prices of stocks of a particular industry). The bubble caused an overvaluation of the companies. This resulted in the ‘burst’ of the bubble which in turn resulted in the worth of shares becoming a small fraction of their value at the height of the boom, and many companies went out of business.

The Dot Com burst started in the late 2000 through 2001.

Why the Dot Com Burst?

Books and articles on the internet have analyzed and described at length the causes and reasons for the Dot Com Burst. In my view, based on these readings, there are a few key factors for the Dot Com Burst. These key factors are listed below:

Inherently Flawed Model of Monopoly:

A vast number of companies had the same business plan of monopolizing their respective sectors through network effects, and it was clear that even if the plan was sound, there could only be at most one network-effects winner in each sector, and therefore that most companies with this business plan would fail. In fact, many sectors could not support even one company powered entirely by network effects.

Early fortunes:

Vast fortunes were made by a few company founders whose companies were bought out at an early stage (by larger organizations) in the dot-com stock market bubble. These early successes made the bubble even more buoyant.

Disintermediation:

The Web would cut the middleman out; with the demise of the middleman, prices would lower and everyone but the intermediary would be happier. This was not the success story in reality. Many companies closed down within a short time because of failures.

Companies Short Cashed:

Companies like Boo.com, CDNow.Com, etc., had good revenues but the company's costs were just too high. People even suspected mismanagement as one of the other reasons for its failure. Lavish spending of money on advertisements and giveaways were some of the reasons for mismanagement of money.

More Careful Venture Capitalists:

Venture Capitalists are scrutinizing the specifics of each request more carefully than ever, and they are absolutely requiring business plans, something that seemed to be optional at the height of the tech craze. The near-panic days of 2000 drove investors to pour money into start-ups with flimsy plans for fear of missing out on the next hot sector. This craze is gone and there is an air of caution pervading in the tech sectors.

Side Effects:

The dot-com boom caused side effects and the primarily hit sector was that of the networking. The belief was that the amount of fiber optic and copper cable needed to service traffic would go up exponentially.

Based on this continuing assumption, many of these networking companies (like the dot-coms) took on huge debts to finance massive network expansions. They found themselves in trouble after the bubble burst because of their debt loads and the collapse of subscribers.

Y2K

One of the other reasons for the failure was the spending in preparation for the Y2K switchover. Once New Year passed without incident, businesses found themselves with all the equipment they needed for some time and business spending dried up. This correlates quite closely to the peak of U.S. stock markets. The Dow Jones peaked in January 2000 and the Nasdaq in March 2000. Immediately hiring freeze, layoffs, and consolidations followed in several industries, especially in the dot-com.

Initial Public Offering:

In the Dot Com world, a pattern was set that someone pitched a web-related business idea to the venture capitalists, who in turn, financed the launch and heavy promotion of the company. The company then issued an IPO as soon as possible.

These enterprises created paper multimillionaires overnight, and the IPO quickly became more important than products and profits.

This speculative frenzy became an industry in itself. Entire TV channels and websites were devoted to it. Many people knew they were caught up in the bubble but went along with it because there was a lot of money to be made.

Only a small amount of stock was sold for real money at the inflated price, but the same value was attributed to the majority shares owned by the founders and original investors.