

# DOT.BOMB

## Inside an Internet Goliath – from Lunatic Optimism to Panic and Crash

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## 1.

*"The mid-90s were an age that no one really knew, but many were beginning to suspect, would be an Age. The Internet and the World Wide Web were without definition but full of wild expectations. While few Yahoo!'d, America Online was just a dorky company in a bland Virginia suburb, and the expression 'dot.com' sounded odd in conversation, there was an expectant sense that those were just temporary realities – that the Internet was going to change the world, and the retail conducted over it would be the engine. What that really meant wasn't exactly clear. Only the visionaries could describe the future for everyone else"*

– J. David Kuo

In late-1995, Craig Winn, the founder of a couple of retail businesses, had a vision that retail would be dominated by technology, making the traditional retail stores and warehouses redundant. The spread of the Internet seemed to mark the point of arrival for that vision, and Winn decided it was time to launch the next retail revolution. He even had a name for his new company – Value America.

Winn's original business model for Value America was stunningly simple:

- Value America would be a one stop shopping center – where people could furnish a house, buy a car, purchase groceries, do their Christmas shopping, equip an office, etc.
- Value America would have unparalleled selection – because all the products available would be described in multimedia product demonstrations.
- Value America would be "state-of-the-art" – with animated personal shopping assistants, voice recognition capabilities and other cutting edge enhancements.
- Value America would carry no stock – but manufacturers would ship directly to the consumers.

The challenge, Craig Winn realized, was to get there before anyone else. He put together a 250-page business plan and started speaking with the people he wanted to get involved in the business. Due to the fact Winn had been successful in building two retail businesses in the 1980s (The Winn Company with a turnover of \$40 million a year and Dynasty Lighting Classics which went public in the early 1990s once annual sales reached \$65 million) he already knew the right people to talk to.

Very quickly, Craig Winn brought on board Rex Scatena, a lawyer living in San Francisco, as founding partner and president. Two other friends, Ken Power and Joe Page, were hired to handle creative design and technology. Winn and Scatena put up \$150,000 each to get the company started, with the stock of the company being split 70-percent to Craig Winn, 25-percent to Rex Scatena and 5-percent split between Ken Power and Joe Page. They set up base in Charlottesville, Virginia and by Labor Day 1996, the Value America team was hard at work writing code for their new online business.

*"Writing code didn't mean just deciding what the store was going to look like. First it meant writing the software they would eventually program to create the store. Then it meant writing the technological support structure to make the store run. They had to do it all. The upside was that they could use a commercial Microsoft program as a foundation for some of the work, but for the inventory-less system to succeed, they had to program everything consumers needed to complete an order: take credit-card information, provide digital receipts, route orders to the appropriate brand manufacturers, arrange for shipping –*

*everything. In addition, the technology had to handle everything that could possibly go wrong: partial orders, back orders, mismatched orders, shipping delays. The list of problems, it seemed, were almost limitless. Programming consumed their lives for the rest of 1996 and early 1997."*

– J. David Kuo

While the coding was happening, Winn was out visiting manufacturers trying to get them to pay \$15,000 to \$50,000 to develop multimedia presentations for an online store that did not yet exist. Needless to say, very few took up the offer. He needed a big brand to come onboard to get the ball rolling. So Winn approached Hewlett-Packard. By April 1997, he had met with HP managers more than 30-times, when suddenly, HP's general manager made the connection and understood what the Value America business concept would offer.

*"Winn walked them through the seven things consumers wanted from an online store, the five things that brands needed, and the five key principles of e-commerce, as Internet retailing was now widely known. Suddenly he could see it in their eyes. For the first time in an HP meeting, Winn saw he had made the connection. HP's general manager told Winn he'd hit at the core of HP's nascent e-commerce strategy – the need to reap the benefits of selling directly to consumers via the Internet without taking the Internet risk all on its own. For HP, the risk in selling directly to consumers online wasn't so much the financial risk of building an online store as it was the danger of alienating current vendors and hurting bottom-line sales."*

– J. David Kuo

Finally, Craig Winn had the big name he needed. HP agreed to sell its entire line of consumer and small business products through Value America, so long as Value America purchased the products through one of its five biggest distributors. That way, HP would not have to handle the shipping of products. It wasn't exactly what Winn had in mind, but he came up with a new idea to take advantage of this arrangement. He contacted each of the five distributors, and told them whichever helped Value America to get more brands on board would get their business. Within weeks, more than 100 new brands signed up with Value America, each paying between \$15,000 and \$20,000 for premium placement and the cost of preparing a multimedia product demonstration.

These were exciting developments, although the enthusiasm was tempered somewhat by the fact Value America still did not have a functioning Web site. When the online store was launched in early October 1997, it was pretty basic – the personal shopper and voice recognition ideas had fallen by the wayside. The first version of the Web site could not even process credit card orders – but at least Value America had opened its doors. And, since anything Internet related was very popular in 1997, Winn decided the time was right to get more shareholder funding. He sold 100,000 Value America shares for \$1.50 each to his close friends.

The ease with which Craig Winn was able to sell those shares started him thinking. He approached several investment banks, with the idea of having them raise \$10 million so Value America could move into the big leagues of the Internet landscape. This was about the same time Netscape, Yahoo!, America Online and Amazon.com were all completing hugely successful IPOs. All of the investment bankers Winn spoke with felt building scale and securing online landscape was more important than reaching profitability. They even suggested that instead of

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