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Starting a New Company . . .

Jeff Finkelstein

While I was a student at the CU MBA program, the Internet promised to fundamentally change the way businesses operated. From the fall of 1998 to when I graduated in June of 2000, we frequently had guest speakers who had started hot new companies and had personally cashed out for tens of millions of dollars.

So after trying to start a similar company with some business school colleagues, I joined a $46 million venture-backed start-up. Although sanity had returned to most of the business world, back at the start-up the rules of the post-dot-com economy didn't yet apply. But after a year and a half with the company (and with no products, customers, or a viable business model), I left to start my own high-tech firm.

I decided right away that I didn't want to pursue venture capital. Nor did I want to pursue the latest and greatest bleeding-edge technology. Instead, I focused on a current business need—communicating via personalized e-mail with customers in a privacy-friendly way.

I did my market research and found that in just a few short years, more than 45% of all Americans had signed up for an e-mail account, and 84% checked their e-mail on a frequent basis. I also found out—by talking with potential customers—that most businesses and organizations weren't using e-mail as a way to interact and talk with their prospects and customers. Marketing managers were afraid of violating their customer's privacy, and often didn't know where to start with e-mail. After all, business schools tend to teach marketers how to work with an ad agency that will help them craft a message, and develop radio, print, and television commercials—not how to do direct marketing on the Web.

Armed with market research and a desire to fill a real business need, I formed a company. I built a Web site, and licensed or built the required e-mail marketing tools. Thanks to a down economy, contract programmers and commission-based sales people were much easier to find than they were just a couple of years ago when companies begged people with minimal experience to work for highly inflated salaries.

And also due to a slow economy, businesses are aggressively looking for new ways to cut costs and increase the bottom line. Our pitch frequently revolves around shifting a few budget dollars away from a traditional postal mail campaign, and using the money to instead communicate more frequently with their customer database.

Through a lot of hard work, a great deal of networking, and extremely targeted advertising campaigns, nine months later the company has a healthy client base, including several Fortune 500 companies. We won't be posting multimillion dollar quarterly earnings any time soon, but then again, neither will many of the Internet start-ups I worked in and around in the past. We take what we do seriously, but we're not infected with a belief that we're radically changing the world. We are a Boulder-based company, though, so we do like to think that shifting to e-mail helps save trees. ;-)

The irony is that in a way, I do have the venture capitalists to thank: I carefully saved my money while I worked at the start-up, and have leveraged those precious funds to create Customer Paradigm.

Jeff Finkelstein, CU MBA 2000, is founder of Customer Paradigm, an e-mail marketing and privacy consulting company in Boulder, Colorado. Send your thoughts to Jeff: <jf@customerparadigm.com>.

From the editor . . .

This issue of the *CBR* cites examples of how the business model for successful e-commerce companies has evolved and taken different forms. In addition, we highlight research in the use of e-commerce in an area where it may not be obvious—on-line auctions.

The 38th annual Colorado Business Economic Outlook Forum will be held December 16 at the Marriott City Center in downtown Denver. See page 2 for more information. Please join us.

—Richard L. Wobbekind

A Small Survival Story

Dax Stephens

Celebrity founders. . .16 accomplished senior executives. . .Web content, development, and design departments . . .PR, promotions, business development. . .Etc.. . .Total headcount of more than 100, not including the many consultants on hand. . . Offices in Los Angeles and New York. . . Sound familiar, perhaps too familiar, or even painful? We were a company funded at the height of the Internet craze. We raised $28 million with a business plan focused on aggregating eyeballs around celebrity Web sites, with "depth of content and products and services". . .oh, and there was a B2B element in there somewhere. Our company promised to harness the power of technology to create communities of consumers and better their lives. We were a sexy story, sound business fundamentals aside. . . millions of monthly page impressions, exciting celebrities, many fun promotions and events.

Of course, at the end of the day our business, as it was, turned out to be unsustainable. Not surprisingly, revenues were way out of line with our overhead. Thank goodness for a core competency that we had just considered a means to an end—infomercials. "Yes, that's right, and if you call in the next 17 minutes, this can be yours for just $59.99!" After all, our celebrity relationships afforded us ready talent, and we had some heavy-hitter direct response television and retail people on our team. It was the part of our business that we played down to Wall Street, and yet it was our bread and butter. It is the reason we are still here today.

The very painful "fat-cutting" process that many, including us, went through in 2001 forced us to concentrate on revenues and, more importantly, profits. Our focus in the business turned away from Web content, the on-line marketplace, and the e-whatever, and went exclusively to the next big meal ticket—new hit infomercials! We had no choice, since there was no VC money and very limited infrastructure remaining. "A revolutionary new product only available through this exclusive TV offer.". . .Thankfully we did discover our next hit product, which pulled us out of those dark times.

It isn't easy to give up the vision for the company and settle—at least for a while—on what will keep the business viable, particularly when the viability of the business centers around something as unsexy as infomercial products. The truth is, I'm not sure that the vision as it existed for us and for many others will ever materialize. But recently I have been inspired to ask, looking up to this point, whether we have actually (albeit unwittingly) realized some of the promises of the Internet and e-commerce that we set out to achieve. The Internet promised us, and we promised others, the ability to reach millions of consumers with abundant information and purchase opportunities, while giving them a voice. It promised low-cost customer acquisition and retention, and "smart," targeted marketing.

Our not-so-sexy offline business has generated a database of 760,000 customers. This, together with our celebrity sites, has garnered a total of 1.5 million e-mail addresses and 1 million unique visitors a month. The infomercials drive 7 to 10% of our sales on-line. We have the ability to send out 1.2 million e-mails per month, with targeted e-mail blasts converting at around 0.03%. On-line sales can dramatically increase margins by cutting out telemarketing and media costs. And we still provide forums for customers and fans of our 12 celebrities to communicate with us and with each other.

At the end of the day, a successful offline business focused on the impulse buyer allows us to fine-tune the electronic impulse sale. Conversion rates with the latter aren't always the best, but now we have the luxury of time to make them better—versus beating the clock before we run out of money. It is a bifurcated effort of building a sound offline business while growing the CRM and database back-end.

The fact that we were funded as an Internet company and that today we are surviving in the black feels like a miracle. Truth is, the era in which we were founded and the expectations of our institutional investors dictated that we focus almost exclusively on the one channel. Focus on scaling that channel was too soon. . .clouded by the emphasis on the exit scenario. Of course, everyone knows this now.

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Colorado Business Economic Outlook Forum 2003

Monday, December 16, 2002

New Location!
Marriott City Center
1701 California — Downtown Denver

1:15 p.m. Welcome and Colorado economic outlook for 2003
2:10 p.m. Audience question and answer panel session
2:40 p.m. Keynote speaker: Tom Shane, The Shane Company
3:15 p.m. Concurrent discussion sessions

- Population, Labor Force, and Personal Income in 2003
- Will High-Speed Internet Speed High-Tech Growth?
- Grow Your Own: Bottom Up Approaches to Economic Growth in Colorado
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Auction on the Internet: How Good Is It?

Atanu R. Sinha

Auctions have been used for buying and selling since at least 500 B.C. in Babylon. However, the dawn of the Internet has really brought auctions into the spotlight for many people. This is due, in large part, to eBay, the auction site that claims 46 million members, and, very importantly, has been a rare shining light in the midst of innumerable Internet failures. As one sign of its success, eBay's stock price has held up very well in the last two years of market slump. But this article is not about eBay; instead, it is about specific issues that may impact Internet auctions.

Most sellers do not have the wherewithal to sell directly to buyers; they need to sell through an intermediary. Using an auction mechanism allows the seller to get the price that the "market will bear" through competition among bidders, and without having to invest in obtaining information about possible demand. So long as a large number of people can be brought in to bid, and safeguards like prevention of bidder collusion can be ensured, the seller can get a "good" price. The Internet allows participation from a potentially large pool of bidders; the auctioneer works as the intermediary whose reputation and attraction effort help draw bidders. For its role, the auctioneer receives a commission on the sale price, which ranges from 1.5% to 5% at eBay. Part of this commission is spent by eBay in bidder attraction efforts. My research shows there is an inherent conflict in this arrangement; that is, when a seller relies on the auctioneer to expend a part of this commission in bidder attraction efforts on behalf of the seller. The auctioneer wants to expend less than what the seller desires, and this conflict is exacerbated when the commission rate is low as in the case of Internet auctions.

My research also finds that in exchange for a lower commission, if the seller is allowed to share in the attraction effort then that arrangement is in the best interest of both the seller and the auctioneer. But that portion of the seller's attraction effort has to be observable by the seller for it to work. The option that eBay provides to sellers is one such arrangement. This option allows each seller to select bidder attraction effort according to her/his own need based on a menu of alternatives. For example, eBay offers sellers the following bidder attraction features beyond the basic "listing fee" (which ranges from $.30 to $3.30 for a standard auction):

Listing Upgrade	Listing Upgrade Fee
Home Page Featured	$99.95
Featured Plus!	$19.95
Highlight	$5.00
Bold	$2.00
Gallery	$0.25
Gallery Featured	$19.95
List in Two Categories	Double the insertion and listing upgrades fees (excluding Scheduled Listings and Home Page Featured).
10-Day Duration The longest listing duration available	$0.10
Scheduled Listings	$0.10
Buy It Now	$0.05

This arrangement also satisfies the observability criterion, since sellers can easily go to the site and check whether the chosen alternative has been implemented by eBay. Furthermore, if a seller is interested in obtaining information about the relative attraction power of these alternatives before deciding on the "right" one, she/he can find information from the site about past auctions of similar products that used such alternatives, and relate them to the number of bidders attracted to the products. Additionally, these seller chosen attraction efforts bring fees for the auctioneer. All these give Internet auctions an edge over conventional brick and mortar auctions for many product categories.

Another challenge that Internet auctions face is that the auctioneer does not typically monitor the number of sellers and bidders. So at any given time several items are being sold, and many of them have the same start and end times. In a separate research project I found that it may not be in the best interest of the auctioneer to allow as many sellers as possible to sell their wares. Increasing the number of items for sale, even if the auctioneer does not spend to attract these items, can decrease total revenue for the auctioneer. This occurs due to bidders reallocating their interest away from some items to "newer" items. Furthermore, the revenue decrease can happen even if "newer" bidders come in. Thus, the auctioneer needs to analyze the data generated from past auctions to determine the relationship of buyers' interest among different types of items. With this information, some restrictions can be imposed on the number of items and types of items that can be sold during a given period.

An additional challenge is preventing "shilling," whereby a seller places a confederate bid on his/her behalf and attempts to raise the price. My research on shilling shows that it can be a practicable strategy for a seller, although I do not claim that it actually occurs in practice on a regular basis. One way to reduce the possibility of shilling is to have bidders not be identified at the current bid price; instead, only the bid price is displayed without their e-mail identities. This arrangement of anonymous bidding also reduces the chances of bidder collusion, whereby bidders try to achieve lower selling prices by not upping each other's bids. Introduction of this arrangement can help maintain the integrity and reputation of Internet auctions as a fairer place for buying and selling.

In summary, Internet auctions are likely to stay even after the euphoria and novelty wear out. For firms to be profitable in this venture, it is perhaps important to pay attention to the issues discussed in this article.

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An Update on e-Commerce

Erin Hickey

Everyone has a good story to tell about the bursting of the dot-com bubble. Believe it or not, most of them do not end happily ever after. However, there is a part of this story that a lot of people tend to overlook. Despite the failure of thousands of these so-called dot-coms, e-commerce and the use of the Internet as a fundamental business tool have grown substantially over the past few years. According to the latest eMarketer report, on-line sales, excluding travel, will grow to nearly $13 billion this holiday season. This represents an increase of 16% over fourth quarter 2001, four times the rate by which overall retail sales are expected to grow. The report states that 3 million people will make their first on-line purchase this quarter. Consumers also seem to be spending more and more of their hard earned money on-line. eMarketer estimates that the average Internet shopper will spend more than $1,089 in 2002, up considerably from the 2001 figure of $866. By 2004, the average Internet shopper will spend $1,400 a year.

This enormous market has not gone unnoticed by the more traditional “Old Economy” companies. Managers of such legacy firms are faced with an overwhelming task of readying themselves for the transition into the now-essential business of e-commerce. In a recent issue of *Communications of the ACM,* authors Pinker, Seidman, and Foster present five myths of e-business development to help managers prepare for this important evolution.

1. *The first-mover has the advantage, and everyone else is on-line anyway, so give up.* It has not been proven yet that slow-moving legacy firms can’t compete with the first-movers. What really matters is a sound e-business strategy.
2. *It’s all about finding the next killer application.* Managers are often convinced that the secret to e-business success is to create an innovative new product using the power of the Internet, rather than using it to improve the products and services they already offer.
3. *The only way to get started in e-business is to spin-off or acquire a dot-com.* While spin-offs and acquisitions may be easier in some cases, they often limit the parent firm and do not integrate e-business with the firm’s core processes.
4. *A single department or functional area should lead e-business initiatives.* E-business activities should exist throughout a company’s value chain so that activities better complement each other.
5. *The CIO should lead all e-business efforts.* More commonly, a new role of CeCO (Chief e-Commerce Officer) is evolving. Often the CeCO will be created within the office of the CIO, or by designating the CIO as CeCO.

By taking note of these five myths, the authors hope that managers of legacy firms will develop a better idea of what key factors they need to look at when making the inevitable decision to adopt an e-business strategy.

It is clearly evident that e-commerce is here to stay. Not only did it spawn a business revolution in the late 90s, but it has continued to grow dramatically even after the much-hyped dot-com bubble burst. With projections of colossal on-line sales figures for years to come, it is an industry with a very bright future.

Erin Hickey is a junior in the Leeds School of Business at CU-Boulder. He is majoring in marketing, and hopes to complete the school’s entrepreneurship program as well. He has worked at the Business Research Division of the Leeds School of Business for the past two years. Please send any comments to <erin.hickey@colorado.edu>.