

# Dot-Com Cash Crash



After the dot-com bubble burst in 2000, Jeff Bezos' letter to shareholders began with: "Ouch. It's been a brutal year for many in the capital markets and certainly for Amazon.com shareholders. As of this writing, our shares are down more than 80% from when I wrote you last year." How did Amazon survive? One word: cash.

The bubble was created by frenzied investors who gave huge sums of cash to the likes of Pets.com and Living.com – companies with zero profits. These same investors and speculators told these dot-coms to use their startup capital to "get big fast" — and they did.

In January 2000, there were 17 dot-com Super Bowl commercials, each costing \$2 million for a 30-second spot. But the spending went way beyond Super Bowl Sunday, and when the cash ran out, the bubble burst.

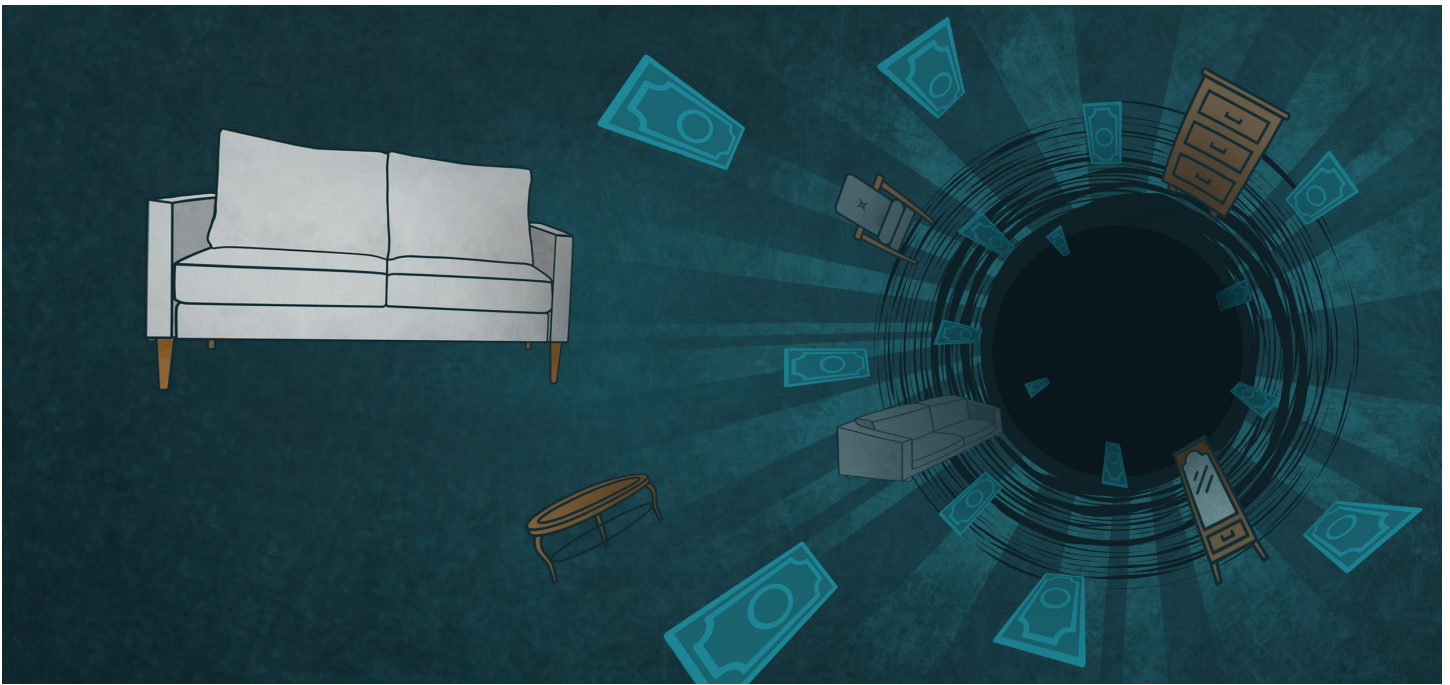
## Down Boy

Pets.com went public on Valentine's Day 2000.

Overnight it raised \$82.5 million (some serious cash). In its prospectus, it listed 7 keys to its strategic success and over 30 risks. Its strategy was very similar to most dot-coms of the day: spend a lot of cash to gain a massive customer base. If you weren't in diapers at the turn of the century, you probably remember Pets.com's ubiquitous sock puppet mascot. The sock puppet appeared everywhere from the Macy's Thanksgiving Day Parade to primetime TV.

While Pet.com's award-winning ad campaign was incredibly successful, it wasn't free. In its first full quarter after becoming a public company, Pets.com spent \$17 million on sales and marketing — making its sock puppet its highest-paid pooch. It spent another \$10.6 million buying its largest competitor, PetStore.com, continued to sell products for less than what it bought them for (always a recipe for disaster), and offered free shipping. Imagine that! Steep discounts at checkout and free delivery for heavy bags of Puppy Chow. Customers were barking for more,





but in that same quarter, Pets.com only reported \$8.8 million in revenue.

As its cash ran out, Pets.com begged for more. Unfortunately, internet startups with no profitability plan all went to the dog house. On Election Day, just 268 days after Pets.com's IPO, Pets.com would go out of business having spent all \$82.5 million. That's like losing just over \$307 thousand a day. Fortunately, all sock puppets go to heaven.

### **I Wouldn't Bed On That**

Living.com was founded in 1998 and launched its site in July 1999. The company's strategic partners (aka frenzied investors) included Benchmark Capital, Austin Ventures, Comdisco Ventures, Pivotal Asset Management, and GE Capital. Even Starbucks, investing \$20 million wanted in on the house party. In all, Living.com attracted about \$70 million to start an online home furnishing store. Living.com's experience was one of inexperience when it came to selling furniture. But who really cared about experience in 2000? In its rush to get off the couch and gain a massive customer base, Living.com did the unthinkable: it bought a brick-and-mortar store in the heart of North Carolina's furniture belt. Shaw

Furniture Galleries had been in business for over fifty years when Living.com knocked on its door promising everything but the kitchen sink. The dot-com startup paid more than \$5 million to gain access to Shaw's established customer base and manufacturing relationships.

The buy-out proved to be even more costly. Only a handful of Shaw's furniture manufacturers were willing to partner with the newcomers from out of town. On top of that, thirty percent of shipments were returned mostly due to damage (that's nearly a third of its business!), and scratch and dent inventory began to pile up. Living.com spent \$40 million in its first 18 months and another \$40 million in its last six trying to fix problems. The company filed for bankruptcy on August 15, 2000, pulling the welcome mat out from underneath employees, customers, and Shaw.

### **Welcome to the Jungle**

Amazon held significant shares in both Pets.com and Living.com, yet it failed to recognize the pivotal role its early leadership played in establishing the success of online shopping. Jeff Bezos wasn't under any delusion that his business model, like all first-generation dot-



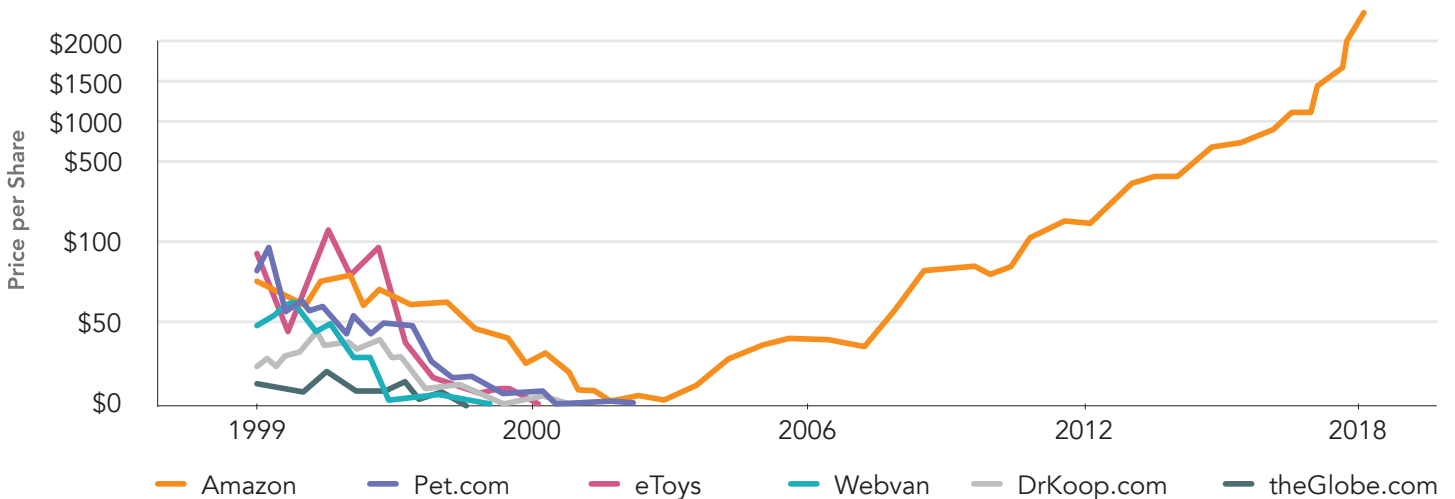
coms, wasn't a risk. However, it was a risk he believed in. As Bezos explained in his letter to shareholders in 2000, "With a long enough financing runway, Pets.com and Living.com may have been able to acquire enough customers to achieve the needed scale [to be profitable]." Pets.com and Living.com came up short, but Amazon survived because by the time the dot-com bubble burst, it had been in business since 1995 and a public company since 1997, giving it a long financing runway on which to build scale. Further, as other dot-coms burned through cash and couldn't get more, Amazon fortuitously acquired overseas capital just a month before the crash — giving it just enough (\$672 million) oxygen to survive. Without its head start and

lucky infusion of cash, Amazon could have very well been the biggest dot-com bust of them all.

Cash gave Amazon the runway it needed to survive and ultimately take off. Today, Amazon is one of the most successful companies in the world, and Warren Buffett calls Jeff Bezos, "The most remarkable business person of our age." In every letter to Amazon shareholders, Bezos includes a copy of his original letter from 1997, "We believe that a fundamental measure of our success will be the shareholder value we create over the long term." If you had invested \$5,000 in Amazon's stock when it first went public it would be worth at least \$2.4 million today. That's a lot of cash.

# Activity

Guess the missing dot-coms on the graph and answer the questions below with your team. Options: DrKoop.com, Pets.com, theGlobe.com, Webvan, and eToys.



1. Did these dot-coms fail from having an unsustainable business model, or do you believe Jeff Bezos when he said, "With a long enough financing runway, Pets.com and Living.com may have been able to acquire enough customers to achieve the needed scale"?
2. All the companies above failed to copy Amazon's continued growth over profits strategy. If you were to begin a company during the dot-com age, what strategy would you have used?
3. If you were beginning a company, which would you rather do: plan for the long-term, and use your cash slowly or get big fast and lean on investors? Which would be a safer strategy?
4. Many other large companies take years to become profitable like Tesla and Uber. Why do you think some companies can rise to prominence despite not be profitable for years while others can't?
5. How has cash allowed your company to continue operations? In what ways do you influence the use of cash?
6. If you and your team have the book, "Seeing the Big Picture" read chapter one and then discuss how you can improve cash at your company.

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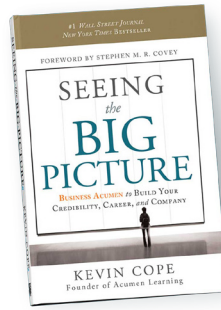
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