

## Let the buyer beware

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In this article I would like to examine the substance, or otherwise, behind the current enthusiasm for any form of internet related investment. In my opinion, the key to the phenomenon is productivity. Any overall growth in the nominal value of an economy, which is not matched by equivalent inflation, must be due to improved productivity. Consequently it is the internet's ability to deliver improved productivity which will determine the long-term value of technology shares.

Internet technologies offer a multitude of ways to improve productivity. These include: reduced publishing costs; better knowledge management; shortened supply chains; reduced cost of data entry; to better reuse of information resources; greater competition; and increased cross-border trade. The list could go on and on. Suffice to say however we're only just seen the beginnings of a revolution in the way information is managed and distributed. Because we are only at the beginning of this process there are still huge gains to be made. Contrast this with the situation in manufacturing, after decades of continuous improvement, significant productivity improvements are increasingly difficult to find and expensive to implement.

One of the most common complaints about the new technology shares is that they lack intrinsic value. The terms old economy and new economy are frequently used and could possibly be replaced with 'undervalued economy' and 'overvalued economy'. Meanwhile the famous conglomerates and corporate raiders of the 1980s are distinctly irked at finding their place in the FT 100 index being usurped by upstarts with no track record. The problem for the likes of Hanson PLC is that it is becoming increasingly difficult for them to produce bricks more efficiently than they do already.

In the long-term of course there will be no such thing as new economy or old economy there are simply more and less profitable and efficient organisations. Conventional measures of company value will be as important as ever. The business stars of the next ten years will be those who succeed in combining the productivity offered by the new economy with the intrinsic value inherent in the old. Inevitably this will mean a combination of the best new businesses and the most agile or weighty of the establishment pack. For the investor these are exciting but dangerous times. Nothing I say should be taken as investment advice, but I would like to examine some of the criteria which may contribute to the success of the winners.

So-called dotcom companies are usually consumer oriented retail businesses which rely on the internet to provide a shopfront. They compete with conventional mail order and high street retail businesses head on. Their main advantage is the ability to compete nation-wide from a tiny fixed cost base, no expensive shops, no expensive glossy catalogues and relatively few staff. Also they can be much more agile in the way they modify their catalogue to reflect demand

because changing the catalogue is instant and effectively free. The main challenges are logistics and marketing, logistics can be out-sourced, so that leaves marketing. A recent article in the Financial Times estimated that the cost of establishing a dotcom consumer brand in the US is now around 200 million dollars, and it is here that those shareholder funds are being spent. It is not surprising that we are seeing so many TV and newspaper adverts for websites these days. In the long term this advertising spend has to be converted into real and sustained business, and for that to happen there has to be something in it for you and me. In other words, a dotcom can only succeed long term if it offers tangible benefit to the consumer; better prices, better products, superior service or some other unique ingredient. In a nutshell only buy the shares if you like the product!

Other recent beneficiaries of the enthusiasm for internet investments have been companies like Dixons with Freeserve, which again provide a consumer oriented vision of the internet phenomenon. Dixons were smart enough to get in early and capitalise on their status as a pioneer of a new route to market. The underlying concept of free internet access in return for 'cyber footfall' is already commonplace with the trend being towards completely free (or highly subsidised) internet access as a loss leader for other revenue streams.

Meanwhile whilst billions are being spent on trying to make the internet work in the business to consumer market some companies are benefiting hugely from the resulting demand for services, infrastructure, expertise and content. For example companies such as Cisco Systems which produces much of the hardware to plug the internet together or even Microsoft for whom the internet has meant an ever expanding market for operating systems and internet enabled development tools. The point is that whatever book companies ultimately have the greatest market share they are highly likely to be major consumers of internet technology. Similarly any company which sells logistics cannot fail to benefit from a growth in demand for warehousing and delivery services.

Finally the major growth area in e-commerce has been, and is likely to continue to be, in business to business transactions. Here the potential for more efficient communication, shorter supply chains reduced transaction costs, better product information and so on can make a real contribution to the most important business objective of all... greater productivity in the real - global - economy.

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