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   Joan Fontrodona, IESE professor

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WEEKLY INSIGHT

eToys blames Goldman Sachs of its death
The bankrupt Internet toy seller eToys has filed a lawsuit against Goldman Sachs, alleging that the underwriters intentionally underpriced eToys' offering and received kickbacks from its customers who profited when the shares soared. The dotcom raised $166 million from its IPO but was forced to declare bankruptcy less than two years later. (From Reuters) [Full Story]

Highlights
- Born in Los Angeles in 1996, eToys appeared headed to dominate the online toy sector. It was backed by respected venture capital firms such as Idealab, Highland Capital Partners and Sequoia Capital Partners.
- According to Jupiter Media Metrix, during the holiday season of 1999 eToys drew more customers than the Web sites of Toys "R" Us and Amazon.com.
- In May, 1999, eToys raised $166 million during its IPO after pricing its shares at $20, advised by Goldman Sachs.
- Over the last two years, the value of the company had been depreciating. In March, 2002, it announced the close of its web site, sold its BabyCenter.com Web site to Johnson & Johnson and filed for bankruptcy.

Press Review
From E-commerce Times
"While scores of tech shareholders have filed lawsuits based on similar claims during the past two years, the eToys suit appears to be the first one brought by a company that went public. Most of the earlier lawsuits alleging impropriety in the IPO process - including one pending against eToys - name both the company that went public and the underwriter as defendants. Priceline.com, Expedia.com, Buy.com and Drugstore.com all have been named in shareholder lawsuits in connection with their initial public offerings. (...)
Presumably, more money raised at the outset might have helped the e-tailer to survive a bit longer. After all, the eToys brand has proven valuable to KBToys, which bought the bankrupt company's assets and inventory at auction for $8.7 million and has used the recycled domain name to boost its share of Web traffic. Grossman noted that eToys was different from many failed dot-coms. "It had a really great concept," he said. "It had an actual business model that made sense, not just some pie-in-the-sky idea. The problem was capital, and if they had had additional cash they might have had the chance to hang on and become profitable." [Full Story]

From The Street.com
"There've been a lot of lawsuits against [brokers], but this is really the first company saying it's not happy with the offering and that it thinks it was mishandled,' said Kyle Huske, a market analyst at IPO.com. 'There are so many other companies that could follow.' (...)
The fact that eToys has waited until now to file a lawsuit may be a reflection of the general backlash against brokers for the way they handled stocks during the boom. Huske also noted that brokers are more likely to settle such allegations out of court now, given that many of them are also under investigation by the New York State attorney general for conflicts of interest."

From The Guardian
"The extraordinary boom and bust of the late 1990s and early part of this decade has left many investors who had their fingers burnt looking for someone to blame. Credit Suisse First Boston in January paid $100m to settle claims that it mishandled share sales during the peak of the bull market. Regulators accused the bank of taking effective kickbacks for giving clients access to some of the hottest flotations. Earlier this week Merrill Lynch also agreed to pay $100m to settle claims brought by the New York State attorney general that its research analysts had been offering biased advice to investors in internet stocks to help the firm win investment banking business."

Commentary by...
Joan Fontrodona, IESE professor
eToys-Goldman Sachs, lack of models or conflict of interests?
eToys lawsuit against the investment bank Goldman Sachs claiming the banking giant intentionally undervalued the e-tailer's 1999 initial public offering has reopened a discussion about the origin of dotcom mishandling during the IPO. Was it a result of ignorance or was it a product of the underwriter's mala fide? In May 1999, eToys debuted in Nasdaq at $20 a share. The shares closed the session at $76.56. At that time, everybody looked happy. eToys raised $166 million, its brand appeared in the glamorous ranking of IPO's that multiplied their initial price by 100, and Goldman Sachs scored a new success in this kind of operations. Two years later, the share price was worth just 9 cents and the company filed for bankruptcy. And now everybody complains, of course. Analysts, accused of having undevalued the share, may argue that
in the short run it was situated below the price they had set. eToys moans that if the starting price had been higher, they would have raised more money and, therefore, would have had more cash to consolidate the business. Others wonder if $166 million wasn't more than enough to prove whether the company was viable. And so on...

In the meantime, some made their money. The lawsuit now under way considers that, with the low valuation of eToys, Goldman Sachs wanted to reward some of its clients offering them the chance to buy cheap in order to sell later at a price substantially higher, and even perceiving some kind of commission for this "good service".

Historically -long before the Internet revolutionized the stock market--, analysts have received pressures to issue buy or sell recommendations of a company's shares or to set an IPO price in accordance with the interests of some of their clients. There are several reasons for this. On the one hand, strong competition forces investment banks to maintain excellent relationships with both current and prospect clients. On the other, walls between research and commercial departments are not clear in the internal organization of banks. Moreover, sometimes the analysts' compensation system is tightly bound to the volume of contracts they generate. Thus ethical codes, internal and government regulations and the enormous sums of money that firms spend to build ethical cultures of investment are practically useless against the prospects of operations that may become direct commissions for the analysts or for some of their clients.

Apart from how right each of the parties involved may be, in this case they seem to be two of a kind. On one side, the irrational euphoria -something we can only say now- of the late nineties joined together with the potential conflicts of interests in which financial analysts develop their activity and the immaturity of the market. This drove them to seek new formulas to value rapid growth companies but without any profit, such as dotcoms, to the detriment of the traditional financial instruments for company valuation.

While suits from affected investors abound, up to now there is no precedent of a dotcom company complaining about its initial valuation (and less, once bankrupt). Lack of models and the crisis of trust that the investment-banking sector is going through make it difficult to determine how the case will turn out or if some others will follow. On the horizon of eToys-Goldman Sachs conflict plenty of financial and even ethical questions arise. There are also issues about the model of analysis of an industry that is still under construction.

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EBCENTER ARTICLE

**The Internet, the missing link between supply and demand**

Ricardo Castrillo, Research Assistant at EBCenter

The net allows any consumer to buy a product made-to-measure, something that also benefits companies which are able to reduce the risk of accumulating too much stock. [Full Story]

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REPORTS

**Mobile infrastructure market will grow to $2.3 billion in 2005**

**Title:** Mobile Business. A critical evaluation of the market for mobile enterprise solutions

**Source:** Datamonitor

**Date:** May 2002

**Abstract:** Datamonitor believes that the **mobile enterprise solutions market** will remain relatively stagnant for the next twelve months in North America and Western Europe. The global market for mobile middleware will grow from $389 million in 2002 to become a **$731 million** revenue opportunity **in 2003**. The global total market size for **managed enterprise mobile solutions** will reach **$678 million** by **2006** and the mobile enterprise infrastructure market will grow at a CAGR of 66%, rising from $300 million in 2001 to
approximately $2.3 billion in 2005. According to the survey, large companies might not prove to be as profitable as might be imagined, but SME with 251-1000 employees is the segment that presents a considerable opportunity. [Full Story]

1 in every 9 who have tried online banking have given up

**Title:** Why online banking users give up?

**Source:** Forrester

**Date:** May 2002

**Abstract:** A growing number of European Net users have tried online banking and then have given up. To understand why, Forrester looked at the UK online banks and carried out a survey which highlights that some of the reasons are service design issues and sticking to traditional channels, above all telephone banking (21%).

The users who have given up online banking are much like those who still bank online: young, male, technology optimists with full-time jobs. The only big difference is their confidence in online security. To stop other customers switching off online banking, banks will have to tackle the flaws and give incentives to consumers to use different channels. In addition, banks must explicitly accept liability for unauthorised access into their systems. [Full Story]

**Spain, the country with the highest Audio-Video use**

**Title:** Audio-Video protocols and online Music

**Source:** NetValue

**Date:** May 2002

**Abstract:** NetValue has released a study on the online music sector on the Internet in four European countries. In Spain, where Audio-Video usage is the highest among the countries studied, Audio-Video protocols usage increases regularly (1.4%). In the other countries it slightly drops (Germany, 1,1%; France, 2,1%; United Kingdom, 6%), this drop corresponds to the end of Napster activity.

The peer-to-peer software Morpheus is the most used in the UK and in Germany with a community of respectively 3% and 9% of Internet users. Audiogalaxy Satellite is the leader in Spain, with 13,5% of users. The study shows that the different programs used in March 2002, separately count fewer users than Napster alone one year before.

In Europe, Audio-Video protocols users are mostly men under 25 years old, Netvalue says. [Full Story]

**COMPANIES**

**SCH focuses on European e-banking**

The Spanish bank SCH has sold its Latin American stake in online affiliate Patagon and is refocusing its business on Europe. SCH has purchased the 11.41 per cent stake in Patagon Euro from Wencesalao Casares, Patagon founder. As a result, American and European affiliate are now two distinct entities wholly-owned by their respective owners, and are to control operations in their two separate areas. Within a month, Patagon America is to stop using the brand name "Patagon", under which all online services were offered. From Europe Media. [Full Story]

**AOL reduce pop-up ads in its web site**

America Online subscribers’ complaints have been listened to. The provider has announced that it will reduce the number of pop-up ads, as part of the plan to improve the user experience at AOL. The pop-up explosion began more than five years ago when AOL switched to a flat monthly fee instead of charging members by the hour, making the online service more dependent on advertising revenues. From MSNBC. [Full Story]
Vodafone Announces Big Loss in UK
Britain's largest mobile phone operator, Vodafone, has announced that it lost about $22.9 billion last year due to write-downs in the value of acquisitions it made during its far-flung expansion at the height of the technology boom. Even so, the company's results before one-time items for the 12 months ending March 31 were somewhat better than many analysts had expected, and its shares jumped by more than 8 percent in early trading on the London Stock Exchange. From Yahoo News. [Full Story]

WE RECOMMEND
3G: a European debacle
Europe is fast losing its edge in high-speed wireless Internet, a megaproject, equivalent in size, vision, and expense of America's Apollo space program in the 1960s, Business Week says. 3G has stumbled from the get-go, a victim not just of miserable market timing but also of a host of local problems ranging from shortsighted and greedy national politicians to a regional policy that imposed a single expensive technology. Moreover, from Nokia to Vodafone, the phone biz is the soul of Europe's tech industry. Each of these companies was intent on riding 3G to global stardom. But the mobile Net would prove far trickier to orchestrate. In the cell-phone business, operators simply invested in networks and sold handsets and subscribers produced their own content simply by talking. In the mobile Internet, without compelling content and services to sell, high-speed networks are a waste of money. And Europe's phone giants have spent half a trillion dollars on licenses, acquisitions, and networks. Now, they are treading madly to stay afloat in a sea of debt. From Business Week. [Full Story]

100 companies which will change the world
The Red Herring 100 issue includes the annual survey of everything that is great about technology, innovation, and entrepreneurial capitalism. This year's list of the best 50 private and 50 public companies reflects three noteworthy developments. First, globalisation: more than 20 non-U.S. firms are represented, such as Vodafone and Nokia, both from Europe, and communications giants like NTT DoCoMo and Singapore Telecommunications, from Asia. Second, a return to business basics. For this reason, 20 software companies, such as BEA Systems or the German SAP, appear. Finally, the recovering economy. The ranking highlights biotech firms like NeuroNova and PowderJect Pharmaceuticals; communications, such as Cable & Wireless; and computer hardware, like Dell Computer, IBM or Sun Microsystems. The magazine quotes Apple Computer and Sony in consumer electronics category and Seagate and Hitachi in data storage. In Media category, which is going digital, appear AOL Time Warner and Real Networks. From Red Herring. [Full Story]

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