Available online at www.sciencedirect.com
SCIENCE DIRECT
Omega 34 (2006) 439–447
omega
The International Journal of Management Science
www.elsevier.com/locate/omega

The boys in the bubble: Internet entrepreneurs and stock market value☆

William Forbes*

Loughborough Business School, Loughborough University, Ashby Road, Leicestershire LE11 3TU, UK

Received 14 November 2002; accepted 4 December 2004
Available online 16 February 2005

Abstract

This paper expands the set of non-financial indictors of internet stock value to include that attributable to the retention of the founding entrepreneur. The failure of traditional financial value metrics to adequately explain the Internet stock boom has already provoked much research on non-financial indicators of firms value. The current paper adds to this trend of seeking "intangible" sources of Internet stocks value, by focussing on the role of the founding entrepreneur.

Keywords: Entrepreneur; Internet; Stock market

0. Introduction

The wild frontiers of the "new economy" are being charted by colourful characters. No business section of a bookstore was complete without a handful of biographies, or autobiographies of E-entrepreneurs painted as saviours or cowboys. Feted by the media during the stock market bubble of late 1999–early 2000 dot-coma's momentarily run to ground, waiting to re-emerge in the sunlight of a new dawn. These individuals served as just one of the players in the tragi-comedy that is now known as the late 90s internet bubble [1].

A sudden stream of papers of emerged relating US internet stock prices to traditional measures of value, such as earnings and book value and/or web-traffic data. This literature might be seen as part of a larger literature seeking to capture a company's "intangible" sources of value using non-financial measures, (e.g. [2–5]). One early strand of the literature has focussed upon the use of web-traffic data as a predictor of future revenues. But as Rajgopal et al. [6] have shown the network advantages of greater internet exposure partly reflect "media visibility". Such visibility may be greatly enhanced by the presence of a charismatic founder /leader. This paper seeks to advance the debate by considering the role of this other source of intangible value, the presence of a clear leading (often founding) figure within the firm.

While theories of entrepreneurship abound reliable evidence is more scant [7], particularly in the area of E-entrepreneurs. This paper seeks to improve understanding in this area by examining the effect on firm value of the retention of the founder of the firm. It does so by means of an extension to models currently popular in prior research Internet stock pricing.

The rest of the paper is organized as follows. In the next section we discuss why the presence and background of a founding entrepreneur may be important for valuing Internet stocks. In the second section we present a test framework for establishing whether the presence and background of the founding entrepreneur does indeed add value. A third

☆ Thanks to the Institute of Chartered Accountants in Scotland for funding the research of which this paper forms part and Len Skerratt provided constructive criticism and support for my work. Thanks to the Systems, Operations and Management Centre in Groningen for their hospitality during my sabbatical.

* Tel.: +44 1 509 223 136; fax: +44 1 509 223 960.
E-mail address: w.forbes@lboro.ac.uk (W. Forbes).

0305-0483/$ - see front matter © 2005 Elsevier Ltd. All rights reserved.
doi:10.1016/j.omega.2004.12.004

section discusses the sample frame chosen and data used. A fourth section presents the results of the tests. A final section concludes the paper.

1. Internet stock value and the founding entrepreneur

A brief perusal of newspaper coverage of Internet stocks suggests colourful characters are not in short-supply, witness Steve Case at AOL, Jeff Bezros of Amazon.com, Ernst Malmsten and Kaja Leander of Boo.com, (see Stross [8], Wolff [9], Swisher [10], Malmsten et al. [11]) or Martha Lane-Fox of Lastminute.com.[1] In this paper we can ask such leadership figures add value as well as a little excitement to corporate life for Internet firms.

In addition to anecdotal evidence, the role of the individual entrepreneur has been considered pivotal to economic success by leading academic authorities and has given birth to the who area of academic study entitled Entrepreneurship. Even an entirely altruistic leader can serve a function of both ensuring co-operative behaviour and encouraging the belief others will behave co-operatively [13,14].

The intangible nature of an Internet enterprise at the start-up phase can blur the distinction between the founder entrepreneur and the corporate entity itself. Thus Lewis [15] describes the next foray into the Internet revolution by Jim Clark, founder of Silicon Graphics and Netscape, as follows:

"If he was going to create the most valuable company in America it would need a name. He might as well have written 'Jim Clarke Enterprises' for that is what it amounted to. Instead he wrote 'Healthscape'"(p. 90)

The entrepreneurial function requires the production of an atmosphere of personal commitment to the success of the enterprise. To retain the necessary moral leadership required to steer a successful venture a potential leader requires both consistency and clarity in his or her direction of the firm (Casson [14], p. 6). Such requirements will often conflict with one of the principal characteristics of those willing to found new enterprises, that is an unusually high tolerance for ambiguity in the task ahead [7]. The effect of task ambiguity upon financial decision making has already been explored in a wide-variety of financial decisions [16]. Both technological and financial pressures require quick wits and an ability to weather set backs as the firm evolves in its initial phase. Hence the successful entrepreneur will need to marshal high degrees of commitment by others (employees, suppliers, customers) to a goal which is often only loosely defined. Inevitably such skills are rare and hence not easily replaced.

Furthermore the departure of the founding entrepreneur, often in the run up to, or shortly after, the initial public offering (IPO), can be interpreted as sending a negative signal about the true value of the underlying firm. After all, if the company is so great why sell it [17]? While institutional investors often seek a "heavyweight" to Chair the post IPO firm, some value of the founders charisma is likely to remain.

Whatever the role of the entrepreneur is the average start up we might regard their presence to be particularly central to the success of an Internet start up. This is because of the need to have a physical embodiment of the largely intangible assets that constitute the firm (in the form of brands, organisational and intellectual capital). A strong entrepreneur can help to mitigate some of the costs faced by firms with largely intangible assets [5].

2. Data

Any study of Internet stocks faces the problem that while many companies have very active web-sites only a minority can be in any real sense be described as "Internet" firms. Hence this paper focuses upon a minority of "pure-play" internet firms. In the United States we are fortunate to have a commercially accepted definition of what such a "pure-play" firm is. ISDEX^{TM} is an acronym for The Internet Stock Index^{TM}. This is a listing of 50 stocks that represent the gamut of publicly-traded Internet companies. It has existed since April 1996, which serves as good a date as any from which to chronicle the Internet "bubble".[2] Internet.com Corporation believes the ISDEX^{TM} best represents the Internet investment barometer and it is one of the first pure Internet indexes.

In defining an a "pure-play" internet stock Internet.com relies on generally accepted industry definitions of companies identified through its own and third-party news reporting and company reporting to establish the nature of the companies and their classification. This was necessary because a standard SIC code, or other classification system, has not been created that properly identifies the burgeoning Internet industry and its diversity. The composition and structure of ISDEX^{TM} has met with broad industry acceptance through the licensing of the ISDEX^{TM} on Yahoo Finance, Upside.com and Upside magazine as well as international licensees.

Internet.com allocates firms to the index using a criteria requiring that more than 51% of revenues be generated from web-related activities. This test was established to distinguish companies which would or would not exist without the Internet. ISDEX^{TM} seeks to provide investors with a representative index of Internet companies that exist because of the Internet.

Internet.com, using its own and third party data, has determined that 89 stocks currently (2/99) meet the 51%

[1] Indeed the whole history of computing is strewn with strong characters, often having to bear much skepticism and derision on their path to glory (Slater [12]).

[2] Cassidy [1] distinguishes between the earlier boom and the final rush to cliff, which he regards as having begun in early 1998.