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INTERNET HISTORY – The Dot Com Rise & Crash

Between 1993 and 1997, computer ownership in the western world increased exponentially. The percentage of households that owned a personal computer grew from 15% to 35% in that time period and towards the end of the century, possession of a device that could connect to the internet became more of a necessity than a luxury. This was the Digital Revolution and from it came a very significant economic shift – the shift towards an economy based on information technology rather than traditional industry.

The commercialisation of information technology allowed individuals to explore their personalised needs, therefore simplifying the procedure of transactions, and significantly lowering costs of both production and purchasing. Fuelled by more relaxed tax laws that allowed people to make more speculative investments, many new companies were founded. Investors were eager to invest in these companies for fear of missing out, especially if it had a .com suffix in the company name. This lead to a stock market bubble called the Dot Com Bubble, and during the period of 1995 to 2000 the stock market index rose by 400% as a result.

An unprecedented amount of personal investing also occurred during this boom. At its peak, it was possible for a promising Dot Com company to become a public company and raise a substantial amount of money even if it had never realised any material revenue. People who received employee stock options became instant paper millionaires and stories of people quitting their jobs to engage in full-time day trading were common. The Wall Street Journal suggested that investors “rethink the quaint idea of profits”, and NBC reported on the stock market with the same level of suspense as the broadcasting of sports events.

But, obviously, many dot-coms were not successful. Investors were left with significant losses and the entire crash is estimated to have cost in excess of $5 trillion. By November 2000, most internet stocks had declined by 75% of their original value and the dream was over. So what were the main causes?

Well, 90s society’s expectations of what the internet could offer were wholly unrealistic. Even companies that were successful were highly overvalued – analysts used very high multipliers in their formulas for valuing internet companies. Although more conservative analysts disagreed, their recommendations were virtually drowned out by the overwhelming hype in the financial community around internet stocks.

Many investors foolishly ignored the fundamental rules of investing in the stock market, such as analysing market trends and reviewing business plans. Instead, investors and entrepreneurs became preoccupied with new ideas that were not yet proven to have any market potential. Analysts focused on aspects of individual businesses that had nothing to do with how they generated actual money. For example, one theory is that the bubble burst due to a preoccupation with the “network theory,” which stated the value of a network increased exponentially as the amount of computers hosting the network increased. This concept neglected one of the most important aspects of value: the ability of the company to use that network to generate actual cash.