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Multimedia Live: Built To Sell?

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Abstract. The Multimedia Live (MML) case examines a company's history and evolution into a distinct niche: e-commerce Web site and technology development. MML has created a market niche in developing catalog retailers' Web sites. In this market space, MML competes against larger companies including IBM. The case focuses on Burke's important decision to fund growth via diversification slowly, using internally generated funds, or possibly more rapidly with proceeds from a sale to another business or an Initial Public Offering. Increasingly unattractive trade and stock market conditions for Internet companies have arisen during the summer of 2000. Burke has to decide whether to act quickly or wait it out until the downturn for Internet companies is over. The case is primarily intended for an undergraduate or graduate-level Entrepreneurship course to present some of the challenges associated with starting, growing and diversifying a high-tech venture in a high-velocity environment.

Keywords: business model, situation environment, change management.

1. Introduction

In July 2000, the Computer Technology show at the Los Angeles Convention Center was in full swing. Five years after he had founded Multimedia Live (MML) and alone in his Los Angeles hotel suite for the better part of a day, Ken Burke, CEO and President, was considering his options for the future. Should he fund MML's diversification internally, or was now the right time to consider his options to sell all or part of his venture to expedite diversification? MML could seek a friendly acquisition by a larger company or go public via an Initial Public Offering (IPO). Burke mentioned Oracle, PeopleSoft, or Hewlett-Packard as potential suitors for MML. An IPO could raise needed external funds but would "lock up" the founders' shares for six months or more, delaying the liquidity of those shares. "Regardless of whether we are acquired or sell our stock in an IPO, we would try to raise $45 - $60 million, about 2x-3x projected 2002 sales of $16 million," he said at the time.

MML was based in Petaluma, California, about 40 miles north of San Francisco. It developed e-commerce catalog sites for large retailers. MML's revenues had doubled every year, and it had been profitable since inception. Its work force had tripled in size since 1998.

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1. This case study was prepared by Armand Gilinsky, Jr. Professor of Business at Sonoma State University, with the assistance of Alison Urmson, as a basis for class discussion rather than to illustrate either effective or ineffective handling of an administrative situation. Some data have been disguised at the company's request.

Burke's goal was to reach a 50-50% service/product split in sales revenues, versus the current distribution between services (representing 90% of its business) and software products (10%). According to the June 2000 *Value Line Investment Survey* of software vendors, packaged software typically commanded gross margins of 70% - 80%. MML's gross margins from sales of consulting services had historically hovered in the range of 40% - 50%.

Burke felt he needed to raise at least $50 million to support the recent launch of MML's newest software product, MarketLive™ 3.0. An influx of cash would accelerate MML's transition from solely service-oriented to a combined product and service business. The funds would enable MML to build a significant marketing campaign to support sales and promote brand awareness versus competitors, expand distribution channels from a direct sales organization to third-party distributors. At the same time, however, Burke feared that IBM or other large competitors would probably spend at least 20 times that amount to bring competing products to market.

2. Company History

Upon completion of an MBA in Venture Management and Entrepreneurship at the University of Southern California (USC), Burke worked two years as a business reporter for the *San Francisco Chronicle*. [See Exhibit 1 opposite for Burke's biography.] Burke then started MML with $500 of his own money in 1995. Prior to MML's founding, Burke did not believe he could ever fit into the corporate world. In his words: "Working for another person is absolutely the worst thing I could possibly do. The good side of entrepreneurship is that [now] I don't have to."

Observing the rapid growth of the Internet, Burke worked on his idea to formulate an e-commerce web site development and technology company. Burke recalled:

> I had one of these transition points about two years into the business… I remember it was July and I was kind of confused about where my business was going. At the time, the Internet industry was not just e-commerce, but it was Internets and extranets and it was all over the board. You could pretty much do anything. 'I'll build anything for you, just come and see me.'…That's a good marketing slogan. Unfortunately, it doesn't work very well because nobody knows what you're good at and what you're not good at. As you get more and more competitors in the marketplace, obviously, *they* start to focus. I actually thought back to a statement that was made at our (USC) commencement address in 1993. I don't remember the speaker's name. He said, "If I can leave you with one piece of advice, what I would leave you with is that you if start a business, start one that occupies a niche within a niche."

In July 1997, Burke conceived of MML as becoming the only company targeting catalog retailers (“catalogers”) as its primary business. He described the business as follows:

> We’re about selling online, we’re about merchandizing online…we’re not a dot-com company and not about building web sites. While MML’s focus on B2C e-commerce has been quite narrow, the market we are involved in could be huge.

Exhibit 1: Multimedia Live’s Management Team in 2000

Ken Burke
Founder, CEO and President
Ken Burke received his BA in Marketing and an MBA with honors in Venture Management and Entrepreneurship from the University of Southern California. In between his undergraduate and graduate course work he joined Z-Code Software, an Internet email software company, as a marketing manager. After graduating with his MBA, Burke returned to northern California and worked at the *San Francisco Chronicle* for two years before starting MML. Over the past 5 years, Burke has become a sought-after source in the industry. Newspapers, magazines, television and radio stations have interviewed him. He participates at speaking engagements for various functions, including Direct Marketers Association and Internet Commerce Expo. He has also trained 25,000 entrepreneurs nationwide in the on-line retail business. A weekly column in *Catalog Age Magazine* fills out his schedule. The MML Web site invites visitors to contact Burke for his insights on topics such as C-Commerce, Web technology and general technology.

Jim Gloystein
VP Engineering
Prior to joining Multimedia Live, Jim Gloystein held various positions in Product Development, IT and other management roles at MarketTools, Enwisen, Autodesk, Inc., Living Video Text and PricroPro International. Gloystein holds B.A. degrees in both Sociology and Music from the University of California, Berkeley, and has completed graduate and advanced studies in management and software engineering through the UC Berkeley Extension and other educational institutions.

John Fandel
Chief Operating Officer
Prior to joining Multimedia Live, John Fandel has consulted and been employed at Netscape, Motorola, C-Change Inc. and other Fortune 500 firms and e-commerce companies. Fandel holds a BS degree in Accounting from San Francisco State University and is in the final stage of completing an MBA in Information Systems Technology, also at SFSU.

Len Eschweiler
VP Sales & Marketing
Prior to joining Multimedia Live, Len Eschweiler served as Sales and Marketing Manager for IMS-Net Corporation. Eschweiler studied computer science at Colorado State University and received a B.S. in Finance with a minor in Music from Sonoma State University.

Source: www.mmlive.com

Burke had decided that MML was to become not just “an Internet company,” but instead, “an Internet e-commerce company focused on ‘Business-to-Consumer’ (B2C) commerce.”[2] Multimedia Live’s stated mission became to help the nation’s leading catalogers, retailers, manufacturers, and dot-com companies integrate e-commerce into their overall business mix, and to effectively translate existing brand equity into the emerging digital medium.

Burke’s dream then became a business that grew 169% from 1998 to 1999. MML achieved sales of $6 million in FY 1999 and $11 million in FY 2000. Burke explained his company’s progress:

> The catalog business is a highly seasonal business. Most catalogs are developed in the spring and summer for the Christmas holiday season. One reason we have such a long accounts receivable cycle is that we do the development work for catalogers six months or more in advance. Cash comes in during the fourth quarter, when holiday sales take place. Accounts receivable is like having cash in the bank since we tend to deal only with A+ rated companies.

Burke hoped that MML could reach nearly $40 million in sales by 2003. Historical and projected company financials are presented in Exhibits 2 and 3.

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2. In B2C commerce businesses sold to consumers, whilst in contrast, in business-to-business (B2B) commerce businesses bought and sold goods and services to and from one another.

Exhibit 2: Multimedia Live: Actual and Projected Income Statements, 1998-2003 ($000s omitted)

Fiscal Year Ended June 30	ACTUAL								PROJECTED			
	1998	**%**	**1999**	**%**	**2000**	**%**	**2001**	**%**	**2002**	**%**	**2003**	**%**
Service and license fee revenue	$ 2,370.9	100%	$ 6,382.9	100%	$ 11,644.1	100%	$ 13,719.5	100%	$ 23,219.6	100%	$ 39,676.1	100%
Cost of revenue	1,383.4	58%	3,740.5	59%	6,318.5	54%	5,272.1	38%	6,308.6	27%	9,372.5	24%
Gross Profit	987.5	42%	2,642.4	41%	5,325.6	46%	8,447.4	62%	16,911.0	73%	30,303.6	76%
Operating expenses												
General and administrative	474.2	20%	1,840.4	29%	2,221.7	19%	2,931.8	21%	4,661.1	20%	6,723.4	17%
Sales and marketing	83.0	4%	369.2	6%	1,234.8	11%	1,630.9	12%	4,335.7	19%	6,333.9	16%
Research and development	148.2	6%	212.9	3%	1,126.3	10%	1,482.0	11%	1,522.7	7%	1,568.5	4%
Total operating expenses	705.4	30%	2,422.5	38%	4,582.8	39%	6,044.7	44%	10,519.5	45%	14,625.8	37%
Earnings Before Interest & Taxes	282.1	12%	219.9	3%	742.8	6%	2,402.8	18%	6,391.5	28%	15,677.8	40%
Interest expense (net)	-		28.1	0%	49.0	0%	259.8	2%	299.5	1%	252.1	1%
Pretax income	282.1	12%	191.8	3%	693.8	6%	2,143.0	16%	6,092.0	26%	15,425.7	39%
Income tax provision	100.0	4%	68.0	3%	280.0	2%	857.2	6%	2,436.8	10%	6,170.3	16%
Net Income	$ 182.1	8%	$ 123.8	2%	$ 413.8	4%	$ 1,285.8	9%	$ 3,655.2	16%	$ 9,255.4	23%

Key Metrics:

	1998	1999	2000	2001	2002	2003
Year-to-year growth rate %, sales	**n/a**	**169%**	**82%**	**18%**	**69%**	**71%**
Year-to-year growth rate %, net income	**n/a**	**-32%**	**234%**	**212%**	**184%**	**153%**
Gross profit percentage	**42%**	**41%**	**46%**	**62%**	**73%**	**76%**
EBITDA	**$ 282,100**	**$ 236,493**	**$ 828,834**	**$ 2,741,027**	**$ 6,849,302**	**$16,201,706**
No. of employees (end of year)	**41**	**91**	**130**	**155**	**228**	**300**
Client web sites launched	**7**	**14**	**26**	**52**	**78**	**121**
Web development revenue	**$ 2,370,885**	**$ 6,263,502**	**$10,694,613**	**$ 8,930,000**	**$13,737,200**	**$23,940,654**
Recurring revenue from services	**-**	**$ 119,368**	**$ 949,438**	**$ 4,789,520**	**$ 9,482,429**	**$15,735,463**
Recurring revenue as a % of total	**0%**	**2%**	**8%**	**35%**	**41%**	**40%**

Source: Multimedia Live

Exhibit 3: Multimedia Live: Actual and Projected Balance Sheets, 1998-2003 ($000s omitted)

Fiscal Year Ending June 30	ACTUAL			PROJECTED		
Assets	**1998**	**1999**	**2000**	**2001**	**2002**	**2003**
Current Assets						
Unrestricted Cash	$ 114.3	$ 2,543.8	$ 1,844.2	$ 1,933.2	$ 3,138.5	$ 9,211.9
Restricted Cash	-	-	-	750.0	750.0	750.0
A/R	646.1	2,945.6	4,590.5	3,286.0	5,059.8	8,685.9
Other current	98.7	21.8	109.2	57.8	86.2	122.1
Total Current Assets	859.1	5,511.2	6,543.9	6,027.0	9,034.5	18,769.9
Property & Equipment, net	9.7	129.6	560.1	1,292.4	1,255.4	1,193.5
Other Assets	21.8	77.6	74.7	176.9	214.2	272.2
Total Assets	**$ 890.6**	**$ 5,718.4**	**$ 7,178.7**	**$ 7,496.3**	**$ 10,504.1**	**$ 20,235.6**
Liabilities & Equity						
Current Liabilities						
Bank Line of Credit	$ -	$ -	$ -	$ 750.0	$ 750.0	$ 750.0
Accounts Payable	149.7	1,078.7	1,970.3	1,655.5	1,145.7	1,685.6
Total Current Liabilities	149.7	1,078.7	1,970.3	2,405.5	1,895.7	2,435.6
Subordinated debt	-	-	-	2,000.0	2,000.0	2,000.0
Capital Leases		59.2	207.9	248.4	110.8	47.0
Total Liabilities	149.7	1,137.9	2,178.2	4,653.9	4,006.5	4,482.6
Shareholders' Equity	740.9	4,580.5	5,000.5	2,842.4	6,497.6	15,753.0
Total Liabilities & Shareholders' Equity	**$ 890.6**	**$ 5,718.4**	**$ 7,178.7**	**$ 7,496.3**	**$ 10,504.1**	**$ 20,235.6**

Source: Multimedia Live

3. Early Investor

In September 1999, R.R. Donnelley & Sons Company (Donnelley), a provider of printing and related services to the merchandising, magazine, book, directory, financial, and healthcare markets, became MML's first outside investor. Donnelley invested $3.5 million, receiving a 30% stake in MML in return. In a press release dated September 23, 1999, Burke said:

> We're thrilled, especially because in today's business world of "strategic" this and "alliance" that, it seems rare for anything to come of these highly touted partnerships. But this investment comes on top of an enormously productive and well-established relationship with R.R. Donnelley - their further (monetary) investment proves they're solidly behind us.

Burke also learned a hard lesson from the Donnelley deal. *Fortune* reported that R.R. Donnelley had pirated MML's technology and trained its own staff in its use. Burke later claimed that his mistake was that MML had written no separate strategic partnership agreement outlining the relationship. "I never thought I needed one," Burke recalled. He intended to leave the Donnelley investment untouched in the form of a cash reserve, "as a hedge against future downturns in the business cycle for e-commerce," preferring to fund future growth instead out of retained earnings from operations.

4. Product Technology

MML's MarketLive™ software product was proprietary and considered central to its business strategy. Using MarketLive, MML was able to build and release catalog Web sites in six weeks, whereas it took competitors up to 3-4 months. MarketLive enabled MML to use and reuse development infrastructures repeatedly. In Burke's words, MarketLive was "a rapid e-commerce application development tool," built specifically for catalogers, retailers, direct marketers, and manufacturers that sold products and services on the Web.

The newest version of MarketLive was released on June 27, 2000. Its purchase price started at $35,000. An accompanying press release stated: "MarketLive™ 3.0 offers reduced time-to-market and development costs for high-end e-commerce Web sites. It provides a rich feature set in a complete, easily-administered package." In terms of the software industry's historically lengthy development cycle time, MML's new product represented a breakthrough solution in that it allowed rapid deployment for e-commerce Web sites.

MarketLive 3.0 excelled over MML's previous products in several other ways. First, the component-based architecture of MarketLive 3.0 allowed for infinite extensibility and scalability without sacrificing performance, typically measured in page loading speed, refresh rates, consistency of quality, and ease of use. Second, since it was based entirely on the new Java™ platform, MarketLive now met state-of-the-art industry standards and was forward-compatible with future applications currently in development to enhance and secure web sites. Finally, MarketLive supported multiple application servers already in widespread use, including IBM's Websphere and BEA's WebLogic. This support for application servers would permit greater ease of integration with existing information technology systems or "legacy" systems, overcoming a major backward compatibility challenge faced by rival multi-channel marketing companies. See Exhibit 4 below for a description of MarketLive 3.0's features, including its technological functionality and backward compatibility with legacy systems.

Exhibit 4: MarketLive™ 3.0 Technology

The MarketLive™ 3.0 application was developed to serve the middle market (companies with annual revenues between $10 million - $1 billion) by providing:

Technology - MarketLive™ 3.0 is an enterprise class application built with 100% compliance to the Java™ J2EE standard. It utilizes an EJB (Enterprise JavaBean™) framework so it takes advantage of the inherent scalability of the EJB framework.

Open standards - MarketLive™ architecture is based completely on open standards, which allows other non-MML programmers to work at lower levels of the application (i.e., source code level) and quickly understand how it works.

Interoperability - MarketLive™ is a cross-platform application that runs on Microsoft®NT, Linux®, and UNIX®. It also runs on top of any J2EE-compliant database server such as Microsoft®, SQL, Oracle®, and DB2 and supports any J2EE EJB application server including WebSphere®, BEA WebLogic®, Resin®, and JBoss™. In addition, the application has a set of published APIs (Application Programmers Interface) that enables it to talk with other applications.

Flexibility - because of the separation of the application into layers (presentation, business logic, entity and data layers), the application is flexible to meet the needs of MML's target market.

Ease of customization - MarketLive™'s architecture was specifically designed so that the application could be easily customized based on the client's needs without having to reprogram any of the core application components.

MarketLive™ technology is explained in greater depth at www.mmlive.com. Additional technology information may be found at www.mmlive.com/pdf/MLarchitecture/pdf

Source: www.mmlive.com

One key differentiator for Web sites built with MarketLive was their ease of administration and updating by MML's customers - right from the launch. Previous software of this type had been very inflexible or had required constant reprogramming. "MarketLive was built to break this trend," according to Burke. The ease of modifying MarketLive applications appealed to customers. Each custom application started with the same "vanilla MarketLive™" engine, upon which customer-specific applications were then built. This application thus served as the base upon which the rest of MML's follow-on services could be sold to catalogers. According to Len Eschweiler, MML's Vice President of Sales, MarketLive's technology could provide at least a temporary competitive advantage to MML in several ways:

1. *Complete solutions* - its technology provided a distinct advantage over service-only companies that did not have a product and could not provide the complete solution set preferred by MML's target market.

2. *Efficiencies* - its rapid application development approach provided significant efficiencies in the deployment process. MML could complete its implementation services in 8-12 weeks, dramatically accelerating the typical installation schedule ahead of its competitors in its target middle market space. Rapid deployment also enabled MML to be price-competitive with similarly sized rivals.

3. *Robust features* - its software rivaled or exceeded those of competitive products, with features such as quality, imagery, and ease-of use specifically designed for customers on a case by case basis.

As evidence of its attempt to use its product development efficiencies to underbid the competition, MML signed a contract in June 2000 with Pink Dot, the nation's largest Internet shopping and delivery company. MML bid the deal at $500,000, while a competitor bid $4 million to build the Pink Dot web site. A shopping and delivery service located in the Los Angeles area, Pink Dot had grown from a single location on Sunset Boulevard in 1987 to 12 fulfillment centers by 1999. With 130,000 customers, Pink Dot was the largest such service in the nation. It delivered groceries, including beer and wine, bakery items, drug and household items. "We chose Multimedia Live because of the tremendous experience they have developing B2B and B2C web solutions in the retail, catalog and direct marketing space," said Pink Dot's CIO, Scott Langdoc. According to Burke, MML's MarketLive™ 3.0

technology had provided him with the flexibility necessary to set an unbeatable price, enabling Pink Dot to begin a nationwide roll-out of its delivery service.

5. Clients

By 2000, MML had already brought many popular catalogers on-line, including Coldwater Creek, Limited Too, and Pontiac Mall. In July 2000, *CIO Magazine* awarded the “CIO WebBusiness 50/50 Award” to two sites created by MML, Visualize.com and Ambrosiawine.com. Visualize.com, launched in March 1999, was attracting approximately 200,000 to 250,000 visitors a month by July 2000. Ambrosiawine.com was recognized in the wine industry as an elegantly designed site for users to learn about wine, purchase wine, or to join a wine club or gourmet food club via its affiliated business, Winetasting.com. See Exhibit 5 opposite for a partial list of MML’s clients as of July 2000.

MML built its strategy around what it believed was a very lucrative target market: middle market retailers, direct marketers, and top brand manufacturers with annual revenues ranging between $10 million – $1 billion. Management estimated that there were more than 20,000 companies in this target market, of which over 10,000 catalog companies published 14,000 titles. Two respected catalog industry consultants, Cambridge Group and W.A. Dean & Associates, estimated that consumer catalog sales would reach $43.3 billion and total B2B catalog sales $27.7 billion in 2000. Approximately 75% of the firms in this segment achieved annual revenues in the $10–$50 million range, with the balance representing firms with annual revenues in excess of $50 million. Exhibit 6 below presents a conceptual view of MML’s target market.

Exhibit 5: Partial List of Multimedia Live's Clients

E-Commerce

Ambrosia Wines
www.ambrosiawine.com
Ambrosia Wines sells a collection of exclusive fine wines. The site features a Wine Finder that can select appropriate wines based upon the visitor's input.

Visualize
www.visualize.com
Visualize is a catalog of fine artwork. Visitors can search the site by subject, style, artist, and medium, and view the artwork online.

Big Dogs Sportswear
www.bigdogs.com
This is an advanced commerce-enabled site for this large retailer of casual apparel. Features include content and messaging that automatically tailors itself to the visitor, and a robust deal engine that can handle just about any kind of offer.

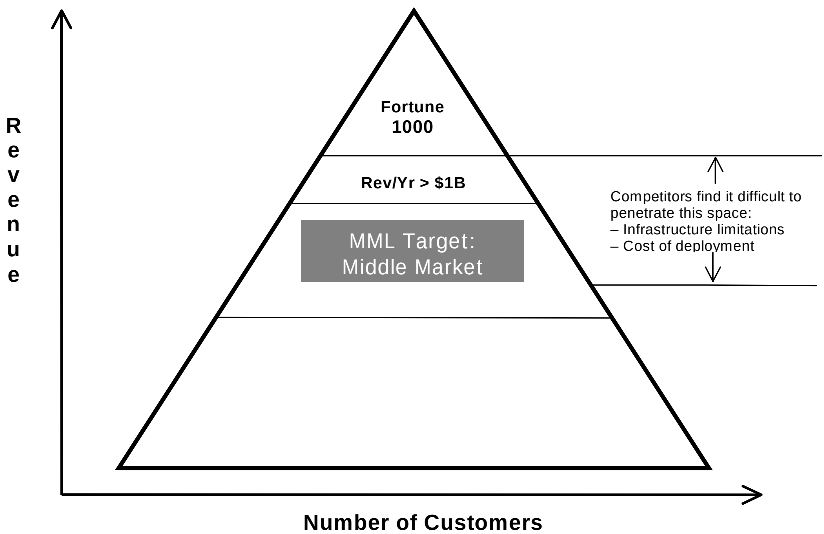
Coldwater Creek
www.coldwatercreek.com
This is an advanced c-commerce site for the #5 Women's apparel cataloger. Features include ensemble selling, real-time inventory system, and a large Outlet section.

The Limited Too
www.limitedtoo.com
Large national retailer of apparel for girls ages 8-12. This site emulates their stores in its style and community orientation.

Pontiac Mall
www.pontiacmall.com
One of three separate online malls for General Motors. Pontiac Mall is a site for Pontiac logo merchandise and focuses on appealing graphical presentation and ease of use. Future projects include similar sites for Chevrolet and Cadillac.

Source: www.mmlive.com,, sites accessed October 2001.

Exhibit 6: Conceptual View of MML's Target Market



Source: MultimediaLive

6. Customer Intimacy

Over its first five years, MML had learned some best practices from its experience in creating e-commerce solutions for its clients. One of these practices was to integrate the three key components to web design - technology, creativity, and marketing strategies - into one web site development process. The use of project teams facilitated bringing a client Web site on-line in four to six weeks. A complete team was assembled for each and every client.

Another practice involved analyzing clients' customer acquisition and retention strategies and then building attractive and easy-to-use web sites. Such sites were designed to increase the odds that initial and repeat purchases would be made by visitors to the sites.

Finally, each web business solution was customized to meet each client's specific needs or wants. MML prided itself on providing what it called "end-to-end web development solutions." At one end was its MarketLive product, and at the other was its follow-up service to customers. MML's services included planning the web site, creating the user interface and design, conducting usability testing, programming the web site, hosting through an

Internet Service Provider (ISP), and integration. Integration of a site involved creating tools to measure acquisition, conversion, and retention of customers. See Exhibit 7 below for MarketLive components.

Exhibit 7: MarketLive™ Components

Order Management	This component manages the entire order processing procedure, including the shopping cart, back order, inventory and checkout procedures.
Campaign Management	This component allows marketers to effectively execute and track marketing campaigns. It integrates promotions, discounts and emails, and adjusts the online display based on the parameters of the campaign. All campaigns can be personalized/segmented by target customer group.
Display Templating	This component allows the marketer to manage every component of the display (pages/cells). These displays can be maintained via MarketLive™'s administration system and controlled by date and target customer group via the personalization engine.
Promotions & Discounting	MarketLive™ contains a powerful discounting engine that enables the marketer to create specific pricing discounts and special offers (i.e., free shipping, free gift) via the administration system.
Customer Loyalty	MarketLive™ ships with a series of pre-built customer loyalty tools including a reminder service, wish list, customer favorites, and customer reviews.
Customer Support	This component provides the customer service department with the basic tools necessary to inquire about web-based orders and can be integrated with live chat software.
Personalization	This component is tightly integrated with the other MarketLive™ components, enabling marketers to deliver specific content, discounts, campaigns, and displays to individual users based on a flexible set of rules which clients can easily develop using MarketLive™'s administration system.
Product/Content Management	This component handles all functions associated with the product catalog including product attributes, categorization, keywords, images, cross sells, up sells, product families and extended content. In addition MarketLive™ has a non-product specific content management system that maintains FAQ's, customer service information, related articles, e-zines, and other site content.
Integration	MarketLive™ was built to be integrated with a wide variety of back-end systems, and incorporates a pre-defined set of API's (Application Programmers Interface) which reduces integration costs and complexities.
Data Analytics	MarketLive™ brings together all of the analytic components via its OLAP-based (Online Analytical Processing) reporting system. This component provides analysis on sales, product, customer groups, traffic, campaigns, content and tool usage, merchandising, and site management using over 100 OLAP-based models included in MarketLive™.

Source: Multimedia Live

7. Internet Retail Markets

Value Line reported that retail sales in the United States in 1999 were $420 billion. Sales in 2000 were projected to be over $460 billion and more than $500 billion in 2001. According to a study done by the Boston Consulting Group, 1999 online B2C revenues across all categories grew 120% to $33.1 billion. That study also predicted B2C sales would increase in 2000 by 85%, growing to more than $61 billion. According to *Value Line,* more than 30% of U.S. households had access to the Internet as of June 2000.

The Boston Consulting Group study included a survey of 412 Internet retailers. It found that only 38% of Internet-only retailers were profitable, while 50% of "clicks-and-mortar" Internet operations were profitable. In 1999, 72% of traditional catalog companies recorded a profit, making them the most successful converts to the Internet. In that year, pure-play retailers had an average customer acquisition cost of $82 while traditional "bricks and mortar" multi-channel retailers averaged costs of $11 per Internet customer. During the holiday shopping period, the difference was even greater, with Internet-only retailers spending $108 for each customer.

In January 2000, *The New York Times* reported that the most visited Internet sites during the 1999 holiday season had been those of traditional retailers such as J.C. Penney, the Gap, Barnes and Noble, Wal-Mart and Toys'R'Us. Also at that time, *The Wall Street Journal* reported that Shop.org had estimated there were at least 30,000 Web sites that offered items for sale. Shop.org, a trade association for electronic retailers, also estimated that about 1,000 of those sites had annual sales exceeding $500,000. According to Forrester Research, annual operating costs for a large-scale corporate B2C Web site ranged from $206,000 for a promotional site, to $2.8 million for a transactional site.

8. Competition

By mid-2000, MML was facing competition in every area of its business. A July 2000 search of the World Wide Web using Yahoo to determine the entire list of competitors resulted in the following matches: Internet consultants (451), technology consultants (528), e-commerce software (401), web site designers (7,603), and web site hosts (2774). MML also faced many well-established competitors in the service side of its business. These included traditional consultants such as KPMG and Andersen Consulting; Internet consultants, including Answerthink and Razorfish; Cambridge, Appnet, and IBM; Internet ad agencies, including Modem Media and Agency.com; and product vendors including Broadvision, IBM and BEA. Exhibit 8 opposite presents a list of MML's competitors.

Exhibit 8: Multimedia Live's Competitors

Service Businesses:

- Traditional Consultants (KPMG, D&T, Anderson)
- Internet Consultants (IXL, Answerthink, RazorFish, Sapient, Scient)
- Technology Consultants (Cambridge, Appnet, IBM)
- Internet / Ad Agencies (Modem Media, Agency.com)

Product Businesses:

- Broadvision
- Art Technology Group (ATG) / Dynamo
- Blue Martini
- Interworld
- Intershop
- IBM (Net.Commerce)
- BEA / WebLogic

Sources: Ken Burke and company reports

Burke spoke about the competition in an interview with *Netcommerce Magazine*:

> I would be foolish not to be concerned about the competition, but I feel Multimedia Live is well positioned with our expertise in the B2C e-commerce niche. To date, we have not been bothered too much with competition in our B2C niche. Most of the larger development companies, like Sapient, Scient, and March First, are chasing the larger B2B projects.
>
> When it comes to the product side of the business, competition takes on a entirely different meaning. Our product, MarketLive, competes head-on with ATG/Dynamo, IBM's WebSphere Commerce, and Blue Martini. While we have good competitors in the e-commerce software space, our application's customer centric approach to personalization, customer loyalty, and dynamic merchandising has captured the imaginations of catalogers, retailers and manufacturers for their B2C Web sites.

Exhibit 9 below presents comparative financial profiles of some of MML's publicly held competitors.

Exhibit 9: Summary Price Performance and Operating Statistics of Leading E-Commerce Platform Vendors and Service Providers

Company	**HQ Location**	**Most Recent Closing Stock Price thru 10/27/00**	**52-Week High ($)**	**52-Week Low ($)**	**Earnings Per Share Last 12 Months ($)**	**Current Ratio (x)**	**Debt/ Equity (%)**	**Sales Revenues Last 12 Mos. ($000)**	**Earnings Last 12 Mos ($000)**
Art Technology Group (ATG)	USA	$ 65.69	$126.88	$26.94	$-(0.25)	5.0	2%	$ 75,600	$ (8,500)
Blue Martini Software	USA	41.69	77.63	22.50	N/A	N/A	N/A	N/A	N/A
Broadvision Inc.	USA	26.69	93.20	17.63	(0.34)	4.1	0%	320,700	(89,600)
Intershop Communications AG	Germany	129.08	264.82	90.16	0.38*	N/A	N/A	N/A	N/A
InterWorld Corp.	USA	2.44	93.50	2.13	(1.19)	2.2	0%	64,800	(37,800)
Sapient Corp.	USA	34.38	75.59	27.25	0.35	6.2	0%	380,900	45,300
Scient Corp.	USA	18.00	133.75	11.38	0.11	6.5	1%	301,900	7,000

*as of 12/31/99
N/A = Not available

Source: www.dowjones.com

9. Future Threats

While e-commerce catalog marketplaces were growing as of July 2000, Burke was aware that several threats could hinder MML's future growth prospects. He felt certain that the industry would begin to consolidate over the next several years. The entry of larger, more established rivals would be a leading indicator of industry consolidation. Larger firms such as Siebel, Oracle, Hewlett Packard and IBM were poised to enter the marketplace by acquiring one or more of MML's competitors. Of those large firms, IBM had already become MML's principal direct competitor. IBM had an unrivaled brand name, a large installed base, and deep pockets. IBM targeted the retailer and catalog client with its Websphere® Commerce product, while IBM Global Services directly performed the installation, integration, and site building. In Burke's opinion, IBM's application product was very general for all types of e-commerce and required significant customization to meet the needs of the middle market. In Burke's estimation, a weak administration system and high implementation costs also limited IBM's application product, particularly for the middle markets that MML was serving. Still, MML had already lost several client engagements to IBM.

Though many of its competitors were much larger and better capitalized, Burke considered this an advantage of sorts, as MML could operate "under the radar" for a while longer. Should MML's target market continue to experience significant growth, however, additional software and service provider firms would likely be attracted to enter into the combined product and service solutions end of the market in which MML operated. Potential direct competitors on the service side of the business included Internet consultants such as Appnet, Interworld, IXL, and Scient. Several of these firms had gone public in 1999, and continued to operate with net losses during their most recent fiscal years. Smaller firms that focused on retailing software, like Retek, Island Pacific, and JDA, were also threatening to enter the on-line catalog market.

A more distant threat, according to Burke, was the inevitability of market saturation. As more and more catalogers made substantial investments to advance their e-commerce technology, they could become less willing to replace their foundation technology. Burke believed it was possible that advancements in "add-on products" such as personalization engines, campaign management systems, and reporting packages could greatly reduce the need for companies to completely replace their existing e-commerce applications in the future.

10. Company Culture

MML was part of a new generation of some 30 “Telecom Valley” startups in Northern California, most located in Sonoma County, an area about 40 miles north of San Francisco’s Golden Gate Bridge. In August 1999, the unprecedented $6.9 billion buyout of start-up Cerent Corporation by Cisco Systems led to a new crop of young telecommunications and Internet companies being sown in Sonoma County. Hundreds of young telecommunications engineers and software programmers in Sonoma County became overnight millionaires due to the acquisition of local startups including Cerent, Diamond Lane (by Nokia) and OCLI (by JDS Uniphase). Venture capital for the so-called “new economy” start-ups was plentiful, and numerous engineers and programmers left their jobs to form their own start-up companies. Meanwhile, the average home price in Sonoma County had risen to over $350,000, placing the area’s housing costs among the least affordable in Northern California (edged out only by San Francisco and Silicon Valley).

Burke believed that his present team, at 130 as of July 2000 and growing exponentially, was one of his strongest assets. Besides creating wealth for himself, Burke wanted his employees to share in MML’s progress and future potential. Each employee was given stock options in MML. As future stockholders, all employees were encouraged to join and participate in executive-level meetings. There were no “closed-door” sessions at MML.

In its early days, MML’s sales staff had earned only a commission-based salary. Later, Burke saw this as a shortcoming and changed the salary structure to salary plus commission. He commented:

> Our number one expense is people: 85% of our costs are fixed costs, that is, payroll costs. It takes us six months to get a new hire up to speed. At $60,000 - $ 80,000 per hire that’s a big sunk cost. Sixty to seventy percent of our employees are engineers and technologists, and thirty to forty percent are in marketing and sales.

With an employee turnover rate of 5% (a full 20% below the industry standard at the time), Burke managed to keep his office staffed despite an extremely tight job market in Northern California for computer programmers, technologists, and engineers. Burke attributed MML’s low turnover rate to the culture he and his team had created. Perks for employees included a concierge service, an on-site fitness center, yoga, and a biweekly BBQ.

11. The Market for Internet-Related Stocks

By mid 2000, six years since its inception, the Internet industry had become the second leading technology in terms of wealth creation. With a total market value exceeding the $1 trillion mark, it consisted of over 400 publicly traded companies in the US. In the ten-year period from 1990-1999, more than 5,000 firms had gone public, raising nearly $400 billion. By 1999, technology companies comprised 70 percent of initial stock offerings, and the median age of companies in these offerings had dropped to four years, according to Jay R. Ritter, a Professor at the University of Florida.[3] Only 18.8% of companies that went public in 2000 were profitable at the time of the offering, according to Ritter. Exhibit 10 shows some of the key changes taking place in the Internet IPO market in 2000 versus 1999.

Exhibit 10: Key Statistics on Internet Companies' Initial Public Offerings (IPOs): 2000 v. 1999

- •Number of Internet IPOs since 1995: 492
- •Number of Internet IPOs trading above offer price: 55
- •Number trading at more than 80 percent below offer price: 153
- •Number of Internet IPOs in 1999: 232
- •Number of Internet IPOs postponed or cancelled in 1999: 13
- •Number of Internet IPOs in 2000: 130
- •Number of Internet IPOs postponed or cancelled in 2000: 133
- •Proceeds from Internet IPOs in 1999: $18.2 billion
- •Proceeds from Internet IPOs in 2000: $12.8 billion
- •Proceeds from postponed or canceled Internet IPOs in 2000: est. $10.4 billion
- •Banking fees from 1999 Internet IPOs: $1.2 billion
- •Banking fees from 2000 Internet IPOs: $820 million
- •Banking fees from postponed or canceled Internet IPOs in 2000: est. $728 million
- •Market capitalization of Internet sector on February 29, 2000: $881 billion
- •Market capitalization of Internet sector on December 20, 2000: $208 billion
- •Revenues from online sales in 1999: $20.3 billion
- •Projected revenues from online sales in 2000: $44.8 billion
- •Number of Internet-related jobs lost in March 2000: 25
- •Number of Internet related jobs lost in November 2000: 8,789

Source: Jenny Anderson, "The 2000 Deals of the Year," *Institutional Investor*, Vol. 35, No. 1, January 2001.

Valuing technology companies had also become a formidable task for investors and potential acquirors. New technology companies typically had a

3. Jay R. Ritter, " A review of IPO activity, pricing, and allocations," *Journal of Finance*, 57:4 (Aug 2002), 1795-1828.

short track record in terms of sales. Their massive investments in intangible assets such as Research and Development, from which future cash flows could be derived, were complicated to quantify. Valuing Internet companies was even more difficult for investors, since those companies not only invested heavily in intangible assets, such as developing new technologies and building a critical mass of customers, but also attempted to transform the way business itself was going to be transacted in the future. Compounding the difficulties of valuation was the fact that the vast majority of Internet companies had been generating significant, and often growing losses. For example, Pets.com lost more than $60 million on revenues of $5.8 million from its inception in February 1999 to the end of that year. Pets.com went public in February 2000 and was already on the brink of bankruptcy by that summer.[4] The lack of profitability further contributed to the substantial uncertainty that surrounded the valuation of Internet stocks virtually since the inception of the industry.[5]

12. How To Grow?

Burke considered the outlook for online catalog sales to be strong, despite forebodings of the imminent failure of several prominent catalog e-tailers. Since April 2000, there had been turbulence in the stock market for new Internet companies and a continued downward slide of Internet stock valuations during that early summer. As other dot-com companies were falling from grace in the capital markets, MML's publicly held competitors predicted revenue shortfalls in coming quarters. Internet companies were beginning staff layoffs in order to stave off bankruptcy. A recent IPO attempt by a one of MML's competitors, C-quential, was withdrawn after successive drops in the planned offering price suggested that the stock market had become far from receptive to new B2C e-commerce offerings. See Exhibit 11 opposite for stock price trend data for some leading company IPOs in 1999 and 2000. It thus remained to be seen whether or not the dot-com downturn would be temporary and what its effect would be on MML.

4. Norm Alster, "Initial Offerings Take a Turn to the Traditional," *The New York Times*, Sunday May 19, 2002, Section 3, page 4.
5. Eli Bartov, Partha Mohanram, Chandrakanth Seethamraju, Philip G Berger, "Valuation of Internet Stocks: An IPO Perspective," *Journal of Accounting Research*, 40:2 (May, 2002), 321-358.

Exhibit 11: Stock Price Trend Data for Leading IPOs between October 1, 1999 and March 31, 2000

Company	First trading day	Offer price	First day close	Current price as of 12/00	% Change in first day of trading	% change from offer to 12/00
VA Linux Systems	12/9/99	$ 30.00	$ 239.25	$ 4.06	697.5%	-86.0%
webMethods	2/11/00	35.00	212.63	31.98	507.5%	-9.0%
FreeMarkets	12/10/99	48.00	280.00	17.50	483.3%	-64.0%
Cobalt Networks*	11/5/99	22.00	128.25	—	483.0%	100.6%
Akamai Technologies	10/29/99	26.00	145.19	12.56	458.4%	-52.0%
CacheFlow	11/19/99	24.00	126.38	6.19	426.6%	-74.0%
Crayfish**	3/8/00	245.00	1,260.00	12.50	414.3%	-95.0%
Sycamore Networks***	10/22/99	12.67	61.58	15.88	386.0%	25.0%
Avanex Corp	2/4/00	36.00	172.00	21.63	377.8%	-40.0%
Selectica	3/10/00	30.00	141.23	8.06	370.8%	-73.0%

* As of 12/7/00, effective date of acquisition by Sun Microsystems
** as adjusted for 1-for-10 reverse stock split
*** as adjusted for 3-for-1 stock split
Sources: Kate Kelly, "Deals and Deal Makers: Investors Discover Gravity as IPOs Return to Earth," *The Wall Street Journal*, March 7, 2001, C1; data provided by Thomson Financial.

Burke remained confident:

> We are what I call, the 'picks and shovels' of the Internet business. It may not be that glamorous, but we build stuff and we build it really well. We are something that doesn't go away…This is the best time to be successful in an industry that is labor-intensive. We will just have to wait and see if the market for high-tech stocks turns around before considering an IPO or sale of the company. When I was doing my MBA at USC, the oddest course I took was called "Harvesting a Business." I learned that entrepreneurs build businesses to sell. And that's been my guiding strategy for MML from the beginning.

Burke maintained that he someday needed to move forward with an IPO or sale for the product side of the business, spinning off the service side as a separate company. In a July 2000 *Inc*. magazine cover story, Burke mused that his company had already received a valuation of $500 million from one investment banker. Yet he warned his interviewer of "turning markets" and "rapidly changing technologies." His thoughts then turned to MML's employees. "You only get to bootstrap a company once," he told the interviewer. "The question is: when is the right time?"

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