

## VINOD GUPTA

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# Internet Stocks as Pyramid Scheme

Just a couple of months ago, I was in India. While having my shoes shined, I heard the shoeshine boy say that he and hundreds of other shoeshine boys in India are compiling a database of all their customers, he explained how he is creating a web site named "Bootpolishboys.com" that will contain a database of all their customers along with their opt-in email address. He also told me that a local investment banker from Hindman Dachs had valued their enterprise in billions, effectively increasing India's per capita income by \$10 per year.

This shoe polish boy was already dreaming of having a castle, yachts, blondes and a fleet of G-4's to shuttle him around the globe. After listening to him, I knew there was something wrong with this whole internet picture.

OK, enough fantasy, I'm just using my Indian fairy tale to help make a multibillion-dollar point.

To get more serious, after I returned from India, I looked at my portfolio of internet stocks. I had a stock called Global Quest, in which I had invested \$100,000. It then became public and was worth millions, but I could not sell the stock because of lock-ups.

When I asked my venture capitalist, he said not to worry, that when the lock-ups would expire, I could cash in my stocks.

That day came and went, but I still could not sell my stock. My venture capitalist said that if we sold the stock, the prices would come way down. When I asked him what I should do, he responded, "I don't know; hang onto your stock."

After a while, Global Quest was sold to another portal called National online,

which bought Global Quest for a billion dollars of its own stock, valued at 50 times revenue.

Shareholders were jumping with joy because that would give them more liquidity so they could sell the stock in National Online and get their real cash in Yankee dollars.

However, we can't sell the stock, because it will take three months for the transactions to go through, and now the value of Global Quest stock depends upon value of the National Online stock. So here we sit and wait.

Meanwhile, National Online has decided to buy another media company called Time Jones Corporation. Since the shareholders did not like the merger, the stock of National Online has dropped even further. However, we can do nothing but wait and watch our value in Global Quest keep coming down.

But who am I to complain? My venture capitalist said that since I got into the game really early, I would still make a lot of money when I sell the stock – so long as there are new buyers in the marketplace to buy National Online stock.

When I analyze this, I find it to be like a pyramid valuation scheme. In a pyramid scheme, the people who get in the game early make most of the money. The people who come in late are left holding the bag and lose their investment. There are the same similarities in the internet companies with huge valuations. A few internet holding companies have many investments and they are "keiretsu," a Japanese word meaning "family." And they keep trading companies and stocks amongst each other with funny money; or in other words, "Internet valuation" stock.

At the same time, the public is so enamored of these funny-money valuations that some people are pulling their money out of safe investments and can't wait to invest in these go-go internet funds.

I asked a friend of mine, who runs a multibillion-dollar mutual fund, about these internet stocks. His reply was: "Ninety percent of them of them will go to zero, but I have no choice. My investors want me to invest money in the Internet, and what can I do? I have to follow their wish; otherwise I will not have a mutual fund to manage."

As someone once said, "there's a sucker born every minute." The greed for 100 percent return on these internet stocks has too many people fired up. They think they're going to hit the mother lode. My advice to them is to hang onto their value stocks like Coke, Disney, Gillette, GE, IBM, Exxon, Microsoft and Berkshire Hathaway, with real revenue and real profits, and not be mesmerized by this whole pyramid valuation.

When the dust settles, a lot of companies will have gone broke and a lot of people will have lost a lot of money. But if the hope that makes you gamble – a hope that some people see as part of the American heritage – drives you to cash in on the funny-money stock of go-go internet companies, good luck.

I hope you all become Bootpolishboy.com billionaires. You can bet on it, but don't count on it.

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Gupta founded American Business Information (now infoUSA Inc.) in 1972. It provides businesses with marketing information tools based on information in telephone books.