Chapter I

iTalk:
Managing the Virtual E-Business

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EXECUTIVE SUMMARY

iTalk was founded in January 1999 and one year later successfully launched a free voicemail service across the entire U.S. The service was made possible by the development of proprietary software that interfaced iTalk's Web and phone servers with the switched networks of the established U.S. telephone companies. iTalk immediately experienced phenomenal Web site traffic, rivaling established telecom providers such as AT&T. Although initially successful, iTalk later foundered in its efforts to generate revenues with services that customers would be willing to buy. Technical problems delayed deployment of new services, and relationships between iTalk's engineers and operations personnel became strained. Facing these and other problems in the summer of 2001, iTalk was not in a strong position to go public or to raise additional funds from private investors. Worse, iTalk had become potential prey for takeover attempts.

ORGANIZATION BACKGROUND

In the summer of 2000, iTalk's stylish new building on Silicon Valley's Route 101 symbolized the incredible power of the Internet to generate economic value through investments in technology. iTalk was founded by Dennis Henderson in January 1999 with $1 million in private funding. Three months later, iTalk had a working prototype ready

to show to venture capitalists, and in May 1999, iTalk closed $11 million in its first round of venture funding. By December 1999, product development was complete, and a free voicemail trial was introduced in the San Francisco Bay area. The trial proved to venture capitalists that iTalk's technology worked, allowing Henderson to raise an additional $40 million in a second round of funding. In March 2000, iTalk's service went nationwide and immediately experienced phenomenal Web site traffic. Over 1,000,000 subscribers signed up for free voicemail within a month after its official launch. Media Metrix, a leading service offering online visitor and Web site usage intensity analysis for different industry segments, reported that iTalk had more than 2,000,000 unique visitors to its Web site in April 2000, second only to AT&T among telecom providers.

Although riding the crest of the dot-com wave in 2000, iTalk later foundered in its efforts to generate revenues with services that customers would be willing to buy. Technical problems delayed deployment of new services, and relationships between iTalk's engineers and operations personnel had become strained. Without generating a revenue stream to cover its escalating costs of operation, iTalk was not in a strong position to go public or to raise additional funds from private investors. Worse, iTalk had become potential prey for takeover attempts by larger companies eager to acquire bits and pieces of new technologies. In July 2001, even though iTalk reported $120,000 in revenue through its paid service, it nevertheless ran out of funding. A large media company had begun negotiating to acquire iTalk for about $20-25 million.

The Dot-Com Phenomenon: Internet Startups in Silicon Valley

Silicon Valley is a 30 x 10-mile area in Northern California between the cities of San Francisco and San José. After Netscape Communications went public in 1995, Silicon Valley became the acknowledged center of the emerging Internet economy and a symbol of high-tech entrepreneurship. Silicon Valley was the birthplace of many Internet dot-com companies, including Yahoo.com, Google.com and eBay.com. In 2000, the approximately 4,000 high-tech companies located in Silicon Valley generated approximately $200 billion in revenue, primarily by leveraging investments in information technologies. Several features common to Internet startups enabled the generation of economic value, despite relatively modest investments in human resources and physical assets.

Typically, Internet startup companies reduced the cost of human resources by compensating employees with stock options in addition to salaries. Employees earned stock options based on the length of time they spent with a startup. Typically, one year of employment was needed before employees could receive stock options. Table 1 (see the Appendix) provides an illustration of a typical stock option compensation scheme designed to reward employees for staying with a company.

If and when the startup issued an initial public offering (IPO) of its stock, employees could redeem their stock options. Assuming a company went IPO after 48 months and its stocks were traded at $100/share, an employee's pure profit would be (100-1) x 10,000 = $990,000. Indeed, startup companies that went IPO, in Internet startup jargon, reportedly generated an average of 65 new paper millionaires every day in Silicon Valley during the height of the dot-com boom (Sohl, 2003). The stock option incentives attracted many software engineers to startup companies, because their potential IPO success could be the source of nearly instant wealth. However, startups also were notorious for demanding

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