The Baseline Scenario

What happened to the global economy and what we can do about it

The Myth of Ariba

Posted on January 18, 2010 by James Kwak | 14 Comments

(Warning: long post ahead.)

I was minding my own business, reading *Past Due* by Peter Goodman (I got it from Simon, who I think got it for free), and there on page 43 I ran into Eric Bochner. I thought that name sounded familiar, and then I remembered what it was. Eric Bochner was a vice president of something or other (and then the vice president of something else or other) at Ariba, where I worked from April 2000 until September 2001 (I was also a consultant there from December 1999). Chapter 2 of Goodman's book is about the Internet bubble, Ariba is his case study, and Bochner is his source.

As far as I know, no one has made Ariba the poster child for the Internet bubble before–people usually go with WebVan, or Pets.com, or something similarly vaporous. Ariba is a more complicated story, but you can make a case that we deserve to be on the poster. At our peak we were bigger than all those pet food companies combined, with a market capitalization over $40 billion (on quarterly *revenues* of about $100 million at that time). More to the point, if Pets.com is comedy, Ariba is tragedy (well, not really, but you known what I mean): Ariba was a real company with a real product that got swept up in its own hype, with unfortunate consequences (but not fatal ones–Ariba today earns over $300 million in annual revenues and a small profit).

Goodman wants to make the case that there was no there there, and Bochner says what he needs him to say. "It was never about creating a business, he said. 'The whole idea was attract investment, sell your story to the Street, and then get yours out'" (p. 47). But there was a there there, at least at the beginning. Ariba's founders–mainly experienced veterans of other successful technology companies, not twenty-somethings with no clue–had a great idea (automating procurement by large companies), and for the first few years almost everything went well. (Ariba was founded in 1996 by seven people; Bochner joined in October 1999, two months before I showed up as a consultant.) The product really worked, it was better than anything out there, the deals were huge, and most of the customers were happy. Goodman says, "there were obvious limitations to how much money Ariba could make selling its software. It was aiming its product at the big Fortune 500 companies. What happened when Ariba ran out of customers?" (pp. 44-45). But you can build an enormous company selling only to Fortune 500 companies and their global equivalents (that's where the money is, after all), and even during the frothy days of the boom we sold almost exclusively to big companies (because that's where the money is).

In Goodman's account, Ariba was basically a fraud. In the book, Bochner was "the lead man in creating [the impression that Ariba was constructing a global marketplace]. . . . From the beginning, Bochner saw this as a rather impossible task," but he went through the motions anyway. Why? In Goodman's words, "the stock was the only thing that mattered. A valuable stock gave Ariba currency it could use to buy other companies" (p. 46).

As I recall, Ariba started out very much as a real company, but was actually blindsided by the Internet boom. (**Update:** Note that I only joined Ariba in 2000, so my knowledge of the early days is based on talking to many people who were there, not actually being there.) In 1999, as industry and financial analysts were talking up the business-to-business e-commerce boom, they were looking for the leaders. The problem was that since business-to-business e-commerce barely existed, there were no leaders. Ariba was the closest thing they could find, at that was already a stretch (at the time, Ariba's product did a good job of automating the process of creating a purchase order, but most purchase orders were automatically faxed to suppliers). Ariba had recently launched the Ariba Network, which was a hub where suppliers could publish electronic catalogs and buyers could route their purchase orders to suppliers, and the analysts hungrily anointed it the next big thing. There was nothing particularly wrong with the Ariba Network; it did what we told the customers it did, more or less. The problem was the hopes that were projected onto it by analysts and, increasingly, by Ariba itself. Ariba's stock price kept climbing and climbing, to the point where Ariba had to at least try to deliver on the market's expectations; otherwise, its stock would have collapsed and it would have been acquired.We got into a vicious cycle where the more the stock climbed, the more dependent we were on the story that was making it climb, and the more ambitious and aggressive we had to be.

We were by no means innocent victims. There was too much watching the stock price, and a lot of believing our own marketing. The jargon that Goodman makes fun of was terrible, and I was responsible for some of it. More important, no one put a gun to the CEO's head and said, "You must try to build a global network of electronic marketplaces and earn transaction fees by providing services to all the participants in that marketplace." The management team could have said, "This is silly. We're going to ignore the hype and focus on what we do well, which is automating corporate procurement of indirect goods" (not direct manufacturing inputs). That's what we should have done, even though it would have meant a collapse in the stock price and being acquired. But the problem is we were swept up in the hype like everyone else. It wasn't just the analysts. The *customers* all wanted to be building global electronic marketplace, and in that group I include just about every large corporation in the world; they were all talking to us and to our competitors (Commerce One, Oracle, i2). They all wanted an e-commerce strategy (because without one their stock prices were being pounded) and *we were their e-commerce strategy*. The customers came to us and said, "We want this, everyone says you're the best, therefore you're our best hope. And here's a big pile of money." And we did our best to build what they wanted. The problem wasn't that the software was impossible to build; we could have built it, although it would have taken a lot longer than anyone wanted to wait. The problem was, as Bochner says, the degree of industrial reorganization required was just not feasible in the short timeframe. It was a business model problem: there was no business model for, say, a single giant marketplace where small business bought everything they needed from a universe of suppliers, all hosted by Bank of America. Bank of America thought there was gold in that hill, and we sold them a semi full of shovels.

Back in early 2000, I think most of us thought it was possible. Otherwise, it's hard to explain the energy, the motivation, and the immense amount of work most of us did. Goodman says on page 55, "The tech start-ups and their Wall Street handlers implicitly ridiculed the work ethic as an antiquated notion while speaking to a different lobe of the American brain–the part ruled by the frontier dream of finding a mountain of gold and never working again." I beg to differ. Maybe the dream was to never work again, but most people realized that to get there you had to work very, very hard, and often at multiple startups. (There are certainly examples of people who used connections to parachute into startups just before they went public, but those people are generally hated within the startup world.) Goodman is right that the discount brokers like Ameritrade did create the illusion that you could become rich by sitting in your pajamas and trading stocks, but I don't think the image of Silicon Valley ever included the idea of knocking off work at noon and hitting the golf course (except maybe for venture capitalists). If Ariba really had been a fraud, then the only people working hard would have been in marketing, PR, and investor relations.

Over time, as with all bubbles, we began to doubt. By late 2000, I think most of us realized that reaching the expectations the market had for us was a long shot. And as I said, the fundamental problem wasn't the software, although the software wasn't as good as it could have been. It was that the customers were failing at building the marketplace communities as fast as they had envisioned, and as the bubble imploded suddenly they were no longer interested anymore, and suddenly the market expected us to collapse. As it turned out, the customers didn't really want what they had been desperately scrambling for less than a year before. And we had over two thousand people lined up to build shovels that no one wanted.

There are obviously parallels to the financial craze of 2004-2007, and we did more or less play the part of Chuck Prince (music, dance, etc.). All of the paper wealth went to the heads of people at the boom companies, who started thinking they were smarter and better-looking than they actually were, just like overpaid bankers are convinced they are actually smarter than their college friends who got Ph.D.s in physics and are now struggling junior professors. (Unlike the Wall Street bubble, however, most of that wealth stayed on paper, because of the rule that stock options vest over four years, and the tendency for most people *not* to cash out at the first opportunity.)

But the big difference, as many have noted, is that ours was an equity bubble, not (for the most part) a debt bubble. Technology startups were funded by venture capital firms, which generally have no debt, and by stock offerings; they generally don't have the assets and steady cash flows to borrow money. (The telecom infrastructure companies were an exception.) There was little margin borrowing to buy stocks, as compared to the 1920s, so when the NASDAQ crashed, the damage did not spill over into other asset classes, and the financial system didn't even wobble.

In Goodman's story, the tech bubble had a scarring effect on the American psyche–two of them, actually. On the one hand, it fueled the myth that you could get rich through investments (buying tech stocks), which shifted household behavior away from working and saving and toward living off of anticipated capital gains. On the other hand, he says the collapse of the tech bubble created a "paralyzing state of cynicism" (p. 81) that hurt the economy for years afterward. Well, which one is it? I think the simplest explanation is that people invested in tech stocks because they wanted to get rich, and they got burned; the real estate bubble is considerably more complicated, because in many cases people *had* to overpay for housing, because people have to buy houses (or rent, but in many areas it's hard to find good rentals –that's a whole other story), whereas no one *had* to buy stock in WebVan.

For those ex-Aribians wondering what happened to Eric Bochner who don't want to buy the book, he's apparently now running a chocolate factory in Iowa City, and he implies that he didn't take much money off the table when he could ("The money I had then, I wish I had now" [p. 49]). I do know a few people who took everything off the table that they could, but only a very few. Most people lost their paper wealth along with everyone else's paper wealth (and unlike Dick Fuld, they hadn't sold hundreds of millions of dollars of stock on the way up).

By James Kwak

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14 RESPONSES TO "THE MYTH OF ARIBA"

Nemo | January 18, 2010 at 2:22 pm |

Nobody *had* to buy a house. They did so voluntarily because they thought prices were going to keep rising, and they fully expected to profit from their decision.

This point is not just academic because it affects public policy choices going forward. Had the house buyers been right, they would not be offering their tax-free capital gains to me now… So any proposal that I should bear their losses is, quite frankly, disgusting.

More foreclosures, please. I want to buy a house someday.

Gumbo | January 18, 2010 at 3:40 pm |

I saw it from the other end as a software vendor. 'The case law covering commercial transactions is obsolete, do the work filling in Ariba's data base or you are the loser we think you are' was the attitude conveyed.

Which made it clear that the half life would be reasonably short.

q | January 18, 2010 at 3:46 pm |

interesting — i lost a not small amount of money in the dot com boom and crash and so decided to sit out the housing boom and crash. was i right?

Ted K | January 18, 2010 at 6:06 pm |

I think it must have been a fascinating time. The only thing I remember is watching CNBC and them doing their best to make you feel you were a moron if you didn't buy the tech stock with the P/E ratio of 200.

It gets back to a common fallacy. It's seen both in the stock market and more commonly in government projects. There's something similar happening in Oklahoma City right now called MAPS 3—"Build it, and they will come". People think if they build a casino in the middle of the dessert it will make money. Las Vegas doesn't happen very often folks. And the type era in which it occurred is not likely to happen again any time soon. The best is when the local poor get sucker punched with a sales tax to pay for sports arenas and city facilities which will only be attended by the city's wealthy individuals.

"Latisha" the African American working as a maid at a local motel gets to pay 1% more on every item of food (a large percentage of her expenditures) she buys so "Edward" the white Bank CEO can have a new facility to watch major league professional sports at. Then "Latisha" gets to listen to Edward bitch about his income taxes on TV. No one cares what "Latisha" thinks and she hasn't got the time to talk about it cause she's working 2 jobs because maid's salary doesn't pay for rent and her kid's clothes. And the wheel keeps turning….

Michael Wasserman | January 18, 2010 at 6:24 pm |

Lots of people who were hurt by the crash did not buy houses. It doesn't matter whether those who did buy houses did so voluntarily or not. What is outrageous is that the people who shoveled money to other people with inadequate income who bought overpriced houses are still very rich.

Ted K | January 18, 2010 at 6:52 pm |

Sorry I should have said "desert" with one s. That one always gets me. No, don't build a casino in the middle of your banana split either. The scaling issues and logistics get complex.

Al | January 18, 2010 at 7:34 pm |

Holy crap, James. You must be worth a fortune now.

The Raven | January 18, 2010 at 7:41 pm |

Pretty classic software industry failure; Fredrick Brooks would recognize the problems, I think. There is something about software development that tempts to overconfidence. Often you can do what you think. Yet it takes so much longer than you think!

James Kwak | January 18, 2010 at 9:41 pm |

No no no. I realize I left out some of the details there. Ariba went public in June 1999. I joined in April 2000, so my options were priced at $89/share (I think). Options don't vest for at least twelve months. By April 2001, when they vested, the stock was about $2/share. I did get a new grant in April 2001, but I left in September, so those never vested.

So, in Silicon Valley parlance, I "didn't make any money" at Ariba. That's the phrase people use if you didn't make money on your options. It's a rather insensitive phrase, as it ignores the fact that I did make a comfortable salary (although it was a pay cut from McKinsey).

Anonymous | January 19, 2010 at 4:26 pm |

I joined Ariba in 1998 when there were less than 200 employees, and I left after well after the crash, so I saw quite a lot. I think James' analysis of what happened is accurate (and I remember James as well). Ariba was a real company, and still is, but it got swept up in some huge forces, and it didn't deal with the enormous growth or wealth very well. These forces dramatically overvalued the stock price during the boom, and I think they have had the opposite effect of devaluing the stock ever since. I know that as Ariba mushroomed it was pretty common to see the quality of the people we hired decrease, though certainly not always, and people's motives for working there became more and more about the stock. Unfortunately, I think this was true of many senior executives as well, and so I can see how Goodman might think that is what Ariba was all about, but I don't think that cynicism is really accurate, at least originally. Ariba was/is a real company that got caught up in some unreal stuff.

Pat McGroin | January 20, 2010 at 7:38 pm |

"Most people lost their paper wealth along with everyone else's paper wealth (and unlike Dick Fuld, they hadn't sold hundreds of millions of dollars of stock on the way up)."

Having observed the stock market for about three years now (while I was working, I dutifully invested monthly through my 401k, without paying much attention to it…even through the internet bubble), I've paid particularly close attention to the seemingly endless stream of Form 4's that are issued on a daily basis from the insiders in corporate America…and I'm beginning to suspect that THIS is how the rich continue to get richer in this country. They regularly and consistently cash in stock grants and options (probably without much thought as to whether their own stock will go up or down in the near future), and in the process can easily amass hundreds of thousands of dollars of additional income each year. Every day I see hundreds of new Form 4's issued…sometimes they just announce new shares or options granted (as part of the company's "Long Term Incentive Plan," of course), but most of the time (especially lately, since the market's up considerably in the last year or so) they describe another director "ringing the register" for tens (or hundreds) of thousands of dollars.

Having worked for Merck from 1993 until 2004, I missed out on cashing most of the (relatively few) stock options that were granted to me between 1996 and 2003 (although I did cash in enough in 1998 to afford a 20% down-payment on a house purchase)…I foolishly sat on the remaining options through the entire stock decline (from the high of $97 in 2000 to $33 by the time I left the company) – always hoping that "things will get better." No doubt I'd be much more comfortable financially if I'd set up a regular schedule of exercising stock options.

marcel | January 21, 2010 at 10:42 am |

So spill it. Where do you rank HK on the quality spectrum?

jk | January 21, 2010 at 9:58 pm |

Some people buy a house because they want to live in a house, not because they want to become speculators.

Dream Dictionary | January 23, 2010 at 10:58 am |

That's the funny thing about dreams, you know.

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