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E-COMMERCE

They Love The Slump

These online businesses are profiting not in spite of the tech slowdown but because of it

By CHRIS TAYLOR SAN FRANCISCO

ONE OF THE LOUDEST CRASHES IN THE TECH COLLAPSE CAME LAST month, when mighty Cisco Systems found itself with so many of its finished routers and components stuck in warehouses and going nowhere that CEO John Chambers had to take drastic action. He wrote off a record $2.3 billion in inventory, including $900 million in processors and $300 million in semiconductors. Similar liquidations are taking place throughout the electronics industry. And they're providing fresh opportunities for a small band of nimble souls who are profiting not in spite of the tech slump but precisely because of it.

Public-auction websites like eBay are doing a fire-sale business in surplus tech hardware. A new Cisco AS5300 access server with a recommended retail price of $50,000 was auctioned off for less than $2,500. Even busier these days is Virtual Chip Exchange, a private marketplace for 4,200 established buyers and sellers of computer chips and semiconductors in 40 countries. VCE is currently the planet's largest electronics B2B exchange, as rated by Jupiter Media Metrix. The privately held company reports that revenues rose past $37 million in the first quarter, up 238% from the same period last year, while profits are in "the high six figures."

The way VCE works is pretty simple: you sign up anonymously with your surplus silicon, set a minimum bid and wait for anonymous buyers anywhere in the world. Deals are done in a matter of minutes. The sold items go for quality control to VCE, which takes an average 9% commission. The sales price and parties' names are kept private (sparing further embarrassment to CEOs like Chambers).

With 30,000 suppliers still unsigned by VCE and with worldwide surplus-chip inventories estimated to be worth $30 billion, the company seems poised to take even greater advantage of the network effect. "The potential is huge," says John McCarthy, an e-business analyst for Forrester Research. Indeed, projections that the semiconductor business will shrink 17% this year seem to be a boon for VCE.

The company's CEO, Mike Wood, isn't troubled by making money off a manufacturer's misfortune. "When you have a headache, the aspirin is not taking advantage of you," he says. By helping clear excess inventories more quickly, "this kind of service could contribute to a turnaround." And if it does, Wood is well placed to continue making money during an economic expansion, when higher unit prices for goods sold on his site would offset any decline in excess-inventory volume.

In the meantime, any business that's in the market to upgrade its technology can do so for a fraction of what it would have paid just eight months ago. Robert H. Wager Co., a firm in Rural Hall, N.C., that makes high-tech smoke detectors, was days away from defaulting on a $200,000 contract because of a shortage of critical semiconductors. A two-month search turned up one supplier with a 14-day lead time. Five minutes on VCE turned up supplies that could be delivered immediately. "We're deliriously happy," says sales director Christine Timchek. Similarly, Texatronics, a contract manufacturer of printed circuit boards in Richardson, Texas, cut its costs 15% after signing up with VCE. Even troubled Cisco is examining the service.

Another firm raking in cash from the tech downturn is Overstock.com, based in Salt Lake City, Utah. Overstock is the world's first purely e-tail site to break even, a feat achieved after burning through just $27 million in venture capital—pocket change in Silicon Valley. Overstock, which buys surplus tech products at liquidation prices and sells them to consumers at an average 60% off the retail price, is best known as a "vulture" site, raking over the bones of deceased dotcoms and snapping up $44 million of their equipment.

But the inventory of former dotcoms accounts for only 20% of Overstock's sales. It's also profiting from other ailing sectors of the tech world. Remember that $50,000 Cisco server that brought $2,500 on eBay? One just like it went on sale for $6,900 at Overstock.com, having cost the site $3,500. Total sales on the site leaped from $4 million in November 2000 to $9 million in December, the crucial month for e-tailers.

Patrick Byrne, the site's founder and

Stock Taker or Undertaker?
Patrick Byrne, CEO of Overstock.com, is cashing in on surplus tech gear from manufacturers—and dead dotcoms

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CEO, says his next project is to do his version of VCE: resell surplus tech hardware not only to consumers but also to mom-and-pop retailers for around 40% off the wholesale price. By comparison, megastores like WalMart usually get at most a 10% discount from jobbers or liquidation agents. Couple that with Overstock's tiny minimum wholesale order—six units—and it appears that Byrne is trying to play Robin Hood to America's 130,000 small retailers. "These guys are getting put out of business by WalMart because they get lousy service from manufacturers," he says. "Now for the first time they'll be buying something cheaper than the chains."

Like VCE, Byrne has found a niche, as manufacturers routinely overproduce by 5% to 10%, a figure that naturally rises during a downturn. Nearly all his surplus items are produced in such small numbers that neither chain stores like WalMart nor catalogs will touch them. The only place such dribs and drabs can go is online.

CEO Byrne is chipper, to say the least. "I don't even follow the stock market," he boasts brusquely. "What do I care if it's down? It just means more dead buffaloes for me to strip clean." And more bargain buffalo meat for his happy customers. ■

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