

Impact of e-Business initiatives on firm value

Ho Geun Lee*, Dong Hwan Cho, Seong Chul Lee

Department of Business Administration, College of Business and Economics, Yonsei University, Shinchon-Dong 134, Seodaemun-Ku, Seoul 120-749, South Korea

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Abstract

A growing number of firms are competitively entering into e-Business because they see the high potential of e-Business growth as an opportunity. The positive expectation of the e-Business market leads most firms to go into e-Business, but it is not clear what kinds of benefits firms gain through e-Business. In this paper, we examine whether firms' economic benefits are related to e-Business activities. For this purpose, we employ event study methodology and assess the cumulative abnormal returns for 782 e-Business initiatives by firms listed in Korean capital markets. The well-known *Dot Com Effect* is verified empirically by this study. The results of this study indicate that e-Business potential is highly valued in the capital market, and e-Business firms are expected to create significant benefits in the future period.

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1. Introduction

People are becoming more interested in the Internet and e-Business all over the world. Such interest can be observed by the increasing number of Internet users. According to NUA, an Internet survey investigator in the US, the number of home Internet users was estimated to be 379 million in 2001 [1]. This figure is about twice the 201 million users in 1999. Korea is not an exception to this fast growing trend, and the number of Internet users in Korea was 19 million at the end of December 2000 [2]. This huge number of Internet users in Korea, and the world,

means a lot of potential customers in the e-Business market.

The e-commerce market around the world was estimated to be more than \$500 billion in 2001, and is expected to reach \$1.49 trillion in 2003 according to Forrester Research. LG Economic Research Institute and Andersen Consulting state that the e-commerce market size in Korea is expected to grow about 100% every year [3]. Another reason that firms have been entering the e-Business market emulously is the high stock prices of Internet firms [4] (p. 25). Korean Internet firms have had very high stock prices compared to other stocks in Korea. The KOSDAQ index was over 290 at one time with an annual growth rate of more than 100%, and this number was actually driven by Internet firms. A number of brick-and-mortar firms, which observed the high stock prices of Internet firms, have been

*Corresponding author. Tel.: +82-2-2123-4470; fax: +82-2-393-7430.

E-mail address: hlee@base.yonsei.ac.kr (H.G. Lee).

making efforts to enter e-Business, and new Internet start-ups have been increasing.

Although many companies enter the e-Business arena looking at the fast growing number of Internet users and the rapid growth of the e-commerce market, evidence of the benefits to firms from e-Business initiatives is far from unequivocal, and the costs of entry are real and overwhelming. Considerable up-front investments for creating e-Business capabilities are required to be a viable player in the current e-Business environment. According to a recent report, the construction and engineering industry spent \$1,863 per employee for e-commerce initiatives, compared with the financial services sector which made e-commerce investments of \$13,628 per worker [5]. The Gartner Group estimates that the average cost of developing and launching an e-Business web site is \$1 million, and it needs \$5–20 million to achieve market differentiation that sets it apart from the competition [6]. Further, the publicly reported figures for hardware and software expenditures in e-Business ventures comprise only 21% of the overall costs, with the predominant expense being the labor costs for developing the site and implementing interfaces to back-end business applications. This cost of development and implementation of web sites is expected to rise by 25% annually [7].

Once these investments are in place, the company needs to promote its e-Business web site. This effort can include putting banner ads in one of the portal sites, or placing commercials in newspapers, magazines, or on TV. As the number of e-Business firms is growing from day to day, these kinds of costs are inevitable, and it looks as if the amount of money required for such advertising is increasing [8] (p. 136). Although e-Business requires many such costs, a growing number of firms are making, or considering making, such investments both in information technologies and in organizational changes related to e-Business. A research question that follows is: *What are the economic returns to firms from engaging in e-Business?*

In this paper, we focus on the market value of firms based on the economic returns they receive through e-Business activities. We analyze the impact of e-Business initiatives on the market value of firms in Korea. For this purpose, we employ the event

study methodology, which is based on the efficient market hypothesis. In an efficient capital market, investors are believed to recognize future benefit streams from managerial initiatives announced by firms, a judgment subsequently reflected in the stock price of the firm. If e-Business activities enhance future cash flows, the capital market would respond favorably to e-Business announcements by firms, and this would be reflected in a positive movement of their stock price. Event study methodologies are very useful tools for management researchers to examine the consensus estimates regarding the future benefit streams attributable to organizational initiatives [9] (p. 626).

The impact of e-commerce initiatives on the market value of firms in the USA was investigated by Subramani and Walden [8]. They validated the popular notion of the Dot Com Effect by showing that the Abnormal Returns of e-commerce initiatives were greater than the normal market returns. However, their research interest was confined to e-commerce firms and a small number of e-commerce initiatives. This study differs from theirs in two distinct ways. First, we have expanded the types of e-Business firms investigated as well as these firms' e-Business initiative types, so that broader ranges of e-Business activities can be evaluated. Second, e-Business initiatives are analyzed in two different capital markets (KSE and KOSDAQ) to investigate whether similar e-Business initiatives result in different firm values in the two markets.

In this paper, we empirically study the *Dot Com Effect* in Korea by assessing the value implications of e-Business initiatives announced by firms. We examine if the economic value of e-Business initiatives is linked to the nature of the stock market, whether the stock market is KSE (Korea Stock Exchange) or KOSDAQ. We also investigate if the economic value of e-Business initiatives is associated with the nature of the e-Business firm layers, whether the layer is Internet infrastructure, application, intermediary or commerce. It is assessed if the profitability of e-Business initiatives is influenced by the nature of the e-Business initiative, whether it relates to business-to-consumer e-commerce or business-to-business e-commerce. It is also examined if the profitability of e-Business is related to the types of e-Business initiatives.

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