Some little fish escaped being swallowed by big fish in the sea of e-learning vendors.

E-Learning

A Consolidation Update

By Paul Harris

Eyebrows were raised through-out the corporate training field in December when the giant McGraw-Hill Companies announced it was pulling the plug on its three-year-old Lifetime Learning unit, a content developer that provided hard and soft skills to the e-learning marketplace. The move came less than two months after the unit's management trumpeted impressive growth achievements and new partnerships with other e-learning companies. Lifetime Learning had the dubious distinction of being the final announced closure of a major e-learning company in 2001.

Illustration by Leo Espinosa

What a year it was for e-learning vendors and their corporate customers!

A handful of vendors continued to acquire technologies and rivals selectively that they thought would bolster their market positions. Meanwhile, weaker competitors hung on desperately or got hitched to another firm—or, sadly, failed on both counts. It was a year in which the e-learning marketplace offered no refuge from the recession's dot.com meltdown. The steady flow of venture capital trickled—a grim message for free-spending entrepreneurs who had banked on their killer apps to revolutionize the world. Although eclipsed by SmartForce's US$284 million acquisition of Centra Software in January 2002, last year was one of meaningful consolidation for an industry that's projected by IDC to produce $18 billion in revenues by 2005. More than 100 e-suppliers closed their doors, while 26 major corporate e-learning acquisitions took place.

Last year, wisps blew regarding other industry-shaping trends. For example, companies from outside of the training industry continued to stake their territory. The arrival on the e-scene of all Big Five consulting firms culminated with the debut of Indeliq, an e-learning venture from Accenture, formerly Andersen Consulting. Enterprise software giant SAP announced that it would roll out an internally developed learning management system in 2002, joining competitor Oracle in the field. And tech giant Sun Microsystems signaled its intentions with its $68 million acquisition of Isopia, a Canadian LMS provider.

So, does McGraw-Hill know something that the others don't? Is that why it's climbing out of the pool just as others are diving in? Not exactly.

"The market is moving toward a full-service system solution," explains one McGraw-Hill executive. Translation: Off-the-shelf content providers, such as Lifetime, aren't a dominant force. The same executive says that McGraw-Hill will take "a fresh look at the market" and possibly return to the e-arena in another role.

The retreat demonstrates that having a large, established parent company doesn't guarantee survival as an e-learning provider, particularly if that parent views e-learning as a risky side venture and not a core area for growth.

Where's it going?

Precisely where the e-learning market might be headed, especially in terms of ownership, continues to be the subject of intense scrutiny. What's certain is that the industry is following the pattern of many young businesses, especially in the software field, in which products and services are so new that many customers can't define their own needs. Vendors are gambling, and often losing, on untried business models. Even less certain is the ultimate destiny of Internet learning in general and its various niches in particular. As the market feverishly seeks to develop credibility, customers will decide whether their hefty investments in e-learning are paying off.

Though corporate trainers may not know precisely what they want from e-learning vendors, they're clearly tired of expensive platforms their employees don't use. They grasp the differences among technology and content offerings, and they insist on one-stop shopping and replacement of tedious content streams with *granular learning objects*. For definitions of that and other e-learning terms GO TO WWW.LEARNINGCIRCUITS.ORG/GLOSSARY.HTML.

Training purchasers also want fewer choices, instead of the current dizzying array of vendors. "The field is currently so fragmented that the largest company doesn't even have a 5 percent share of the market," says Eilif Trondsen, director of the Learning on Demand program at SRI Consulting Business Intelligence.

Structure is coming. Trondsen predicts future growth to include increased participation from such tech giants as IBM, SAP, and Sun Microsystems, which will all flex their muscles globally.

A feverish acquisition pace

In 2001, there were about 26 major corporate acquisitions in e-learning, totaling an estimated $380 million, says E. Yegin Chen, director and senior analyst with Eduventures Inc. That was up from 25 acquisitions with an aggregate estimated total of $200 million in 2000, notes Chen.

The size of transactions is also climbing, says Chen. The largest publicly disclosed transaction in 2000 was $26 million (DigitalThink's purchase of LMS developer Arista Knowledge), while last year's leader was the Sun-Isopia deal at $68 million. DigitalThink's purchase of content developer LearningByte for $60.5 million was last year's second priciest deal. Both Arista and LearningByte were stock transactions. Combined, the three deals helped boost the average size of transactions to $11 million, up from $8 million in 2000. Chen predicts that acquisition activity will increase to roughly $400 million this year and the next, bumping up both the average transaction size and the largest single price. The SmartForce-Centra merger certainly bears that out.

Meanwhile, recent e-learning acquisitions have demonstrated several noteworthy characteristics, according to Eduventures:

- Acquirers tend to be e-learning companies rather than in such allied areas as instructor-led training, software, hardware, or publishing. The notable exception is the Sun Microsystems-Isopia deal. Although many large firms have signaled intentions to contend in the e-learning space, to date most have chosen to build their offerings rather than purchase them.
- Acquired companies are small stand-alone firms occupying a particular e-learning niche. Except for Thomson Corp.'s $2.06 billion acquisition of NETg within the Harcourt General buyout, the acquired or merged firms aren't parts of large conglomerates that are being divested.
- A desire for technology has been the motivator for acquisitions, not the purchase of market share, distributors, or other assets.

The economic slowdown also affected initial public offerings. Not a single corporate e-learning company went public during 2001, compared to the previous year with these six: Centra, SkillSoft, DigitalThink, Saba, WebEx, and Docent. Such tightening of capital markets means companies seeking capital currently face investment or acquisition by a larger industry player, says Chen. He predicts that acquisitions will taper off once access to capital improves.

Steve Thomas, president and CEO of Pathlore, a privately held e-learning company based in Columbus, Ohio, says that much recent acquisition activity represents "bottom-feeding"—desperation sales of companies breathing their last gasps. But generally speaking, he says, this isn't a good time to sell a company. "You never want to sell at the bottom of a market," he insists.

Thomas says the economy is affecting the ability of companies to make purchases, especially public companies whose stock prices are so depressed that they can't make stock deals. "Until the stock market revives and the value of companies increases, we won't see a tremendous [number] of acquisitions based on growth strategies," he says.

The recession also has altered the acquisition strategies of many e-learning vendors, says Thomas. "Prior to the economic turndown, increasing market share was the mantra. CEOs were pursuing that at all costs because they were trying to take their companies public." Unfortunately, he says, many of them made promises they couldn't deliver on—thus stretching resources beyond capacity and giving the entire industry a black eye. "Today, e-learning companies are more concerned with quality of delivery," he says—another healthy trend for their corporate customers.

Thomas adds that major e-learning companies such as Pathlore, Saba, and others will become prime acquisition targets once they achieve annual revenues of $200 to $400 million. Until then, "you won't see real consolidation in this market," he predicts.

Like many of the stronger e-learning firms, Pathlore is positioning itself for the future. A profitable company, it recently received $10 million in funding from Seaport Capital and is using that money to expand internally, including sales and distribution. "Acquisitions will be part of Pathlore's growth," he asserts. Potential areas for acquisition include technologies the company doesn't possess and expansion into new markets, geographically and vertically.

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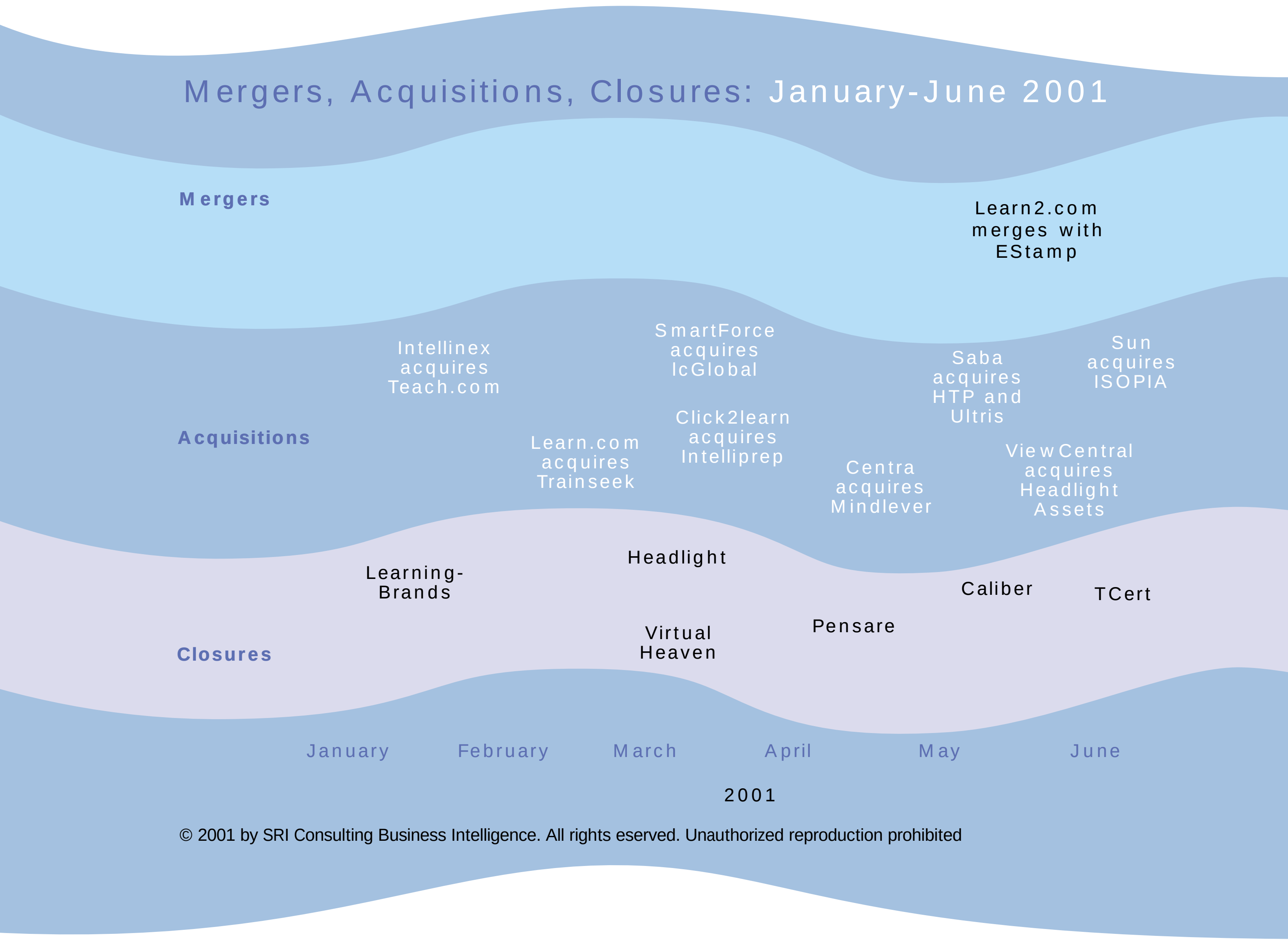


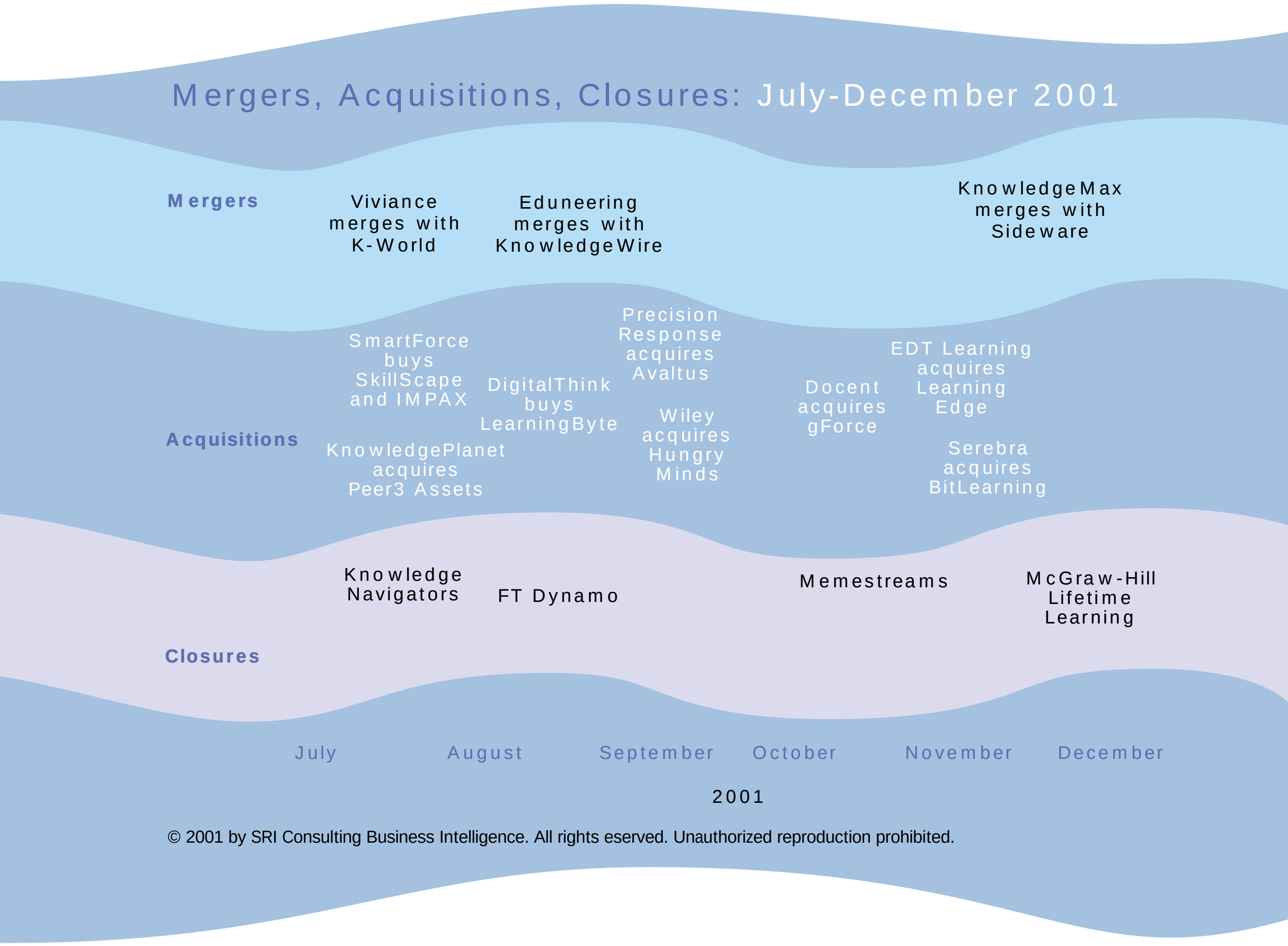
The popularity of LCMS platforms

But even bottom-feeders pursue aggressive business strategies, as last year's acquisitions demonstrated. Chief among those strategies, clearly, is to expand capabilities and product offerings.

Eagerly targeted last year were stand-alone companies producing either LMS or LCMS technologies, snapped up by prominent companies that lacked one or both platforms. Centra, Click2learn, Docent, KnowledgePlanet, and Precision Response added LCMS capabilities to their arsenals via acquisitions last year, while Saba promised to roll out an internally developed system in 2002. DigitalThink, SmartForce, and Sun Microsystems acquired LMS platforms last year. DigitalThink's purchase of LearningByte led the trend of acquiring major content developers in 2001. Following were DigitalThink's acquisition of TCT Technical Training and Knowledge Transfer Systems's purchase of KT Solutions.

Trondsen says that anyone who wants to observe a smart acquisition strategy need look no further than industry leader SmartForce. The company has utilized strategic acquisitions instead of alliances to create its "e3" architecture that integrates and manages three platforms: technology, content, and services. "SmartForce recognized that customers want a total solution, so it created a broad platform that makes sense," says Trondsen. "It includes a lot of simulation functionality—games and simulations that make e-learning more interesting and fun. It will catch on here and abroad."

SmartForce's buying binge includes the 1999 purchase of KnowledgeWell, a company that used interac-



tive learning technologies for training of business skills. The $62.7 million stock deal was the largest publicly disclosed corporate e-learning buyout that year. More typically, SmartForce has gone after companies costing about $5 million. It made seven acquisitions during 2000 and 2001, the industry's largest number of corporate purchases—including the April 2000 buyout of Learning Productions, a developer of Web-based simulations. Last April, SmartForce plucked icGlobal, a behind-the-firewall LMS with which it had collaborated, and finished the year with two more strategic purchases: IMPAXselling.com, a company that trains sales professionals, and SkillScape, a Canadian firm that provides competency-management systems.

SmartForce's blockbuster deal with Centra buys it the dominant U.S. synchronous collaboration provider, along with the LCMS system it previously lacked. It certainly strengthens SmartForce's position as the dominant e-learning provider in the United States.

Headlight's valuable lesson

Alas, for every success story like SmartForce's or Pathlore's, sad tales abound. The most significant to date is last spring's closure of Headlight, a 1999 dot.com startup that targeted small to mid-size enterprises with a hosted offering that provided content from numerous vendors. Its business model sounded promising: Go after the training needs of small companies. Headlight helped pioneer the concept of aggregating content from multiple vendors through an online portal—a model now followed widely by LMS providers through their hosted networks. Relying on content partners, including SkillSoft, NETg, and Element K, Headlight amassed more than 3,000 online courses for its portal. The venture capital firm of Draper Fisher Jurvetson supported the effort financially.

But the business plan was ahead of its time. Out of cash and with no buyers in sight, Headlight became the first dot.com e-learning casualty after only 15 months of operation. A $16 million infusion by Draper to help revise the marketing strategy was too late. Yet, a burned-out Headlight illuminates with important lessons—such as the need for collaboration functionality in vendor platforms and the vast potential of the SME market in general.

"Everyone recognizes that this is a market that needs to be served," says SRI's Trondsen. "But Headlight showed that it's too difficult to serve it directly." For starters, it's hard to justify the marketing costs, given the length of the sales cycle in this industry. Simply locating the correct person at a medium-sized firm can be daunting. "It's too costly to sell directly to SMEs," he concludes.

Mike Wenger, senior director of e-learning for Sun Educational Services, the training organization for Sun Microsystems, agrees that the key SME market is "up for grabs." But he believes "a smart niche player that's adequately capitalized would make it work." Sun Educational Services, the unit that contains Sun's e-learning activities, continues to hear from its medium-company customers on the subject. Says Wenger, "They require a different product set than larger enterprises do."

Another market segment that has failed to find an identity is the so-called collaboration or knowledge-sharing platform. Instead of becoming a solid market niche, it began to register as an optional add-on feature after LMS developers positioned themselves as the cornerstone of corporate e-learning systems, says Trondsen. Casualties of that shift include the United Kingdom's Knowledge Navigators and Pensare of Los Altos, California.

"Pensare tried to leverage several related initiatives into a business model that cut across the traditional boundary separating higher education and corporate learning," says Tom Barron, a consultant who works with SRI. "But it failed to appeal sufficiently to either segment." He says that Pensare discovered belatedly that a content-collaboration platform optimized for "captive audiences"—such as M.B.A. students—proved a tough sell in corporate environments. Collaboration capabilities also played second fiddle to last year's captivation with learning management systems, adds Barron. Pensare customer and investor Duke University ultimately acquired the firm's technology for its own use. Such are the penalties of gambling on a fledgling and fickle market.

Maritz shows moxie

Brian Carlin believes that companies in the field of performance improvement are poised to grab a major share of the corporate e-learning market. Why? Because they possess a diverse array of complementary skills and take a broader perspective of the field than others do.

Carlin should know. He's president and CEO of Maritz Learning, a Fenton, Missouri-based provider of custom training, e-learning, and performance management for sales and service organizations. Maritz Learning is a unit of Maritz Inc., a $1.3 billion provider of performance improvement, research, and travel services. Carlin was formerly head of Librix Learning, an LMS acquired by Maritz this past November. "Learning is a means to an end," he says. "That end is about individual and organization performance improvement."

Maritz's blended learning system elevates e-learning and other training methods from being isolated activities within an organization to achieving

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prime status in its continuous performance improvement process. When Maritz meets with a client, it checks the desired state of performance and determines the best methods to get there. Learning is one component, but so too are incentive programs, market research, brand alignment, and other initiatives, says Carlin. He calls the results "energized competence" and says it's on display within the Anheuser-Busch wholesaler network, among other customers.

"It's our goal to redefine the playing field of the e-learning industry and broaden it into a place in which people can engage in true, integrated, continuous learning across a variety of modes," says Carlin. He vows that Maritz will become a dominant player within the e-learning marketplace and will make acquisitions to get there.

Giants take aim

Other firms with similar ambitions—and the resources to achieve them—include enterprise software companies Oracle and SAP, and hardware firms such as Sun and Cisco.

Following its purchase of Isopia last spring, Sun quickly unveiled new end-to-end e-learning capabilities. Its LearnTone package combines ISOPIA's hosted and licensed LMS packages with Sun's instructor-led training capabilities. The result is a single, integrated source for learning technologies, consulting services, and content delivery solutions.

"A lot of people were welcoming Sun's play in corporate learning," remarks Sun exec Wenger. "Sun brings stability, along with the addition of a company that understands both learning needs and corporate needs. And it's playing within an enterprise context." Sun's also playing in an international arena, not just in northern Europe where early action occurred but throughout Europe and Asia. In fact, Sun has been in the education market for almost a decade, with 250 learning centers in 65 countries.

Though some observers expect e-learning to take a back seat to tech sales at Sun, others salute the tactic. "By selling its routers and switchers, Sun is building the infrastructures for e-learning and e-business," says one insider. "If Sun can promote e-learning—and if that helps sell servers—it makes good sense."

"Absolutely," agrees Wenger. "The goal of Sun Educational Services is to become an industry leader in helping people learn how to use Sun technologies directly, as well as to be recognized as a leader in the education and training market." He says the concept directly supports Sun's views of open architecture and hopes to create a world where the need for networking technologies is increasing.

Pathlore's Thomas says that other big players will pursue the same logical business strategy, including such dabblers in e-learning as SAP, PeopleSoft, and even Microsoft. "Those companies do a good job of sticking to their core competencies. If they decide to venture into this marketplace, it will be to satisfy their own customers, not to jump into a hot market," he says, cautioning that a possible detractor is the heavy service component needed to support sales.

The same goes for other industry giants that are making tentative steps into the e-learning arena—companies such as EDS, Raytheon, General Physics, and Hewlett-Packard. And don't forget IBM, which purchased the Pathware product line in 1999, and is pursuing its Mindspan consulting expertise as well as alliances with SmartForce, NETg, and CBM Technologies. IBM is expected to make an e-learning acquisition this year.

And what about Microsoft? It could change the e-learning landscape overnight if it chose to. But, so far, Microsoft has been content to putter around the edges—for instance, with its Web conferencing utility program, NetMeeting, and by forming an alliance with Blackboard, a software company that helps colleges put their courses on the Web.

Switching from the big fish-little fish metaphor, armchair quarterbacks foresee continued yardage gained by Microsoft when that play fits its goals, such as providing platforms and systems for virtual universities. Yet, sometimes it's impossible to figure what a giant company's intentions are, even after it comes onto the field. For example, after IBM's Lotus division purchased Pathware from Macromedia Corp. in 1999, Pathware disappeared from the marketplace. "We were doing high fives the day IBM bought Pathware," says Thomas. And then there's McGraw-Hill Lifetime Learning, soon to be watching from the stands.

Odds are that if a company does decide to re-enter the e-learning market, it will find it vastly different from when it left. TD

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