

By Tom Barron

**Here's how
training managers
can take the
bull by the horns.**

Main Points

- **The Bad News:** The e-learning market, awash in venture capital and successful IPOs in 2000, has slowed considerably in the U.S. economic downturn.
- **The Good News:** Although e-learning stocks tracked by W.R. Hambrecht + Co finished last year at a loss, they did outperform the NASDAQ composite index, which dropped 37 percent. Compared with other Internet stocks, e-learning firm valuations are holding up fairly well as investors return to valuation.
- E-learning can demonstrate its value to an organization in terms of raw numbers. Assessment and skill-gap analysis tools will come in handy when bean counters come knocking to ask for performance improvement evidence.



E-Learning Weathers a Bear Market

Stock prices are down, venture capital is tighter, profits are still off on the horizon. These are tough times for many e-learning vendors. How should training managers adjust their e-learning strategies in a bearish economy?

What a difference a year makes.

In early 2000, the sector of the training and education field focused on Web-based training was awash in venture capital and successful IPOs. New startups were being announced almost daily. Analysts issued mind-boggling growth forecasts for e-learning, Wall Street's new darling.

Even after last March's sell-off of technology stocks dampened the euphoria around Internet-related companies, the e-learning field continued to blossom. Industry trade shows broke records for the number of vendors exhibiting and the number of buyers attending. Ever-larger contracts were announced. Major software and consulting firms weighed in with e-learning offerings. The field became a magnet for venture capital. Analysts issued market growth forecasts as high as \$22 billion by 2003, from roughly \$1.5 billion in 1999. But a broader economic slowdown, which began in the fourth quarter of 2000 and accelerated as the year drew to a close, has changed the tune of all but the most optimistic forecasters.

Is now the beginning of the long-predicted surge of consolidation among e-learning providers? Are we on the steep, downward slope past the "peak of inflated expectations," as stated in one analyst's growth cycle chart? Is the e-learning party over?

Maybe, say industry analysts, who note that last year's steam—about e-learning and the Internet sector in general—was bound to run out sooner or later. Whether the slowdown in economic growth continues (and how severe it becomes) will be the key to a short- to mid-term prognosis, say several industry watchers.

If the U.S. economy enters a recession and companies move toward cost-containment strategies, the question is

der even the sunniest of economic circumstances. Certain sectors will be harder hit than others.

"It's analogous to IT spending 15 years ago. In a downturn, R&D for information technology would be among the first to go in recessionary cost-cutting," says Michael Moe, director of global growth research for Merrill Lynch. "Nowadays, that would be considered bizarre. In the knowledge economy, the same holds true for e-learning. It's no longer a cost center; it's a strategic necessity."

However, as a result of the downturn, buyers of e-learning products and services must add "long-term viability" to an already long list of variables to consider when weighing which e-learning

technology purchases to pursue—or abandon, as the case may be. Speculation over which types of e-learning providers are best positioned for a slowing economy and how long private firms can continue to rely on venture capital are favorite topics among market watchers.

Following is a look at the extent of e-learning's changing fortunes and some advice for 2001's new realities.

How down?

The bread-and-butter statistics of market analysts reveal a market sector whose fortunes have escalated and declined in tandem with other sectors that make up the Internet economy. Though it's cold comfort, the sector encompassing corporate e-learning providers and companies serving the K-12 and higher education markets hasn't suffered more than other sectors anchored in Internet technologies. But suffer it has, at least from a valuation standpoint.

From a pinnacle in early 2000—shortly after DigitalThink had the most successful IPO of any e-learning company to date—the e-learning market experienced an overall decline in stock prices and venture capital financing. At yearend, seven e-learning companies (including

The Year 2000	1st Quarter	2nd Quarter	3d Quarter	4th Quarter	Total
Bricks & Mortar	\$85	\$13	\$21	\$33	\$152
Consumer	\$41	\$73	\$67	\$0	\$181
K-12	\$343	\$105	\$237	\$80	\$765
Post-secondary	\$239	\$214	\$234	\$127	812
Training	\$223	\$243	\$172	\$145	\$783
E-Learning	\$846	\$634	\$710	\$352	\$2,542
E-Learning as a % of Total	91%	98%	97%	91%	94%
Total	\$931	\$647	\$731	\$385	\$2,694

As part of the general e-business economy riding the foamy head of an expansion wave since the early 1990s, e-learning has dipped from its high crest in 2000. Stocks of leading public companies have stagnated near their initial offering prices, venture capital has become harder to tap, and IPOs have become rarer than the new dollar coins. Mergers and acquisitions among private firms ticked upward; one company would report layoffs while another sought to lower expectations for revenues and time-to-profitability. Rumors circulated about the continued solvency of various private firms.

whether e-learning will bear the same budget cuts that training departments and other so-called cost centers often face during lean times. Progress in aligning e-learning and training with business goals, and growing recognition of the competitive value of a well-trained workforce, will help defy the cost-cutting legacy, say analysts. Thanks to some high-profile cheerleaders, e-learning has made significant inroads in the minds of executives in the past year that won't be undone by a market downturn. At the same time, tough economic times will likely winnow a crop that some people say was ripe for culling un-

four leaders in the corporate training market) tracked by investment bank W.R. Hambrecht + Co were down 4.5 percent.

"Better off under your mattress," says Hambrecht e-learning analyst Trace Urdan in the company's newsletter, of money invested in e-learning during 2000. Other e-learning firms not tracked by Hambrecht also saw stock prices at or below their IPO levels at the end of the year.

Boston-based Eduventures.com, a provider of market research on the education sector, calculates that venture capital financing of corporate e-learning firms shrank from a high of \$358 million in the fourth quarter of 1999, to \$145 million in the fourth quarter of 2000. VC investment in the education sector was down to \$2.51 billion from \$2.57 billion in 1999.

Meanwhile, several large, publicly held e-learning companies (some of which forecast they'll be profitable by the fourth quarter of 2001) have voiced

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concern in recent quarterly filings with the Securities and Exchange Commission as to their profitability. SmartForce, the largest corporate e-learning provider in terms of revenues, experienced a revenue drop of \$27 million for the nine months prior to September 30, 2000, and, as a result, is changing its business model and R&D expenses.

"As a result of the deferral of revenue under e-learning agreements [a result of the company's shift from software li-

censing to hosted services], we have recorded a net loss in the nine months ended September 30, 2000, and expect to record a net loss for quarter 4 of 2000," the company states in its third-quarter SEC filing. "These losses could continue beyond 2000." (Fourth-quarter 2000 earnings statements regarding SmartForce and other public firms were not available at press time.)

Saba, another prominent e-learning technology provider that went public last April, saw revenues for its second fiscal quarter, which ended November 30, increase to \$13 million from \$3.5 million in the same quarter of 1999. But the company reported a loss of \$0.32 per share for the same quarter as a result of rising expenses—three cents less than forecasts by stock analysts. In its own SEC filing a few months earlier, Saba warned that an accumulated deficit of \$86 million and the need to invest heavily in R&D, personnel, and operations will require it "to generate significantly higher

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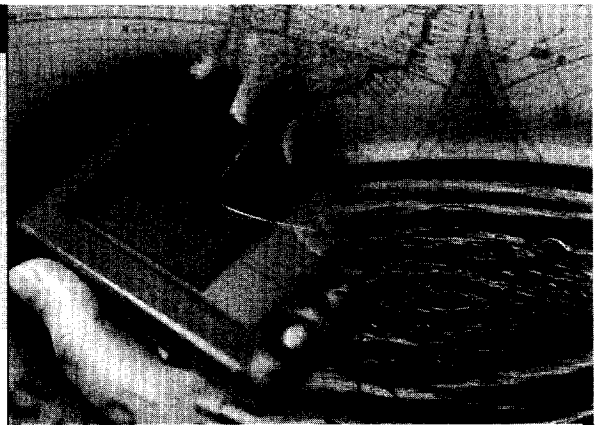
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revenues in order to achieve profitability." At yearend, its stock price hovered in the mid-teens—well below its initial offering of \$22 per share.

Click2learn.com saw its revenues grow 25 percent in the first nine months of 2000, totaling \$31 million for the period. But expenses also rose substantially as the company rolled out new offerings, including a hosted service, and it reported a loss of \$0.32 per share for the third quarter.

"Our limited operating history under the current business model and the emerging nature of the market for e-learning, among other factors, make prediction of the future of our operating results difficult," the company stated in its Q3 SEC filing.

At least two public firms had grimmer news. VCampus, among the first companies to pursue the hosted Application Service Provider model, announced in late December it was laying off nearly a third of its payroll as part of a restructuring effort. The company reported third-quarter revenues of \$2.3 million, down from \$3.1 million in the third quarter of 1999. VCampus predicts it will be profitable by the fourth quarter of this year.

"We believe that a slowdown in economic growth plays to our strengths," says VCampus president Daniel Neal in announcing the restructuring. And in early January, Learn2.com issued a preemptive warning about its fourth-quarter revenues, which it attributes in part to slowing PC and electronics sales that generate demand for e-learning services.

Among privately held firms, rumors swirled over the uncertain solvency of several small firms dependent on venture funds for operations and growth. With a stock market hostile to IPOs, several firms said to be pre-IPO are forced to wait until conditions improve. InterWise, an Israel-based synchronous or virtual classroom technology, is one such company with plans to go public while weathering the market downturn.

"Our quarter-to-quarter sales are growing at a rate of 100 percent," says Joe Didonato, well known for his suc-



"In 2001, the three Rs are reality, revenue, and rational business models," says Peter Stokes, executive vice president of Eduventures.com.

cessful corporate education initiatives at Oracle and elsewhere and who recently signed on as CEO of the Santa Clara branch. "The venture capital is there for the right companies with the right ideas," says Didonato, adding that SEC rules prohibit InterWise from discussing its plans to go public.

How upbeat?

Market watchers say that as sobering as recent statistics are, larger trends show that corporate e-learning and the broad educational technology arena are faring relatively well in a slowing economy. Such areas include the growing number of large contracts, such as the recent \$450 million U.S. Army contract for e-learning technologies won by consultant PricewaterhouseCoopers and a team of subcontractors (see Newsbytes, www.learningcircuits.com).

The entrance of heavy hitters, including Oracle and PwC, from the software

and consulting fields provides further evidence of e-learning's "value proposition," as vendors and stock analysts like to refer to it. A handful of recent VC financing efforts—including a \$47 million financing round for KnowledgePlanet.com, among the largest to date—indicates continued confidence in education technology on the part of institutional investors. And though e-learning stocks tracked by Hambrecht finished last year at a loss, they did outperform the NASDAQ composite index, which dropped 37 percent. Compared with other Inter-

net stocks, e-learning firm valuations are holding up fairly well as investors retreat from valuation methods now considered to be irrationally exuberant.

"In 2001, the three Rs are reality, revenue, and rational business models," says Peter Stokes, executive vice president of Eduventures.com, which last year began expanding its market focus from K-12 and post-secondary online education to include corporate e-learning. Indicators such as the percentage of venture capital that went to e-learning in 2000 bode well for that market's resiliency this year, he says.

"I think we will continue to see private investment activity at roughly the same pace we've seen in the past three quarters," he predicts. "What may change is who invests and the types of companies they invest in." A smaller group of companies will benefit from comparatively larger private investments, Stokes predicts.

Many analysts say that efforts by e-learning vendors and consultants to tie learning to business objectives more closely will pay off in a cost-cutting economy. E-learning has two valuable assets in that regard: savings in training-related travel expenses and reduced loss of employee productivity from having to travel for training. Both of those savings are easier to calculate than more complex performance improvement measures, which have hamstrung many a training department.

Fred McCrea, an e-learning market

analyst with investment bank Thomas Weisel Partners, says that the key drivers propelling e-learning growth will not diminish in a bear market. "If you look inside organizations with regard to their use of training, things are very different than they were in past economic slow-downs," he says. "IT training, for example, has become mission-critical for companies." The term *mission-critical* is voiced frequently by consultants to describe e-learning's presumed resilience in the knowledge economy.

"Businesses now believe that their human capital is the core of their business, and therefore learning is not a cost center but a strategic necessity," says Merrill Lynch's Moe, whose comprehensive report on the e-learning field, "The Knowledge Web," published last May, helped fuel investor enthusiasm.

Some analysts go as far as to speculate that a recessionary chill could actually spur growth of the e-learning market, at least relative to other economic sectors. Others say that a recession will slow demand for training as organizations hold back on hiring and new product or service initiatives.

"A big driver for e-learning has been lack of IT people and the need to retain them. Both dwindle somewhat during a recession," says Clark Aldrich, a former e-learning analyst with market research firm Gartner. As it has in the past, IT-related e-learning "will be a leading indicator of whether and how much demand for e-learning slows down," says Aldrich, who is currently working with a rather secretive e-learning startup, XBoundary.com.

How now?

Resilience aside, tightening equity means that the plethora of corporate e-learning vendors will shrink sooner than many analysts—and e-learning startups—expected. Institutional investors and VC firms are demanding a return to old-fashioned valuation techniques and a shorter, clearer path to profitability. The market will see a spike in mergers and acquisitions and a few bankruptcies, particularly if a full-blown recession sets in.

"It's going to become a buyers market; the vultures are circling," says Stokes of Eduventures.com. "You'll see a thinning of the herd in 2001, and new ventures will

have a tougher time raising money."

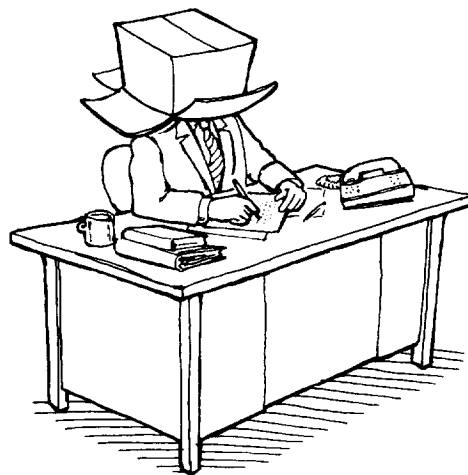
Many analysts agree with that assessment, but opinions diverge on what types of companies are more recession-proof than others.

"Capital will no longer be available for investment in corner-the-market schemes," predicts Andrew Snider, CEO of VIS Corporation, a custom e-learning

developer. "Companies that base their valuations on garnering large market share are going to be in trouble," he says, pointing to some high-profile flameouts in the business-to-consumer market. "Companies that can provide incremental services and have documentable results will succeed in winning capital."

Some soothsayers speculate that learn-

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ing management system providers will face a tough time selling behind-the-fire-wall implementations in a bearish economy.

"I think the infrastructure providers would be hurt most because they tend to be longer term, more strategic investments," says Aldrich. "Those kind of big six- to seven-figure sales will be hard to swallow for organizations watching costs."

Others disagree, saying that LMS providers will fare better as more companies turn to e-learning for the first time and need the infrastructure to manage it.

"You still have to put in that infrastructure before anything else," says Peter Martin, e-learning analyst with investment bank Jefferies and Company. Doing so gives organizations "the tools they need to measure the payback," he says.

Stokes points to the war chests amassed by large content publishers that have been moving into the field, particularly those hailing from the education sector. He notes three that are making bold forays into the corporate sector: Thomson, Pearson, and McGraw-Hill. "As they get aggressive in digitizing their content, they'll have excellent distribution channels," says Stokes.

Most analysts agree that market leaders in various e-learning categories will fare better than copycats in a period of tightening credit. And the largest companies have significant funds to tide them over.

"Even though there's reason for concern, there are a lot of companies that have tens of millions in the bank," notes Aldrich, who doesn't anticipate any slowdown in the introduction of new e-learning technologies. "They're going to be bringing to market things that have been in the pipeline for the last year or so," Aldrich says of the large e-learning providers. "It will still be an exciting time in terms of innovation."

Private firms relying on venture capital to nurture them to profitability will face more scrutiny, but the amount of private equity available means the better business models will find funds. "There's always going to be funding out



"Even though there's reason for concern, there are a lot of companies that have tens of millions in the bank," notes Aldrich of the large e-learning providers.

there for a solid business model and management team," says McCrea.

Plenty more money will be needed by e-learning companies in the rush to establish themselves in "the last great cottage industry," as one consultant calls the corporate training field. A manager who has worked for three major vendors says that the sums spent in marketing themselves and wooing clients will call for plenty of capital. "The burn rates for these companies is amazing," he says.

Advice for training managers

Training managers would be wise to determine the financial strength of e-learning vendors before signing on the dotted line. Many who have been through a year of hype-laden announcements from vendors are already going that extra step.

"Today's consumers of e-learning are much more knowledgeable than a year ago," says Jefferies's Martin. "They're sending out more RFPs,

they're asking more informed questions, and they're making more careful, cost-oriented decisions."

Training departments and other users of e-learning will likely be asked to justify additional outlays in a time of cost-containment. That's where e-learning can demonstrate its value to an organization—at least in terms of raw numbers—in which employees' access to e-learning has become the digital equivalent of the traditional butts-in-seats measure. However, more sophisticated e-learning implementations that encompass assessment and skill-gap analysis tools

will come in handy when bean counters come knocking to ask for performance improvement evidence.

"The world's moving to ROI and assessment, which will be the currency of the knowledge economy," says Moe of Merrill Lynch. "When companies can provide these measures, you're going to see this market explode just like it did for IT training."

One training consultant sounds a cautionary note about falling into the same trap training has in the past in justifying the value of e-learning.

"In a recessionary period, organizations try to improve performance to help cut costs," says Tony O'Driscoll, senior consultant and researcher with IBM's e-business strategy and design practice. If a training organization is more focused on improving the efficiency of the training function than improving the business, it will come up short, warns O'Driscoll.

"You may tell your businesspeople you have the best turbo e-learning system on the planet, but it's not going to hold water unless you can translate that into how it's improving the performance of the business," says O'Driscoll. "E-learning may be hot, but if you spend some resources tying training to business goals, you're going to make a far more convincing argument." □

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