The Rule of the Marketplace

Flawed assumptions contributed to the failure of dot-coms and virtual universities

By **Katrina A. Meyer**

The critics of e-learning seem especially gleeful these days, as one after another of the dot-coms and virtual universities announces layoffs (eCollege, UNext), buyouts (Hungry Minds), bankruptcies (Pensare, ecampus.com), or closure (U.S. Open University, Fathom). What interests most of us is, why the failures? Did these organizations make mistakes that we can (and should) learn from? Or did their troubles result from failures in judgment based on unquestioned beliefs?

By any measure, the number of new companies formed in the past few years has been phenomenal, and the amount of money invested in many of these privately financed enterprises is enough to make anyone in higher education envious. They had media attention and were founded with much fanfare and high expectations. Supporters included entrepreneurs, governors, and university presidents. And, they had capital, seemingly millions of it. Why, then, did so many of them fail?

Is it because, as the critics would like to think, that e-learning has failed and distance education will soon fade from the higher education scene? Or did the declining economy make it unusually tough to succeed in a post-9/11 marketplace? Clearly, many virtual universities—state consortia, individual institutions with virtual components, and some e-learning dot-coms—have survived and are growing. Still, to the extent that even successful organizations are based on flawed beliefs, they might face challenges in the future.

Three false assumptions may explain what went wrong for the dot-coms:

- the cost of product development,
- the number and behavior of potential customers, and
- the value of traditional higher education institutions.

Cost of Product Development

Data on the cost of developing and offering a new program in higher education are rare at best. Estimates range anywhere from zero dollars (for a program supported by reallocated effort) to several millions (especially if the program requires all new faculty, office space, and equipment). The final figures for the estimate likely depend on the institution's or governing board's cost assumptions, accounting rules, and policies on the approval of new programs. For example, does the estimate include only new or marginal added costs, or must it also include the reallocated time and effort of faculty already employed by the institution?

Unfortunately, these costing procedures were put into place for traditional programs: semester-long, classroom-based, and lecture-delivered courses. The cost of developing fully online courses and programs is probably greater, but no consistent data are yet available to prove it.

Since we do not know the base costs of regular degree programs in higher education, how do we estimate costs for an online version? The Technology Costing Methodology Project[1] has found that "technology-mediated delivery is more expensive than face-to-face instruction." The extent to which it costs more depends on a number of factors, including the "amount, type, and costs of human assets utilized in the process"

of course development.[2] Developing high-quality courseware requires an instructional designer, media experts, a Web designer, and, of course, content experts. In addition, given the greater complexity of the product, it will take longer to coordinate, design, and develop, which adds to the cost.

Lastly, the technical support structure for such courses—including networks, computers, and software—also poses a substantial cost, although it cannot be attributed solely to course development because these capabilities support many functions. In any case, hardware and software are estimated to "account for only 20 percent of development costs, with the remaining 80 percent attributable to labor costs."[3] Jones[4] would agree: "Inclusion of technology and other capital costs . . . pale in comparison to the people costs in spite of the large sticker prices associated with acquisition of the capital items."

Therefore, we expect development costs for online courses to be higher. Indeed, Green[5] quoted a dot-com executive who reported that they can "easily spend a million dollars or more to develop a single online course." Does the failure of dot-coms indicate they underestimated the cost of producing quality online courses and programs? Or did they underestimate the cost of producing online coursework at traditional institutions?

Higher education institutions create new courses and programs every year. They can afford this constant innovation and curricular development because of the flexibility and creativity of faculty effort. Faculty work as many hours as needed to accomplish objectives to which they are committed. (Compare this to the popular but erroneous notion that faculty work few hours, or only those spent in the classroom.) In fact, the ability of any institution to respond to emerging initiatives with new curricula is tied to the willingness of faculty to work many hours beyond their classroom teaching obligations.

There is both good news and bad news in this situation. Faculty salaries often comprise the largest portion of the institutional budget, so institutions benefit when faculty are productive and address the continuing need for new curricula. This is the good news. The bad news is that there is a limit to faculty productivity: they are limited by the hours in a day, other obligations, training, imagination, and available resources. These limitations might also explain why new courses are developed so slowly.

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In addition to the cost of developing online courses, the cost of offering them also needs to be included. Many dot-coms adopted the model of contracting for teaching, unbundling the faculty role and separating teaching from course development and student assessment.[6] Some of the companies no doubt hoped that faculty in traditional institutions would flock to the new providers. This presumes that many faculty have the time and are willing to take on extra teaching duties beyond their current obligations; certainly, this is the case for some faculty. Or perhaps adjuncts or other instructors would take on the responsibilities of teaching in online courses and programs, as in the Open University model. In any case, the instructional cost to the dot-com would be lower than hiring faculty who require salaries and benefits and whose time must be spread over research and service obligations. On the other hand, the dot-coms would also not have access to the expandable time of those faculty to help with developing new curricula.

Still, the virtual universities and dot-coms had millions of dollars. Although it is not clear where all their money went, evidently the funds were not enough to develop the courses and programs originally desired. There might be three reasons for this.

First, the dot-coms had to fund the cost of development separately, while traditional institutions could subsidize the development of online courses and programs using faculty. Second, many of the new virtual universities opted for flashy, high-concept (and high-cost) online courses, while traditional institutions began with low-concept courses, developed by faculty with minimal, though growing, skills. Third, the dot-coms needed to spread the cost of developing programs over a large number of future students, while traditional institutions can support the development of future online courses in the budget for educating existing students.

Potential Customers

Two factors controlled the market for dot-coms and virtual universities: the number of potential customers, or market size, and their behavior. Selling education to this new market posed its own problems.

Size of the Market

Early estimates of potential students for the new higher education marketplace were based on the federal government's projection that one in seven adult workers would require some sort of professional development each year. This translates to a $300 billion per year industry, with 30 million students in the United States,[7] or 128 million full-time equivalent (FTE) students worldwide.[8] No wonder this purported market caught the attention of entrepreneurs and higher education institutions, traditional and nontraditional alike.

As with all projections, perfect knowledge is impossible, and something is invariably missed. First, the planners behind the new education providers assumed that the need for training or the desire for education would translate into millions of individuals willing and motivated to enroll immediately in an educational program. Second, they assumed that these students would choose online courses from new and relatively unknown educational providers.

Let us return to the estimate and the expectation that millions of potential customers existed and would soon materialize. Brian Hawkins,[9] president of EDUCAUSE, thought the estimate was

exaggerated in response to optimistic and unrealistic assumptions that were then applied to the rest of the industrialized world. Even if the estimates were overblown, unquestionably training is needed across all levels and segments of the labor force. Moreover, while emerging occupations require a baccalaureate degree, many of the occupations employing the most individuals (for example, service workers) are less likely to do so. In any case, the estimated massive numbers of new (or returning) students to be served by the dot-coms did not materialize.

The Behavior of Customers

So, was it reasonable to expect that hordes of potential students would flock to new education suppliers, some of them unaccredited and others carrying a name new to the educational marketplace, for a product that was untested and unknown? Was it sensible to expect the majority of traditional-age or adult students would be prepared to learn in this fashion? Or, as Burck Smith, founder of Smarthinking, concluded,

> I think some people thought that it would be much easier to change people's behavior than it really is. The technology is there, but the economics, the organization, and the behaviors of people take far longer to change.[10]

Many adults prefer online education. The quandary is how to find these potential students and convince them to try an unknown product. This is a marketing nightmare. Where can an unknown institution find adults who are amenable to online learning and want to enroll immediately?

The University of Phoenix has bought nightly television commercials in an attempt to find its market. This is an expensive marketing tool, although it might be the best way to encourage many Americans to think about further education. Once these customers are contacted, though, how does a company motivate them to enroll, sometimes in a program lasting three or four years, pay tuition and fees throughout, and do the work each class demands? Deciding to tackle this enormous hurdle takes most students quite a bit of time—it demands a major commitment. Failing to understand this hesitation causes false assumptions about the probable behavior of potential students.

Convenience Versus Learning

These two errors—incorrectly sizing the potential market and misunderstanding its true desires—might be the fundamental causes of a mismatch between the early entrepreneurial organizations and their environment. They bring us to the last quandary of marketing online higher education: balancing the selling of convenience with the rigors of learning.

Education is a substantial cost to the student in terms of time, money, and effort. It has been termed an investment in the student's future, something that will create economic, professional, and personal returns worth a heavy commitment of time, money, and effort. As education is increasingly offered through asynchronous online programs, surely it will become more convenient for students to pursue an education at a time and place better for them.

Convenience should not be construed as making learning easier, however, or less deep, complex, and challenging. In other words, the challenge must rightly move away from students' having to negotiate their family and work commitments to attend classes on campus and toward achieving a level of learning produced by involvement with the course or program.

The Competitors

The main competitors to the new dot-coms were the emerging e-learning efforts of traditional institutions. These institutions continue to be held in high regard—not always deservedly, but they benefit from their good reputation nevertheless. This public regard is the greatest advantage colleges and universities have when it comes to competition with new, unknown providers.

Many traditional institutions have created angry non-customers, however, by their approach to adult learners. This includes, but is not limited to, offering courses only at the convenience of faculty, not easily accepting the transfer of credits, requiring seat time, and providing less-than-current curricula.

These policies created a backlash from potential customers, making them willing to try any new provider. The enrollment figures for the University of Phoenix—currently around 133,700 students, of which 49,400 are enrolled in online programs[11]—might reflect the size of this market of customers who are angry at their local colleges and all too willing to see what the new provider will offer.

Nonetheless, e-learning at many traditional institutions has grown enormously. From fall 1995 to academic year 1997–98, the number of distance learning courses and degree or certificate programs doubled, from 25,730 to 52,270 courses and from 860 to 1,520 programs. Student enrollments also doubled, from 753,640 to 1.6 million enrollments.[12]

In other words, traditional institutions turned into worthy competitors to nontraditional providers—despite ample room for improvement. It seems that the local college advantage is not easily discounted, even though loyalty to an institution can and has been lost by poor policy, rude behavior, and bad decisions affecting students.

Perhaps traditional higher education institutions had an advantage because the market was different (in both size and customer preferences) than originally thought. The dot-coms' misperception of adults' willingness to pursue a radically new form of education was a serious error. Much of the adult population expected education to resemble that provided by traditional higher education institutions. Of course, expectations can and do change.

Traditional institutions might also have had an advantage when it came to understanding students' technical limitations. There is a clear disconnect between the push for more sophisticated applications, including film clips and visuals, and the technical limits of students' home computers, Internet service providers (ISPs), and patience, despite strides in making more bandwidth available to more places.

Ignoring students' technical capabil-

ities and their ability to pay current ISP rates might have seriously hindered the success of more flashy, high-concept online courses. On this point, the traditional institutions (with their need to train faculty and their subsequently slow rates of innovation) might have inadvertently provided more appropriately designed courseware for the majority of students.

Lessons from the Dot-Com Battlefield

What, if anything, can we learn from the dot-com battlefield and the decline of some virtual universities? The lessons might be fairly basic ones.

First, any new business must know its potential customers: how many there might be (estimating pessimistically), how they think, what they expect, and what it will take to have them buy this new product. Trusting that they will come once you "build it" is not wise. "Everyone was hoping that you would just sort of come to the Web and people would just log on and use the services, and that would be that."[13] Clearly, hoping it will all work out as one supposes does not represent sound business planning.

Second, new providers must have a comprehensive understanding of their product, especially how buying a higher education differs fundamentally from buying a car or even a house. While convenience is increasingly important to students, higher education customers work very hard for their educations and sacrifice a lot. Value for money (or effort) may be just as important a concept to students.

Third, providers need to know their cost of production, both for their own product and for those of their competitors. The ability of traditional institutions to subsidize the creation of new online courses and programs meant that independent dot-coms had to find the resources to pay for this development. Because "competitive advantage will accrue to those who deliver such education cheaper, better, or in a more targeted fashion,"[14] the cost of production must allow for a competitively priced, but high-quality product. This is not easy.

Fourth, new providers need to know and understand how their competitors' reputations and current offerings affect customers' behavior. Never underestimate the competition, especially their ability to read the marketplace and to experiment and improve.

More Lessons

Let us on campus not rejoice at this situation. If traditional institutions have prospered in the face of competition from some dot-coms and virtual universities, it might not have been due to better planning or wiser execution. The declining economy may have played an enormous role in pushing the new and fragile dot-coms to close. In this case, a reviving economy and better-planned dot-coms could emerge again to compete with traditional institutions.

The marketplace for learning will continue to change as large numbers of adult workers face layoffs and students enroll with greater expectations for online learning. For traditional institutions in years past, pursuing slow but steady growth and experimentation seems to have been a good choice. This approach might not work as well in an economy that is less forgiving and more demanding of convenience, product relevance, and programs that will help students survive in an increasingly uncertain economy. In other words, the market forces that created the initial rush to dot-coms and virtual universities could well reappear in the future. While the past few years might have been a difficult time for these new entities to launch their operations, future conditions may be more welcoming.

Foretelling the future is a dangerous occupation, yet it seems likely that new forms of higher education will continue to evolve. Perhaps after this rough spell, any new forms will be better planned and based on fewer misconceptions. Customer demands will catch the attention of a wiser group of entrepreneurs (in new organizations and traditional institutions alike), and education will remain a growth enterprise. Be assured, the creative spirit of institutions and faculty will continue to pull, tug, flex, and transform existing institutions into new models, but better and wiser dot-coms could make complacency among higher education institutions a dangerous indulgence. *e*

Endnotes

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