

Steve Casburn
1 December 1998
LIS 387.9 - Lennon

**Information Marketing Final Paper:
A Study of Knowledge Universe**

Introduction

As the sizes of many public (and formerly public) services have grown during the last 60 years, they have been transformed in the public mind from services into industries. Where there was once "army procurement," there is now "the military-industrial complex." Where there were once "hospitals," there is now "the health-care industry." And where there are now "schools," we can soon expect to find "the education industry."

At the forefront of developing this nascent industry is Knowledge Universe, a privately held corporation owned by former "junk bond king" Michael Milken, his brother Lowell, and Oracle CEO Lawrence Ellison. With a combined personal net worth of about \$7 billion (and the ability to raise as much additional capital as they need), the Knowledge Universe owners could become the dominant players in the \$650 billion education market.¹

Knowledge Universe: The Market

Like the American military in 1940 and American hospitals in 1970, American K-12 schools are confronted with an array of new challenges and new costs that threaten to overwhelm its current structure. The pace of technological innovation is making life-long learning a necessity and up-to-date school supplies ever more expensive. Many public schools, especially along our borders and coasts, are straining under the burden of teaching immigrant children from dozens of different countries. The school buildings themselves, many of which were built in the 1950s and 1960s for the Baby Boomers, are in many cities falling apart because of age and neglect.

American universities, once the pride of the nation and the envy of the world, are also increasingly troubled. From 1990-91 to 1994-95, state funding for public universities increased by only 0.4% in real terms, while enrollment rose by 2.6%.² As universities require more and more research money to keep their doors open, professors are spending less and less time teaching. And professors who do teach sometimes wish they didn't, as right-wing critics assail the academy as being a haven of "political correctness."

These problems and controversies in the American educational system have led to increasing public support for choice in education. In a 1996 Gallup poll, 36% of those polled favored "allowing students and parents to choose a private school to attend at public expense."³ Parents want their children to have a greater variety of educational choices. Corporations want to stop paying for remedial education for their employees so that they can allocate more money to re-training. Older Americans want to gain or regain basic skills without the embarrassment of going back to high school. [Kotler, 148-64]

The amount of revenue that awaits a company that can address these needs is mind-boggling. A company that could capture five percent of the education market would have an annual revenue of \$32.5 billion, vaulting it into 23rd place in the Fortune 500, between Amoco and Kmart.⁴

Knowledge Universe: The Players

Enter Michael Milken.

Five years ago, Milken's controversial career seemed to be at an end. In February 1993, he was released from federal prison after serving 22 months and paying a \$1 billion fine for six counts of felony securities fraud.⁵

Still ahead of him were 5,400 hours (135 full-time weeks) of mandatory community service.⁶ Then, shortly after his release, Milken was diagnosed with prostate cancer.

Rather than give up quietly, Milken took up the dual challenge of staying alive and rehabilitating his tarnished reputation. In the summer of 1993, while undergoing successful chemotherapy, he founded (and half-funded) a \$40 million organization called CaP CURE to coordinate research into a cure for prostate cancer. And in 1996, after several years of giving annual awards of \$25,000 each year to 150 top teachers through his Milken Family Foundation (he has given away a total of \$30 million to date)⁷, he contacted Lawrence Ellison about forming a company called Education Technology.⁸

Ellison was a natural partner for the enterprise, with a background in management and technology to match Milken's expertise in attracting capital and publicity. The 54-year-old Ellison founded Oracle in 1977, and has been its chief executive officer as the company has grown into the world's leading database management company.⁹ (In addition, Oracle's \$400 million training subsidiary is the second-largest computer training company in the world, behind IBM's.¹⁰) Oracle is 280th in the 1998 Fortune 500, with

annual revenues of \$5.7 billion¹¹, and Oracle stock holdings have helped Ellison amass a personal fortune estimated at \$6 billion.¹²

But it is the 52-year-old Milken who is clearly the center of Knowledge Universe - both its greatest strength and greatest weakness. On the one hand, Milken's unprecedented success at restructuring the securities market in the 1980s is what gives investors unlimited faith in his ability to restructure the education market in the 1990s.¹³ His influence extends to politics as well: Los Angeles mayor Richard Riordan is a friend, all four ex-presidents are board members of CaP CURE, and President Clinton returns his telephone calls.¹⁴ On the other hand, Milken's unsavory reputation has served as a highly conductive lightning rod for critics of the privatization of education, and his "control freak"¹⁵ management style works better for securities trading than for running a \$1 billion company.

Ellison's presence in Knowledge Universe is important, but it is Milken whose actions and decisions will make or break the company.

Knowledge Universe: Its History and Composition

As its original name indicates, Knowledge Universe was initially established by Milken and Ellison to explore profitable uses of technology in education. Shortly after the company's 1996 founding, Milken expanded its scope from technology in education to the vertical integration of the education industry¹⁶, and increased its capitalization from \$300 million to \$500 million (\$250 million from Ellison and \$125 million each from Michael and Lowell Milken¹⁷). Their initial goal for the company was to gain "10% of the \$100 billion global market for continuing education, at-home products, and similar products."¹⁸

Knowledge Universe's revised mission statement reflects this increased scope: "To help improve and enrich 'Human Capital' from birth to post-retirement and to provide life-long learning opportunities for individuals and corporations."¹⁹ [Kotler, 68-69] In a 1996 interview, Milken said he believed that "entertainment, technology, telecommunications, and education will continue to come together to create a new dynamic for education."²⁰ [Kotler, 81]

Milken seems to be ready to exploit that new dynamic. When he decided to expand the company, Milken divided the

education market into 31 segments and prepared a separate plan to enter into each segment.²¹ [Kotler, 249] Because he has so many possible directions in which he can move and because he can draw on practically unlimited amounts of capital, Milken has been able to move in quickly on every can't-miss opportunity that he finds. According to one account, Knowledge Universe "targets firms in turmoil that could be snapped up on the cheap and then rapidly expanded through marketing savvy and financial help."²² [Kotler, 241-44]

From its two headquarters (one near Silicon Valley, one near Milken's home in Los Angeles), the Knowledge Universe corporate office coordinates the eight subsidiaries that the company has acquired, as well as the three new divisions which the company has created. (Knowledge Universe also owns minority stakes in several education-related companies, including Mattel, Hasbro, and Nobel Education Dynamics²³). The 11 current parts of Knowledge Universe are:

1. *Bookman Testing Services* - specializes in proficiency testing for computer professionals. Established in 1979, bought in 1998.²⁴
2. *Children's Discovery Centers of America* - operates 250 day care centers and 14 elementary schools.

- 1997 revenues: \$93 million; 1997 profits: \$2.5 million.²⁵ Bought in 1998 for \$85 million.²⁶
3. *Knowledge Universe Interactive Studio* - will develop interactive educational products.²⁷ Still in planning stage.
 4. *Knowledge Universe Publishing* - will create, distribute, and publish materials for the subsidiary companies and the general public.²⁸ Still in planning stage.
 5. *Knowledge University* - will provide on-line college-level and/or continuing education courses.²⁹ Still in planning stage.
 6. *LeapFrog Toys* - produces educational toys for children aged three to eight. Established in 1995,³⁰ bought in 1998.
 7. *MindQ Publishing* - provides computer-based training software for the Java programming language and Microsoft Office. Established in 1993, bought in 1998.³¹
 8. *Nextera Enterprises* - provides advice for corporations about how to leverage their human capital. 1997 revenues: \$76.5 million; 1997 losses: -\$7.4 million.³² Established and bought in 1997.³³ IPO offered in October 1998.³⁴ (Knowledge Universe has acquired and now runs several small consulting firms through Nextera.³⁵ Total acquisition cost: \$80 million.³⁶)
 9. *Productivity Point International* - provides training for a wide variety of technical products. Trained more than one million students in 1997.³⁷ Bought in 1997.

10. *Spring* (formerly the CRT Group) - the leading training and personnel services company in the United Kingdom. Knowledge Universe's first acquisition (a 48% stake), in August 1996.³⁸ Cost: \$169 million.³⁹
11. *TEC Worldwide* - provides training and support for corporate CEOs.⁴⁰

As the above list shows, Knowledge Universe has focused its initial acquisitions on beginning to "create a comprehensive line-up of services"⁴¹ in the high-margin, high-growth area of corporate training (1,7,8,9,10,11). It has also bought two children's companies (2,6) and established what will become its core divisions (3,4,5). The company seems to be establishing footholds in areas in which it can make an immediate profit while it readies its basic corporate infrastructure to support further expansion. So far, the strategy has been successful -- one current estimate of Knowledge Universe's market value is \$4 to \$6 billion, several times its initial capitalization of \$500 million.⁴²

Knowledge Universe: Its Competition

Like Microsoft in the software industry, Knowledge Universe is in the enviable position of having no real

competitors, *per se*. No other company is trying to vertically integrate the education market, and no other company is currently in a position to do so.⁴³ Knowledge Universe's combination of an early start and unlimited access to capital will be as hard for a competitor to overcome as Microsoft's near-monopoly in PC operating systems and \$14 billion bank account.

But Knowledge Universe (again, like Microsoft) does face a discrete set of competitors -- some of them strong and well-established -- in each market segment.

In the corporate training market segments, Knowledge Universe's corporate foes include DeVry (1997 revenues: \$352 million), ITT Educational Services (1997 revenues: \$262 million), Sylvan Learning Systems (1997 revenues: \$246 million), Learning Tree International (1997 revenues: \$165 million), and CBT Group (1997 revenues: \$118 million).⁴⁴ (Estimates of the number of companies providing corporate training services run as high as 53,000⁴⁵ -- it is a highly splintered market.)

In the childcare and preschool market segments, Knowledge Universe must contend with KinderCare (1997 revenues: \$597 million) and ARAMARK (1997 total revenues: \$6.3 billion; revenues from childcare operation unknown).

Knowledge Universe can afford financially to continue to bide its time and wait for relatively risk-free opportunities to expand into other market segments. However, if doing so allows determined competitors time to consolidate strong positions in the two large segments of the education market that Knowledge Universe has not yet entered -- namely, K-12 and university education -- then this strategy might prove to be a serious blunder.

[Kotler, 233-38]

Knowledge Universe: Its Prospects

The education market of the late 1990s is beginning to resemble the oil market of the early 1980s: it is expanding so fast that only a fool would lose money in it.

Michael Milken is no fool.

At a time when more and more people are willing to pay more and more money to receive more and more education, Milken had the foresight to line up the capital to build a company to satisfy these potential customers.

The marketing challenge now facing Knowledge Universe is to establish its brand name.⁴⁶ If Knowledge Universe can make its name synonymous with "high-value life-long learning," then they could very well end up as the largest

privately held corporation in America. [Kotler, 46-49; 442-45]

Knowledge Universe has started its long-term branding efforts at the right end of the life cycle. If it can establish a preference for Knowledge Universe products among the parents of pre-schoolers, then those parents will go on to look for Knowledge Universe affiliated elementary schools, junior high schools, and so on (it is no coincidence that Knowledge Universe is beginning to acquire private elementary schools). In Kotler's terms, what Knowledge Universe is doing is beginning with a strategy of "selective specialization," which will set the company up for its eventual strategy of "full market coverage." [Kotler, 269-72]

The growing popularity of charter schools gives Knowledge Universe an excellent opportunity to break into the public K-12 market. Charter schools are "publically funded schools run by special community groups or foundations independent of local school districts."⁴⁷ About 1,000 charter schools currently exist. Obviously, Knowledge Universe can't buy such schools, but its publishing subsidiary can provide them with specialized

curricular materials; a market that traditional textbook publishers are ill-equipped to enter.

Knowledge Universe is also in a better position than potential competitors to take advantage of another on-going development: high-speed Internet access. As cable modems become available during the next five to ten years, people will be able to access real-time, high-quality video through their home computers. Knowledge Universe has the money to hire a whole stable of well-known professors to offer a high-end series of on-line, interactive university courses.⁴⁸

Expansion into the K-12 and university markets would also have a synergistic effect on Knowledge Universe's core publishing and interactive media subsidiaries. The company seems to be moving toward spinning off common shares of its acquired subsidiaries (while retaining 100% of the voting shares)⁴⁹, but it will probably keep full ownership of its core groups. It makes sense, then, for Knowledge Universe to start turning those core groups into productive profit centers as soon as possible.

Because Knowledge Universe is privately held, there are no reliable public estimates of its overall profitability. However, given the nature of the companies

that it has bought and the growth in its estimated market value, it is a safe assumption that the company is currently turning a profit. If Knowledge Universe continues to follow its opportunistic and careful strategy of buying companies, then it should remain profitable for the foreseeable future.

Conclusion

Knowledge Universe has the makings of a powerful education conglomerate. It has practically unlimited capital behind it. It has a clear vision. It has no real competitors. It occupies a large and rapidly growing market. It has some of the right pieces (and no wrong pieces) in place.

The company still faces several pitfalls, however. The "Knowledge Universe" brand name is far from established, and one or two well-publicized scandals involving its subsidiaries could hurt it for years (school privatization maven Chris Whittle found out the painful way a few years ago that parents can be very sensitive about their children's education).⁵⁰ [Kotler, 468-71] Knowledge Universe is still a relatively small and fragile company (its expected revenue for 1998 is \$1.4 billion⁵¹), and any

tragedy involving Michael Milken (a recurrence of cancer or return to prison) might leave it dead in the water.

Milken's management style might drive away capable executives (his initial choice for vice-chairman -- and de facto CEO --resigned after three months on the job, citing Milken's continual interference as the reason⁵²), and his unsavory reputation might drive away customers.⁵³

Many things could go wrong for Knowledge Universe.

The smart money, though, says that Michael Milken will once again be Master of the Universe.

¹ "<http://www.hoovers.com/features/industry/nonav/schools.html>"; 18 November 1998.

² Calculated from Tables 38, 173, and 322, *Digest of Education Statistics 1997*. Washington, DC: U.S. Department of Education, 1997.

³ Table 24, *Digest of Education Statistics 1997*.

⁴ "<http://www.pathfinder.com/fortune/fortune500/500list.html>"; 1 December 1998.

⁵ Deutschman, Alan. "Up the Green Staircase." *GQ*. October 1998.

⁶ Kasindorf, Jeanie Russell. "What to Make of Mike." *Fortune*, 30 September 1996.

⁷ Deutschman, *ibid*.

⁸ Kasindorf, *ibid*.

⁹ "Ellison, Lawrence J." *Who's Who in America 1999*. Marquis Who's Who: New Providence, NJ, 1998.

¹⁰ Martin, Justin. "Lifelong Learning Spells Earnings." *Fortune*. 6 July 1998.

¹¹ "http://www.pathfinder.com/fortune/fortune500/500list2_251.html"; 30 November 1998

¹² "<http://www.forbes.com/asap/tech100/>"; 18 November 1998

¹³ Vrana, Debora. "Education's Pied Piper with a Dark Past." *Los Angeles Times*. 7 September 1998.

¹⁴ Kasindorf, *ibid*.

¹⁵ Deutschman, *ibid*.

¹⁶ Nocera, Joseph. "If Mike Were 25..." *Fortune*. 30 September 1996.

¹⁷ Morris, Kathleen and Lisa Sanders. "Dealmakers: Professor Milken's Lesson Plan." *Business Week*. 4 August 1997.

¹⁸ Crock, Stan. "Up Front: A New Universe for Milken to Master." *Business Week*. 28 April 1997.

¹⁹ "<http://www.knowledgeu.com/vision.html>"; 1 December 1998

²⁰ Nocera, *ibid*.

²¹ Martin, *ibid*.

-
- ²² Feldman, Amy. "Milken's New Empire Amasses Education Companies Worth \$1B." *New York Daily News*. 23 March 1998.
- ²³ Deutschman, Alan. *ibid.*
- ²⁴ "<http://www.teckchek.com/company/companyinfo.html>"; 18 November 1998.
- ²⁵ "<http://www.hoovers.com/capsules/12970.html>"; 18 November 1998.
- ²⁶ Dow Jones News Service. "Milken-led company buys education firm." 1 April 1998.
- ²⁷ "<http://www.knowledgeu.com/companies.htm>"; 15 November 1998.
- ²⁸ *ibid.*
- ²⁹ *ibid.*
- ³⁰ "<http://www.leapfrogtoys.com/areas/about/about.html>"; 1 December 1998.
- ³¹ "<http://www.mindq.com/corporate/corporate.html>"; 18 November 1998.
- ³² "Consulting Firm, a Milken Investment, Plans IPO." *Los Angeles Times*. 25 September 1998.
- ³³ "<http://www.nextera.com/corporate.htm>"; 18 November 1998.
- ³⁴ Bailey, Steve and Steven Syre. "The Latest Incarnation of Milken." *The Boston Globe*. 14 October 1998.
- ³⁵ Vrana, *ibid.*
- ³⁶ Bailey and Syre, *ibid.*
- ³⁷ "<http://www.knowledgeu.com/companies.htm>"; 15 November 1998.
- ³⁸ Martin, *ibid.*
- ³⁹ Nocera, *ibid.*
- ⁴⁰ "<http://www.knowledgeu.com/companies.htm>"; 15 November 1998.
- ⁴¹ Morris and Sanders, *ibid.*
- ⁴² Martin, *ibid.*
- ⁴³ Martin, *ibid.*
- ⁴⁴ All revenue figures are from "<http://www.hoovers.com/>"
- ⁴⁵ Martin, *ibid.*
- ⁴⁶ Vrana, *ibid.*
- ⁴⁷ "<http://www.hoovers.com/features/industry/nonav/schools.html>"; 18 November 1998.
- ⁴⁸ Woody, Todd. "The Riddle of Knowledge Universe." *The Industry Standard*. 13 July 1998.
- ⁴⁹ "Consulting Firm, a Milken Investment, Plans IPO." *Los Angeles Times*. 25 September 1998.
- ⁵⁰ "<http://www.hoovers.com/features/industry/nonav/schools.html>"; 18 November 1998.
- ⁵¹ Schmit, Julie. "Milken's venture: Reading, Writing, and Returns." *USA Today*. 21 July 1998.
- ⁵² Deutschman, *ibid.*
- ⁵³ Woody, *ibid.*