

McGraw-Hill: GradeSummit

Faced with several business deals up in the air, and a handful of other challenges, Michael McLean ponders the next step for his department's latest online product. As he stands to leave for a meeting with Ed Stanford, president of McGraw-Hill Higher Education, he turns, looks out the window, of his fifth-floor office and notices the large "Lifetime Fitness" sign glaring out at him from the next building. "That's exactly where I need to be," he sighs, and leaves the office.

In April 2002, Michael McLean, the Executive Editor for Testing and Assessment at McGraw-Hill Higher Education faced several challenges within one of McGraw-Hill's newest online initiatives. Pressures from used books, competing technologies, and insufficient resources had made it much more challenging to grow his online business. In addition, he needed to reconsider his targeting strategy and determine the most viable bundling strategy to move forward his Testing and Assessment Product group.

With the ongoing changes in the marketplace, McGraw-Hill Higher Education is constantly challenged to provide innovative solutions both online and offline to meet the evolving needs of its consumers, while at the same time maintaining a competitive edge in authorship and intellectual capital. In addition, it is constantly seeking new business opportunities outside the core textbook space to create new revenue streams.

In September of 2001, McGraw-Hill Education officially launched GradeSummit, its new online testing and assessment product for higher education. The online diagnostic tool provided a more efficient way for students to assess their learning and improve their grades. Instructors also benefited from having to spend less time monitoring and tracking students' learning needs. After successfully completing its beta trial during the summer of 2001, GradeSummit seemed to be a product with significant promise.

This case was prepared by Evelyn Hsia (T'02, MBA Fellow, Center for Digital Strategies) and Professor Yiorgos Bakamitsos, with the assistance of Professor Hans-Ch. Brechbühl of the Tuck School of Business at Dartmouth. It was written as a basis for class discussion and not to illustrate effective or ineffective management practices. The authors gratefully acknowledge the support of the Glassmeyer/McNamee Center for Digital Strategies, which funded the development of this case. Version: January 2003.

The Book Publishing Industry

The U.S. Book publishing industry is a highly fragmented market. In 2001, it generated \$25.4 billion, a tiny 0.1% increase over 2000¹. It has undergone numerous consolidations over the past two decades and emerged as a three-tiered industry, with a few dominant players, some medium-sized publishers, and lots of small players. In 2000, six dominant publishers consisting of Bertelsmann (Random House), McGraw-Hill, Scholastic Corporation, News Corporation Limited, Viacom and Time Warner Publishing, held 31% of the total market share (Exhibit 1²), with McGraw-Hill itself grabbing 6% of the market. For more details on the publishing industry, see Appendix A.

Education Market

The educational book segment achieved the largest share of publishing revenue in 2000 with a 27.9% increase over the previous year. The segment saw US sales of \$7 billion and an annual growth rate of 7.7% during 1996-2000.³

In the book publishing industry, college textbooks are generally the most profitable since they have lower production costs, higher cover prices due to lower sales volume, and are not subject to government guidelines. This segment saw sales of \$3.47 billion in 2001, a 7.2% increase from 2000⁴. However, the high price tag of new educational materials has encouraged a stronger market for used textbooks. The used textbooks market accounts for 20%-40%⁵ of college book sales. Publishers try to counter the reduced demand for new titles by introducing new editions every few years.

College texts are sold directly to students through college or private bookstores. These channels accounted for 79%⁶ of sales in 1996. However, in recent years, the Internet has played a larger role in student purchases, and has likely reduced the college bookstores' share of this market.

The major book publishing companies focusing on higher education in 2002 are Pearson, International Thomson, McGraw-Hill, Houghton Mifflin, and John Wiley. In college publishing, McGraw-Hill is the number 3 player behind Pearson and Thomson.

Trends

The educational book sector is expected to be the most dynamic segment of the market, with predicted sales growing by 21% between 2001 and 2005. These optimistic projections are fueled by a number of factors, such as a baby boom in the next three years (10-14 year olds)⁷, increases in enrollments in schools and colleges, more technical and scientific job opportunities, and greater funding for libraries and other learning institutions. As education

¹ American Association of Publishers: March 1, 2002 (<http://www.publishers.org/stats/index.htm>).

² Euromonitor: Books in the USA: Market Size for 2000.

³ Euromonitor: Books in the USA: Market Size for 2000.

⁴ Publishers Weekly: Industry Sales Flat in 2001 at \$25.4 Billion, March 4, 2002.

⁵ Standard & Poors: Publishing, March 14, 2002.

⁶ Standard & Poors: Publishing, March 14, 2002.

⁷ Publishers Weekly: Industry Sales Flat in 2001 at \$25.4 Billion, March 4, 2002.

has become a more critical factor for jobs and advancement opportunities, an increasing number of young people are going on to college, and many more adults are returning to school to further their education. The average higher education consumer is older than in the past. In 2000, more than 51% of consumers fell within the 35–44 age group.

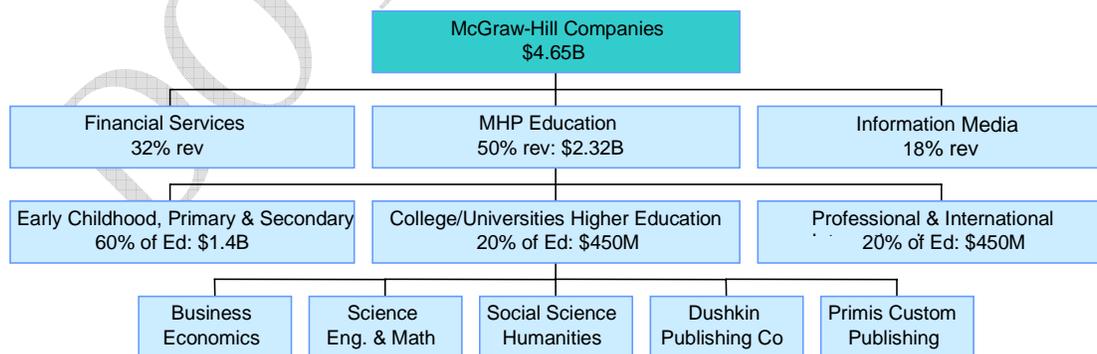
The need for accountability and standards has recently created a potential market opportunity for assessment and achievement products. The industry is also encouraging customized, tailored learning to help individual students. Digital technologies are starting to play a greater role in educating and connecting teachers to students and parents. Such products allow teachers to plan lessons, maintain grade books, post assignments, and communicate with students and parents online. Some products even provide homework, grading, tutorials, and diagnostic testing capabilities, which can be accessed instantaneously online. Companies such as McGraw-Hill, Pearson, Houghton Mifflin and Grolier (Scholastic) provide online supplemental materials to parents, teachers and/or children online. It is cheaper and more efficient to mass-produce and distribute this information in a digital form.

McGraw-Hill and Higher Education

McGraw-Hill Publishing (NYSE; MHP) was incorporated in 1925. It is a leading producer of educational materials today. MHP has three main divisions; Financial Services (Standard & Poor's), Information and Media Services (Business Week and other magazines and television stations), and McGraw-Hill Education. Details of these divisions are outlined in Appendix B.

McGraw-Hill Education is a leading global educational publisher which contributes 50% of the company's revenue (Exhibit 3). Higher education is the largest business unit within McGraw-Hill Education. Figure 1 below shows the company's organization, and a break down of McGraw-Hill Education.

Figure 1: McGraw-Hill Organizational Structure



Economic Environment

With the dramatic and exhilarating rise of the Internet during the years 1996-2000 many firms, new and old, large and small, took the opportunity to jump into the web, but the subsequent crash in late 2000 brought about the first recession of the new millennium. The impact was so great that revenues of both large and small firms alike suffered in the ensuing year. McGraw-Hill was no exception, although it was hit nowhere nearly as hard as some other firms in the industry. In the book publishing industry, the recession put some pressure on demand, but overall sales were still up 1.9% in 2001.⁸ As companies rush to streamline their operations and cut costs, advertising expenditures were also tightened. The economic environment of 2001 posed challenges for all divisions, particularly education and media, although media was affected the most since it generated a significant amount of revenue from advertising.

Corporate Strategy

McGraw-Hill's overarching corporate strategy is to provide a vast selection of products and services, while continually innovating to find new technologies and new forms of delivery.

McGraw-Hill is positioned to provide a broad range of products to meet the growing needs of learners from pre-K to career. As a leading US testing and supplementary materials publisher, it has lessened its own reliance on uneven revenue streams associated with education adoption cycles. Testing and supplementary products do not face these cyclical issues and can be purchased by states at any time. They account for a significant growth opportunity for the future.

McGraw-Hill Education

While McGraw-Hill Education generates about half the firm's revenue, it only produces a third of its profit⁹. Its operating margin is lower than the Financial Services division and only slightly higher than Information and Media Services. Analysts believe that more scale in the college market can help McGraw-Hill Education's position. They also believe that McGraw-Hill Education's focus in education should be on capital efficiency rather than growth. McGraw-Hill Education's college revenue was around \$450M in 2001.

Within McGraw's Education division, its growth strategy is to:¹⁰

- Be the preferred e-learning solution
- Increase online programs for higher education
- Push e-books and other technologies
- Expand national presence of the McGraw-Hill learning network

⁸ Standard & Poor's Industry Surveys: Publishing, March 14, 2002.

⁹ Credit Suisse First Boston Analyst Report: April 22, 2002.

¹⁰ McGraw-Hill Annual Report 2000.

The K-12 industry is not a capital efficient business since free manuals and materials are frequently distributed and ongoing market share wars are constantly being waged in a consolidated marketplace. This segment has less adoption opportunities than in the past, but may benefit from the recent Federal Education bill to provide funds for reading programs. This bill would ultimately impact 2002 sales provided the funds were given before classes started in September.

In the Professional publishing division, the sluggish economy has not helped programs to take off as quickly. However, the division should benefit from its upcoming release of Encyclopedia of Science and Technology, as well as other future offerings.

International publishing realized strong growth in the Asia-Pacific market and in Canada. But Latin America, its largest operation saw a dramatic decline which offset all the gains by this division.

Higher Education, the single largest business unit within McGraw-Hill's Education division, experienced increased revenue contributions and more stable revenue streams than all other divisions.

Supplemental product publishing is another good business unit with higher margins, lower capital intensity, and brighter growth prospects. McGraw-Hill bought Tribune Education's supplemental business in 2000 and its focus on the supplemental market is to drive growth and provide capital efficiency.

Of the three subsections within Higher Education (business and economics, science engineering and math, social science and humanities), business and economics is the strongest unit with dominant market positions in several disciplines while the other two have solid performance. All three function as silos. They each have their own separate departments, management teams, organizational structure, and sales teams. Although the organization tries to reduce redundancy and increase efficiency and resource sharing across the groups, it is extremely difficult to execute. However, there are tremendous benefits to this structure. Each section can tailor its presentations and services to the needs of its customers. More customized offerings and a closer understanding of their target customers has allowed them to provide better and more effective offerings.

MHHE Marketing Strategy

Over the past several years, McGraw-Hill has made steady progress in expanding its sales efforts, increasing its profitability, and taking market share from their largest competitor, Pearson, by leveraging its better sales organization. However, McGraw-Hill still needs to increase its scale in the college category in order to cover the cost of giving away manuals and materials for promotional purposes.

The higher education marketplace is fairly price competitive although margins are higher in this segment. Many consumers view these products as commodities and expect publishers to price accordingly. McGraw-Hill Education's efforts to market textbooks to professors, has created many "value added" solutions such as instructor manuals, overhead transparencies,

test banks and suggested exams. These “value-adds” come bundled with the instructor’s version of the book.

McGraw Hill Goes Online: Challenges & Issues

Computers began to enter the publishing world in the early 1970s, first as a back office tool for keeping track of inventories, recording sales, and generating invoices, and later expanding into desktop publishing. The incredible growth and deployment of the Internet in the last decade has changed the landscape of publishing. The Internet allowed the distribution of electronic files that was not possible using traditional digital methods.

The advantage of this transformation is that ink and paper are no longer required. An electronic file can take a variety of different shapes and forms. It can be used to generate a printed text, translated into different file formats, transmitted across the Internet, linked to video and audio files for multimedia display, contain dynamic links to other files, and incorporated into searchable databases. The drawback is that electronic files cannot be read directly, but must be accessed through some medium (computer) that is compatible with the original medium used to create the file.

In this digital age, professors are increasingly pressured to incorporate more and more digital or e-learning materials into their teaching. In an effort to reap more revenues from existing products, publishers are packaging digital materials with their textbooks and encouraging professors to buy and use these materials.¹¹ These digital technologies range from tools that provide tutorial services, to databases with information on books, digitized books, and online research portals.

John Wiley & Sons created a digital tutorial service, eGrade which provides online practice problems, as well as adam.com, which provides access to a database of book materials. McGraw-Hill Companies, Pearson, Houghton Mifflin, and Wiley offer digitized books online through various vendors as well as custom services allowing professors to aggregate content from different sources. Although custom publishing is only about 5% of the market, it is growing rapidly. Ebrary.com, Pearson’s joint deal with EBSCO info services, and McGraw-Hill provide an online research portal. Also in 2001, Vivendi’s Houghton Mifflin unit introduced online versions of its most popular titles using Rovia Inc’s web-based platform. The offering included interactive quizzes, ‘one-click’ connectivity to web links, customizable notes (including highlighting, book-marking, and exporting content), and professor communications (annotations and notes).

At the turn of the millennium, there was considerable interest in e-books and e-publishing. As a consequence, publishers and firms started to produce a substantial number of electronic books. However, sales in e-books have not grown as quickly as expected.¹² The main reason for this lack of growth is the e-books device-dependence that require tablets in order for them to be read. Unfortunately for the e-book publishers, these tablets are not as widespread as would be necessary for the proliferation of e-books. According to Jupiter Media Metrix, there

¹¹ Publishers Weekly: April 2, 2001.

¹² Wall Street Journal: March 5, 2002.

were only 100,000 in use at the end of 2001¹³. However, some experts still say this industry is expected to reach \$1 billion by 2005, and will soon represent 25% of textbook sales¹⁴.

Online Learning Dynamics

Online testing is a new phenomenon. True functional online testing has many challenges. One huge issue is the lack of security in online exams. Unless there is either a biotechnology that ensures the identity of test takers, or a proctored room for people to take the test, online testing will not be accepted as a reliable source for high-stakes testing. The former has no executable solution that has been proposed, but the latter is already in existence in many test-taking environments such as those for standardized entrance tests like the MCAT or GMAT.

In the online learning market, there are a number of forces influencing power and control. According to Michael McLean:

“Several forces are at work. Content is king, and our competitors and we have the intellectual capital and content. However, online learning is also keenly about delivering the content and who owns the proverbial “pipe” for that delivery. Will it be a third party platform company like Blackboard or the universities themselves or the publishers or a late arrival that develops a breakthrough technology like a Microsoft?”

There are a number of issues with online testing. First of all, there is always the issue of privacy and loss of face time with professors. On the professor’s side, the issue is on ensuring identity.

GradeSummit

GradeSummit is a diagnostic online self-assessment and exam preparation tool for students. It instantly measures their learning needs and helps them to focus their study time. GradeSummit is a low-stakes tool, which allows students to understand their strengths and weaknesses before they take the real exam. It is a tool that allows students to assess their learning and improve on their understanding of the subject matter. It is not used for high-stakes testing or grading due to security and technical barriers. The technology is similar to existing solutions from The Princeton Review, Kaplan, and others in that it provides students with diagnostic feedback on areas in which they need improvement. However, the benefit of GradeSummit is that it is tied to course texts and other materials. It enables students to learn faster and more effectively with instant feedback, tracking, and reporting. Students can also compare their performance to their class, school and other groups.

To the instructors, GradeSummit provides a diagnostic reporting tool for both individualized instruction and large lectures, and could potentially reduce their office hour commitments. GradeSummit also offers instructors the ability to create and manage graded online

¹³ Wall Street Journal: March 5, 2002.

¹⁴ Wall Street Journal: March 5, 2002.

homework assignments. Table 3 presents the value proposition to both students and professors.

Table 3: GradeSummit's Value Proposition

<u>Value Proposition to Students</u>	<u>Value Proposition to Professors</u>
<ul style="list-style-type: none"> • Focus on important topics and how they should be studying • Assess and track progress in specific areas • More effective and efficient use of studying time • Assess strengths and weaknesses • Increase grades • Optimize study time • Measure their learning 	<ul style="list-style-type: none"> • Minimize workload • Collect data on students' strengths/weaknesses • Allow students to work at own pace • Create customized assignments for class, team and individual students • Collect data without uploading, downloading, or editing anything • Use in place of graded homework

It is estimated that 20% of students buy study guides (MH Higher Education controls 18% of the overall study guide market). GradeSummit is a good substitute, which offers all the benefits of these study guides, tutorials and other diagnostic tests. It can be versioned for specific McGraw-Hill books as well as competitor books, and is often sold as a bundled offering with certain textbooks, although it can be sold individually.

McGraw-Hill moved into the assessment and test preparation market for higher education courses in 2001 mainly because no one else had offerings in this space. According to Ed Stanford, president of MHHE, "GradeSummit is the beginning of a new frontier that is likely to impact learning significantly. Early feedback from the educational community has been very positive"

Competitive Dynamics

GradeSummit's competitive advantage is that it is a tool designed to offer more than the current product offerings and provides greater functionality in a web-based environment. Given GradeSummit's value proposition, there are no direct competitors who can match GradeSummit's capabilities. However, several similar types of products have been introduced by their closest competitors, which compete to a certain extent. These competitors are Wiley's eGrade, Peregrine's Biology/Chemistry/ Psychology virtual classrooms, and AWL's QuizMaster/StudyWizard. Exhibit 6 compares major strengths and weaknesses of these competing products. Exhibits 9 and 10 provide a list of GradeSummit's most direct

competitors as well as other major competitors such as publishing houses and standardized testing providers.

Other non-direct competitors who may potentially be a threat are technology companies who have developed assessment technologies and have access to content through partnerships. For example, Vantage Technology, Princeton Review, ClearLearning, and a cluster of other companies could conceivably be a huge threat if they can access the content via one of McGraw's publishing competitors. Similarly, their existing publishing house competitors could potentially be a threat if they transfer their online learning tools to the higher education space, or if they partner with these technology experts. The online market is evolving quickly and it won't be long before new competitors arrive or existing publishing or technology corporations move into this space.

Traditional assessment products such as paper, desktop software, tutors/TAs, instructors, general-purpose and standardized products still hold some clout in the higher education assessment space particularly in smaller, more personalized schools where face-to-face interaction is more critical or where the technology infrastructure has not been set up, and security is still a major barrier.

Product Design and Development Process at McGraw-Hill

Although McGraw-Hill does not develop the actual technology itself, they partner with ExamWeb, an existing technology company to implement the assessment engine. They work very closely with ExamWeb to develop a product solution that is unique and customized to their customers' needs, while outsourcing some of their other website design work to experts in that area. Overall, the GradeSummit team is intimately involved with the product lifecycle from start to finish.

MHHE's strategic relationship with ExamWeb exposes GradeSummit to ExamWeb's weaknesses. ExamWeb faces a low cash position, and has not yet realized revenues from the GradeSummit deal. Until that occurs, ExamWeb will struggle to survive, unless it can sustain its short-term cash needs and profitability with other revenue sources. The agreement between the two parties also contractually obligates GradeSummit to pay a 20% royalty on sales with a minimum payment of \$1.80 per unit. This hinders McGraw-Hill Higher Education from expanding its assessment tool internationally since it would be very difficult for international markets to support this type of royalty arrangement.

McGraw-Hill introduced a soft-launch of its GradeSummit tool in January 2001 in which it offered free trials of its product. A prototype was designed and six focus groups were set up to assess consumer acceptance. The initial introduction received significant interest from both students and faculty. A few months later, McGraw-Hill decided to run its beta test, and the results were also quite positive (Appendix C). After considerable market research involving customer surveys and focus groups, McGraw-Hill Higher Education became fairly confident that its new online product was meeting a need in the market. Appendix C shows some key results from one such customer survey. Actual sales were realized after its official launch in September of that year.

In addition, GradeSummit would like to increase its offerings to increase market penetration. In order to do so, it will have to commit significant time and effort to building each new course. It takes about 3-4 months to build a new course because McGraw-Hill Education does not use preexisting materials. The process involves hiring authors, writing questions, and getting the information up on the site. Ultimately, more resource and budget have to be committed to this endeavor.

According to Michael McLean, the process for new product development at McGraw-Hill higher Education intimately involves the customers by first identifying their needs, followed by testing some preliminary ideas, and finally launching and tracking the product.

The launch has been scaled back due to economic conditions. The original business plan was to introduce 30 courses by 2002. However, due to the dramatic impact of the economy on the bottom line, management has decided to scale back its efforts and resources in this area until improvements in economic trends, hurdles, sales cycle, and revenue projections can be realized. GradeSummit offers six courses and it is now starting on numbers seven through twelve. To achieve its original goal, it needs a significant amount of resources. The benefit of this investment is not only attracting many more professors and students to the website, but increasing switching cost as more courses are made available.

Targeting Strategy

McGraw-Hill can segment its customers into institutions, instructors, and students. Of these three major segments, McGraw-Hill forcefully targets the faculty segment and is beginning to focus more attention on the student segment. McGraw-Hill Higher Education's challenge is to determine who the most profitable customers to target are.

GradeSummit's main focus to date has been professors and undergrads at universities and colleges across the nation. Those that are most suitable are the institutions where professors have limited time, and programs are highly structured; with large classes, many TAs, and schools which follow certain textbooks very closely. Professors have the ability to make decisions and influence purchases made by their students. Students are obligated to obtain the required course material in order to study for their exams and pass the course.

GradeSummit is positioning itself as a timesaving, streamlined product for students and faculty. Other similar tools require much upfront work by professors in order to implement them. With GradeSummit, professors can be as involved or uninvolved as they want. For the students, the product will help them focus their study time and be more effective both in and out of the classroom setting.

Although TAs and tutors also have some influence on students, they often do not have control over their purchase decisions. Due to the complexity and difficulty of personalizing the publisher-to-student relationship, publishers have not focused extensive efforts or resources on directly marketing to them.

The student market is so massive in volume that it is very difficult to target them individually and build up loyalty. The potential lost upside of selling directly to students is that there may be higher margins to be realized by the publishers. GradeSummit's primary objective is to

prove that its product is viable and then it can focus its efforts on directly marketing to students.

According to Michael McLean, “We have initially targeted instructors at larger institutions without the time and resources necessary to effectively interface with their students. The program is ideal for instructors with large sections or classes and those venturing into distance learning models seeking means to connect with their students.” Although it is still early to assess customer loyalty, it is clear that students and even the technologically challenged faculty are extremely quick to embrace the product and its promise.

Another potentially very profitable segment might be the parents of undergraduate students or parents of the incoming freshmen class. A perpetual program could be set up that would cover either part of or all of the materials necessary for higher education studies. The program would generate recurring revenue from a captured customer group. Parents could contribute to a ‘book fund’ or give the program as a gift to their sons or daughters. In an environment where much of the learning material is electronic and variable costs are low, the benefits of such a program are quite similar to a season’s pass for a ski resort. Skiers pay upfront for the pass whether or not they take full advantage of the lifts. Similarly, students pay full price for their educational materials at the beginning of the term. Over the course of the term, they have access to all relevant materials, whether online or offline. Publishers benefit whether students actually use the materials or not.

Another potential target segment is the universities and colleges themselves. Forming a long-term relationship or strategic alliances may result in recurring revenues from existing and future products. For instance, one model for such a perpetual source of revenue stream is the Dell corporate lease concept in which undergrads pay a packaged price for all their books and learning material during each year of their studies. Dell leases the new PCs to corporations for a certain number of years. After the lease has expired, the companies can renew their leases by sending back their old PC and receiving a new up-to-date version.

In the same manner, publishers could potentially negotiate a four-year lease program with universities and colleges, in which students could get all the books and materials that are necessary for the courses in which they are enrolled. At the end of each year, publishers can decide whether they want to recycle their books or just leave that responsibility in the students’ hands. As materials are updated from year to year, and new products and learning materials are introduced each year, students will benefit from always getting the latest set of materials at a previously agreed price. This is something that publishers need to consider to ensure a stable revenue stream.

GradeSummit Marketing Strategy and Tactics

Product / Bundling Strategy

As a book publisher, McGraw-Hill is geared toward selling new books and earns no money in the used book market. Since new editions come out approximately every three years, its revenue source from new books is adjusted accordingly. Most of the revenue is realized from

the first year sales of the book. New digital technology drives new book sales because customers must now buy the new book in order to get the supplementary software that is bundled with it. However, GradeSummit has started to offer deals that allow its software tool to be sold separately in stores, continuing to allow customers to buy used books.

Furthermore, GradeSummit sells its products with competing books. Bundling its online testing tools with competitive or complementary products creates a huge new revenue source for McGraw-Hill. The average student is more concerned with having valued added materials and tools as opposed to whether such a tool is being bundled with competing products. In fact, students who like the product would rather have all their books bundled with this technology.

Pricing

GradeSummit is priced at \$8 (net) when packaged with a McGraw-Hill book and at \$19.95 stand-alone. The net price to bookstores and other retailers is \$12. GradeSummit also offers a “Try it for Free” option whereby a student can have access to the first three chapters’ material of any course without charge.

Promotion

GradeSummit’s promotional strategy is to only communicate to students and faculty who are interested and involved in any of the six courses that are currently being offered. Otherwise, the product promotion is kept at low visibility in order to prevent customers’ disappointment after going to the site and finding out that GradeSummit does not yet offer their courses.

The sales process begins with sales reps pitching the product’s advantages and benefits to a faculty member. Once the faculty member agrees, the business deal is closed. However, no sales are booked until the product is shipped in September. Although the professors have signed up and have even gone online to try the product, they still can easily order texts through the bookstore without GradeSummit.

Forecasting and projecting revenue for the new product is extremely difficult, since initial agreements are not accurate predictors of actual sales. Due to the difficulties in reporting sales they have devised a tracking system. All “promised” adoptions are tracked and are discounted by 15% since some of these sales may fall off. Strong leads (better than 60% chance of closing) are being tracked as well and discounted by 65%.

Distribution

The distribution channel also presents a challenge for GradeSummit. Schools prefer to distribute and buy books through the local or school bookstores. However, GradeSummit has a dicey relationship with this distribution channel because of control and authority. Bookstores want control over the ordering process and want to ensure that professors order exclusively through the bookstore. Encouraging professors to order through McGraw-Hill’s website or other online bookstores would only create further friction within this channel. GradeSummit needs to find a better way of leveraging this channel in its sales strategy.

GradeSummit Challenges

As head of the GradeSummit project, Michael has the responsibility of evaluating and solving the many challenges that GradeSummit and McGraw-Hill face.

Target Customer Issue

Determining the target customer is not an easy task. Given the existing channels via bookstores and online sites, who would be the most effective customer segments to target? Among the faculty, students, parents, and a host of other possible segments, who would be the most profitable to target? Should the faculty-student paradigm be shifted toward the student? Should McGraw-Hill consider a program that generates perpetual or recurring revenue?

Bundling with Used Book

Used books are continuing to take away a significant share of publishers' revenues. Should GradeSummit bundle its tool with used books? By bundling GradeSummit only with new books, students are forced to buy new books. However, GradeSummit has introduced a new problem by starting to offer deals that allow its software tool to be sold separately in stores. This once again allows customers to continue to buy used books.

Bundling with Competing Books

Looking at the benefits of bundling GradeSummit with competing books, it is critical to determine if these benefits actually outweigh the costs. Increasing the sales of competing products may be a potential threat to GradeSummit's own profitability. It buys competitors visibility into the new online initiative, and buys them time to create their own competing technology. Students often buy course books for the book alone and not the supplementary materials. Supplementary materials such as GradeSummit may increase the value of the book, but does not divert brand acknowledgement from the book. The danger of such a bundled offering is that consumers may actually associate competitors' books with the positive benefit of the supplementary tool. Given these and other considerations, how serious is the threat of bundling with competing books?

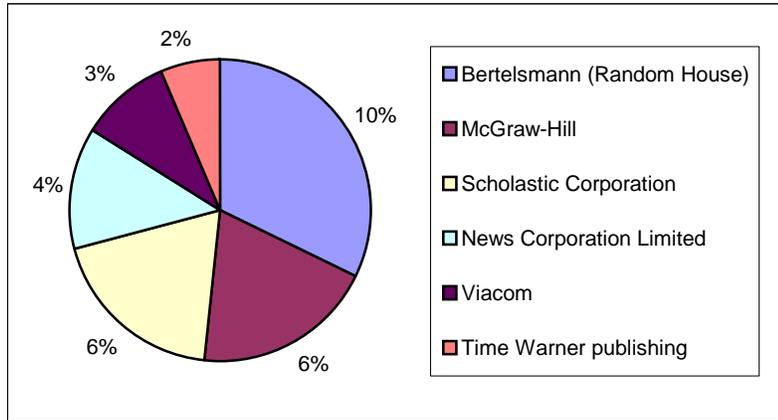
Resource Procurement Issue

Budgetary constraints have only allowed six courses to be deployed by mid-2002. There are insufficient human resources to increase scale on this project. If more time and people could be deployed to create new courses and enhance the technology, GradeSummit would be able to realize greater penetration and offer greater value to its market. More courses would also increase the possibility of entering into other channels. In addition, building more products and courses will increase barriers for competitors to enter this same space. At the moment, competitors can freely enter and offer courses that GradeSummit is not offering. The benefits are immense. How should Michael persuade senior management to allocate more resources into the GradeSummit project?

In order to continue to grow its sales and market share in the publishing industry, McGraw-Hill Higher Education could focus on a few short-term and long-term strategies. First, it could focus on maintaining competitive edge in e-learning, and expanding and promoting those offerings. In addition, it could seek out appropriate strategic alliances with competitors and software vendors in the testing and assessment space. In the longer term, McGraw-Hill Education could focus on creating new business opportunities outside the core textbook and traditional publication space.

A major challenge for Michael is anticipating the market's readiness for McGraw-Hill's products and services. Forecasting is always a difficult task for a relatively new product, so considerable effort should be put into market research, customer surveys, or focus groups in order to ultimately provide electronic solutions that meet the market's needs.

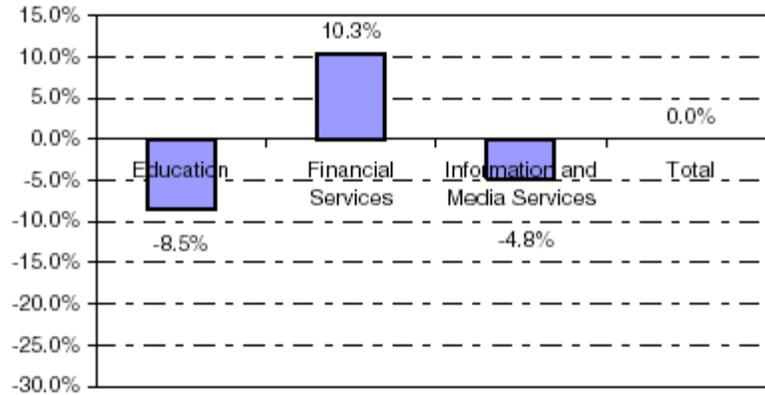
Exhibit 1: 2000 Book Publishing Market Shares



Euromonitor: Books in the USA: Market Size for 2000

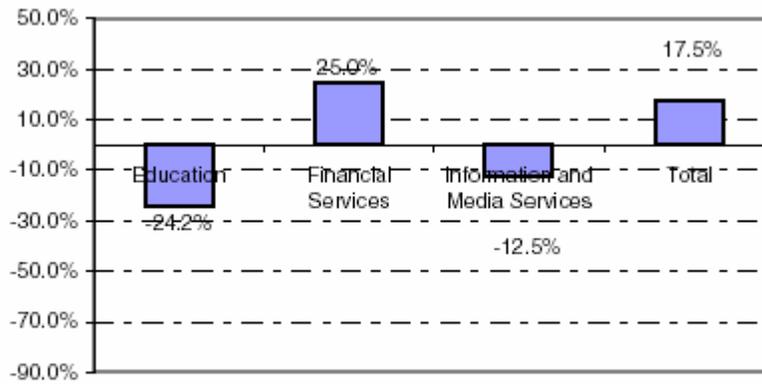
Exhibit 2: Biogen Idec financial results for 2003

A. First Quarter 2002 Revenue Growth by Division



Source: Company data.

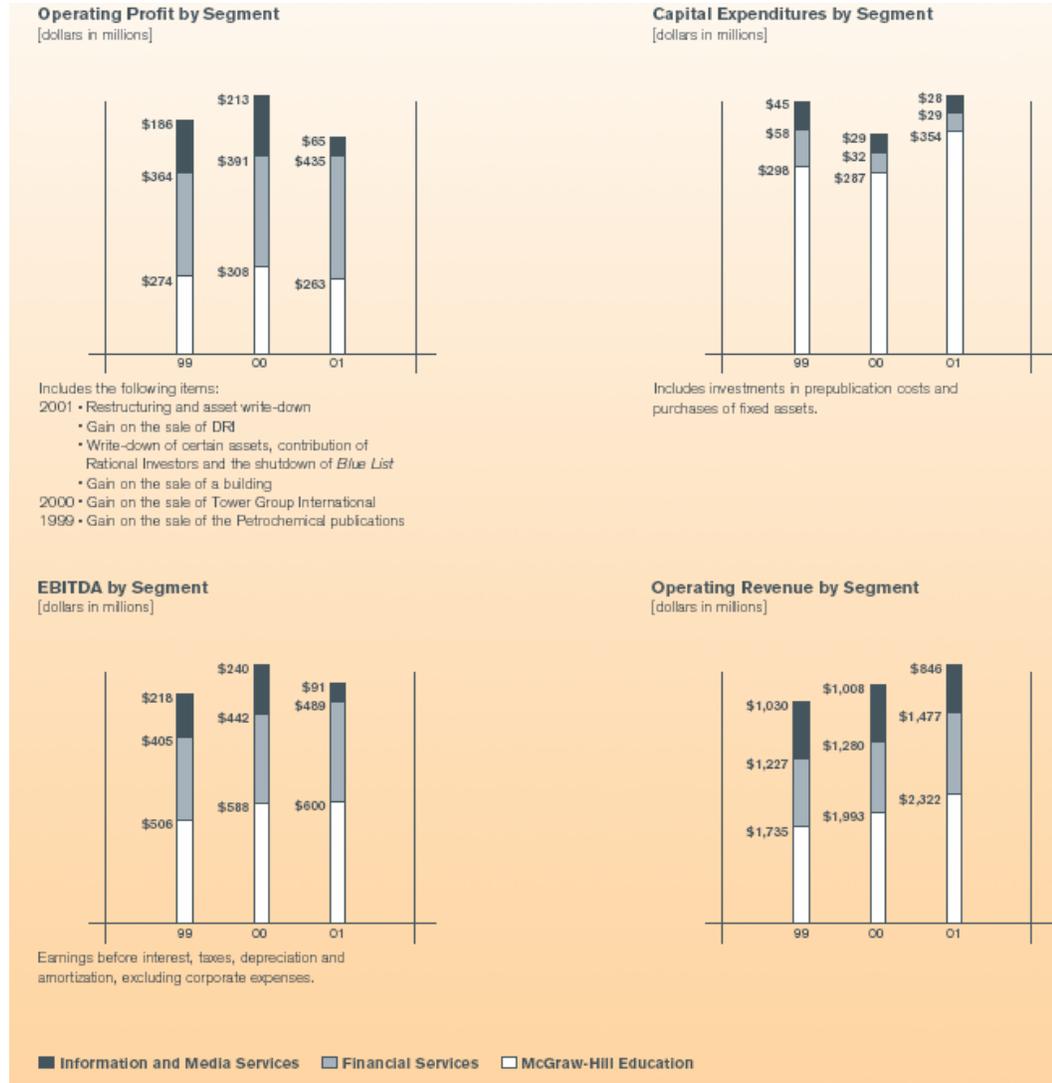
B. First Quarter 2002 Operating Margin Growth by Division



Source: Company data.

Exhibit 3: 2001 Financial Data

Education Generates 50% of the Revenue, but only 34% of the Profits



McGraw-Hill Annual Report 2001

Exhibit 4: Divisions within the School Education Group

SRA/MHP	Supplementary materials, niche basal programs for elementary
Wright Group/MHP	Supplementary products for early childhood, elementary, remedial
Macmillan/MHP	Basal instructional programs for elementary market
Glencoe/MHP	Secondary and postsecondary publisher
CTB/MHP	Customized and standardized testing materials, scoring services
MHP Children’s Publishing	Consumer-oriented learning products
MHP Digital Learning	MHP Learning Network: new digital products

Company Source

Exhibit 5: GradeSummit Tool (www.gradesummit.com)

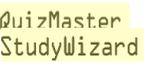
The banner features the GradeSummit logo with a mountain background. Below the logo are three main navigation buttons:

- Students:** Find out how you can elevate your grades and optimize your study time. Try GradeSummit for FREE! More Info...
- Professors:** Help your students optimize their study time for your class. Try GradeSummit for FREE! More Info...
- Registered Users:** Optimize Your Study Time. Elevate Your Grades. Take it to the Summit. GradeSummit. Includes a login form with fields for Username and Password, a Login button, and links for 'Forgot your password? click here', 'Have a card with a passcode? Register Here', and 'Register Here'.

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Exhibit 6: Product Pipeline

						
Provider	McGraw-Hill	Wiley	Cresca (Pearson)	Peregrine/ Pearson	AWL/Pearson	All
Developed	2001	2000	1998 – 2001 new launch	1998	2000	1998 - present
Functionality	Students customize any exam, choosing topics and subtopics	Students can customize problem sets and quizzing.	Students can select areas to study by chapter	Students select areas to study by text subject	Students select areas to study by chapter in SW.	Students select areas to study by chapter.
Student Analysis	Detailed feedback on each subtopic and chapter. compared with classmates or worldwide.	Tells students only if they answered correctly or incorrectly. Very limited analysis by topic.	Tells students if they answered questions correctly or incorrectly, students must scroll	Tells students if they answered questions correctly or incorrectly.	“Diagnostic report with suggested study areas”. Results tied to text learning objectives	Total number of right vs. wrong answers in quizzing sections.
Professor Analysis	Aggregated and individual student data. Professors can send email direct to students.	Aggregated and individual student data. Adjust grades for partial credit, and send messages to students.	None	None	Aggregated and individual data from QM. None for SW.	Some sites give students the option of emailing results to professor.
Hosting	Hosted online.	LAN maintained by school.	Hosted online.	Hosted online.	SW is downloaded to individual's computer, QM resides on LAN	Hosted online or via WebCt, BlackBoard, etc.
Course customization	Students can customize exams to only cover what's in the instructor syllabus. Instructors cannot upload their own	Professors can preset quizzes and exams, edit questions, and add original questions.	None	None	Professors using QM can create exams for students, choosing content and adjusting grade scale. Professors	Professors can customize some content via a course management system.

	content or edit existing questions.				can add and edit	
Price	Individual purchase for \$8 package, \$15 standalone for each course. Free trial of first 2 chapters of any product.	Available for a license fee for adopters of selected Wiley texts.	Unsure – probably will need a buy in to <i>Course Compass</i> . Product launch is in August 2001.	\$10 first 3 months, \$1.50 per month after/course. Institutional purchase for \$2/student, 1 st 3 months, \$.50/student per month thereafter. Also bundled	Free	Free with most course. Some publishers are now password protecting sites and bundling pass cards with new texts.
URL	www.gradesummit.com	jws-edcv.wiley.com/college/egrade/	www.cresca.com/testflight/index.html	www.biology.com ; www.chemplace.com	www.awlonline.com/products/	Individual

Exhibit 7: Preliminary Estimated Book Publishing Industry Net Sales 1992, 1997, 1999- 2001

	MILLIONS OF DOLLARS									
	1992	1997	1999	2000	2001	1992-1997	1999-2000	2000-2001	1992-2001	1997-2001
	\$	\$	\$	\$	\$	PCT CHG FROM 98	PCT CHG FROM 99	PCT CHG FROM 00	%CMPD GROWTH 1992-2001	%CMPD GROWTH 1997-2001
TRADE (TOTAL)	4661.6	5774.1	6732.1	6540.8	6369.9	0.5	-3.7	-2.6	3.5	2.5
ADULT HARDBOUND	2222.5	2683.6	3036.7	2885.9	2626.5	0.4	-11.6	-2.2	1.9	-0.4
ADULT PAPERBOUND	1261.7	1731.7	2047.2	1900.7	1827.21	7.3	-7.2	1.4	4.8	2.7
JUVENILE HARDBOUND	850.8	908.5	1061.4	1201.1	928.6	11.3	13.2	-22.7	1.1	0.5
JUVENILE PAPERBOUND	328.6	470.3	646.8	763.1	887.8	23.2	16.4	17.9	11.7	17.2
RELIGIOUS (TOTAL)	907.1	1122.7	1218.9	1248.9	1305.1	3.3	2.5	4.7	4.1	3.6
BIBLES, TESTAMENTS, HYMNALS & PRAYER-BOOKS	260.1	285.4	310	323.3	315	4.7	4.3	-2.8	2.2	2.5
OTHER RELIGIOUS	647	847.3	906.9	923.6	990.1	2.8	1.8	7.2	4.8	4
PROFESSIONAL (TOTAL)	3106.7	4166.4	4720.4	5129.5	4739.1	6.8	8.7	-7.5	4.8	3.3
BUSINESS	480.3	768.1	909.9	888	888	6.8	*	*	*	*
LAW	128.1	162.7	1726.9	8.5	*	8.5	*	*	*	*
MEDICAL	622.7	856.5	982.8	6.9	*	6.9	*	*	*	*
TECHNICAL, SCIENTIFIC & OTHER PROF'L	855.6	1029.1	100.8	4.3	*	4.3	*	*	*	*
BOOK CLUBS	742.3	1143.1	1272	5.2	1324.5	5.2	1.5	3.3	6.7	3.9
MAIL ORDER PUBLICATIONS	630.2	521	428	-12.3	353.9	42.8	4.8	-18	-8.2	-9.2
MASS MARKET PAPERBACK	1263.8	1433.8	1552	2.5	1546.6	2.5	0.5	-0.8	2.3	1.9
RACK-SIZED										
UNIVERSITY PRESSES	280.1	367.8	411.7	5.1	408.2	5.1	-2.4	1.5	4.3	2.6
ELHI (K-12 EDUCATION)	2080.9	3005.4	3424.7	3.3	4183.6	3.3	13.3	7.8	8.1	8.6
HIGHER EDUCATION	2084.1	2669.7	3128.8	8.3	3468.9	8.3	3.5	7.2	5.8	6.8
STANDARDIZED TESTS	140.4	914	218.7	6.9	250.1	6.9	7	6.8	6.6	6.9
SUBSCRIPTION REFERENCE	572.3	736.5	788.9	2.8	816.4	2.8	2.6	1.3	4.1	2.7
OTHER SALES (INCL. AV)	449	510	541.6	2.9	577.2	2.9	3.3	3.2	2.8	3.1
TOTAL	16918.5	21641.9	24480.6	6.3	25322.7	6.3	3.4	0.1	4.6	4

*American Association of Publishers (<http://www.publishers.org/stats/2000prelim.htm>)

Exhibit 8: Book Publishing Industry Net Sales Projections, 2001-2004

\$ millions	Actual	Projected				CAGR 01-04
	2000	2001	2002	2003	2004	
Consumer	11,071	11,684	12,168	12,672	13,193	3.1%
Professional	5,129	5,243	5,522	5,815	6,121	3.9%
K-12 Texts	3,881	3,795	4,014	4,232	4,469	4.2%
College Texts	3,237	3,649	3,930	4,226	4,539	5.6%
University Presses	402	452	474	496	519	3.5%
Standardized Tests	234	249	265	283	302	4.9%
Subscription reference	809	849	882	916	949	2.8%
Other	559	559	559	559	559	0.0%
Total	25,322	26,480	27,814	29,199	30,651	3.7%
<u>Consumer sub-categories:</u>						
Trade	6,541	7,146	7,477	7,819	8,174	3.4%
Mass market paperbacks	1,559	1,546	1,616	1,685	1,754	3.2%
Religious	1,247	1,306	1,353	1,401	1,450	2.6%
Book clubs	1,292	1,338	1,380	1,424	1,468	2.3%
Mail order	432	348	342	343	347	-0.1%
Total consumer books	11,071	11,684	12,168	12,672	13,193	3.1%
Consumer books as % total	43.7%	44.1%	43.7%	43.4%	43.0%	

Source: Association of American Publishers, Book Industry Study Group, Inc.

Exhibit 9: Major Direct Competitors

eGrade (Wiley)

Wiley's eGrade is also web-based software that enhances academic productivity. Instructors can automatically assign, deliver, grade, and route homework, quizzes, and tests while providing students with immediate scoring and feedback on their work. eGrade excels at delivering quantitative and technical problems and is the first homework management tool to provide a wide range of math-based questions, as well as support for other academic disciplines. It has also been tested on thousands of students in hundreds of courses at numerous different universities in the past three years.

The Biology/Chemistry/Psychology Place (Peregrine/Pearson)

Peregrine Publishers offers three virtual classrooms in Biology, Chemistry and Psychology. It is also an online tool providing interactive study tools and test preparation help. Students can take practice exams tied to leading textbooks, explore news about one of the three topics, share ideas with the online community, and find access to other reliable web resources. Instructors also benefit from the same resources, but have the ability to create an online syllabus.

QuizMaster/StudyWizard (AWL/Pearson)

Addison Wesley offers a couple of products that are closely related to GradeSummit. QuizMaster is a network-based testing system that allows students to take tests, help professors grade tests, and provide detailed analyses of exam results by individual, class and course. It creates critical diagnostic reports and also allows professors to customize grading scales. StudyWizard on the other hand is like a study guide that helps students review concepts, practice test questions, and receive immediate feedback and diagnostic reports.

There are a variety of other online study tools that provide some components of these functionalities. However, none seem to provide the level of feedback and guidance as GradeSummit.

Exhibit 10: Major Traditional Book Publishers

Pearson (<http://www.pearsoned.com>)

Pearson Education with 2001 revenues of \$3.8 billion is the world's leading integrated education publishing company with its single largest market in the US. Its brands such as Prentice Hall, Longman, Scott Foresman, Addison Wesley, NCS Pearson, are well known by consumers. Its educational publishing operations provide quality content, assessment tools and educational services both online and offline to a worldwide marketplace of all ages. In the online world, it is also a global leader providing nearly 2,000 textbook companion Web sites, the InformIT website for technology professionals, and the Learning Network, for teachers, parents and children. Its parent Pearson had 2001 revenues of \$6.2 billion.

International Thomson (<http://www.thomsonlearning.com>)

Thomson Learning is one of the largest global providers of tailored total learning solutions. It offers courseware, test preparation, testing, assessment, and certification. In Education, it serves secondary, post-secondary and graduate-level students, teachers, and learning institutions in both traditional and distance learning environments. Thomson Learning is a division of The Thomson Corporation, which had \$7.2 billion in 2001 revenues. Thomson itself is a leading, global e-information and solutions company in education, business and professional markets.

Houghton Mifflin (<http://college.hmco.com>)

Houghton Mifflin's mission is to enrich people's lives through learning and being entertained. It is now a wholly owned indirect subsidiary of Vivendi Universal (www.vivendiuniversal.com) and in August 2, 2001, its stock was removed from the NYSE. Vivendi had revenues of 57,360 million Euros in 2001. It is a world leader in media and communications, and aims to be the world's preferred creator and provider of entertainment, education and personalized services to global consumers.

John Wiley (<http://www.wiley.com>)

John Wiley is a leading publisher for the scientific, technical, and medical communities worldwide with 2001 revenues of \$613.8 million. Its programs encompass print and electronic products. It publishes textbooks and other educational materials in print and online for undergraduate and graduate students and lifelong learners. Its programs have emphasized mostly on the sciences, engineering, mathematics, and accounting, but are increasing focus in business, education, and modern languages.

Exhibit 11: Major Testing and Assessment Firms

Kaplan (<http://www.kaplan.com>)

Kaplan is the leader in electronic test preparation, serving more than 3 million students over the past 60 years, and has 3,000 classroom locations worldwide. It offers preparation for 35 standardized tests, including entrance exams as well as language and professional licensing exams. It also offers private tutoring and admissions consulting services. It is a wholly owned subsidiary of The Washington Post Company.

Princeton (<http://www.review.com>)

Princeton Review has three divisions: Test Preparation Services, Admissions Services and K-12 Services.

In the Test Preparation division, it provides test preparation at 500 classroom locations worldwide. In addition, it provides admissions counseling, one-on-one tutoring, and online instruction. It has continued to develop new and innovative products and forms of delivery (classroom, online) to help students raise their scores on standardized tests. On June 19, 2001, it became a public company and is listed on the NYSE.

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Appendix A: The Publishing Industry

The publishing industry is sub-divided by the American Association of Publishers by distribution methods into trade (adult and juvenile), religious, professional, book clubs, mail order publications, mass-market paperback, university presses, ELHI (K-12), higher education, standardized tests, and subscription reference. Table 1 and 2 below shows industry sales for these categories and their distribution channels in 2001. Books are sold through retail stores (regular, chain, and college bookstores), wholesalers, libraries and institutions, government, industry, and individual sales (sales reps, mail). Among retail outlets, large chain bookstores had the highest sales followed by small chain and independent bookstores.¹⁵ In order to move huge volumes, publishers often offer wholesalers and bookstores around 50%¹⁶ discount off the suggested retail price. Profit margins vary by categories and even from book to book, but school and college texts often have higher sales net of returns than adult paperbacks.

Table 1: Major Segments (Industry Sales¹⁷)

4.5M	Adult hardcover, paperback
1.8M	Children's hardcover, paperback
2.5M	Religious, Bibles, and other religious
4.7M	Professional
1.3M	Book Clubs
1.5M	Mass Market Paperback
0.4M	University Presses
4.2M	ELHI (elementary and high school)
3.5M	Higher education
0.3M	Standardized tests
0.8M	Subscription reference

Table 2: Distribution Channel¹⁸

Retail Outlets	35%
Mail Order/Book Clubs	20%
College Bookstores	17%
Schools	15%
Libraries/Institutions	10%
Others	3%

Book publishing is a labor-intensive business. Book publishers employ a wide range of people including editors, copy editors, graphic artists, proofreaders, illustrators, and researchers. They outsource much of their printing and distribution functions. Publishers compete for readers based on content, service, price, and subject matter, and also face competition from other forms of media.

¹⁵ Euromonitor: Books in the USA: Market Size for 2000.

¹⁶ Standard & Poor's Industry Surveys: Publishing, March 14, 2002.

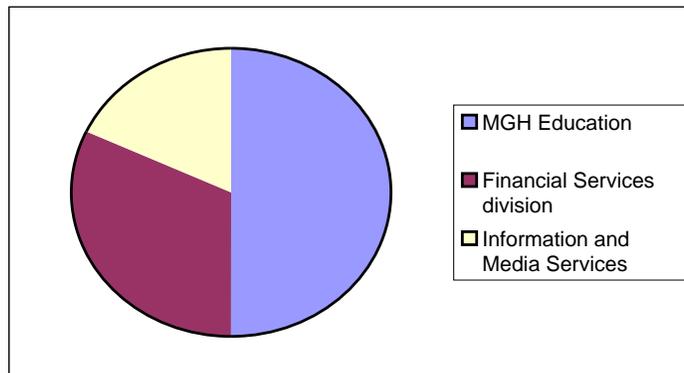
¹⁷ Publishers Weekly, March 4, 2002.

¹⁸ Standard & Poor's Industry Surveys: Publishing, March 14, 2002.

Appendix B: McGraw-Hill Divisions

McGraw-Hill is the world's largest producer of textbooks, tests, and other educational materials for elementary, secondary and higher education markets. With revenues of \$4.65 billion in 2001, it provides informational products and services such as books, magazines, newsletters, software, online data services, CD-ROMS, fax, and TV broadcasting. In 2001, it served the business, professional, and educational markets globally. Its key areas are finance, business, education, construction, medical and health, aerospace and defense.

McGraw-Hill Divisions



McGraw-Hill has three major divisions: McGraw-Hill Education, Financial Services, and Information and Media Services.

McGraw-Hill Education is recognized as a credible provider of quality textbooks and learning materials. It serves the elementary and high school, college and university, professional, and international markets. There are two operating units, School Education Group and Higher Education, Professional and International Group. The School Education Group has seven divisions (Exhibit 4) and makes up 59.4% of the 2001 education revenue.

The Financial Services division consists of ratings, indexes, investment analysis and information, corporate valuation, and the S&P. Financial Services is the strongest performer, driving both top-line and operating margin performance. It is the only segment with revenues up (10%) in the first quarter of 2002 (Exhibit 2). This is because of revenues being tied to recurring revenue streams, protecting it from cyclical market fluctuations like those in education.

Information and Media Services provides Business Week, the leading global resource for news in the business world and has over 5 million readers. Information and Media suffered during the economic downturn due to exposure to advertising. Ad spending had decreased significantly and its dominant product, Business Week struggled with a third less ad pages, and publications in energy, aviation and health only added slightly to its stability.

Appendix C: Pilot Test Survey Key Results

In a pilot test conducted by GradeSummit, the following statistics were collected from user surveys and strongly reinforced the notion that students felt that the GradeSummit tool was invaluable.

Approximately 90% of the respondents felt that being aware of their weaknesses through GradeSummit influenced their study habits and the way they prepared for test.

About 90% of the students felt they were better prepared for their exams than if they had not used GradeSummit.

Over 74% of the respondents use the computer or Internet at least 20% of the time for studying or preparing for exams.

Approximately 85% of the respondents indicated that they might use the product even if the professors did not require it.

The majority of professors (56%) are not requiring the use of GradeSummit, but respondents filling out the survey are still using it.

About 56% of the respondents would consider paying \$19.95 to use GradeSummit for an entire semester if your professor didn't require it?