IVEY BUSINESS REVIEW

CRACKS
IN THE FOUNDATION

PG.41 For CPP Investment Board, infrastructure investment opportunities are close to home

MEDIA PG.12
Winter is Coming...
Why Blizzard's Titan is poised to ice Bethesda's Elder Scrolls Online

TECH PG.07
Feature Insert: Bye Bye Birdie
Insight on Twitter from thought leaders writing for the Ivey Business Review Blog Network

TELECOM PG.15
Three's Company, Four's Allowed
Rogers could use a fourth Canadian telecom player to its advantage

INTERVIEW PG.34
Carol Stephenson & Gerard Seijts
IBR talks with Carol Stephenson and Gerard Seijts about Ivey, leadership, and the importance of diversity

FALL 2013 • ISSUE 1, VOLUME 5

The Ivey Business Review is an undergraduate business strategy publication conceived, written, and managed exclusively by students at the Ivey Business School, to provide a forum for tomorrow's business leaders to develop, voice and discuss their thoughts on today's business strategies, threats and opportunities. Each article has been created specifically for the magazine and comes from several months of intense collaboration between the writers and members of the Editorial Board.

CONTRIBUTORS

Editor-in-Chief
Connor Lyons

Publisher
Michael Zawalsky

Creative Director
Myles Linder

Faculty Advisor
Chris Williams

Website Manager
Niklas Lubczynski

Lead Graphical Artist
Jason Cao

Graphic Design
Madison Abernethy
Madison Dunn
Marina Ghobrial
Liam Hunter
Daniel Knecht
Cindy Liang
Victoria Lyons
Nicholas Reddon
Vinita Shah
Rosy Zhao

Special Thanks To:
Cameron Bossert
Alex Cook
Kiva Dickinson
Emily Docherty
Joseph Ghobrial
Tom Hansen
Guy Holburn
Ryan Hui
Lauren Lee
Eileen Mercier
Peter Ottmann
Fabian Papa
Olivia Steedman
Dylan Tedaldi
Dave Unipan

Editorial Board
Nikita Babailov
Shelly Bajaj
Sean Bandyopadhyay
Mario Campea
Joshua D'Souza
Michael Delplavignano
Eric Fong
Brittany Girling
Nicholas Kuchtaruk
Niklas Lubczynski
Connor Lyons
Amanda Robson
Daniel Rozhko
Michael Zawalsky

Board of Directors
Matthew L. Ball
Andrew Cornhill
Matthew H. Hall
Jack Hansen
Mathu Jeyaloganthan
Jordan Mayes
Will Meneray
Anshul Ruparell
David Safer
Calvin White

Fact Checkers
Gareth Domingo
Emily Rowe
Andrew Shon
Jitesh Vyas

Subject Matter Expertise Provided By:
accenture

FROM THE EDITORS

Nearly 3,000 years after the concept was first introduced, time travel remains a truly indelible superpower. Unlike super-strength, invisibility or telekinesis, the ability to see the past or future offers something far more potent: possibility. It gave Ebenezer Scrooge a chance at redemption; transformed Biff Tannen from a small-town bully to a Presidential Kingmaker; and ensured that the Terminator could, well, always "be back".

Without a doubt, corporate executives would leap at the chance to hold such a power. Yet, the best CEOs have never been prognosticators. Indeed, many of those who did have a glimpse of the future produced products that will be but footnotes in the history books of tomorrow. Others ended-up so transfixed on the vision they once saw that they fail to see the future becoming the past. No, the best CEOs have been those who lead their companies to define the future. They know not what it has in store, but hold dearly the notion that the long-run is the point in time when all inputs are variable and all suppositions suspect. Managerial forecasting can only go so far.

In this issue of Ivey Business Review, we present several articles focused on how leadership can confront tomorrow using only their wits, resources and team. In the case of "Three's Company, Four's Allowed," IBR outlines how Rogers can pre-empt changes to the telecommunications industry to profit from a fourth player. "Charting Porter's Flight Plan" speaks to the importance of developing a strong action plan in uncertain times for the airline industry. Meanwhile, "Winter is Coming…" and "Cracks in the Foundation" describe how shoplifting a long-term perspective can draw out competitive advantages.

We hope you enjoy it,

- The Editorial Board

Feature Insert: Bye Bye Birdie
IBR Blog Network
Insights on Twitter from thought leaders writing for the Ivey Business Review Blog Network
07

Winter Is Coming...
Nicholas Zeeb & Ishan Tikku
Why Blizzard's Titan is poised to ice Bethesda's Elder Scrolls Online
12

Three's Company, Four's Allowed
Colin Lernell & Rajdeep Mukherjee
Rogers could use a fourth Canadian telecom player to its advantage
15

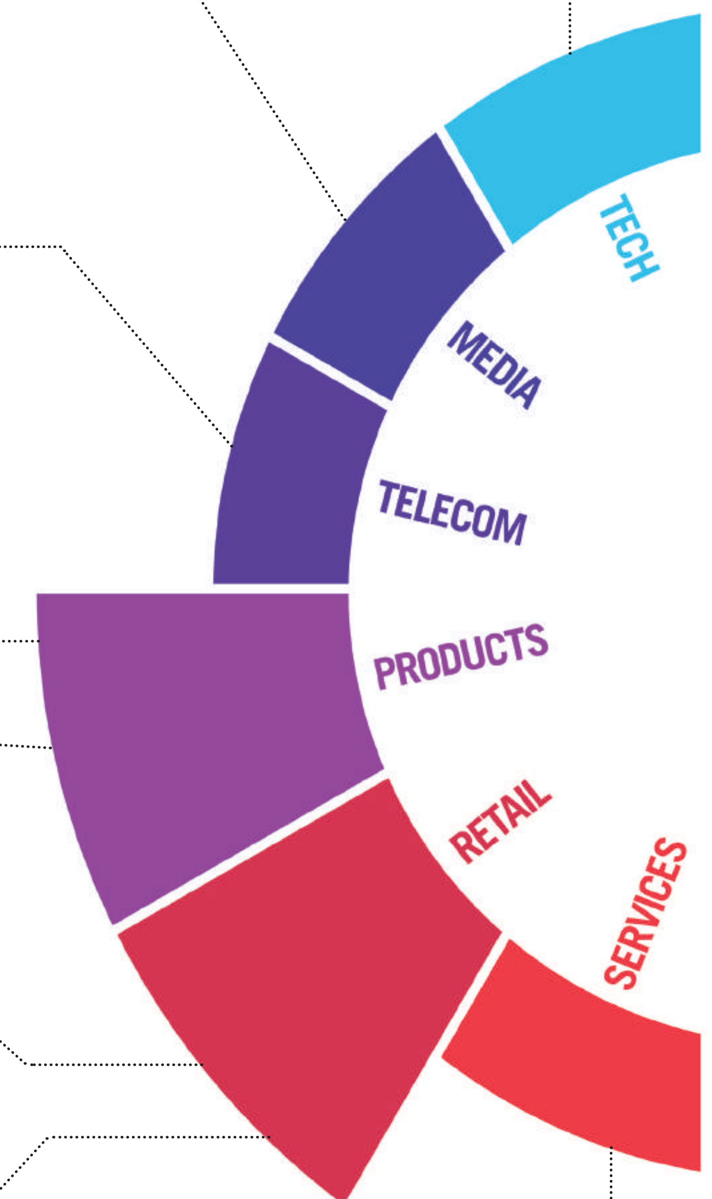
Soylent: Nutritious and Ambitious
Jonathan Vollett
Positioning first as a breakfast staple, and later a lifestyle brand
18

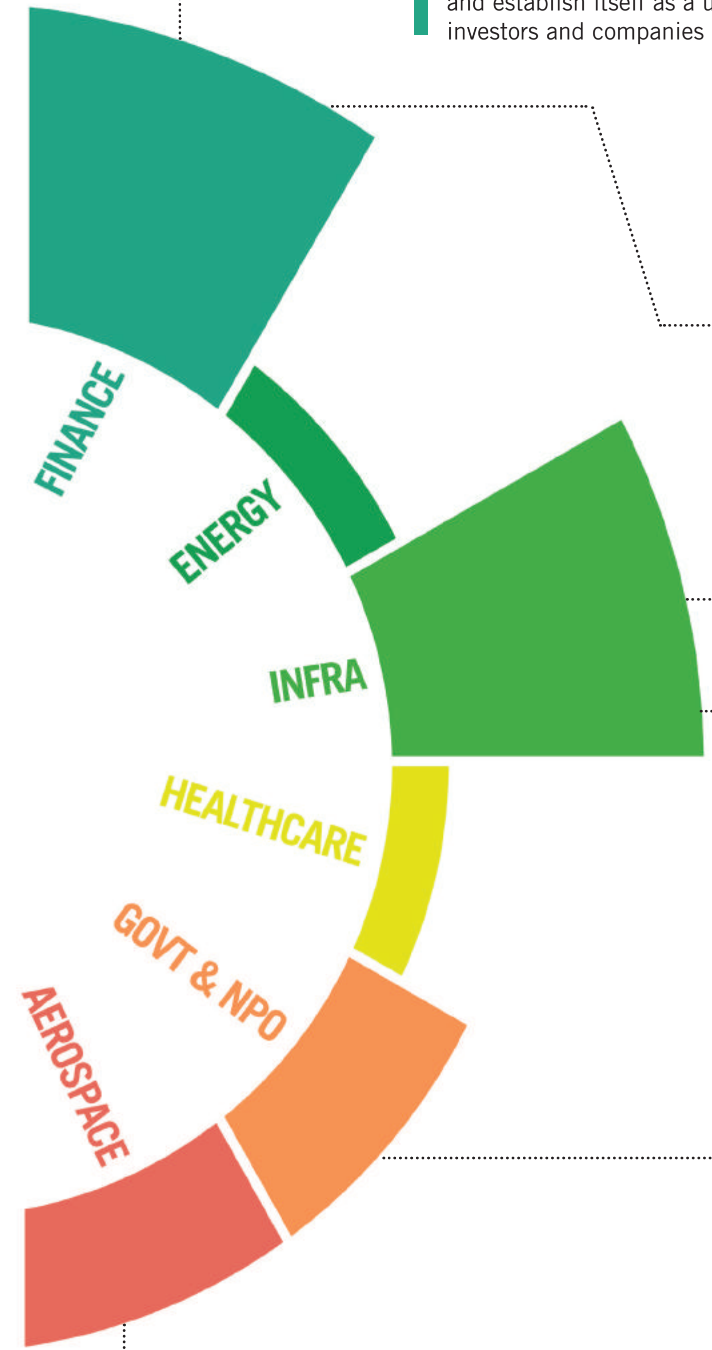
E-Cigarettes up to BAT
Morgan Moskalyk & Nick White
Reigniting British American Tobacco's Australian business
21

Baby Steps
Hannah Baker
How Lululemon can overcome current controversies by entering the baby clothing market
24

Sneakernomics
Adrian Uthayagumaran & Steven Lo
Sizing up the growing sneaker market
26

Tech Startups En Pointe
Nicole Korb & Alexandra Maringola
Learning about talent recruitment from Canada's premier dance company
29





48

The Second Coming of SecondMarket
Alex Keszthelyi & Kevin Russell
How SecondMarket can fill the hole left by Facebook and establish itself as a unique trading platform for investors and companies

45

'Til Death Do Us Part
Felix Boisse & James Hammond
How Insurers can de-risk the impact of increased life expectancy

41

Cracks In The Foundation
Madeline Cavadias & Cristina Osorio
For CPP Investment Board, infrastructure investment opportunities are close to home

38

Here Comes The Sun
Amy Wang
How Downstream Solar Players Can Capture the Pakistani Solar Market

34

Interviews
Connor Lyons & Michael Zawalsky
IBR talks with Carol Stephenson and Gerard Seijts about Ivey, leadership, and the importance of diversity

31

Charting Porter's Flight Plan
Aprameya Rao & Mohsin Khandwala
Exploring the potential strategic runways for Porter to evolve into a national player

SPONSORS

Organizations that embrace thought leadership position themselves well for the future. Thought leadership runs to the very core of Ivey Business Review's mission. We applaud our sponsors, who have recognized the value in encouraging tomorrow's leaders to engage in discussion of today's business issues. We thank our sponsors for their continued support as we execute this critical mission.

PLATINUM

GOLD

SILVER

BRONZE

FEATURE INSERT: BYE BYE BIRDIE

Insights on Twitter from thought leaders writing for the Ivey Business Review Blog Network

IBR Blog Network

Where #Twitter goes, not even @JackDorsey knows

Liam Boluk – *November 05, 2013*

In reviewing Twitter's prospectus, Wall Street analysts and journalists have focused on two things: the company's slowed user growth and its ongoing unprofitability. What's missing in this analysis is the significance of these happening concurrently.

A plateau of users is, of course, inevitable. The problem is that Twitter appears to be entering the 'mature' stage of its growth cycle before having established a profitable business model. Were the company still in the growth stage, valuations would be focused on the size of its social network (i.e. Monthly Active Users, or "MAU"), rather than earnings or margins. Now, however, the company should be proving its ability to derive value from this social network. The decision to pursue an IPO despite this uncertainty (and several quarters before they needed to) suggests that management and/or shareholders believe one or more of the following scenarios:

1. Key financial and operating metrics (namely MAU, ARPU, revenue growth, earnings growth) are likely to experience a material decline or slowing

2. Social media multiples are likely to compress at a rate greater than increases in Twitter's intrinsic value

3. Twitter is unlikely to demonstrate a viable business model over the next few quarters (and be even deeper into its mature growth phase)

4. The company has an increasingly imbalanced risk-return ratio for shareholders going forward

IPOs are often compared to entering "adulthood" or "graduation". The problem with Twitter is that it has yet to decide what it wants to be when it grows up. If Twitter were still in a period of hyper-growth ("puberty"), this uncertainly would be okay. As a company now in its "early adulthood," proclaiming boundless potential is no longer enough.

Twitter's business model remains a major concern for investors, especially with slowing user growth, and a relatively small customer base. The lack of profitability is exacerbated by Twitter's desire to remain in strict control of the advertisements available on its platform. As a result, Twitter is increasingly reliant on its own engineers and core user generated content to build its viewer base.

– The Editorial Board

The @Inmates have Overtaken the #Asylum

Will Meneray – *November 06, 2013*

This weekend, I read a fascinating article by Tim Simonite in MIT's Technology Review on the gradual decline of Wikipedia. Despite being an "encyclopedia that anyone can edit" few ever do: of Wikipedia's 365MM annual readers, only 31,000 are active editors.

Despite Wikipedia's efforts to increase engagement, the gap between users generating content and users reading content has persisted. It is the editors themselves who refuse to open the doors to new players. The prisoners have officially taken over the Wikipedia asylum. Similarly, Twitter is hostage to a small group of content creators:

"THE PROBLEM WITH TWITTER IS THAT IT HAS YET TO DECIDE WHAT IT WANTS TO BE WHEN IT GROWS UP."

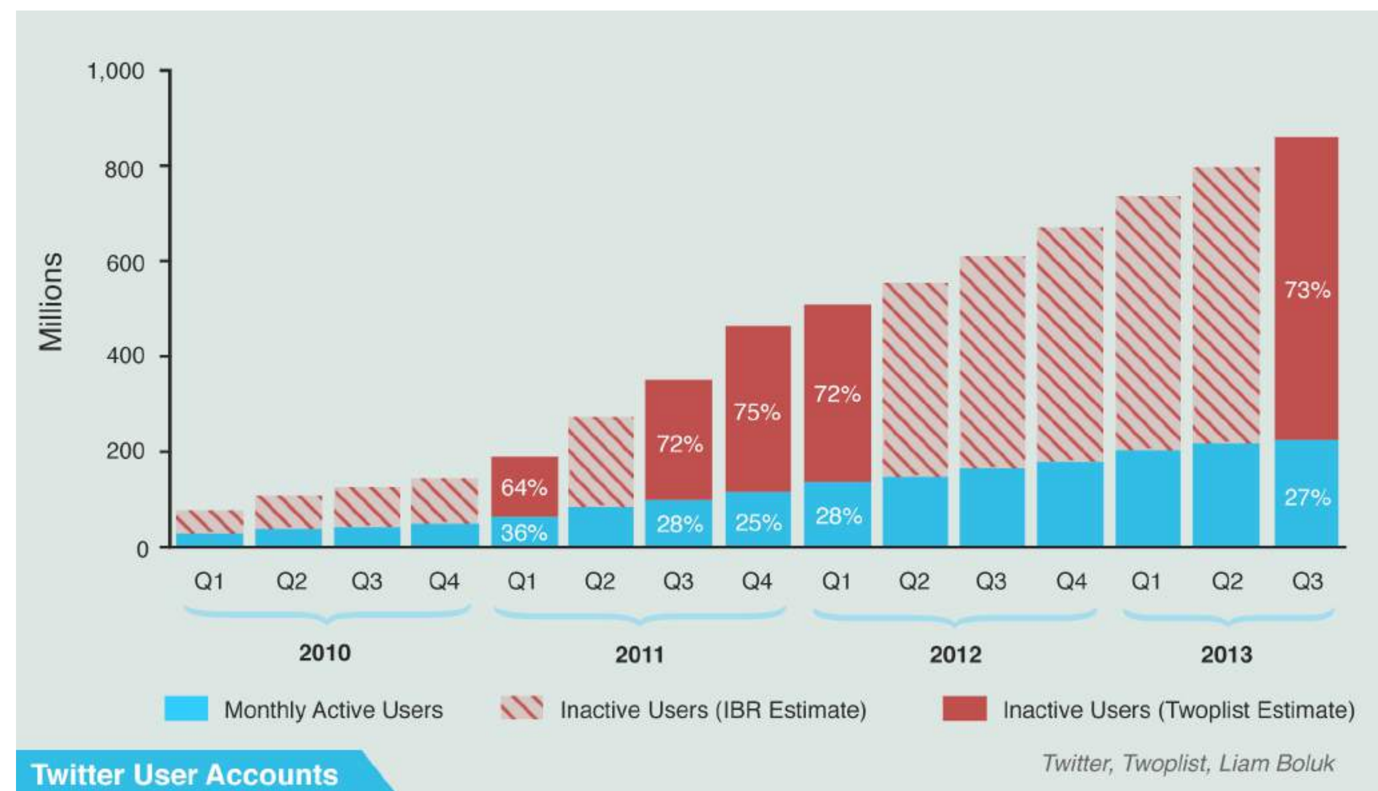
It is clear that both companies share similar fundamental characteristics, as well as roadblocks in overriding the demands of core content generators. When first launched, both were nothing less than revolutionary methods for communication and collaboration online. Most importantly, when assessing their ability to make business decisions, both rely heavily on a small core group of users to generate the vast majority of their content.

The resulting dilemma Twitter faces is that every implementation of a new feature carries with it the very real risk that a small but important group of users will reject it and cause damage to the quality of the service as a whole. Although this is a very real scenario for Twitter, it contrasts strongly with Twitter's peers like Facebook, where connections are far more decentralized and the loss of any single individual, even a well-known one, is minimal.

It will be difficult for Twitter, a company adamant on maintaining a product with little embellishment, to find new ways to generate growth. Twitter must decide "what it wants to be when it grows up" to provide investors a business model worthy of investing in.

Not only is the power of the few worrisome from a content generation standpoint, but also from a content digestion standpoint. With consumers continually digesting the same type of content from the same core producers, developers will find little reason to create new applications that will add value to Twitter's platform. If consumers aren't interested in changing the way that they use Twitter, what value can a new application add? Therefore, Twitter's in-house engineers have their hands tied when trying to upgrade a system that's resisting change, and instead spend time maintaining the preferences of core producers.

– The Editorial Board



Twitter User Accounts

Twitter, Twoplist, Liam Boluk

How Much User #Growth is left for @Twitter?

Liam Boluk – *November 19, 2013*

Twitter's user base was once expected to compete at, or at least near, the scale of Facebook. Today, however, reaching even half of the world's largest social network's current (and still growing) 1.2 billion MAUs seems unlikely. At the end of 2012, for example, Twitter CEO Dick Costolo reportedly set a 2013 year-end target of 400MM users – more than double 2012's finishing 193MM MAUs. With only 232MM MAUs as of September 31st, it now looks as though Twitter may not hit even 25% of Costolo's goal (250MM).

In fact, it's quite possible that 'peak Twitter' is not that far off. At current growth rates, the service will likely settle around roughly 350MM MAUs by the end of 2016. On the surface, 50% growth in a metric as important as MAUs should be encouraging for both management and shareholders. Yet, in the quick boom-and-bust social media space, a 14% compound annual growth rate may disappoint – and Twitter would still be short of Costolo's 2013 goal more than three years later. However, I have doubts that the service will deliver against this forecast, let alone surpass it.

Beyond establishing a profitable business model, management has outlined two overarching priorities: increasing penetration (MAUs) and enhancing per-user engagement. While success on these two fronts would represent an exponential increase in the volume of content created by and available to its users (both good things), it could also threaten the service's usability.

Unlike other social networks, Twitter's value is overwhelmingly focused on real-time communications. As a result, it shows its users an uncurated list of every followed user's tweets in reverse chronological order. Conversely, Facebook, LinkedIn, and Google+ each expose their users to only select, algorithm-determined updates from their network. This "everything" approach has historically made it difficult for those who don't check Twitter multiple times per day to remain engaged in the service.

Increases in the number of Twitterers a user follows and/or the number of tweets put out by each followed user will exacerbate this issue – and could thus limit Twitter to a maximum "saturation point". But is there data to support this?

The graph opposite does look like a positive story. Despite immense growth and expansion from "early adopters" to more mainstream users, Twitter has managed to stabilize its conversion rate of account registrations into MAUs. Yet, this same stabilization suggests the service is not scaling well. As a social network, the network effect should mean that the service's value to its user base will increase with each additional user. A 2.3x increase in user registration since Q3 2011 should therefore have driven a meaningful increase in the registration-to-MAU conversion rate. Furthermore, Twitter has benefited from increased cultural significance and integration over the past few years, as well as expanded its functionality and released new features. As result, the 27% figure estimated by Twoplist is cause for concern.

These trends should concern those relying on MAU growth to enhance shareholder value or provide Twitter with "monetizable scale". It also suggests that product changes are needed to support further growth, as my colleague Will Meneray discussed. Without them, Costolo's goal may never be within reach.

Twitter's 14% CAGR of MAUs pales in comparison to oft-compared peer Facebook's 132% CAGR from 2004-2011. But is growth in MAU the most important metric for Twitter investors?

– The Editorial Board

What Network Monetizes Users Best

Liam Boluk – *November 20, 2013*

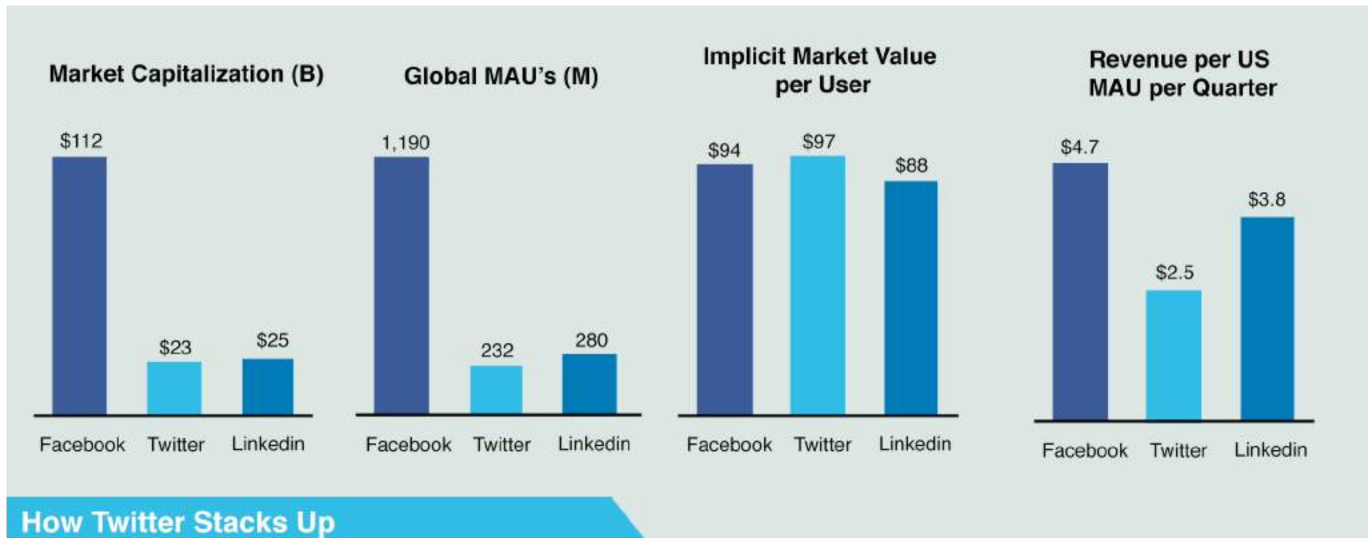
As Twitter's MAU growth slows, investor attention will shift from the size of the company's user base to how well the service extracts value from its users compared to other social networks - and whether it's set up to enhance this performance. However, I would argue the traditional way analysts evaluate this (average revenue per user, or "ARPU") overlooks the more important, proximate question: "How well does Twitter monetize usage?"

Despite the many differences across the major social networks, there seems to be a rough consensus around what a social networking user is worth (~$93). Interestingly, when we look at monetization (i.e. what drives this value), we see significant variability across these services. Twitter, for example, is only able to derive52% of the revenue per user that Facebook does. However, if we drill deeper we can see there is actually a far more meaningful metric – one that shows how successful each company is at deriving this revenue.

According to comScore, Facebook captured close to 84% of total time spent on a social networking site in the third quarter of 2013. Despite this, Facebook is not particularly skilled at monetizing this usage; its leading revenue figures are largely driven by its overwhelming lead in per-user engagement.

Though yet to turn a profit, Twitter, is actually quite effective at monetizing usage, generating 3.5x as much revenue from a minute of its user's time as Facebook. To put this in perspective, generating $10 in advertising revenue from a user would require 1,600 minutes on Twitter – and nearly 5,700 on Facebook.

This means a few things. First, there is a lot of upside opportunity for Facebook if it can increase its lackluster time-monetization. Twitter's story is stronger, despite its significantly lower MAU ceiling. Efforts to drive additional engagement (and



How Twitter Stacks Up

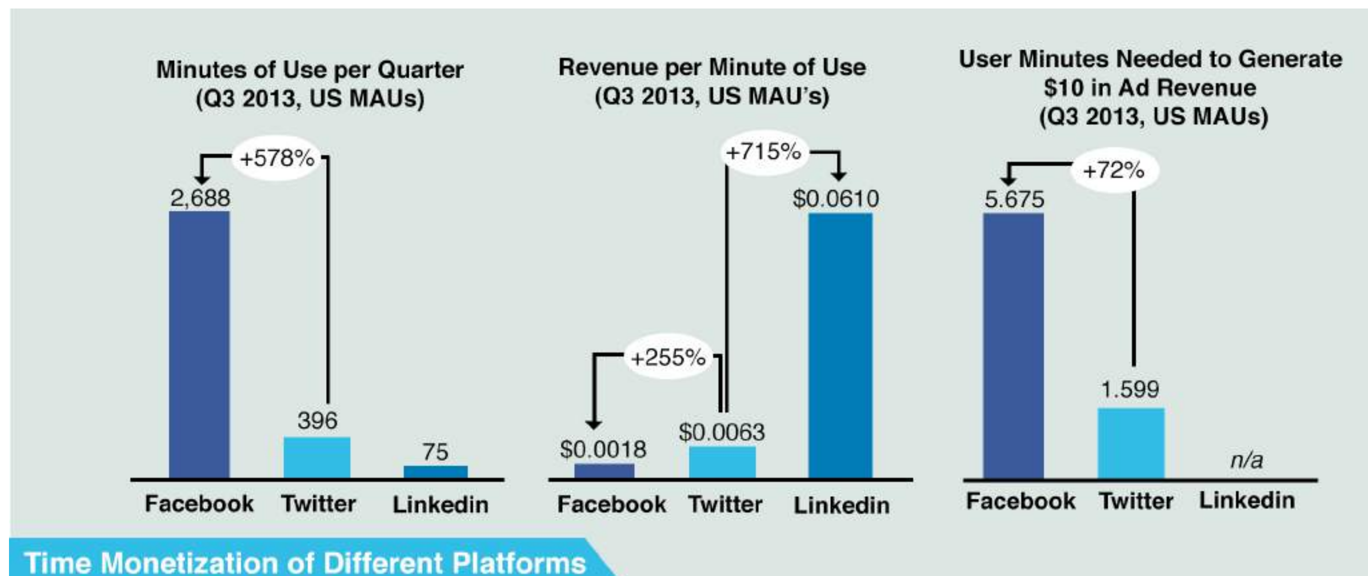
therefore time) can lead to direct and meaningful increases in revenue. Twitter may never reach the monolithic scale management once hoped – but who said it needed to?

Twitter has yet to produce a profit, but investors have continued to buy into the prospect of users generating cash flow. If Twitter is truly nearing, if not past, its peak (as concluded by Boluk), exploring new avenues of revenue in the form of altered services and added features should be explored. This of course (as Meneray points out) has to be deployed in a manner that pleases active content generators, as their input is central to Twitter's value as an effective information disseminator.

A possible route would be to introduce algorithms that curate users' newsfeeds, similar to Facebook's newsfeed, providing a cleaner presentation of pertinent data. This has the potential to increase user engagement and generate a higher conversion of account registrants to MAUs.

Twitter's focus should also be on providing management forecasts that are better synced with actual outcomes. As Boluk noted, Twitter is likely to miss its CEO's user growth numbers by a massive margin, likely a large disappointment to public markets. LinkedIn has been a successful public stock, trading nearly 5x its IPO price, largely because it has beat market expectations time and time again, bringing investor confidence in the company's ability to outperform analysts' projections. While accurate estimates of value drivers like user growth and profitability are obvious benchmarks for public companies, Twitter is especially reliant upon these figure. Should Twitter fail to meet its projections, it is not only the investors Twitter need worry about, but its own employees. As concluded before, Twitter is heavily reliant upon a group of innovating engineers – engineers who are invested in Twitter's stock. Therefore, should Twitter fail to have realistic projections, it loses the ability to offer competitive compensation packages for top talent, losing, perhaps, its most competitive advantage.

– Editorial Board



Time Monetization of Different Platforms

A leading global investment organization

- Get exposure and hands-on involvement
- Broaden your opportunities
- Learn and grow
- Work collaboratively
- Make a meaningful impact
- Help build the future
- Contribute to our critial purpose

OVER $188 BILLION INVESTMENT PORTFOLIO AS OF JUNE, 2013

We invest around the world on behalf of 18 million contributors and beneficiaries of the Canada Pension Plan.

Guided by our purpose, we are independent, accountable and focused on performance.

Learn more at **www.cppib.com**

Toronto London Hong Kong New York São Paulo

WINTER IS COMING...

WINTER IS COMING...

Why Blizzard's Titan is poised to ice Bethesda's Elder Scrolls Online

By Nicholas Zeeb & Ishan Tikku

The PC and console video game industry is defined by intense competition between large development studios continually providing bigger and better products for gamers. Occasionally, two competitors square off for the attention and dollars of a particular gaming segment. One such major battle is set to take place in 2016. In 2014, Bethesda's Zenimax Online (Zenimax) will release a subscription-based Massively Multiplayer Online (MMO - an online video game supporting millions of simultaneous, interacting players) version of its wildly popular video game franchise Elder Scrolls. The franchise's last game, Skyrim, sold over 10 million copies, and its next title, Elder Scrolls Online (ESO), has gamers worldwide impatiently anticipating its release. But amidst all of the excitement this new game has generated, one critical concern remains. Activision Blizzard (Blizzard), the world's leader in MMO gaming, sits poised to rip away ESO's user base right after the game establishes itself. Due to the $450 million investment from the world's leading private equity firm in media and communications, Providence Equity Partners Inc., Zenimax has significant external pressure to succeed with ESO. Therefore, Zenimax must act now in order to keep ESO alive in the long-term, and generate the required return on this investment.

A Stormy Outlook

Over the past decade, Blizzard has become the world's largest and most profitable pure-play video game developer. Its World of Warcraft (WoW) franchise has been the most popular subscription-based MMO since its launch in 2004. Blizzard has also achieved immense success from its other popular franchises, Diablo and StarCraft.

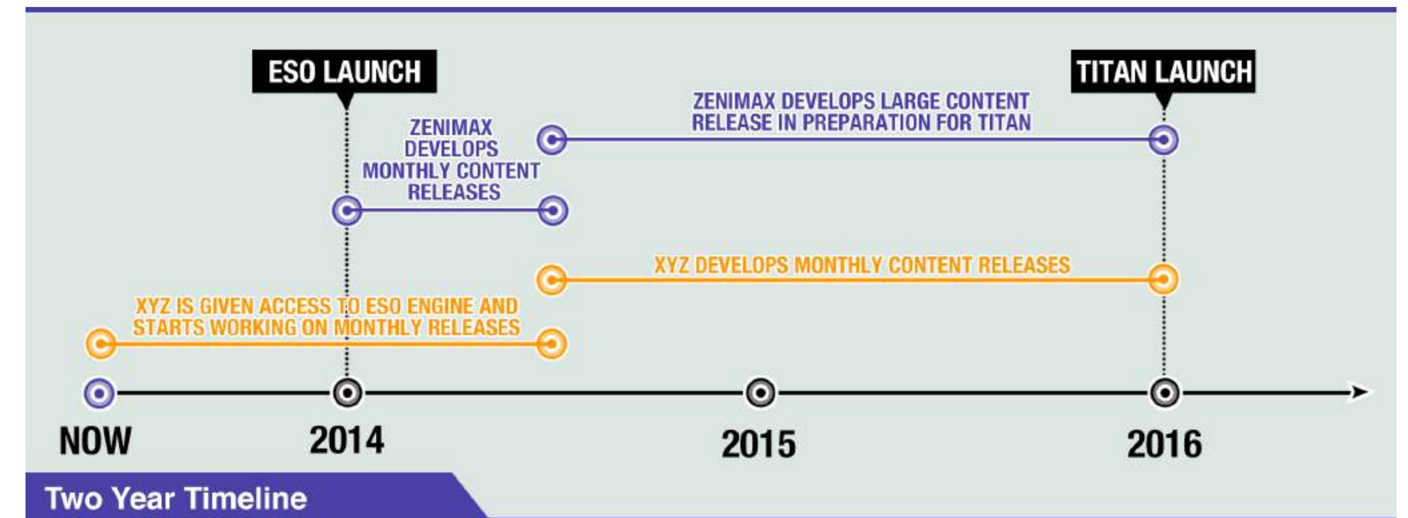
In spite of its successes, Blizzard has experienced some setbacks this year with WoW and Diablo that have tarnished its otherwise stellar image. For one, the subscriber base of WoW declined by two million users this year, down to its lowest subscriber base since 2007. Moreover, the company failed to anticipate a deluge of problems with the virtual online economy that it developed for Diablo 3.

"ZENIMAX MUST PROTECT ESO'S SUBSCRIBER BASE FROM TITAN, AND PURSUE ACTIONS THAT ENSURE THE LONG-TERM SUCCESS OF ESO."

Given these setbacks, Blizzard must demonstrate its resiliency to its investors. This entails a successful game launch that recoups the market share Blizzard has enjoyed in the past. To this end, Blizzard announced that it was delaying its new game, Titan, until at least 2016, in order to provide enough time to perfect the launch of its new title. These steps indicate that Blizzard is implementing a comprehensive strategy to rebuild its reputation, which poses a significant threat to Zenimax in 2016. Zenimax must protect ESO's subscriber base from Titan, and pursue actions that ensure the long-term success of ESO.

Preparing for the Storm

One of the key differentiators of MMO gaming is that these games require an intense time commitment from its players. As such, Titan's release will likely cause subscribers to choose whether to continue their subscription with ESO or switch to

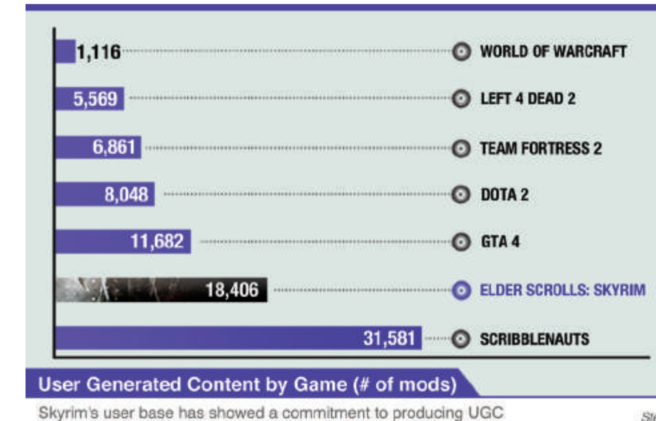


Two Year Timeline

Acting now will allow Zenimax to prepare for Titan's Release

Titan. To prevent churn, Zenimax must provide its users with a large content release alongside Titan's launch to rejuvenate interest in the Elder Scrolls franchise. Furthermore, Zenimax must anticipate whether Blizzard will forgo its standard subscription payment model for Titan, and instead implement a free-to-play (FTP) option. An FTP model would allow players free access to servers and only require micro-transactions for specific content. To compete against a free offering, it is crucial that ESO's large content package also be released for no additional cost to the player. Considering that the average video game expansion pack is $60, or a third of the $180 that a $15 monthly subscription fee generates per year, it is clear that every user lost would require ESO to sell three copies of its new expansion. Therefore, it is smarter to release this content pack for free in order to maximize subscription revenues.

However, this shift in focus creates problems for Zenimax's value proposition to gamers and its internal capabilities. ESO attracts two different segments of the gaming population. First, there are the gamers loyal to the Elder Scrolls brand. These players are more likely to finish the in-game content provided at launch and then stop playing until the next extensive launch of gameplay. Thus, the large content release will keep these players involved with the ESO franchise. On the other hand, many gamers will be drawn to the open-world experience virtually synonymous with MMO. Gamers in this segment tend to be more impatient with content releases. Since they play the game continuously, they seek more frequent updates and will not accept waiting for two years before any additional gameplay is made available. In order to satisfy this segment and decrease churn rates, Zenimax cannot afford to forgo monthly releases by completely shifting its focus to a larger content package. Unfortunately, Zenimax does not have the capacity to develop both streams of content internally and needs to find a way to expand its development capabilities.



User Generated Content by Game (# of mods)

Skyrim's user base has showed a commitment to producing UGC

Handing over the Anvil

One solution that Zenimax must adopt is utilizing user-generated content (UGC) to allow gamers to contribute to the Elder Scrolls universe. Skyrim benefited from this model as its custom creation kit allowed gamers to develop hundreds of hours of extended gameplay, including over 2,500 modifications within the first week alone. Zenimax should use this ability to produce UGC to its advantage. By providing a similar content creation kit, Zenimax can manage the resulting pipeline of UGC to add to future monthly content releases. However, Zenimax must develop a system to ensure that only the most popular UGC is published in order to maintain its reputation of high-quality gameplay.

Zenimax should also take a page from Valve Corporation - a videogame developer and the world's most successful online software distributor. The company's distribution platform, Steam, utilizes a system called Greenlight, which allows users to vote on in-development games that they want to see published. Zenimax could use a similar system, where unreleased UGC is listed on the ESO website. The UGC with the highest number of votes at the end of the month would be published within a future monthly content release. By offering a single marketplace to vote on content, Zenimax provides potential developers with the opportunity to receive better recognition than just posting their modifications on their own websites. To control quality, gamers using the development kit would have to sign a contract prohibiting the creation of inappropriate content. A penalty of

being banned from ESO's servers should be used as a deterrent. To ensure high quality UGC and promotions that are compelling enough to encourage voting, Zenimax must motivate its user developers through revenue sharing. Using a model similar to YouTube, Zenimax should provide unit revenue per vote over a specified threshold, provided that the content has been passed to launch.

By combining an incentive plan with this type of rating model, Zenimax increases its capacity to create content while ensuring it does not dilute its brand image with undesirable gameplay. However, it is unlikely that UGC would be able to sustain monthly content releases by itself. Since managing UGC and implementing gameplay onto servers would require additional resources that may not be feasible for Zenimax, the company must consider additional methods to increase its capacity.

Recruiting a Follower

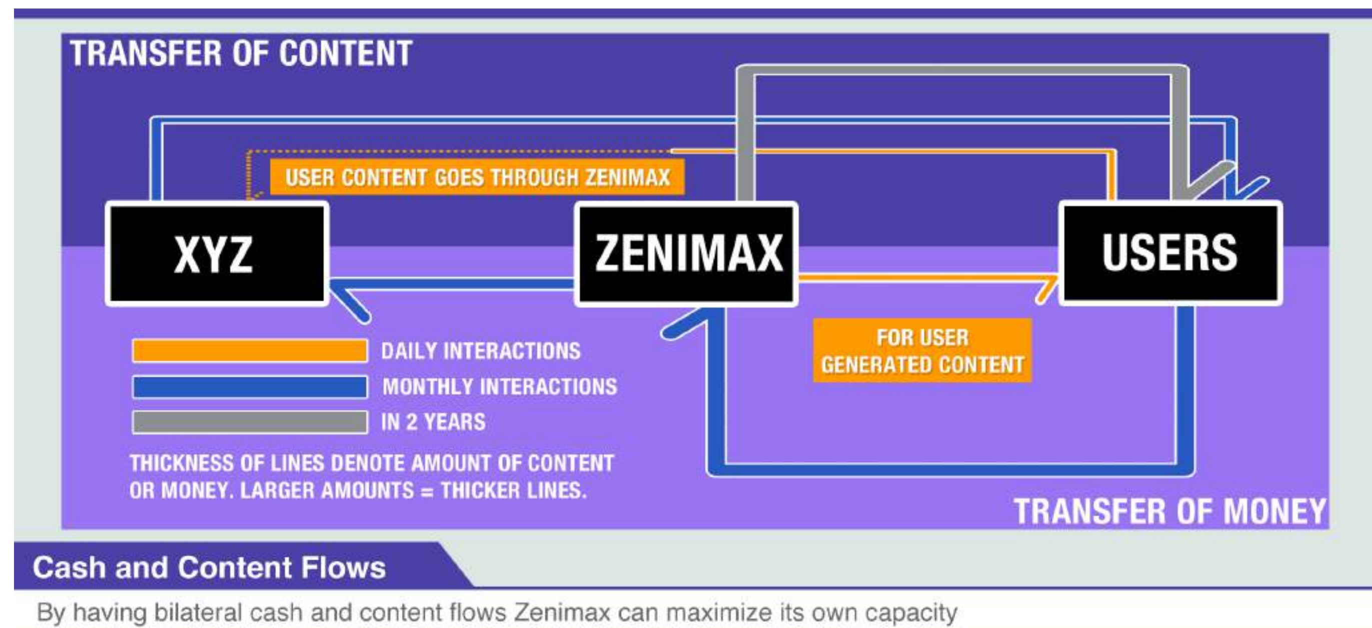
Zenimax must subcontract its monthly content development to a smaller game design studio. Though most developers would be unwilling to provide external parties access to their game's engine, the potential benefits of this partnership far outweigh the negatives. This agreement will allow Zenimax to focus on the large content release to counter Titan, while the partnering studio would control monthly releases and management of UGC. In this way, Zenimax will be able to increase its capacity to develop a multitude of services that will make ESO successful in the MMO market.

Zenimax can establish a partnership with one of the indie development studios affiliated with Sony, whose newly established rapport with Zenimax has been well documented. The Elder Scrolls franchise is so well-recognized that any one of these studios would jump at the chance of associating itself with the brand through continuing the development of ESO. After signing the appropriate confidentiality agreements, the small development company (XYZ) would receive access to ESO's game engine ahead of launch, as well as servers for testing and developing new gameplay. Zenimax should produce the monthly releases itself for the first six months after ESO's launch. This time period is extremely crucial as the game will be susceptible to potential decreases in consumer interest. After the six month mark, Zenimax should allow XYZ full rights to develop monthly content so that Zenimax can begin production on the larger content package set for release alongside Titan's launch.

Ideally, Zenimax would pay XYZ $1 per subscriber per month. The pay-by-subscriber model is highly beneficial to Zenimax. It provides incentive for XYZ to develop high quality content each month to reduce ESO's churn rates and thus continue to grow the ESO player community. XYZ's main incremental cost in the agreement would be any additional employees required to meet project deadlines and revenue sharing targets for UGC. XYZ would monitor and integrate the UGC content pipeline into its monthly releases. Zenimax would still cover the costs of running ESO's servers and infrastructure, but it would only require a small amount of employees to work on transitioning XYZ's monthly releases onto ESO's servers. By subcontracting monthly content releases to a smaller studio, Zenimax will be able to prepare itself for the inevitable showdown against Titan.

A Spring Thaw

The importance of preparing for Activision Blizzard's release of Titan cannot be understated. Blizzard will be using all of its resources to rebuild its reputation which will directly impact ESO's sustainability. In order to defend its user base, Zenimax must focus on preparing a large content release alongside Titan's launch, while subcontracting its monthly releases in order to expand its capacity. Through this process, ESO will be able to thrive despite the release of Titan and become a long-running MMO title.



Cash and Content Flows

By having bilateral cash and content flows Zenimax can maximize its own capacity

THREE'S COMPANY, FOUR'S ALLOWED

Rogers could use a fourth Canadian telecom player to its advantage

By Colin Lernell & Rajdeep Mukherjee

"I've never seen how a four-player [wireless] market can work in a country like Canada. I never thought of it as a sustainable model," said Nadir Mohamed, CEO of Rogers Communications, in a July press conference. In the face of unrelenting regulators with the political will to introduce a "fourth wireless player in every region of the country," Mr. Mohamed and Rogers' incoming CEO, Guy Laurence, might consider never saying "never". Instead, the two CEOs need only look to France for an example of how they might actually be able to capitalize on the situation.

The largest of France's "Big Three" wireless operators, Orange (formerly France Telecom), helped new entrant Free Mobile simultaneously grab market share, hurt competitors' margins, quell consumer and regulatory tempers, and even earned significant revenue on the entrant's growth. With Canadian regulators likely to set roaming rates and push for foreign entrants to ensure a fourth player's success, Rogers might need to reconsider its own deterrence strategy when dealing with Canadian entrant Wind Mobile.

Vive La Liberté

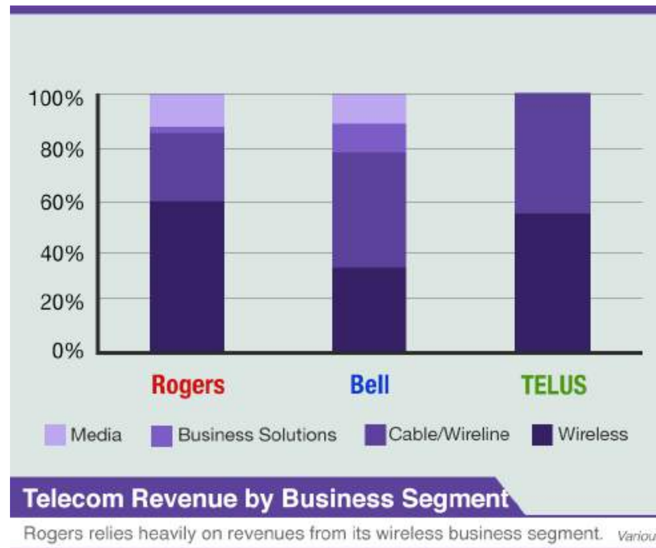
Prior to 2011, in a scenario eerily familiar to Canada's, France's telecommunications industry was in a state of distress in the minds of its wireless consumers. The French Big Three telecoms held nearly 90% of the market, were charging high prices, and were sharing a suppressive strategy to stifle new entrants. A dissatisfied public pushed French regulators to facilitate the entry of a fourth wireless operator.

Enter Free Mobile (Free) in 2012. Igniting 10% to 50% cuts in competitors' rates, Free Mobile took 11% market share in under two years. Free was able to accomplish this after signing an exclusive wholesale network-sharing deal with Orange to cover 97% of the French market. Orange, the largest operator in France, with roughly the same market share that Rogers holds in Canada at 37.5%, is estimated to have earned more than €2 billion on the Free deal, while still experiencing 3.2% year-over-year subscriber growth through 2013. On the other hand, the second and third largest operators, SFR and Bouygues Telecom (BT), lost 2% market share each, slashing margins and losing revenue, without recovering a cent. Rogers might be concerned with short-term market share, but the Orange deal demonstrates the strategic advantage of being a facilitator.

Rogers Has the Most to Lose

In the event of a foreign or domestic entrant gaining traction, Rogers has the most to lose of the Big Three in the current environment. Rogers is the largest wireless operator in Canada with 34% market share, compared to 28% each for Bell and TELUS. Rogers has a strong presence in Ontario, Quebec, and British Columbia; the provinces where new entrants such as Wind are looking to expand. Rogers also received 57% of its revenues and 64% of its operating profits from the wireless segment in 2012; compared to 30% and 53% of revenues for Bell and TELUS respectively. Furthermore, Bell and TELUS benefit from a shared network infrastructure, having built out their tower networks together, reducing each other's capital expenditures while capitalizing on economies of scale.

THREE'S COMPANY, FOUR'S ALLOWED



Telecom Revenue by Business Segment

Rogers relies heavily on revenues from its wireless business segment. *Various*

Push or Pull?

Rogers can either continue deterring Wind and other entrants' growth or facilitate their inevitable presence. Historically, despite political and regulatory push-back, the big three effectively kept new entrants below a collective 5% market share. This remained effective until regulators redoubled their efforts in the hopes of spurring competition, courting large foreign competitors, regulating mobile contracts and fees, and striking down most Big Three bids to reconsolidate the market.

Deterring New Entrants

Rogers, Bell, and TELUS have sought to keep entrants small: they have lobbied the government to prevent pro-entrant regulation, inhibited negotiations on tower and network-sharing deals, and successfully used stand-alone sub-brands such as Chatr, Virgin, Fido and Koodo to compete on price without reducing the parent-brands' margins. Continuing this strategy would have three consequences:

1. Regulatory Vendetta

First, dissatisfied consumers will continue to push for regulation to bridge any competitive advantage Rogers, Bell, and TELUS have over Wind and other small players. This occurred through 2012 and 2013 when the Canadian Radio-television and Telecommunications Commission (CRTC) created a new "Wireless Code of Conduct," which reduced contract lengths, enforced phone unlocking, and limited termination fees to increase churn between firms. With international roaming caps and investigations underway, regulators show no signs of slowing down.

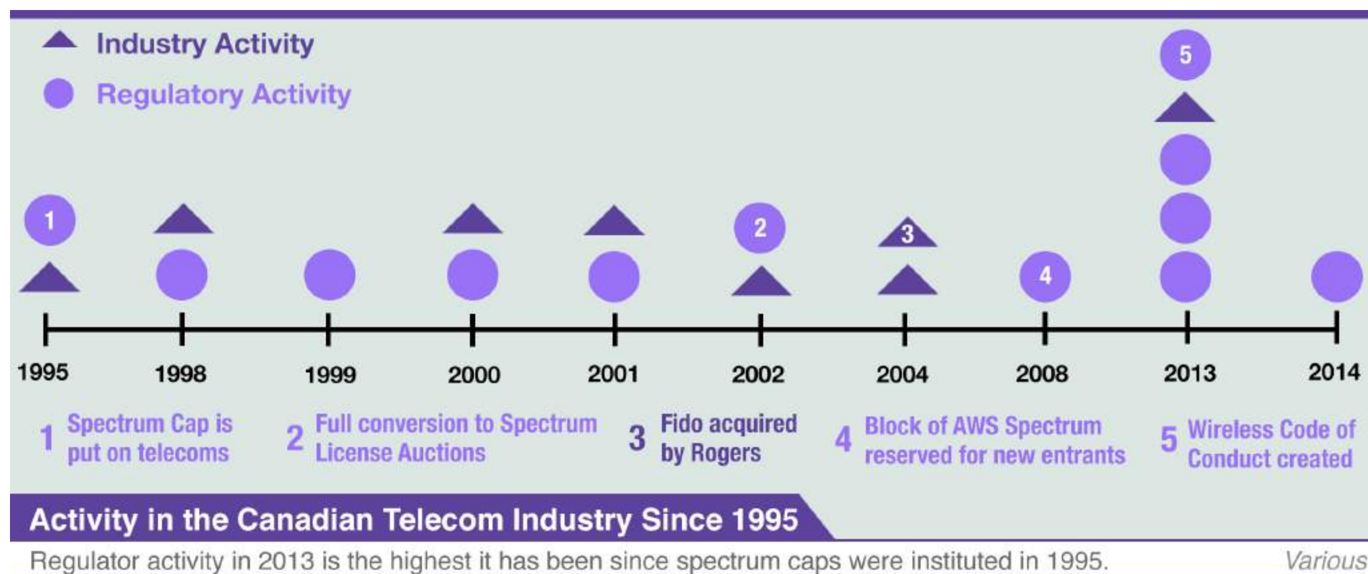
2. Let Them Roam

Second, the CRTC has forced Rogers to negotiate a domestic roaming deal with Wind and other entrants; the CRTC would be pressed to set those rates themselves if they remain high. Roaming agreements currently do not allow Wind to offer its users 3G-compatible network coverage or unlimited roaming offerings like those of the Big Three.

French regulators threatened rate-setting until Free's launch, while the United States Federal Communications Commission went ahead with U.S. rate-setting in 2008. Regulators in Canada have already begun the pricing of fixed-line broadband internet reselling, and will likely enforce network-sharing prices between Wind and all-incumbent networks if nothing changes.

3. Stranger at the Door

Third, Canadian regulators have prevented foreign ownership of telecom companies for national security and protectionist reasons. Regulators recently amended this policy to allow for foreign entrants to own companies with up to 10% market share due to their concerns that the failure of small players would lead to low-cost sub-brands closing their doors, and a subsequent increase in prices. Although a foreign investor would not be able to own over 47% of a telecom with greater than 10% market share, having a small player with 2% market share would be an attractive investment opportunity, especially with Canadian regulators actively courting foreign telecoms. This would provide favorable regulation in exchange for competition.



Activity in the Canadian Telecom Industry Since 1995

Regulator activity in 2013 is the highest it has been since spectrum caps were instituted in 1995. *Various*

Regulators have already prevented the indirect equity owner of Wind from purchasing Allstream, citing national security concerns. Having a competitive domestic fourth player would likely reinforce this conservative approach to foreign investment.

The worst case for Rogers would be the entrance of a large foreign player. United States telecom giant Verizon Wireless reportedly considered entering the Canadian market by acquiring Wind in the summer of 2013. Although Verizon backed off, it has kept an ear to the Canadian market by having lobbyists on the ground. With more capital for marketing and infrastructure expenditure, not to mention considerable brand awareness, a firm like Verizon could turn a small player into a serious contender in the Canadian market.

Keep Your Enemies Closer

Rogers should reserve resources spent on deterring Wind, and instead facilitate its growth to create monetary value. The market share captured by a foreign entrant such as Verizon would dwarf that of Wind's organic growth. If an exclusive network-sharing deal is negotiated instead, it could pre-empt CRTC-regulated roaming rates. This would allow Rogers to retain sole revenues from Wind users roaming on its networks instead of splitting revenues with Bell and TELUS. Rogers could then calm regulators and politicians who would be able to claim a win in their efforts to increase competition.

Profiting on Wind's Growth

If Rogers is to facilitate Wind's capture of market share, it will have to incur losses. However, there are three reasons why Wind's growth will not be as pronounced as Free Mobile's. First, Canada's population density is lower than France's, reducing domestic roaming demand to 30% of the market. Second, unlike Free, Wind does not have a TV, phone, fixed-line broadband, and wireless bundle to attract bundle-discount subscribers from the Big Three. Third, Wind currently has poorly perceived network quality.

If Rogers facilitates Wind's growth, it will see an initial decline in market share, but this will be temporary. Projections assume a 10% decline in Rogers' average revenue per user (ARPU) with market growth based on analyst projections. Despite short-term losses, the long-term strategic benefits are significant with Bell and TELUS likely to amass similar losses without recovery. Simply aiding Wind's growth, however, is not enough for Rogers to take full advantage of this opportunity.

Short-Term: Network-Sharing & Royalties

Rogers should negotiate and sign an exclusive network-sharing deal with Wind. This would be both a wholesale roaming deal and a deal to supplement coverage within Wind zones. Traffic can be selectively pushed between Rogers' and Wind's networks when necessary, with only Wind paying for the extra coverage. Such a deal is unlikely between Wind, Bell, and TELUS – the latter two already share a network, creating complicated negotiations and possible capacity issues.

Appended to that deal should be a royalty agreement. Since Wind could serve subscribers outside of Wind zones, Rogers should earn royalties on any Wind customer using primarily Rogers' networks. This will benefit Wind as it can quickly gain market share and still reap the lifetime value of those customers as it builds out its own towers.

> "ROGERS CAN INVEST ITS SAVED FUNDS IN ITS HIGHER-GROWTH SEGMENTS"

Long-Term: Tower-Building

Once a relationship has been established, Rogers should negotiate a tower-building deal with Wind in Ontario, British Columbia, and Alberta; there are no obvious partners in these provinces. Rogers has already signed tower-building agreements with MTS in Manitoba and Videotron in Quebec in 2013 to split high capital costs, indicating that it sees merit in such deals. Alberta in particular has the largest and fastest growing adoption rate of mobile devices, and newly-developed areas require significant investment. Bell and TELUS already have the competitive advantage of splitting costs on building, upgrading, and maintaining network infrastructure.

Over 52%, or $1.1 billion of Rogers' capital expenditures come from its wireless segment. Saving on wireless infrastructure expenditures means that Rogers can invest saved funds in its higher-growth segments, such as media, machine-to-machine, home monitoring, and its new financial technology ventures.

Facilitated Disruption

Incumbents in a deregulated environment normally use a deterrence strategy for disruptors. This often ends in unfavorable regulations and a loss of market position to entrants with favorable rules on their side. By switching to a facilitator strategy, Rogers would mitigate an aggressive regulatory environment, while saving on infrastructure costs, creating a stabilized long-term partnership with a competitor. This would level the playing field with its two nearest rivals. Mr. Mohamed may not have seen a sustainable four-player model yet, but perhaps he or Mr. Laurence can make one happen while reaping the rewards.

SOYLENT: NUTRITIOUS AND AMBITIOUS

Positioning first as a breakfast staple, and later a lifestyle brand

By Jonathan Vollett

In January of 2013, 24-year old programmer Rob Rhinehart spent a month eating nothing but a self-formulated and self-made concoction he described as a "thick, odorless, beige liquid." Rhinehart named the product "Soylent", after popular Charlton Heston film Soylent Green. Unlike it's namesakes, which was made from actual people, Rhinehart's Soylent was based on a rigorous (though non-professional) analysis of the various "raw ingredients the body uses for energy." Over his month-long trial, Rhinehart recorded his mental and physical performance and made alterations to his formula.

His alleged results were superlative, "my physique has noticeably improved, my skin is clearer, my teeth whiter, my hair thicker and my dandruff gone. My resting heart rate is lower […] My working memory is noticeably better. I can grasp larger software projects and more complex scientific papers more effectively. My awareness is higher. I find music more enjoyable. I notice beauty and art around me that I never did before…I used to spend about 2 hours per day on food […] Now I spend about 5 minutes […] the average American spends $604/month on food […] at personal scale, (Soylent) costs me $154.82/month".

"ROB RHINEHART SPENT A MONTH EATING NOTHING BUT A SELF-FORMULATED AND SELF-MADE CONCOCTION HE DESCRIBED AS A 'THICK, ODORLESS, BEIGE LIQUID.'"

Matching these results is Rhinehart's equally bold ambition to revolutionize the global food industry.

This past summer, Soylent raised over $1 million in crowd-funded capital, as well an additional $1.5 million in seed funding from the likes of Andreessen Horowitz and Lerer Ventures. Despite this customer and investor traction, the question remains the same: "will Soylent be able to produce a profitable and sustainable business model?"

Rhinehart's Lofty Goal

Rhinehart's vision is to replace food as we know it by providing an all-in-one solution to nutritional needs. His goal is to provide Soylent at a price point of $5/day in developed markets, and still leave room for a small profit margin (it is currently priced at $10/day). On a personal level, Rhinehart wants to bring Soylent to those too poor to afford nutritious food. Currently, his plans include tailoring the business and product for the mass-market. However, by failing to target specific markets and overlooking the importance of implementing a proper strategy, Rhinehart will struggle to achieve the sales needed to achieve scale and lower cost per product; making it unfeasible to sell for $5/day.

Finding the right market

Soylent's proposed goals are poorly matched with its current capabilities. As of now, Soylent is burdened by attached capital with profit targets and requires extensive funding to build manufacturing infrastructure. In its current financial position, advocating to offer minute profit margins is a poor way to attract investor capital. Only once manufacturing plants and distribution networks are established could Soylent have the luxury of providing the product at cost.

"WERE SOYLENT TO BRAND ITSELF FIRST AS A BREAKFAST SUPPLEMENT, SOYLENT WOULD BE POSITIONED AS THE MOST EFFICIENT PRODUCT IN THE MARKET FOR THE MOST IMPORTANT MEAL OF THE DAY. "

As of now, Rhinehart should focus on a strategy that will achieve the first and most important goal: bringing Soylent to the right market. First, Rhinehart needs to clearly identify Soylent's most effective target consumer. As a health food product, it is highly nutritious, beating out all competitors from a sustenance standpoint. However, it's still in an early stage of development making it unappealing to a broad set of consumers due to its unappetizing look, lack of flavor, and one-formula-fits-all format. Without immediate improvements to these characteristics, Soylent will struggle to gain sustainable traction.

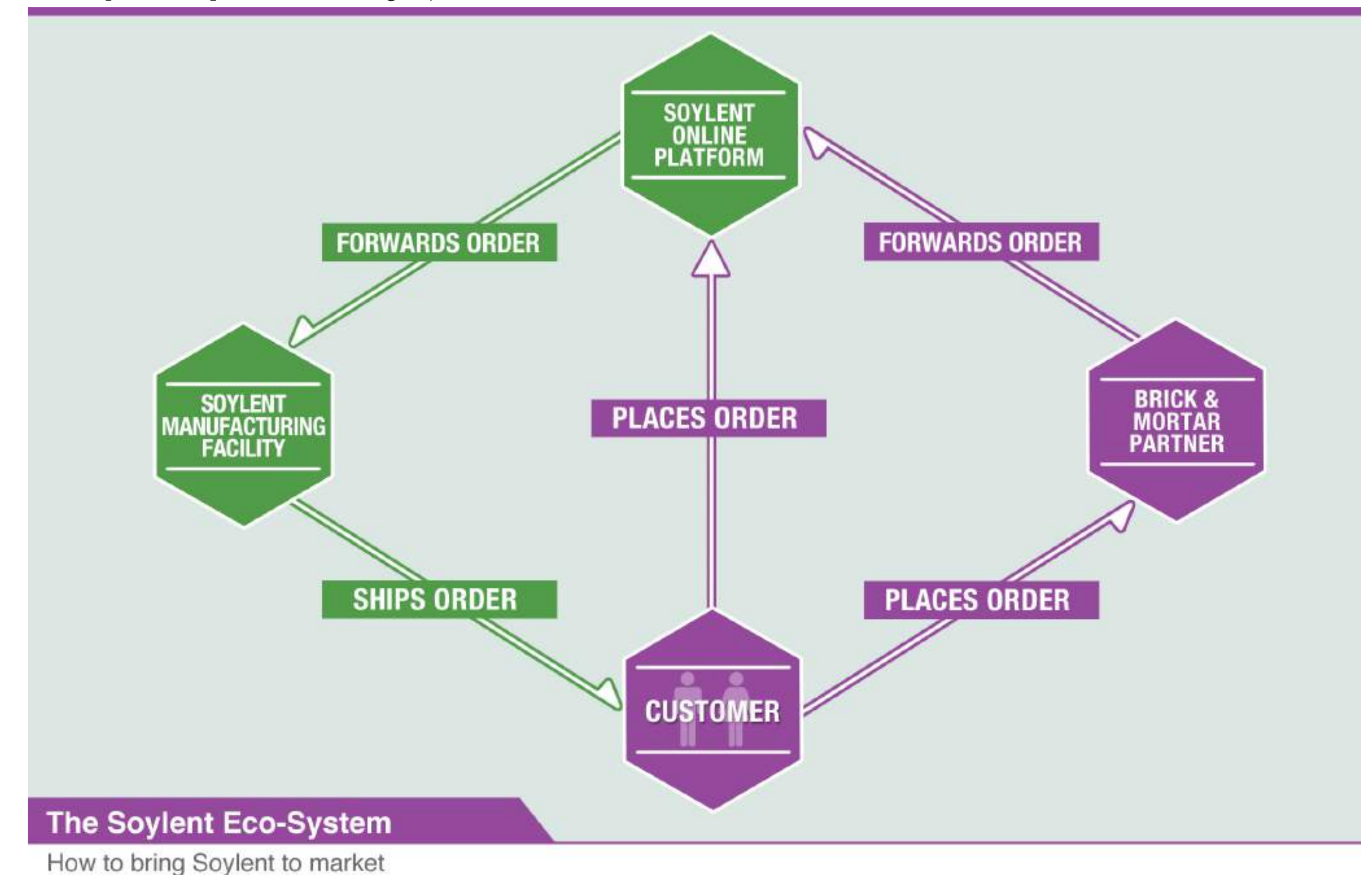
While Rhinehart hopes to bring Soylent to the underprivileged population in the long-term, he is currently without the volume to produce a profit while selling Soylent at close to cost. In terms of composition, Soylent is well-positioned to be the most nutritionally complete meal supplement in the market. As such, it is best geared towards a developed market where consumers are increasingly conscious of the content of their meals and are well-versed in the benefits of healthy foods.

Consumer health-food segments are growing quickly and hold a lot of potential, generating revenues of $32 billion in 2012, and which are expected to double by 2021. Although Soylent effectively functions as a meal replacement, narrowing the product's scope to a specific meal would appeal to a wider demographic that wouldn't feel locked into an overwhelming "Soylent Lifestyle". Meal supplements are consumed by users for a myriad of reasons, but primarily for their convenience and health benefits. Were Soylent to brand itself first as a breakfast supplement, Soylent would be positioned as the most efficient product in the market for the most important meal of the day. Positioned solely as a morning meal, consumers will be more receptive to adopting the product, as mornings are naturally the most rushed time of day.

Strategies

A Breakfast Favourite

In order for Soylent to successfully capture a larger part of the market for breakfast food in the developing world, it must make aggressive investments into R&D to develop different flavours,



The Soylent Eco-System

How to bring Soylent to market

textures, and, more importantly, customizations to fit the needs of different body types. To spur interest from new customers, Soylent should implement a 30-day free trial period. In exchange, customers would be asked to provide feedback and suggestions on which flavours and textures they liked best. The insights from this initiative should prove extremely valuable, given the product's infancy and need for continuous refinement. Free trials also work well as a marketing tactic, generating word of mouth advertisement. Furthermore, this testing phase would shield Soylent from negative reactions of mass-market consumers, by receiving continual input to develop and strengthen Soylent's brand in the product development process. Soylent should delay full product roll-out – which is currently planned for December 2013 – until it can integrate this feedback.

"ONCE SOYLENT HAS DEVELOPED ITS PRODUCT PORTFOLIO, IT CAN THEN FOCUS ITS ATTENTION ON BRANDING ITSELF AS A LIFESTYLE PRODUCT"

It's a Wonderful Life

Once Soylent has developed its product portfolio, it can then focus its attention on branding itself as a lifestyle product. With a diverse selection of colours, tastes, and supplements for different lifestyles, Soylent has the opportunity to further generate a loyal following. Soylent undoubtedly holds a level of advantage over other meal supplements because of its nutritional efficiency, but with product development, an identifiable brand, and (future) endorsers, it will position itself very strongly. One of Soylent's prominent advantages is its ability to eventually replace all meals, providing consumers with sufficient nutrition for months, years, and possibly forever. Compounded over its use, consumers stand to save enormous amounts of time and money. As a long-term option, consumers will have legitimate incentives to adopt the "Soylent Lifestyle".

Soylent's current brand recognition is concentrated on the West Coast (and major urban cities across the US). As an initial roll-out phase, Soylent should partner with a respected company in the food nutrition space (such as GNC) that could offer products in select stores. This partner would fill orders on behalf of the customer and forward it to the online platform. Due to Soylent's product quality, customer retention should be an easy task assuming a smooth distribution system is maintained. This will be facilitated through delivery of Soylent right to customers' doors, and assistance in the process will be directed through Soylent's online platform or through its in-store partner.

Risks

Competition

Soylent is not without its weaknesses when targeting a fairly saturated breakfast market. With large incumbent conglomerates like Kraft and Kellogg, it is essential that Soylent quickly develop a niche following. These long-standing giants (founded in 1903 and 1906 respectively) have an abundance of resources from which to draw upon to defend their position. An agile organization among them could even attempt a copy-cat product and utilize their retail relationships to capture the market ahead of Soylent because recipes aren't patentable.

Potential competitors from the private label meal replacement industry consist of Unilever (SlimFast), and Abbot Laboratories (Ensure) each of whom have sizeable market shares, and the capital and infrastructure to release a breakfast-specific Soylent competitor. However, the overall industry remains fragmented with over 230 firms in the US. With low barriers to entry and low switching costs, Soylent has a tangible opportunity to offer a unique value; a full diet supplement with complete nutritional value. Further, Soylent is well positioned to create a loyal following, and with further product development, market testing and branding, it can defend its market share from the larger players.

Health Risks

As his own product's guinea pig, Rhinehart experienced first-hand the effects of his product's testing phase, proving it was not ready to be consumed on a regular basis. If similar challenges arose with new product versions, it would pose a significant risk to Soylent. SlimFast's 2009 major recall of its ready-to-drink brands illustrates the need for extensive product testing. Even with significant health benefits, Soylent can easily fall prey to a few cases of negative publicity that could derail its ability to bring the product to mass market. To mitigate such risks Soylent needs to market the product as part of a healthy diet, emphasizing limited daily consumption – similar to the warnings of energy drinks – and not the foundation of a diet as Rhinehart had initially recommended. Only upon further testing and feedback should Soylent broach the conversation of diet supplements.

So What's the Next Meal?

Soylent would be well suited to focus exclusively on product development in the short-term. By building a loyal following, expanding its product line and extensively testing its formula, Soylent can position itself for mass market consumption. Until that point, Soylent must endure the necessary growing pains before arriving at the right strategic recipe.

E-CIGARETTES UP TO BAT

Reigniting British American Tobacco's Australian business

By Morgan Moskalyk & Nick White

Big Tobacco, once one of the most lucrative and stable industries, appears to be burning out in many of the world's developed countries. Government intervention through advertising bans and increased taxation is exacerbating the fact that consumers are increasingly informed about the well-known health issues associated with smoking cigarettes. The tobacco industry's decline is especially apparent in Australia, where the prevalence of smoking and per smoker consumption are steadily declining. Estimates have Australian tobacco sales on a compound annual decline rate of 3.4%, but expectations are that market degeneration will accelerate to upwards of 4% through 2017.

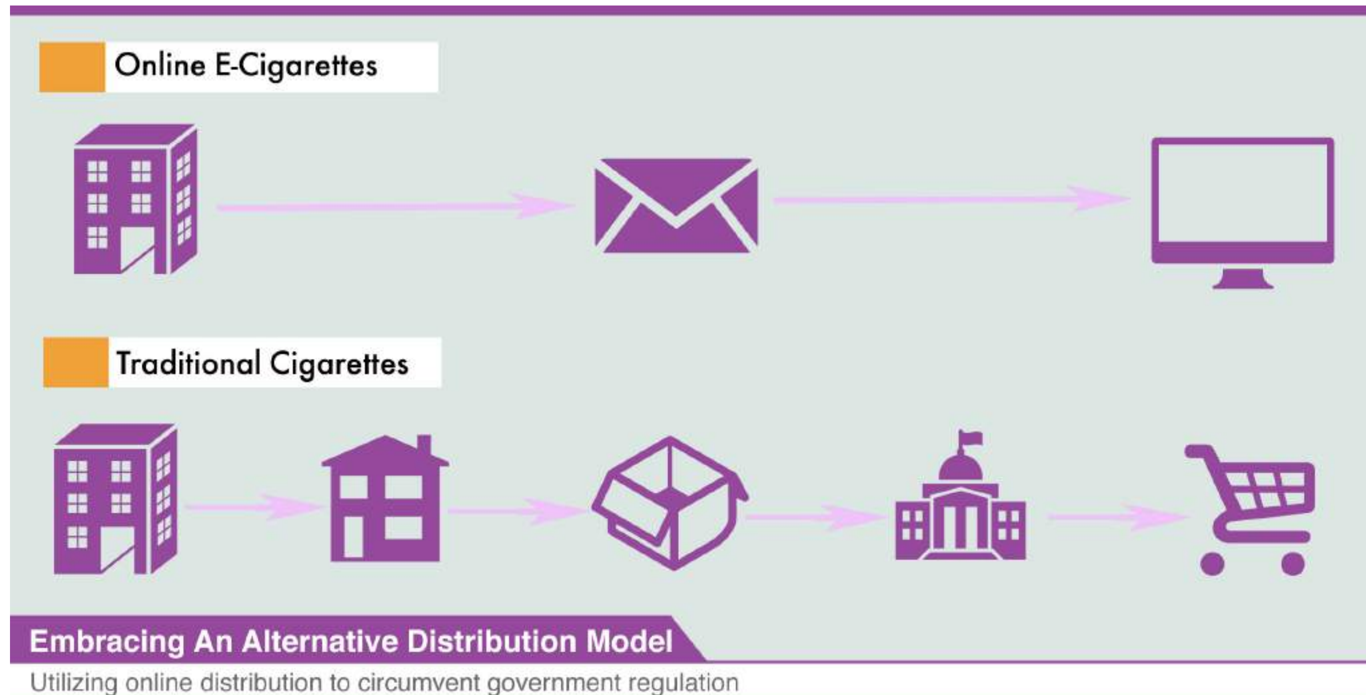
For British American Tobacco (BAT) – the producer of Winfield (an Australian favourite), Benson & Hedges, and Holiday cigarettes, a weak forecast outlook "down under" is especially threatening, as 30% of its global revenue is derived from the country-continent. The historical market leader has been able to maintain consumer traction because 95% of consumers demonstrate brand loyalty. However, the Australian government has stripped tobacco companies of branding privileges, forcing cigarettes to be sold in drab olive green packs, with graphic health warnings covering 70% of packaging and only uniform font brand names listed on the bottom, thus removing a core strength used by BAT.

Tobacco's Technological Breakthrough

Unfavourable market and non-market conditions in Australia reveal opportunity, however, for both BAT and the e-cigarette – a nascent technology that is a "safer" alternative to traditional, combustion cigarettes. The e-cigarette industry is in its infancy with sales just short of $2 billion, but Goldman Sachs estimates that e-cigarette sales could reach $10 billion by 2020. This would account for more than 10% of total tobacco industry volume and 15% of total profits. BAT, which recently launched its own version of the e-cigarette in the UK, is well-poised to protect its tobacco market leadership in Australia, albeit by broadening its product portfolio. BAT should pivot from being a traditional, tobacco-centric company to prioritizing e-cigarettes in Australia. This represents a bold strategy which can grow the firm's share of the market, allowing it to both capitalize on growth in a new category and hedge from relying upon the status quo: being the leader in a declining market.

"Does Not Contain Tobacco"

The e-cigarette industry has been built on the idea of "vaping" rather than smoking. The new name for the act of lighting up derives from the fact that e-cigarettes operate by heating a nicotine-infused liquid solution, producing vapour which resembles smoke. Importantly, e-cigarette producers are marketing this new activity as a healthy alternative to smoking, which reduces the stigmatization associated with traditional cigarettes. This is exemplified by the promotion of "vape bars" – swanky lounges that emphasize using e-cigarettes as a cool and social activity. The sentiment of messaging associated with e-cigarettes is not new to the tobacco industry; it is analogous to past marketing tactics used to sell traditional smokes - the Marlboro Man campaign being a famous example. This time though, companies want the experience and product to be distinctly separate in the minds of consumers, regulators, and the general public. On its website, one producer of e-cigarettes prominently notes that



Embracing An Alternative Distribution Model

Utilizing online distribution to circumvent government regulation

"although nicotine is derived from tobacco (as all nicotine is), e-cigarettes do not contain tobacco."

To some extent, those behind e-cigarettes have good reason to want to separate them from the negative health effects and consequent stigma attached to traditional tobacco. E-cigarettes have not yet been medically proven to be safer than regular cigarettes, but most of the carcinogens and toxins have been stripped from the new version of an old product, leading many to believe they are certainly a better replacement.

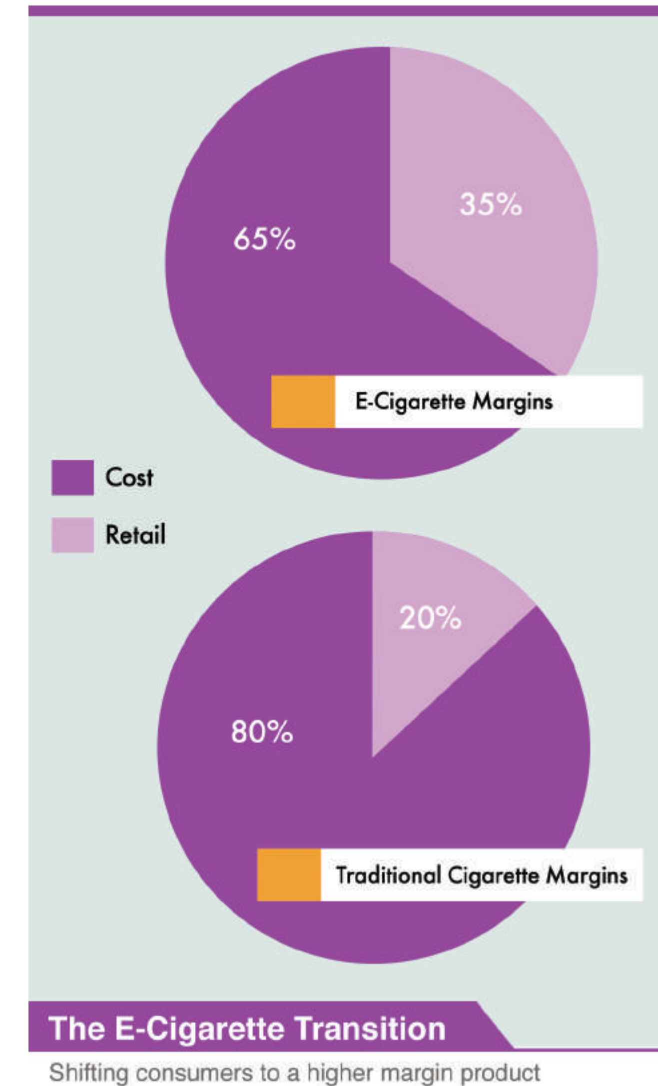
Many of the world's leading e-cigarette producers are Big Tobacco firms, but they have maintained separate brands specific to e-cigarettes, highlighting a strategy aimed at separating the new devices from its core product lines. Lorillard entered the e-cigarette market by acquiring Blu e-cigarette in April 2012 for $135 million. The distinct Blu unit now accounts for 4% of Lorillard's sales. Reynolds followed suit, launching its own Vuse line of e-cigarettes in the summer of 2013. BAT has likewise sought to capitalize on the e-cigarette space and has launched its own e-cigarette known as the Vype, albeit only in the UK. A variety of other, smaller firms fill out the rest of the global competitive space. Bigger players have largely contained their foray into e-cigarettes to the United States and Europe, however, signalling uncertainty about what drives adoption and about how regulation will play out in various jurisdictions. Australia, for example, has not yet seen a major entrant into the e-cigarette market, allowing BAT to be the first.

Blazing Into Australia with Vype

In order to protect itself from another Big Tobacco player transplanting its e-cigarette offering into Australia and gaining first mover advantage, BAT should first use its already-built Vype brand to solidify its prominence in the Australian tobacco market. Core reasons for BAT to patriate Vype into Australia include its size advantage over the existing e-cigarette boutiques, and the firm's experience rolling out Vype in the UK. The firm should blitz the Australian market through social media promotion to develop a strong presence online, allowing it to build the Vype brand quickly; speed is important with such high rates of customer loyalty to nicotine products. Going online enables BAT to market its product without using traditional advertising, which is tightly regulated for cigarette producers in the country. Online promotions must emphasize brand rather than product, though this can be done efficiently and fits into the marketing strategy of selling lifestyle rather than e-cigarettes themselves.

"THE E-CIGARETTE INDUSTRY HAS BEEN BUILT ON THE IDEA OF "VAPING" RATHER THAN SMOKING."

Unfortunately for BAT, it will not be able to sell the Vype through retail channels: government regulation currently restricts e-cigarettes from being sold in the traditional outlets for cigarettes in Australia, like grocery stores. As a result, BAT must resort to online sales. In attempt to bridge the convenience gap between traditional retail and online selling in Australia, BAT should launch a Vype mobile app. The app can offer a periodic ordering feature that extracts usage patterns to alert users when a refill is needed, allowing Vype users to enjoy a personalized purchasing experience, and providing for additional customer engagement avenues to build further awareness. This would match the positioning BAT currently employs with Vype - hip and relevant. Similarly, BAT should replicate the brick-and-mortar Vype Social Bars it has used to build awareness for its product in England. The Social Bars, though unable to sell the product directly due to retail sales restrictions, can complement the "does not contain tobacco" marketing approach that has been taken with Vype by hosting an atmosphere where vaping is encouraged.



The E-Cigarette Transition

Shifting consumers to a higher margin product

There are obvious risks associated with expanding in order to enter the tightly regulated Australian market, but there remains definite upside. Implanting the Vype brand will allow BAT to capture a new audience of consumers who are intrigued by the idea of vaping. Moreover, realizing growth from the expanding e-cigarette market will serve to hedge against declining traditional tobacco sales. The financial upside derives largely from the fact that margins on the new, vapour-based products are 35% compared to 20% on regular cigarettes. Finally, BAT has real incentive to diversify its presence in Australia by transplanting its e-cigarette capabilities because the Australian government is considering the idea of banning traditional cigarettes altogether should the e-version be proven safe. Though the government remains reticent to the likelihood of such a progressive policy measure, the Australian government is known for being a leader in implementing environmental and health and safety legislation.

If the ban were to go through, BAT would see a serious drag on its $1.6 billion of Australian cigarette sales. Surely, in that case, the demand for e-cigarettes would pique, and competitors would look to take advantage of the forced shift of consumers away from regular cigarettes; it would displace consumers who are used to a particular brand for their nicotine fix. To differentiate, BAT would have to be willing to take a unique approach not yet used by incumbent Big Tobacco players in the e-cigarette market.

Accelerating Adoption

BAT should also expand with a second e-cigarette offering that features its traditional Winfield brand in order to spark familiarity amongst its traditional tobacco smokers and drive e-cigarette adoption. Traditional smokers are not as susceptible to the new category of vaping, because they are used to the traditional product and partial to their favourite brand. One Big Tobacco executive notes that there remains difficulty in adjusting smokers to a different product due to emotional and cognitive dissonance; marketing an e-cigarette in a manner that caters to their loyalty remains ideal. Preferably, a Winfield brand will even help Australian smokers of non-BAT cigarettes transition, allowing the firm to capture competitors' market share. BAT should not be overly concerned about whether the Winfield e-cigarette cannibalizes its traditional tobacco sales, either, as there is higher margin in the e-version. This strategy is well suited to combat a potential government ban of cigarettes and also provides a proactive approach to hedge against a declining industry while positioning BAT for a differentiated competitive position.

Clearing the Air

To thrive with this dual-offering, the clear distinction between Vype and traditionally branded e-cigarettes must be highlighted to avoid confusing consumers. Currently, in the UK, the Vype brand is disassociated with BAT's other products, and avoiding reference to this relationship in Australia must be done so as maintain the validity of its message alongside the Winfield e-cigarette. Clear establishment of product offerings with distinct benefits, differentiated perceptions, and separated user bases will avoid a loss of BAT's message in translation.

BAT must be prepared to diversify its product offerings in Australia to take advantage of growth in the higher-margin e-cigarette category and to protect against decline in the traditional cigarette space. Its Vype product, currently marketed as a vaping product and not a smoker's product, can be transplanted from the UK in order to build a new consumer base, while a Winfield-branded e-cigarette can enable it to transition smokers to the product of the future.

BABY STEPS

How Lululemon can overcome current controversies by entering the baby clothing market

By Hannah Baker

When Vancouver-based Lululemon Athletica (Lulu) first opened in 1998, founder Chip Wilson imagined a "community hub where people could learn and discuss the physical aspects of healthy living." By relying heavily on the expertise and feedback of professional yoga instructors, Lulu began developing products that complemented the workshops and classes offered in its very own stores. Over the past decade, Lulu quickly became a Canadian retail success story earning itself a reputation for quality and innovation in the high-end active-wear industry by using patented high-performance fabrics with its signature yoga pants line. Lulu built a tremendously loyal following, adopting the mantra "friends are more important than money" and propelling it to be Canada's fastest-growing brand in 2012.

A Little Too Transparent

Unfortunately, despite its storied past, in the last year Lulu has had to deal with turbulent public relations. First, on March 18th 2013, the company recalled all black Luon pants, its highest selling item, due to a design flaw that made the pants too sheer. Shortly thereafter, CEO Christine Day announced she would be stepping down once a successor was found. Chief product officer Sheree Waterson, resigned following the Luon incident. Lulu's share price dropped 8% following the recall and more than 20% after the CEO's announcement. The company subsequently saw a decline in sales and responded by lowering its original revenue and earnings-per-share forecasts for the remainder of the fiscal year. Making matters worse, on November 6th 2013, Mr. Wilson caused an uproar when he blamed the shape of women's bodies for causing the yoga pants to be too sheer and occasionally pilling. These recent shortcomings have damaged brand integrity and harmed investor confidence. Lulu needs to take action in order to reestablish its brand image.

The Original Yogis

While Lulu has entered into international and men's-only markets, there is another expansion strategy that can quickly restore investor confidence. Babies; the original yogis, could provide Lulu with a low-risk, low cost opportunity to boost the firm's market position. Lulu's flexible and unique materials mesh well with babies' unique needs. and Lulu only needs to produce baby-sized versions of its existing products.

The entire Canadian children's-wear industry is worth $4.6 billion, with babies aged 0-4 representing 50% of the market. Children's-wear is dominated by five major players which make up 70% of the market: Toys "R" Us , The Children's Place Retail Stores, Ascena Retail Group, Carter's, and The Gymboree Corporation. Baby apparel items are priced similarly across the leading retailers, suggesting that the major players compete primarily on price. In contrast, Lulu will be well positioned to steal market share from the incumbent children's-wear players by entering the market with a superior quality product offering backed by a well-known brand.

For example, Lulu could introduce a one-piece jumper into its current collection. With fabric technology that insulates, controls moisture and odor, and benefits from Lulu's chic branding, a one-piece jumper could function as an everyday outfit. This durable product would lessen the burden on mothers to constantly purchase cotton outfits for their child's casual every day wear.

A Natural Fit

Lulu's primary customer base are women aged 25-34 who have high disposable incomes, lead busy lives, and are concerned with maintaining a healthy lifestyle. As these women are of childbearing age and many have young children, Lulu does not need to attract a new customer demographic to enter the baby's clothing market.

Lulu is also well positioned to fulfill the psychographic shopping habits of this target market. Mothers are exceptionally concerned about the well-being of their newborns. Studies show that over half of mothers prefer to research products before shopping and want their children to have the highest quality products irrespective of price. This is evident by the fact that baby budget planners suggest a minimum clothing budget of $750 per year for a child under the age of five. In this regard, Lulu has an advantage with the quality of its products being the key selling point.

Lulu maintains its devout following in part by impressive secondary offerings such as complimentary mom and baby yoga classes. Lulu can continue to impress by providing an online platform for mothers to access resources and share recommendations with one another. In doing so, Lulu can continue developing its brand and push its newly developed baby products.

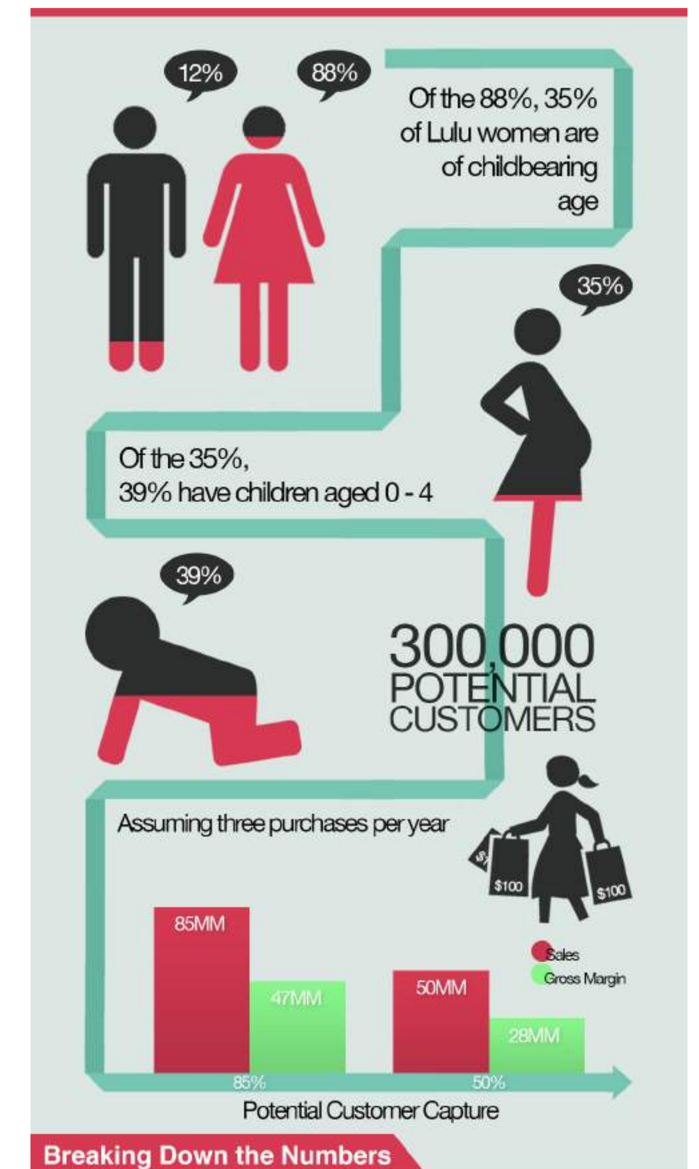
Crawl Before You Walk

For Lulu, the most effective means of initial distribution is via its pre-existing online store, which drives nearly 300,000 visits each month. Research shows that 62.5% of moms research clothes for their children online, of which 40% make a purchase. When launching its baby line, Lulu should test the market by initially offering its products for sale online and in flagship stores, which will allow for mothers to see and feel the innovation provided by Lulu. As Lulu has one of the highest retail revenues per square foot in North America, the potential negative impact of introducing new products storewide needs to be considered. Selling primarily through its online platform will mitigate potential revenues lost from core product lines being replaced by baby apparel in brick and mortar stores.

The price for Lulu's baby's apparel should be set in line with the gross margins of its other products at 55%. Although this represents a higher gross margin than that of other baby apparel manufacturers, which have a 35% gross margin, Lulu's fabric technology and brand equity justify a higher price point.

The Value of Lulu Babies

Based on projections, Lulu can expect to attain a sales figure between $50 million and $85 million annually from the launch of a baby line. These estimates include only the expected additional sales from pre-existing Lulu customers, while the launch of a Lulu baby line should also attract new customers who had previously not shopped there.



Breaking Down the Numbers

Expected revenues from the Lulu baby line *Momcentral Consulting*

Lulu is entering an epoch where it must implement a low-risk and low-cost option to restore investor confidence and reinvigorate its brand image. It can do this by providing a superior solution to the universal needs of babies and by extension, their caregivers. As such, Lulu is expertly positioned to enter the high-end baby apparel market with few outstanding obstacles. It has already captured and impressed the target market, produced fabrics that would fit the distinct needs of babies, and established online and in store distribution channels. The baby's apparel strategy also follows one of Lulu's favourite adages: "the world moves at such a rapid rate that waiting to implement changes will leave you two steps behind: do it now, do it now, do it now!"

SNEAKERNOMICS

Sizing up the growing sneaker market

By Adrian Uthayagumaran & Steven Lo

He gazed at the rim, gathered himself, took two steps, and soared towards a breathtaking dunk. Michael Jordan had just completed another one of his signature gravity-defying slams. The camera pans down towards his feet, sitting in a pair of black and red Nike Air Jordan 1's. During that thirty-second ad, Jordan influenced a generation who would grow up obsessed with his sneakers. "It's gotta be the shoes" remarked an awe-stricken Spike Lee as his Mars Blackmon character.

Sneakers: Fad or Trend?

Sneaker culture dates back to the 1950s when James Dean popularized the Converse Chuck Taylor All Stars. The trend accelerated in the 1980s, when sneakers went from being athletic wear to an essential urban fashion accessory (thanks in part to Run DMC's song "My Adidas"). At the same time, Nike partnered with Michael Jordan and released the Air Jordan, an iconic sneaker, which earned a loyal cult following. Twenty years later, 85% of sneakers are sold for fashion, compared to 15% for athletic purposes.

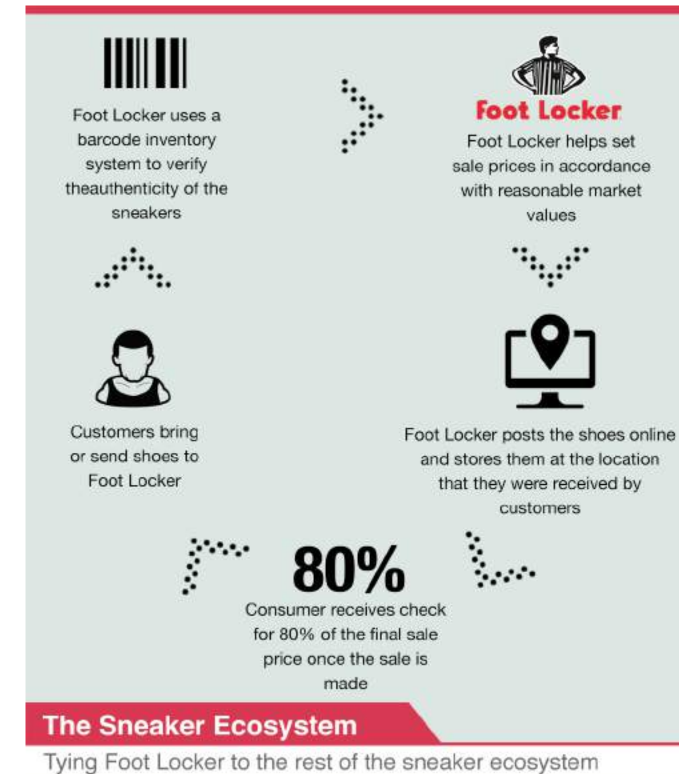
What has spawned out of this new fashion category is known as "sneakerhead" culture – a group of people that collect, trade, and admire sneakers. The community has vastly grown in size over time, as demonstrated by the growth in the Sneakernews Instagram page, which has over 1.5 million followers. Comparably, NBA stars Chris Paul and Dwight Howard only have 1.2 million and 440,000 respectively. Sneakerheads have shown extreme dedication to attaining valuable limited edition sneakers. In December 2011, customers in Houston, Texas lined up for five days in anticipation of the Air Jordan Concord XI, a throwback to a 1995 bestseller. Resellers often line up alongside sneaker collectors so that they can quickly turn a profit on the secondary market, selling sneakers for upwards of five times the manufacturer's suggested retail price.

The Shoe Store

In 2012, Nike released the long anticipated Air Yeezy II, a sneaker made in collaboration with hip-hop star Kanye West. It was produced in limited quantities and sold in store for $245 per pair. On the same day, a pre-order auction of a pair of Air Yeezy II sneakers sold on eBay for $90,300. Was it the shoes? This egregious resale price clearly revealed the value that resellers have long been aware of: there are immense profits available in the sneaker resale market.

"A PRE-ORDER AUCTION OF A PAIR OF AIR YEEZY II SNEAKERS SOLD ON EBAY FOR $90,300."

On any given day, 5,000 sneaker auctions are closed on eBay with an average selling price of $250 per pair. The value of shoes sold in the secondary market can be compared to the average price of men's sneakers in the United States, retailing at $104 per pair. Remarkably, sneakers sold through eBay account for approximately $450 million in revenue per year, without considering offline private sales such as sneaker boutiques, consignment shops, and sneaker conventions. Conservative estimates suggest that the secondary market for sneakers could be as large as 25% of the entire North American primary sneaker market valued at $3.6 billion.



The Sneaker Ecosystem

Tying Foot Locker to the rest of the sneaker ecosystem

Sneakerheads are willing to pay significant premiums over the retail price to purchase their desired sneakers. Footwear manufacturers like Nike intensify this demand by grossly undersupplying the market through the release of limited quantities. This produces a secondary market with significant arbitrage opportunities. Market makers such as eBay are able to profit from special edition sneaker transactions by charging a commission on sales; the giant consumer-to-consumer corporation currently accounts for 13% of all sneaker sales in 2013. Original footwear manufacturers, however, are left out of the lucrative secondary market that they have created.

The Shoe is on the Other Foot

Footwear manufacturers have long resisted increasing the supply of sneakers because a commonly used and traditionally successful marketing strategy has been to limit supply in order to create hype and exclusivity around the brand. The strategy has been quite effective in building brand image, and justifying higher prices on the rest of the product line. However, with the advent of e-commerce and social networking, the secondary market for sneakers has grown larger and more efficient. Footwear manufacturers who were once forgoing a small amount of profits in order to create hype and exclusivity are now sacrificing even greater profits in order to maintain their strategy. Sneakers sold on eBay are roughly 2.5x the average retail price of sneakers sold in North America. Manufacturers have been so effective in producing high demand products that they have created an enormous opportunity for other retailers to extract value.

Market Mediums

Sneakers sold in the secondary market typically go through three main channels: eBay, sneaker boutiques, and consignment shops, and sneaker conventions. eBay generates profits by charging the seller 2% of the spread between the initial offering and final selling price, offering a cost effective method for buyers and sellers to exchange sneakers for cash. Buyers will often perform numerous searches in order to find a desired listing to place a bid. Still, the biggest concern is that counterfeiters will take advantage of the online marketplace to profit off of the demand from buyers unable to purchase their desired sneakers in store. The presence of counterfeiters creates distrust in the secondary market and has remained a genuine concern for buyers.

Sneaker boutiques such as Flight Club sell sneakers on consignment to buyers and charge a 20% commission on each sale to the sellers. Buyers are able to acquire sneakers with confidence in their authenticity as the experienced Flight Club staff will verify them. However, Flight Club only has two physical stores: New York and Los Angeles. For buyers outside of these two cities, they must order the sneakers online and have them shipped, adding an extra cost to the already premium-priced sneakers. Nonetheless, Flight Club represents the extent to which boutique sneaker shops are profiting from the opportunities created by footwear manufacturers.

Sneaker conventions provide another medium for buyers and sellers to meet and conduct sneaker sales. However, most sneaker conventions only happen once a year in a given geographic region, limiting the timing and breadth of sneaker purchases.

"THE BIGGEST CONCERN IS THAT COUNTERFEITERS WILL TAKE ADVANTAGE OF THE ONLINE MARKETPLACE"

The Opportunity for Retailers

Foot Locker represents an organization that could benefit from entering the secondary sneaker market. With revenues of over $6 billion in FY 2012, of which $850 million were attributed to sneaker sales, Foot Locker holds approximately one quarter of the total sneaker market. As the sneakerhead culture has become more prevalent, the opportunity to enter the secondary market is becoming more and more enticing. The $450 million in secondary market sales through eBay represents the equivalent of 7% in overall sales for Foot Locker. Foot Locker could capitalize on this trend and create a business model with the potential to grow internationally in the future as the sneakerhead

Sneaker Culture Development

A timeline depicting the progression of the sneakerhead culture

culture continues to blossom in emerging markets like South America, Eastern Europe, and China.

Does the Shoe Fit?

Foot Locker should follow a similar consignment business model to Flight Club by selling sneakers in the secondary market through select brick and mortar "House of Hoop" locations and online. This would likely necessitate Foot Locker entering into agreements with manufacturers, allowing it to access the secondary market without straining the relationships currently established. From a commission standpoint, charging 20% on each item sold through its stores is competitive with Flight Club's fee structure. This business model allows Foot Locker to create a new revenue stream from a market that was previously missed by large licenced retailers. Furthermore, it can help legitimize the market by providing a guarantee of authenticity to any sneakers sold through its channels. If Foot Locker were able to capture 20% of eBay's secondary sneaker market, it would increase sales by $90 million. Additional operating costs should be very low, as much of the infrastructure is already in place. These sales projections lead to an assumed $81 million in additional profit, which would represent a potential 11% increase in annual EBITDA and profits, making this an extremely viable and lucrative option for Foot Locker.

"[FOOTLOCKER] CAN HELP LEGITIMIZE THE MARKET BY PROVIDING A GUARANTEE OF AUTHENTICITY"

Typically, official retailers have not entered the secondary market as it could risk damaging their image by selling these products. However, Foot Locker is not positioned as a premium brand and therefore is unlikely to see the same brand erosion that Nike would see by selling sneakers directly in the secondary market. Furthermore, by selling these sneakers in flagship, high concentration stores, Foot Locker could take advantage of cross-selling opportunities that arise from the additional customers entering the stores in search of sneakers that were previously only found through other market mediums. Keeping the shoes sold on consignment near the largest communities of sneakerheads (Los Angeles, New York) and selling them through select stores, is the most effective way to directly combat Flight Club.

In addition to Flight Club, Foot Locker should mimic Ticketmaster's TM+ business model. This platform allows customers to simultaneously browse through all the available products and corresponding quantities through other mediums, giving greater transparency to the secondary market. Pursuing this channel supports the value of Foot Locker's platform; the ability to determine a fair price with official and documented market information.

Foot Locker has the opportunity to form new relationships with a profitable and growing population of sneakerheads, and provide them with the secondary market solution that they have been yearning for. In order for Foot Locker to grow its revenues and serve this demographic, they must focus on sourcing shoes from the secondary market and then reselling them to create hype to drive sales across product lines. Foot Locker must continue to focus on providing its customers with the products they want. Like Lee always says,"It's gotta be the shoes."

TECH STARTUPS EN POINTE

Learning about talent recruitment from Canada's premier dance company

By Nicole Korb & Alexandra Maringola

Tech startups live and operate in an inherently volatile environment, where technological changes can create havoc on human capital management. This reality necessitates the need for an effective human resources (HR) strategy. Successfully managing employees is critical since startups must stretch limited resources.

Startups from Waterloo to Silicon Valley are failing to use HR strategically to attract and retain the talent necessary to facilitate quick growth. Many tech startups tend to employ shortsighted HR policies rather than well thought out HR strategies. Simply relying on fully stocked refrigerators, beer o'clock social events, and the exceptionally vague yet attractive "cool atmosphere" does little to curb the ever-increasing cost of retaining scarce talent.

Technology and Tutus

Much like start-up tech firms, the National Ballet of Canada (NBOC) must be innovative in order to succeed in an ever-changing environment. NBOC must be creative in order to attract audiences and it must have dancers with the ability to adjust their capabilities to create innovative products. An unlikely source for HR know-how, NBOC has succeeded in rising in international ballet comparisons. Its award-winning HR strategies have earned it the title of being one of Canada's Top 100 Employers.

The Importance of Flexibility

Role adaptability is ingrained into the dancers at NBOC by virtue of conscious managerial tactics, which rotate dancers and build skills beyond what is immediately required. This involves cross-training athletes to develop different kinds of musculature and styles of movement.

Tech start-up founders can mirror NBOC's adaptability among its own employees by adopting similar cross-training activities. Despite limited human capital during the early stages of the company's lifecycle, protected work hours should be established to help in the development of additional skills. Employees should be placed in rotational teams so activities simultaneously cross-pollinate business developers with technical developers. This diversity in workplace activity can reduce role fatigue and incent extended employment tenure, muting the impact of "start-up mentality" – a rising trend whereby employees spend less than a year at a series of start-up firms. The cost of managing cross-training exercises from the beginning will be offset, since fewer resources will be needed to acquire new talent down the road during critical business phases.

Look for Subtle Cues

While the corporate world is fond of memos and emails, NBOC has foregone formal communication when managing dancers in order to promote perceptive ability: the capacity to pick up on the nuances of what choreographers are asking. Such a skill is valued because dancers who are able to interpret verbal and non-verbal cues require less attention, freeing up the choreographers' directing capacity.

While start-up managers and choreographers do not necessarily share the same communication styles, the effectiveness of their daily interactions with employees rely on mutual understand-

ing of pre-established norms. Employees who are able to understand their managers' informal sentiments are more able to confidently take on independently-guided responsibilities. Additionally, a manager's ability to convey expectations can enhance their own confidence in employees, allowing them to take on projects with limited managerial attention. This would increase organizational capacity and enable manager-founders to focus on critical strategic tasks.

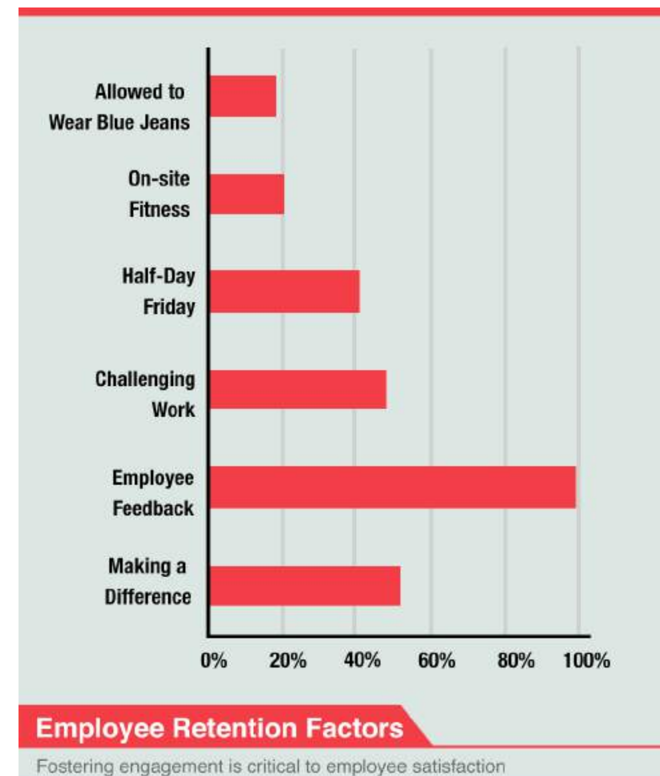
Fostering employee independence requires that startup managers explicitly facilitate formal reflection in early career stages, and encourage autonomous work on non-critical tasks to establish an understanding of managerial expectations. Tech startup managers should consult with their employees following task completion. They should identify which cues their reports instinctively acted on, and how close their interpretation of the task was to expectations. Critically, employees must be given direction about why and how their interpretation of the assigned task differs from their managers'. If utilized from the on-boarding stage, a continuous and deliberate feedback loop like the one described will empower employees and, in the process, align the objectives of manager-founders and subordinates.

"EMPLOYEES WHO UNDERSTAND MANAGERS' INFORMAL SENTIMENTS CONFIDENTLY TAKE ON INDEPENDENTLY-GUIDED RESPONSIBILITIES"

Firms must learn to listen to more than one voice as well. Just as NBOC invites guest choreographers for a fresh perspective and new interpretations, startups must actively seek expertise from mentors and "Entrepreneurs in Residence" at incubators and other organizations. The ability to listen to and understand several voices helps offices transition to a growing number of employees, as well as assists firm expansion to new markets.

Passion Overtakes Risk

Key to both technology startups' and ballet companies' success is utilizing employees' natural risk aptitude for firm growth and innovation. NBOC's HR strategies have proven extraordinarily effective in accomplishing this. Dancers face many risks including limited opportunity for promotion and career-halting injuries. Passion is the driving force behind a dancer's risk aptitude; therefore, it is imperative that ballet companies keep employees engaged. NBOC does this by offering dancers the opportunity for challenge and growth by casting them in a variety of performances. Passion is also the motivator for start-up employees who risk professional set-back and forgo large salaries and prestige from working for a more established company. Stagnation is unfamiliar to the talent that both startups and ballets recruit and thus consistent challenge increases engagement levels, improving employee retention and work quality. Moreover, this HR strategy supports NBOC's overall firm strategy as the more avant-garde, and innovative works allow the Ballet to attract different audiences - thereby expanding its market.



Employee Retention Factors

Fostering engagement is critical to employee satisfaction

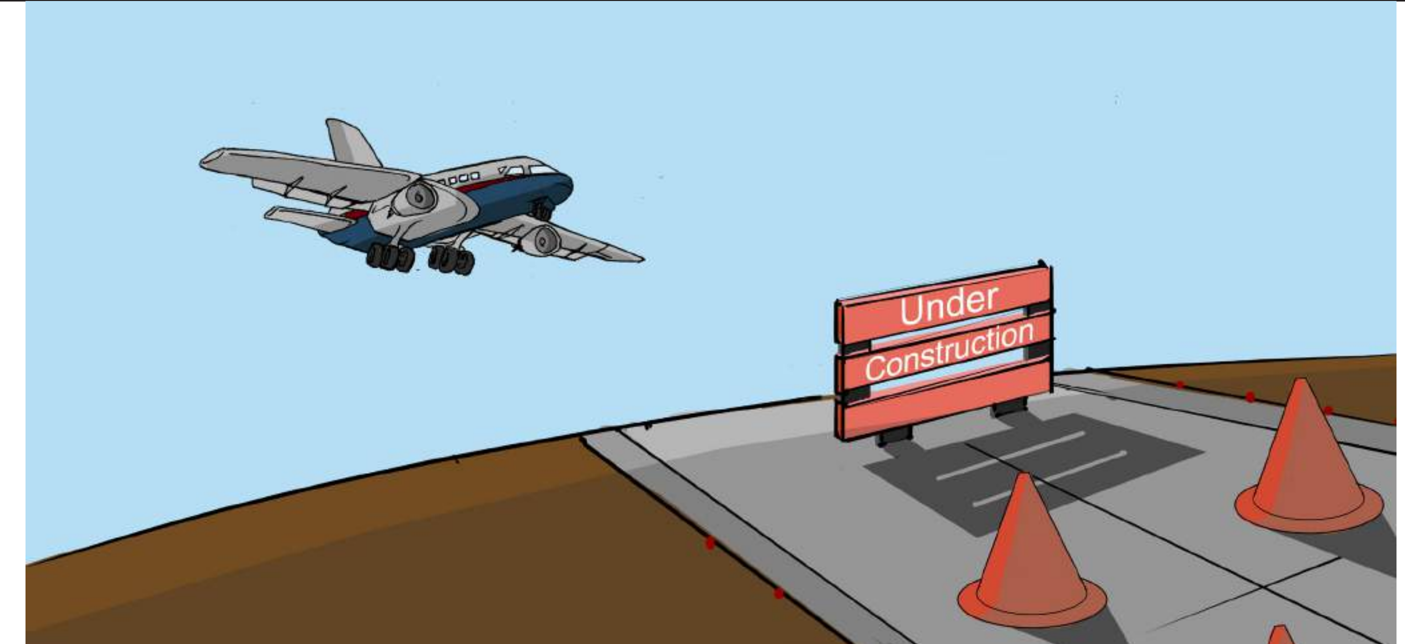
Stretching Talent

Another prong to this strategy is casting dancers in roles beyond their current capabilities. The idea is that learning and performance happen concurrently, not consecutively. The NBOC's amalgamation of the learning process with rehearsals combines development and productivity, saving time compared to companies that allocate separate periods to each.

By exposing employees to groundbreaking projects, and roles beyond their comfort zones within these projects, startups can similarly utilize their workforce's risk and challenge driven nature. Managers should also reward this trial and error behavior.

Retaining Top Talent is Not a Grand Act

Tutus and technology start-ups bear little resemblance, but HR techniques employed by the Ballet provide startup founders unique insight to build competitive advantages in an industry that has seemingly overlooked HR. A flexible workforce with strong listening skills can increase already-limited organizational capacity. Moreover, cross training helps employees navigate the inevitable ups and downs of startup life, while matching the demanding pace of innovation that is necessary to compete. Ballet Master Peter Ottman notes that "innovation is the lifeblood of everything: arts, technology, and architecture – and it's the constant flux that keeps people going." His company, NBOC, demonstrates startups can use HR to not only inspire such innovation, but also embrace it.



CHARTING PORTER'S FLIGHT PLAN

Exploring the potential strategic runways for Porter to evolve into a national player

By Aprameya Rao & Mohsin Khandwala

Since 2006, Porter Airlines(Porter) has been sticking it to the big guys; now it's looking to become one. Porter is seeking to grow the 2.5 million passengers it carried in 2012 with its downtown Toronto hub, and expand beyond its convenience-focused value proposition. The airline currently owns 85% of the landing slots at Toronto's downtown Billy Bishop airport (Billy Bishop), and is now hoping to fund an expansion of the airport, increasing the number of runways, and allowing the airline to offer connections across North America. The airline is hungry for growth, having added six planes to its fleet and forming new partnerships with other airlines for connecting flights in the last two years. Porter must be prepared to explore a number of strategic alternatives to evolve from a regional and niche player to a national competitor, some of which are contingent on the government's approval of the Billy Bishop expansion.

Cleared for Takeoff?

Porter is a differentiated niche player that has developed somewhat of a cult following. It prides itself on simplicity; providing convenience at competitive prices. Porter reduces costs strategically, by using one aircraft type, one-class service, and a single base where it owns a majority of the landing rights. By focusing on one type of service offering, for business professionals, Porter has achieved the lowest breakeven load factor of Canada's airlines at 49% (larger carriers breakeven closer to 80%). The Billy Bishop expansion is management's ideal catalyst for growth. Porter wants to continue utilizing its strong position supported by its landing rights, recognized brand, and customer perception.

The economic benefits of the expansion would be shared with Toronto; cities such as Washington DC have similarly used downtown airports to effectively spur economic growth, relieve major hubs, and offer relevant connections from the heart of the city. Instead of building a new airport or transit infrastructure from scratch, the City Centre expansion opportunity might help Toronto's economy take off.

En Route

Porter's CS100 jets would put many new markets within range in the case of expansion. Out of the 13 prospective routes, only two (West Palm Beach and San Francisco) have a single carrier offering flights from Toronto via Air Canada. The rest of the potential routes present multiple options for customers, but may still have room for more players. The idea behind Porter's proposed expansion is to better compete with Air Canada and WestJet; providing new and existing customers with the options they want while flying outside Eastern Canada or the Northeastern US. The most attractive routes will be those that provide Porter passengers with the most travel options, by providing flights to major hubs. It is a strategy that Porter has already tried through interline agreements with Icelandair (via St. John's), Singapore Airlines (via Newark) and South African Airways (via Washington DC). An expansion to the Western seaboard cities would provide Porter customers with the opportunity to travel directly from downtown Toronto to various destinations across the Pacific coast.

Porter's Current & Potential Routes

If Billy Bishop expands, above are the potential routes that Porter can add to its existing offerings

Turbulence in Flight

Canada's mainline carriers will without a doubt try to replicate Porter's route and fleet expansions. One way they can go about this is to acquire landing slots at Billy Bishop airport, thereby increasing service and competition from downtown Toronto. Should Air Canada or WestJet acquire further landing slots at Billy Bishop – which is unlikely since the next round of bidding is not planned for the foreseeable future – they would still need to acquire CS100 aircrafts in order to fly medium-haul routes. The proposed expansion and exemption to the jet ban will only apply to these aircraft, which neither Air Canada nor WestJet plan to purchase.

A more likely alternative for the mainline carriers is to partner with the Union Pearson Express, which will be completed in late 2015. A tremendous amount of economic and political capital has already been deployed to build the 25-minute direct train service from downtown Toronto to Pearson Airport. However, the time to the airport is only one facet of the convenience sought by travelers: the smaller Billy Bishop airport will still offer a more seamless and efficient process from airport to airplane. Nonetheless, with a comparable travel time to Porter's Billy Bishop location, it is imperative that Porter focus on the in-flight services that differentiate it from its competitors. Service extensions could include in-flight WiFi, much like Southwest Airlines' recent offering, a significant value-add for its target market of business professionals. With a low breakeven load factor, Porter has room to reduce profit margins in order to erect a defensible value proposition against the competitive convenience introduced once the Union Pearson Express is completed.

> **"IT IS IMPERATIVE THAT PORTER FOCUS ON THE IN-FLIGHT SERVICES"**

A Safe Landing

If the City of Toronto approves the Billy Bishop Expansion, Porter first needs to determine the most profitable routes based on its unique customer segments and corresponding competition. San Francisco, Los Angeles, and Vancouver seem to carry the most opportunity based on the criteria appealing to business customers, the lower competitive threat, and the available interlining opportunities, all while not sacrificing the convenience aspect that Porter prides itself on. Porter also needs to negotiate to ensure the Toronto Port Authority does not raise landing fees if the expansion is approved. Finally, it must counter competitive reaction from Air Canada, WestJet, and other potential entrants to the Billy Bishop hub by creating distinct differentiating in-flight services to solidify its position as business friendly, efficient travel.

POTENTIAL ROUTE	CUSTOMER SEGMENT	COMPETITION	INTERLINE CONNECTIONS
Calgary	●	◐	◐
Vancouver	●	◐	●
San Francisco	●	●	●
Los Angeles	●	◐	●
Las Vegas	◐	○	○
Orlando	◐	○	◐
Edmonton	◐	◐	○
Winnipeg	◐	◐	○
Nassau	○	○	○
Miami	○	○	◐
Tampa Bay	○	◐	○
Fort Myers	○	◐	○
West Palm Beach	○	●	○

Evaluation of Potential Route Alternatives

San Fransisico, LA, and Vancouver are the most attractive options

In Case of Emergency...

Under the scenario that Porter's proposal to expand the Billy Bishop airport fails, it will likely have to choose between the lesser of two evils; either an IPO or an acquisition. Porter has previously explored the possibility of going public to raise funds for fleet expansion, but then decided to use internal funding. As it stands, the IPO option still remains a viable opportunity to raise the required funds. In this scenario, investors would have a poor perception of Porter's growth and expansion opportunities. However, an avenue Porter could pursue is to function as a dividend stock buoyed by steady cash flows. An IPO would provide Porter with the funding to explore potential value adding investments such as the aforementioned addition of in-flight services. The failed expansion would place Porter in a position where its focus would be to defend its value proposition, widen its profit margin, and grow its dividend payout. An expansion into Pearson Airport would be ill advised, as its identity as the downtown, chic, and efficient airline would be lost. Pursuing an IPO will likely come at depressed valuations if done on the tail end of an unfavourable ruling, and places Porter in a fragile position with few strategic options to expand.

Connecting Flight

Many analysts have been pointing to Porter's recent bold moves as a sign that it is simply setting itself up for acquisition. In the past, Wardair did just that: it announced significant fleet and route expansions leading to an acquisition by a wary Air Canada before it could execute. Many say that Wardair didn't have the resources to follow through on the expansion, and it was just a tactic to pressure Air Canada into making the acquisition. The difference with Porter though, is that it does have the assets and resources to compete.

The acquisition route still offers multiple benefits for Porter. It provides growth from multiple centres, resources for fleet expansion, and strategic direction from an entity that has already grown from regional to national.

Currently, there are three sets of potential acquirers: a Canadian chartered airline like Air Transat, a foreign airline looking to gain access to the Toronto business travel market (most likely from the US), or a major Canadian airline like Air Canada or WestJet. It is unlikely that a Canadian charter airline would look to acquire a scheduled service operator such as Porter simply because of the strategic and operational differences between the two models. Porter is also too small to make a significant difference to a potential US acquirer's bottom line. Further issues with the Investment Canada Act and antitrust rulings would work against foreign acquirers. This leaves a major Canadian Airline as the most likely acquisition source.

Both Air Canada and WestJet would be very interested in the opportunity to acquire Porter. Not only does it remove the threat of an additional mainline competitor nationwide, it provides the acquirer airline with a highly profitable hub in downtown Toronto, which meshes well with Air Canada Express or WestJet Encore. Moreover, neither WestJet nor Air Canada would want to cannibalize routes that they hold a monopoly or duopoly on from Pearson.

Porter and WestJet share a customer perception that they are the little guys on the side of the people. They value simplicity and convenience, and Porter can blend in seamlessly as an eastern hub for WestJet Encore. Porter already has 26 Bombardier Q400s that would complement Encore's seven current aircraft and 20 ordered. The Q400s have proven to be a profitable vessel and would be highly valued by Encore.

If the expansion is rejected, Porter is best suited to set itself up to be acquired by a larger player, preferably WestJet. Being acquired is the most lucrative way for Porter to step into the next stage of its growth towards becoming a large North American airline.

Now Boarding

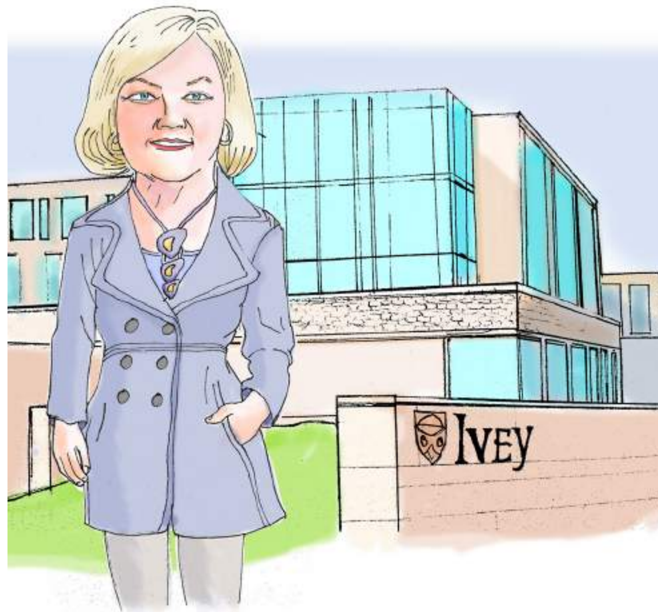
Although the runway is not quite clear for takeoff, Porter is in a position to grow, an initiative that has been seemingly impossible in the Canadian airline industry. In the airline's quest to continue lightening the load for loyal passengers and refining the flying experience, the airport expansion represents the essential and logical next step that will be beneficial for passengers, residents, the TPA, and the Toronto economy at large.

INTERVIEW: CAROL STEPHENSON

CAROL STEPHENSON

IBR talks with the outgoing Dean of Ivey Business School about her highly celebrated tenure and how the school has changed in the past ten years

Conducted by Connor Lyons & Michael Zawalsky



IBR: Your transition into business education came after 30 years in telecommunications; how did you manage such a dramatic shift in industry focus?

CS: The problems that you are solving are similar, whether you are in education or the private sector for example there are human resource issues, financial issues, and marketing issues in both sectors. The main difference is the culture. In business, people are focused on the profits and losses, and understanding whether the returns are good or bad for a particular decision. You also have more levers, like bonuses, to help you meet your goals.

In the academic environment, I'm required to lead through influence. The way that I am able to make change is by trying to convince people that the idea is a good idea; it has to be well thought out and factual becauseyour colleagues don't necessarily have to make that change. It's an interesting challenge, and some of my private sector experience helped me. As a part of The Stentor Alliance, which involved all 10 incumbent phone companies at the time across Canada, we had to work on national marketing, technology evolution, and regulations for a group of 10 companies, and we could only actually lead through influence.

I also would say that I am a pretty focused person; once a decision is made, I focus on the execution. I learned that in the private sector. It's easy to get distracted in an academic environment because there are so many good ideas. If you don't pick some, get everyone aligned, and then focus on them, you run the risk of being too scattered, and not actually completing anything. So I would say that I learned in the private sector how to focus on results and get things done.

IBR: An increasing number of reputable business schools such as Wharton and Stanford are pushing to make more of their content available online. Do you see an opportunity for the case method to be facilitated online?

CS: Well, I think the case method is very much about what we would call the "Ivey Experience", the sorts of activities that you're a part of through being physically here and working with the students around you. A lot of the skills that businesses are looking for come from these experiences: negotiating, interpersonal skills, team work, etc. When I ask recruiters what stands out about an Ivey student, they reply with "they have so much confidence, they have learned to analyze quickly, come up with a solution, express their point of view and actually implement it." That comes from what happens in the classroom around case discussions, and I don't think it's easy to get that online.

Carol Stephenson
Former Dean, Ivey Business School

For the past decade, Carol Stephenson served as Dean of Ivey Business School, and led the faculty through a period of expansion in terms of programming, research, and geographic reach. Stephenson also oversaw the fundraising and construction of Ivey's new, award-winning building.

She previously held a number of executive roles in the telecommunications sector. As CEO of Lucent Technologies Canada, Stephenson led the company through tumultuous times to triple its market share. Before that, she served as President and COO (Americas) of BCE Media and Vice-President of Bell Canada. Carol has extensive Board experience at a variety of prominent companies, including, Ontario Teachers' Pension Plan, and General Motors Company, where she served as Canada's nominee to the Board to help restructure the auto giant following the financial crisis.

Stephenson's many contributions to her country were recognized with her appointment to the Order of Canada in 2009. Notably, she sat on the Vancouver Organizing Committee for the 2010 Olympic and Paralympic Games, and was a member of the Prime Minister's Advisory Council on Science and Technology.

She holds a Bachelor of Arts degree from the University of Toronto and completed executive management programs at University of California, Berkeley, and Harvard Business School.

IBR: You have made cross-enterprise leadership a priority during your time as Dean. Could you explain to our readers what cross-enterprise leadership is and why it is particularly important?

CS: The primary example I use to explain cross-enterprise leadership is an acquisition. Traditionally, in a business school, an acquisition would be taught in a financial context, valuing a company and structuring the deal. In reality, an acquisition is less about the deal and more about how you integrate that acquired company. What do you do if the IT systems don't work together (which always seems to be the case), how do you deal with two very strong competing brands, how do you integrate corporate cultures, etc. For a really good leader to be able to understand and resolve these issues, you can't stick to your own silo of finance, marketing, human resources, etc.; you have to understand how the integration works across the entire enterprise. Hence, cross-enterprise leadership.

It is that ability to look outside your own business unit, discipline or siloed position that will provide a much broader view of the problem to solve the business issue. I sometimes describe it as turning business education on its head, because often you start by considering one function, and then you use that function to solve the problem. In the real world, you have to bring various disciplines together to solve a problem. The case method works well for this; you need the knowledge of various functions in order to solve problems. Once again demonstrating cross-enterprise leadership.

The concept came from my own career. I was on a rotational program early on in management, and what I learned was that the more experience I had in various roles and functions, the better I was at decision making in general. My own experience taught me that having a very good cross-enterprise understanding makes it much easier to lead. I believe in it, and I've seen it work successfully.

"WHEN I ASK RECRUITERS WHAT STANDS OUT ABOUT AN IVEY STUDENT, THEY REPLY 'THEY HAVE SO MUCH CONFIDENCE, THEY HAVE LEARNED TO ANALYZE QUICKLY, COME UP WITH A SOLUTION, EXPRESS THEIR POINT OF VIEW AND ACTUALLY IMPLEMENT IT.'"

IBR: During your tenure, what were the key strategies you implemented in order to build Ivey's brand in key markets internationally?

CS: Well there are a few things that really help Ivey's brand, and the first is our cases. We are the top producer of cases in Asia and India, and the number two producer of cases worldwide after Harvard. You would be amazed how many people read these cases both at the academic and student level. When I was at the Beijing Olympics, this young woman came up to me and we started talking. When I told her I was from a business school in Canada called Ivey, she said "Ivey! I just did an Ivey case". Our focus on producing cases has really pushed our brand internationally.

Secondly, I've encouraged our faculty to offer opinions to media sources on various business topics, with several placed in the internationally read Financial Times. Every time I visit the UK, I meet with the Editor of the Financial Times and talk to her about what we're doing, so I think the media placement helps our brand a lot.

Finally, we've started 'issue forums' where we pair a faculty member and the research that they're working on, with a practitioner to conduct a forum under Ivey's name. It creates discussion around issues that are important to the world of business. If people are hearing about and recognizing your work, to me that is the biggest brand builder.

There is no doubt that growing our brand internationally is challenging given our position in Canada. I often ask people in the US, "how often do you hear about Canada?" "Well very seldom, unless it's Keystone." That's a little bit like all business schools in Canada. We actually have to work harder than others to get brand awareness just because of our geographical location.

IBR: Ivey has greatly expanded its HBA program in recent years under your guidance. Was the smaller HBA program unsustainable given the aspirations for what it wanted to become?

CS: In business terms, I would say it was an underutilized asset. We had this great asset called the HBA program, and we were doing little with it. We weren't marketing it, and we weren't really talking about it. You would be considered crazy in business if you had something that you knew was one of the best things in your product portfolio, and you chose to ignore it. So during our strategy setting in 2005 we said, this is a huge asset but look at who's in the program – mostly students from southern Ontario. Why wouldn't people from across the world want to come to this, wouldn't that make it an even better program?

We decided to take action, so we implemented a gradual growth program. We made sure to keep the growth slow enough to maintain quality candidates, adding one section at a time, and hired more faculty. We had a really good product roll-out plan in order to do this well.

IBR: What were some of the other tactics beyond just the product roll-out strategy? Of the strategies used, which focused on expanding the appeal of Ivey beyond just southwest Ontario to across Canada, and the world?

CS: First, we went to 400 high schools across Canada and started talking about the program, eventually bringing with us some of the HBA graduates from those schools. We then talked to guidance counsellors and students about the program to increase overall awareness, going to the market as opposed to just placing big ads in the newspaper. It was a pretty grassroots initiative, which took a lot of resources, time, and effort, but was well worth it.

IBR: The shift to a one-year Ivey MBA has affected the schools rankings and perception of quality. How have you and the school dealt with those views and what are the benefits to the one-year as compared to two?

CS: It goes back to our 2005 strategy. It was driven by the opportunity cost for a student to be out of the workforce for two years instead of one. We also found that with a 12-month program, we had a 92% contact time compared to the two year program, which really swayed our decision.

> **"I HAVE ALWAYS SAID, DO NOT RUN YOUR STRATEGY BASED ON RANKINGS BECAUSE THE METHODOLOGY CHANGES ALL THE TIME. IT WAS COURAGEOUS, BUT I THINK IT WAS A GOOD MOVE. I CAN'T IMAGINE GOING BACK TO TWO YEARS."**

We also looked at whether recruiters would hire these students without the summer placement in the middle of their program. We found that the percentage of students who work at the same company after graduation as their four month placement was actually low, around 20%. So we took all the factors together and said why wouldn't we make a change. We knew that this was happening in Europe and we thought there was a strong opportunity to implement it in North America as well. We tested afterwards whether the placement rates worsened - the answer was no, they actually got better.

In regards to the rankings, they don't measure whether it's a one-year or two-year program. At the same time, there were a few silly things that happened due to the timing of the convocation. But I have always said, do not run your strategy based on rankings because the methodology changes all the time. It was courageous, but I think it was a good move. I can't imagine going back to two years.

IBR: Currently, the composition of Board of Directors worldwide has an unbalanced gender distribution; how do you think this impacts the strength of company governance?

Three of the four boards that I sit on have three or more women, but I have been on boards where I have been the only female, and it does make a difference having a couple of women; gender goes away.

> **"I HAVE BEEN ON BOARDS WHERE I HAVE BEEN THE ONLY FEMALE, AND IT DOES MAKE A DIFFERENCE HAVING A COUPLE OF WOMEN; GENDER GOES AWAY."**

I hate to overgeneralize, but I also believe that women tend to be less afraid to inquire if something doesn't make sense to them. It comes back to that diversity that we talked about before; you have different people, different thinking, different styles and that diversity makes for better governance and Board discussions.

I do think that we need to increase the number of women on Boards. Twenty years ago I would have said that as women hold more senior executive positions, they would start to join more Boards, but it hasn't really happened. Why is this? It's a complex issue and there's no single answer, but recently there has been a lot more attention on it which is a good thing.

The Ontario Securities Commision has just come out with some proposed guidelines which will be interesting to see. They're still in the consultation stage right now, but essentially it's the 'comply or explain' model. I think that causes Boards to think about "do we want to explain this?" I think it is actually a good strategy, we'll see what happens.

FOR MORE FROM CAROL STEPHENSON:
www.iveybusinessreview.ca

GERARD SEIJTS

IBR talks with Ivey's foremost expert on leadership about organizational change, culture, and the benefits of diversity.

Conducted by Connor Lyons & Michael Zawalsky

IBR: How do leaders, when assuming a new and challenging role, ensure that they demonstrate cross-enterprise leadership?

GS: Any person stepping into a leadership position must bring an integrated view of the organization or department in order to be successful in his or her role. Good leaders – whether it's in academia or business – understand the important and unique contribution that each function in the organization has to offer: marketing, accounting, operations, finance, etc. They have to because there typically are no finance problems; there are only business problems, which oftentimes require solutions that touch on the various functional disciplines. Leaders must therefore take the time to learn about each element of the organization if they are not already familiar with them. When making a transition into a new role or new organization, leaders must spend the time to listen first – to many different voices, and then slowly start to tackle the issues with a truly cross-enterprise perspective in mind.

IBR: What is the benefit of diversity within an organization?

GS: Look, if six people on your senior executive team continually agree on issues, then five people are redundant. Diversity is a good thing – in terms of gender, age, cultural and ethnic backgrounds, functional background, and so forth. As a leader, you not only need to create a diverse environment but also leverage diversity. You need to be able to create a culture where people feel free to challenge you, raise concerns and speak with candor. In the financial crisis there were too many organizations where that simply wasn't the case – there was no culture of constructive dissent. Think about it … how often do people come storming into your office saying "we have a hell of a problem here!" People may be reluctant to do that. People often tell the leader what he or she wants to hear, not what they need to hear. In some organizations *you* become the problem if you raise a problem.

Leaders therefore must go out on the floor and learn to listen to the whispers and get information first-hand from diverse sources. My point is simply this – you can create a diverse workforce but as a leader you also need to learn to take advantage of it. Learning to listen to the whispers is crucial for leaders aiming to pick up the signals necessary to make informed decisions.

IBR: What ability does a leader have to change a culture that may have predated their tenure?

GS: I believe that leaders who are new to the organization and who are asked to bring change should understand the organization and its core values but, at the same time, should never be afraid to put those values up for discussion. For example, when Jack Welch stepped back [from CEO of General Electric], Jeffrey Immelt took the top job. However, the two other candidates to succeed Welch went to different organizations where they did not do well and their tenure was short-lived. As industry experts observed, both may have fallen for the belief that what had worked at GE could be readily transplanted to 3M and Home Depot. What both examples showed, however, is that culture can be very resilient. There are many examples of people stepping into leadership in an organization who eventually derailed because they didn't fully appreciate the culture. Ivey has a culture, or a set of expectations, and I think both students and faculty must understand that culture in order to do well.

> **"IF SIX PEOPLE ON YOUR SENIOR EXECUTIVE TEAM CONTINUALLY AGREE ON ISSUES, THEN FIVE PEOPLE ARE REDUNDANT."**

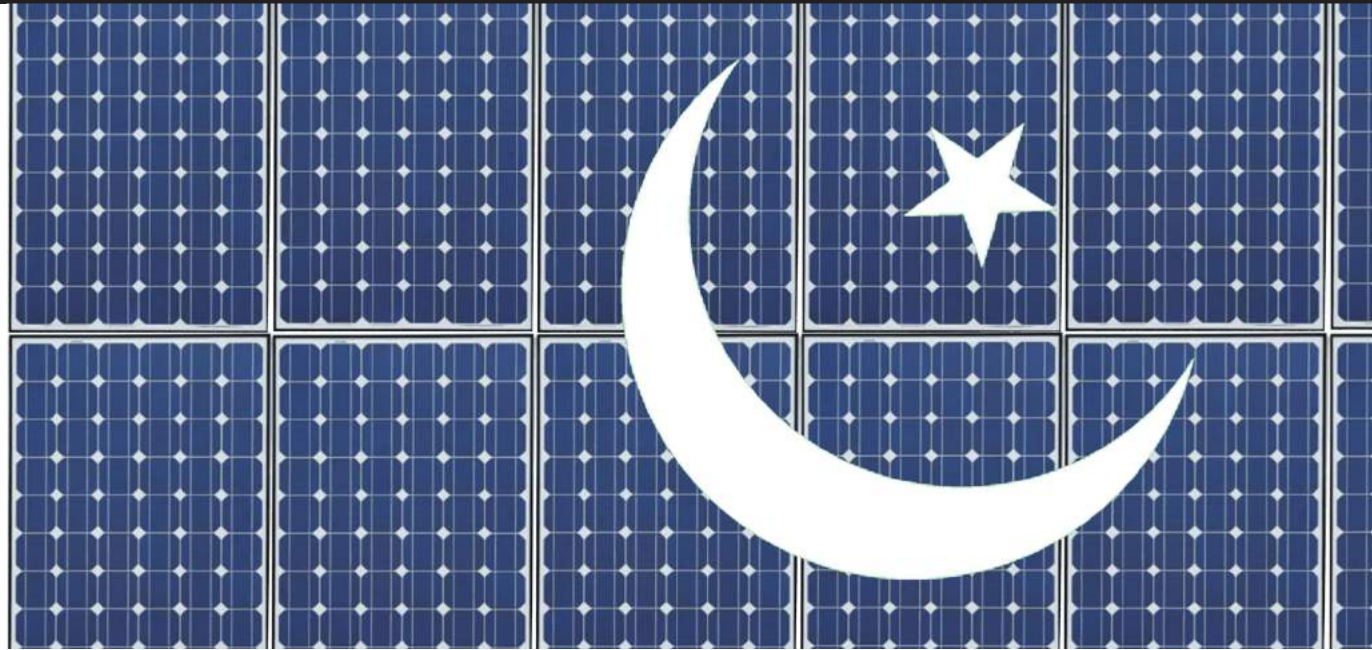
IBR: As we go into Ivey's leadership transition, how can the new Dean best adjust to the challenges associated with a transition?

GS: Job or leadership transitions are challenging. Michael Watkins from IMD wrote about two challenges that any leader must master when transitioning into a new role, both equally important. First, the organizational change challenge; what must you do to transform the organization or department to achieve high performance? Second, the personal adaptive challenge; what must you do in terms of adjusting your style and building competencies to be successful in the new role? Personally, I think that for most people the second challenge is most difficult to master. Of course, we can help any leader by giving the full support that is needed to set him or her up for success.

FOR MORE FROM GERARD SEIJTS:
www.iveybusinessreview.ca

Gerard Seijts, PhD

Gerard Seijts is a Professor of Organizational Behavior and Executive Director of the Ian O. Ihnatowycz Institute for Leadership (www.iveyleadershipinstitute.ca) at the Ivey Business School, Western University. He also holds the Ian O. Ihnatowycz Chair in Leadership. His research and teaching interests include leadership, organizational change, and motivation. He has taught EMBA, MBA, and HBA courses in various subjects. He is the author of numerous publications, including his most recent book, Good Leaders Learn: Lessons from Lifetimes of Leadership (Routledge, 2013). He is frequently cited and referenced across media channels, and has worked with organizations in Canada, Asia and Europe. He received his PhD from the University of Toronto. You can follow him on Twitter @IveyLeadership.



HERE COMES THE SUN

How downstream solar players can capture the Pakistani solar market

By Amy Wang

The solar industry is quickly becoming a growing market with considerable global reach. In recent years, the exponential growth of global photovoltaic (PV) panel manufacturing capacity has coincided with a decline in the cost of PV panels, approaching $0.50/kW from $4.00/kW in 2006. These plummeting prices have forced upstream players to tighten their belts in an industry that frequently sees new startups rapidly outpace their own growth. However, inclement conditions for manufacturers prove to be favorable for downstream players (i.e. procurement companies and system integrators) as the levelized-cost (net installation cost divided by its expected lifetime energy output) of ownership for solar projects continues to decrease. Solar is starting to make both environmental and economic sense in many developing countries as the cost of solar power systems become increasingly affordable relative to diesel and uninterruptible power supply generators. Worth mention, definitively, is Pakistan.

Darkness in Pakistan

Pakistan is currently facing a genuine energy crisis with national demand outstripping supply by a record 40% in 2012. This is not only adversely affecting the nation's GDP growth but also its domestic stability, as exemplified by a wave of violent protests throughout the summer of 2013. Pakistanis, who in some areas face regular blackouts lasting upwards of twenty hours, are forced to rely on costly diesel generators to power their homes and businesses during power outages. Pakistan's current shortfalls in electricity generation (up to 4000MW/day) cannot be met by domestic providers in the short-term without significant investment in the nation's energy infrastructure that will prove both costly and labour-intensive. The gap between the dwindling supply and ever-increasing demand in Pakistan must be met by foreign investment until the government can repay the energy industry's massive accumulation of circular debt.

"WITHIN MAJOR URBAN CENTERS, SMALL BUSINESSES COMPRISE A MARKET SEGMENT THAT IS BRIMMING WITH UNTAPPED POTENTIAL. "

Dawn Approaches

Growth in the solar markets of developed economies has been predominantly driven by feed-in-tariff policies guaranteeing fixed-rate investor returns. However, the Pakistani government has not yet enacted similar solar subsidies. Though the present lack of governmental support may prevent companies from immediately developing capital-intensive, utility-scale solar farms, there exists enormous potential for pursuing relatively low-cost distributed generation projects in niche markets. Downstream players, namely those companies that specialize in distribution, system integration, and installation, can profit immensely from a multi-pronged strategy to better sustain their long-term success.

For prominent North American players in the system integration industry to transition successfully into servicing the downstream market in Pakistan, they must familiarize themselves with the existing policies concerning solar energy and local culture. This daunting task can be accomplished by hiring the necessary staff locally. In addition to generating domestic jobs, companies will be better positioned to devise a long-term, holistic strategy based on developing customer relationships. Incoming companies must segment the overarching market in a sequential process, as not all target markets can be captured simultaneously. Growth will begin organically in urban areas and eventually trickle down into off-grid, rural regions.

Targeting the Urban Rich

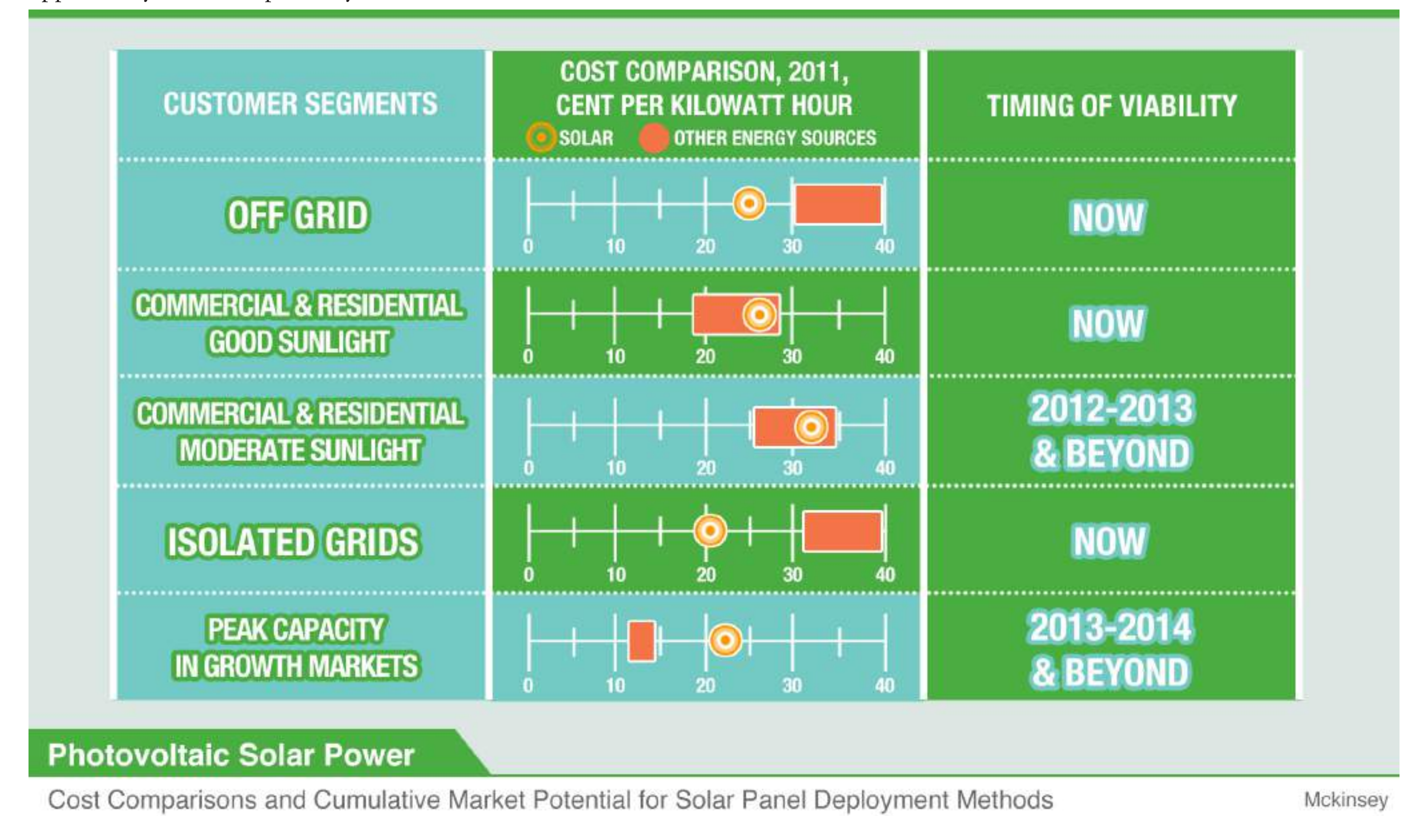
Middle class and high-income families in urban centers, long-accustomed to receiving grid electricity before the energy crisis, have showcased their willingness to pay a premium for standalone solar systems during desperate times. Solar system sales, largely driven by the influx of both domestic and foreign startups hoping to capitalize on the desperation of local Pakistanis, have nearly doubled year-over-year in the first nine months of 2013. Still, solar systems should be marketed as a cost-effective solution, and not merely an expensive means by which families can avoid an energy outage.

Incoming entrants must quickly establish credibility in the market by creating high-quality solar systems tailored to the local environment. Incorporating a thick Ethylene Vinyl Acetate (EVA) film will ensure both the quality and reliability of solar panels, as will the use of solar inverters that can withstand both the high temperatures and fluctuations in grid voltage present in Pakistan. Since Pakistan boasts one of the highest solar irradiance levels in the world, the use of high-quality panels has the opportunity to be exceptionally efficient.

Solar is Good for Business

Companies entering the Pakistani solar industry can pursue a number of opportunities in distributed generation by honing in on lucrative segments beyond residential, such as gas stations and the telecommunications industry. Within major urban centers such as Islamabad, small businesses comprise a market segment that is brimming with untapped potential. Not only can foreign entrants sell systems to small businesses, they can also enter into dealership agreements that would offload a majority of the risks inherent in geographic expansion onto the dealers. Homegrown distributors would retain a portion of the revenues generated from selling the foreign supplier's products. While the local distributor would oversee daily in-store operations, the foreign entrant would be largely responsible for ensuring product quality and providing after-sales services and training. This would allow the downstream solar companies to expand their geographic reach organically by capitalizing on pre-existing relationships that the local distributors have already established.

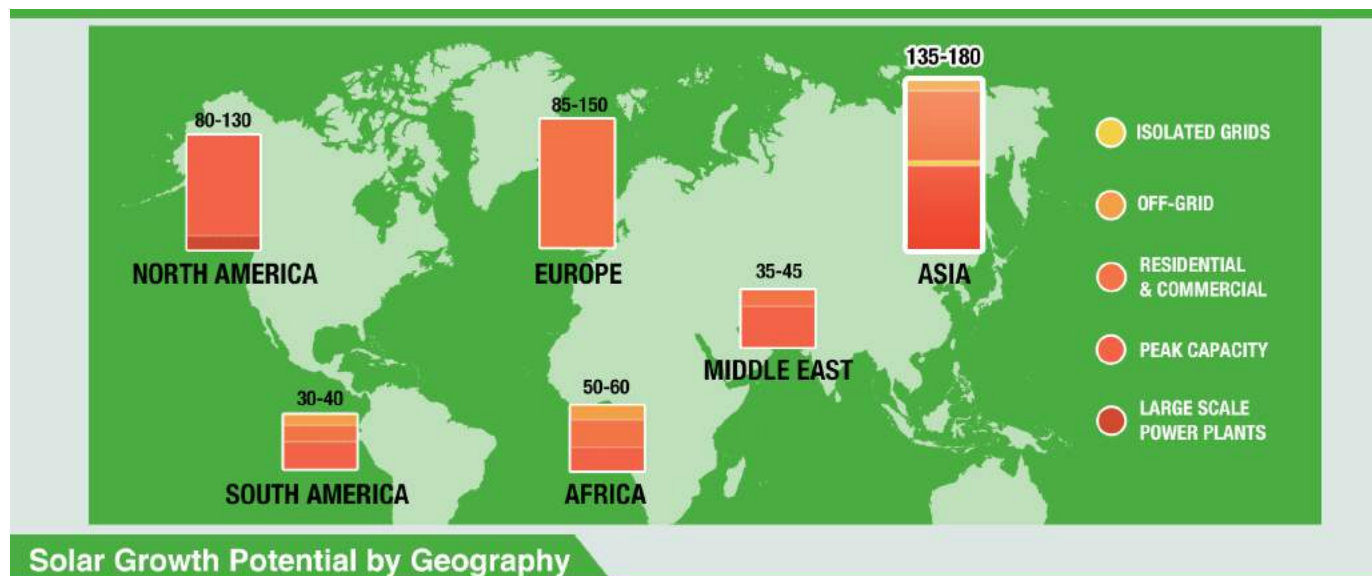
An example of a common dilemma faced within the contemporary Pakistani solar market (and the potential solution provided by solar) can be seen in the case of a customer who drives into a gas station during an extended period of load shedding – when the government redistributes electricity among different areas in a city due to a shortage in energy supply. In this scenario the owner is confronted with two difficult options: power the station using a costly backup diesel generator at an average cost of 32 Rupees (Rs) per kWh (compared with solar energy at approximately Rs 14.40/kWh) to allow the customer to fill up on gas at great expense to the owner, or turn the customer away.



Photovoltaic Solar Power

Cost Comparisons and Cumulative Market Potential for Solar Panel Deployment Methods

Mckinsey



Solar Growth Potential by Geography

Countries in the Middle East and Asia will continue to focus on commercial and grid solar expansion — Mckinsey

Effectively, the energy deficit forces businesses to close during power outages, and eventually forces many into bankruptcy. By financing the installation of a standalone or hybrid solar system over an extended period, small business owners can continue to operate their business even during load shedding while earning additional revenues from their extended working hours.

And Also the Urban Poor

Standalone, direct current solar systems are optimal for locations where the typical energy requirement per household ranges from 50-100W. Innovations in PV technology have made solar kits viable due to their portability, customizability, flexibility of application, and ease of installation. To successfully market to the urban poor, proving the effectiveness of these systems is imperative. Given the enormity of the market, initial penetration should be targeted towards low-middle income families that are already paying a premium for diesel generators or actively seeking alternative sources of energy. Companies should further segment by geography. Households living on the fringes of major urban centers, compared to those living in the outskirts of rural areas, have a higher per capita income, making them more likely to purchase/meet the payment obligation of these systems.

Subscribing to Solar

Companies hoping to tap into the urban poor segment must be aware of two risks: the inability of individuals to pay for a full-cost solar system, and the uncertainty of payment collection. It is unlikely that consumers with limited knowledge on the effectiveness of solar systems will pay for the full cost upfront. Additionally, these consumers likely do not have the means to invest in standalone systems as per capita income in impoverished areas is lower than the national average. These barriers can be overcome by targeting entire communities instead of individual families. Instead of paying an amount, which would be approximately equal to their annual income, for a residential home solar system, the urban poor would pay a subscription to gain access to the community solar farm. Given that lower-income urban neighborhoods are densely populated, the system will be funded by an average of 50 families per community. This centralized system would entail foreign downstream players to act as an Independent Power Producer. However, customers would pay a flat rate in addition to their electricity consumption to cover the shared maintenance, warranty, and after-sales service costs. The supply will be closely monitored to ensure system reliability and accurate payment metrics.

Companies establishing standalone solar in rural regions can expect to receive an unlevered IRR in the mid-teens over the 40-year life of the asset. These returns could be improved by the addition of modest debt levels, especially if financing from the World Bank or other development agencies is available. This return is initially modest, but will allow companies to enter the undeveloped market and establish themselves in the communities, generating a sticky customer base with associated long-term recurring cash flows. Margins will widen as operations expand to further communities and Pakistan's GDP expands.

Riding the Solar Wave

It is a common axiom that companies best positioned for success do not follow market opportunities as they arise. Rather than going where the growth is, they create growth in rapidly emerging markets. New entrants hoping to capture a young market brimming with potential must act early in anticipation of future growth. The sands of the solar industry are shifting quickly, painting a new landscape that will see considerable change in the next decade as companies move from developed to emerging economies, pursue distributed instead of centralized distribution projects, and continuously innovate to target high-growth, under-saturated rural markets plagued with energy poverty.

CRACKS IN THE FOUNDATION

For CPP Investment Board, infrastructure investment opportunities are close to home

By Madeline Cavadias & Cristina Osorio

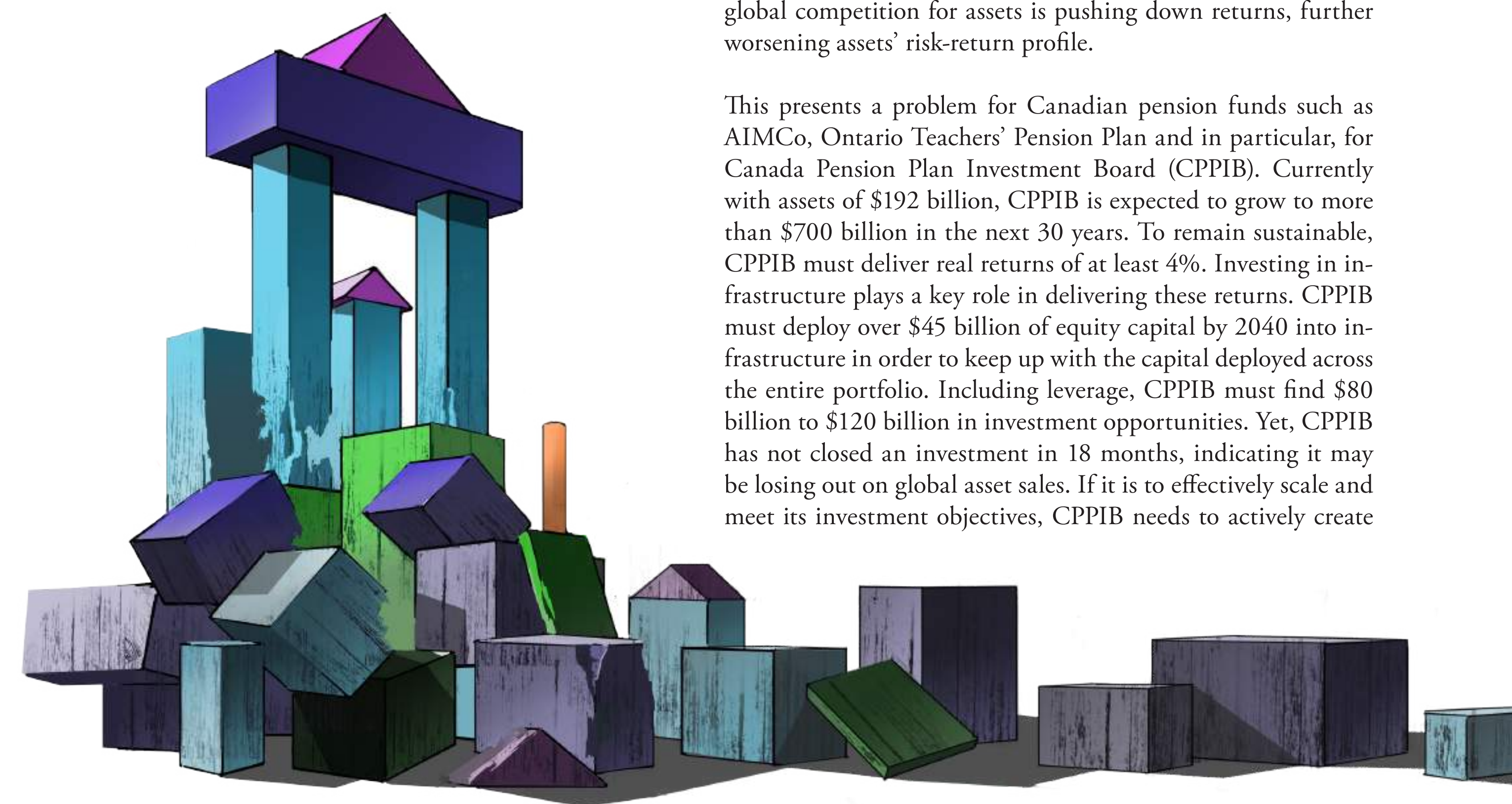
Bridges are falling, highways are crumbling, and water and wastewater systems are operating over design capacity. Over the last 40 years, cash-strapped governments of developed countries have lived off the legacy of past investments, failing to keep up with growth or in some cases even necessary maintenance. Thus the question, how will governments pay for desperately needed upgrades? With a mounting debt burden, rising entitlement costs, and opposition to tax increases from the electorate; their hands may be tied. Enter private sector investors.

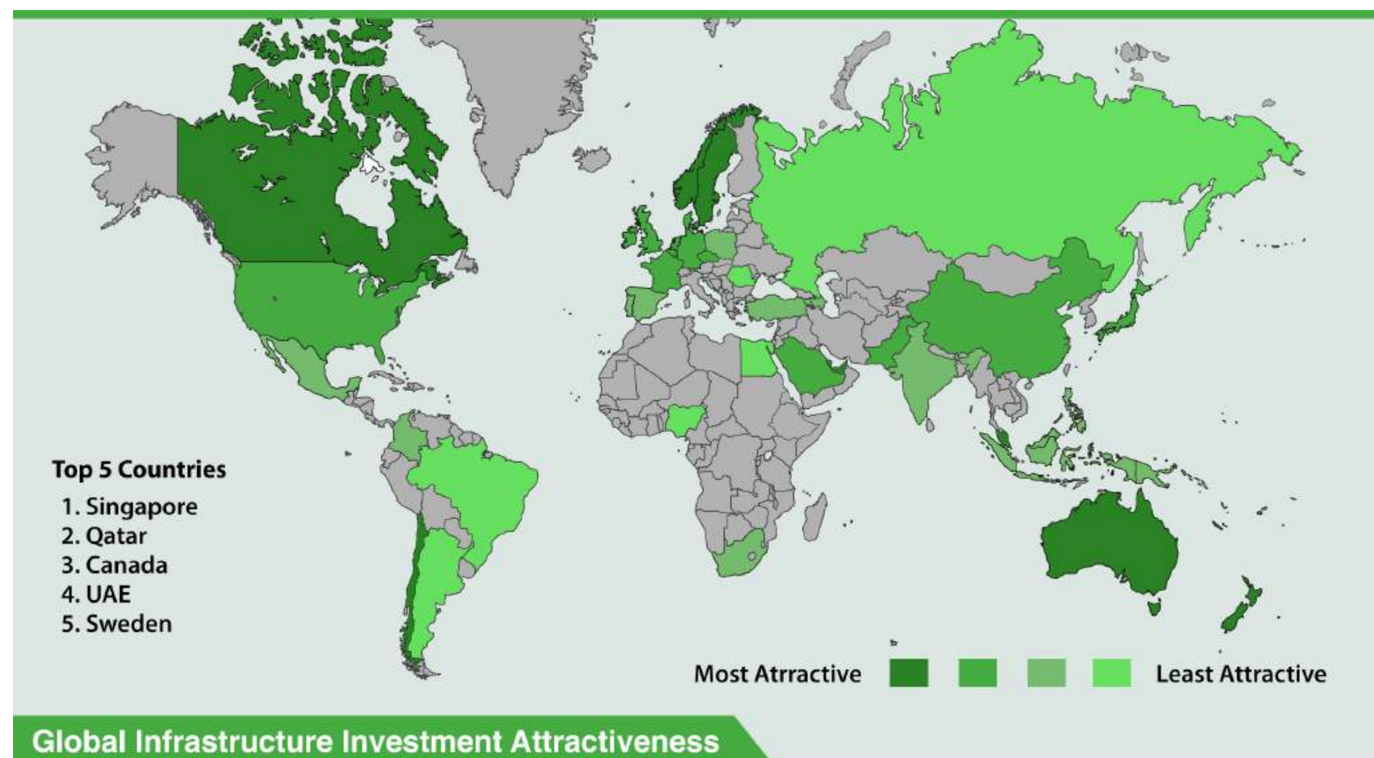
Fortunately, infrastructure assets are in demand. The long-term, stable, recurring cash flows offered are particularly attractive to pension funds as they match their liabilities well. This has led pensions and other sovereign wealth funds to increasingly invest in infrastructure - OECD private pension funds increased their infrastructure investments from US$10.7 trillion to US$17.0 trillion between 2001 and 2009, representing 6% compound annual growth. Canadian pension funds are no exception; they have increased their portfolio allocation in infrastructure from 1.9% ($15.9 billion) in 2007 to 4.6% ($42.1 billion) in 2011. This trend is expected to continue going forward as Canadian pension funds are targeting an average allocation of 7.5% towards infrastructure.

"DESPITE THE RISKS IN DEVELOPING ECONOMIES, IMMENSE GLOBAL COMPETITION FOR ASSETS IS BIDDING DOWN RETURNS, MAKING THEM LESS ATTRACTIVE ON RISK-ADJUSTED BASIS"

Currently in developed economies, especially North America, opportunities to invest in infrastructure are scarce. While some countries, like the UK, have divested many of their assets to the private sector, most others are reluctant to fundraise in the same manner. This has forced some investors to look to developing economies. Although these countries offer higher returns, only the most risk tolerant private sector investor will invest in these regions as properly quantifying the associated risks is challenging. For example, Bechtel, a US corporation, was forced out of its water investment in Bolivia due to a consumer rebellion. Bechtel increased water rates by 50% to achieve a projected IRR of 16%. The increase ended up being too costly for the impoverished country and forced the government to terminate the contract. Despite inherent risks in developing economies, immense global competition for assets is pushing down returns, further worsening assets' risk-return profile.

This presents a problem for Canadian pension funds such as AIMCo, Ontario Teachers' Pension Plan and in particular, for Canada Pension Plan Investment Board (CPPIB). Currently with assets of $192 billion, CPPIB is expected to grow to more than $700 billion in the next 30 years. To remain sustainable, CPPIB must deliver real returns of at least 4%. Investing in infrastructure plays a key role in delivering these returns. CPPIB must deploy over $45 billion of equity capital by 2040 into infrastructure in order to keep up with the capital deployed across the entire portfolio. Including leverage, CPPIB must find $80 billion to $120 billion in investment opportunities. Yet, CPPIB has not closed an investment in 18 months, indicating it may be losing out on global asset sales. If it is to effectively scale and meet its investment objectives, CPPIB needs to actively create





Global Infrastructure Investment Attractiveness

Canada represents a comparative return for infrastructure investments

its own investment opportunities. If it doesn't, it will be forced to accept returns below its hurdle rate or else face being locked out all together.

Oh, Canada

To date, Canadian governments' fiscal budgets have been dominated by health, education, and social services. Investments in infrastructure have been inadequate and failed to keep pace with the growing population, increased urbanization, threat of natural disasters, and deterioration of assets. This underinvestment in public infrastructure has created an estimated infrastructure gap of CAD $50 billion to 125 billion, which, if continued, could cost Canada up to 1.1% of real GDP.

"UNDERINVESTMENT IN PUBLIC INFRASTRUCTURE HAS CREATED AN ESTIMATED INFRASTRUCTURE GAP OF C$50 BILLION TO 125 BILLION, WHICH, IF CONTINUED, COULD COST CANADA UP TO 1.1% OF REAL GDP."

This infrastructure gap provides a large opportunity for CPPIB if it can convince governments to privatize underfunded assets. Generally, the public is less wary of domestic pension funds than traditional private investors, whom they suspect might cut corners in the pursuit of profits; they believe what's good for the pension fund will be also good for them. This alignment of interests gives domestic pensions a strategic advantage when investing in Canada. If Canadian governments and their constituents can be convinced that asset sales will benefit them, domestic pensions will create a large infrastructure market with certain structural protections, leaving them a market unto themselves.

Faced with little political license to increase taxation, governments may have no option but to look to the private sector to finance their capital programs either through asset privatization, or through public-private partnerships (PPP). Given existing consumer expectations regarding the role of government in providing certain inalienable services (water, wastewater, etc.), it will take time before large-scale, wholesale privatizations can be achieved. Until then, smaller scale PPPs present an attractive early-entry opportunity.

A PPP is an approach to procuring assets where the private sector works alongside the government to construct and at times operate assets according to a predetermined contract. In this scenario, the private sector assumes a large portion of the financing and construction risk, while being compensated based on service delivery performance. PPPs are not new to Canada - 92 projects have been completed since the 1990s, most of which were after 2009. The majority of these projects have been small but as the infrastructure gap widens, larger opportunities will become available. Although opportunities will not be immediate, CPPIB is well positioned to enter this market, especially in the $500 million to $2 billion equity range.

ASSETS	Average Deal size	% deals post 2011	Value of Infra	Total Deals Closed	Political Acceptability	Risk	Total
Airports	8	6	10	10	1	4	39
Bridges & Tunnels	9	2	9	8	4	1	33
Rail/Light Rail	12	10	2	6	9	1	40
Marine Ports	5	5	8	8	4	4	34
Roads	11	1	6	2	6	8	34
Education	4	6	5	6	9	9	39
Healthcare	10	3	1	1	9	9	33
Solar	3	11	7	4	6	4	35
Wind	7	6	3	3	6	4	29
Power	6	4	4	5	9	1	29
Wastewater	1	12	12	12	1	9	47
Water	2	6	11	10	1	9	39

Asset Class Rankings

A top score for Wastewater indicates it is the most attractive infrastructure asset class

Ultimately, success in privatization will hinge on pension funds' abilities to convince voters that they will operate more cost effectively than government and that their billing will be more equitable to the regular user. (E.g., in wastewater, usage based billing will keep residential users from subsidizing large industrial users). In order to achieve this, governments will need to decouple the cost of assets from an opaque tax regime that obscures the true cost of the service by implementing a usage fee based model alongside privatization.

Opportunities Abound

With investment opportunities in nearly every infrastructure asset class, CPPIB needs to narrow its scope to those areas that are most likely to prove successful. Due to the potential ongoing deal flow, the high number of assets still available for private sector involvement, and the lower risk nature of the assets, wastewater is particularly attractive. Wastewater assets are monopolistic in nature and are generally unaffected during economic cycles, unlike typical market-based infrastructure investments. Additionally, there has been very little private activity within the wastewater sector since it is considered an inalienable service. However, private sector involvement in wastewater assets has recently gained momentum through PPP Canada and various municipalities.

Wastewater deals to date have been small, despite the need for upgrades in urban cities. CPPIB already has successful experience with water and wastewater assets through holdings in Anglian Water in the UK. Although wastewater is considered an inalienable service, in the minds of Canadians it is an outbound item, similar to garbage collection. The perceived risk of service disruptions is not as severe for outbound items as it is for inbound items (i.e. water to your home, electricity, etc.), thus decreasing the risk of public outcry over private sector involvement especially that of a pension fund like CPPIB.

In particular, Toronto poses a great opportunity. The city's investment backlog of linear infrastructure and waste treatment facilities is larger than any other major Canadian urban centre. In 2012, this backlog was estimated to be valued at $1.6 billion, representing 6% of Toronto Water's total asset value. The average age of these systems is approximately 50 years, with 5% of the assets being over 100 years old. Flooding this past summer, climate change, rapid urbanization, and sewage overflows into Lake Ontario have emphasized the need for upgrades. The Don River and Central Waterfront Project (DRCWP) has been identified as a project that would improve Toronto's current wastewater system, one of the priorities of the current municipal government.

The goal of this project is to improve Toronto's wastewater by building new underground infrastructure systems and facilities. This project's construction is broken down into four different stages with an estimated 25 years until completion. Currently, the project has progressed onto Stage 1. The second and third stages, though undersized ($203 million and $109 million respectively), pose an opportunity for CPPIB to begin building a relationship with the government, laying the groundwork for involvement ahead of Stage 4. This stage is the most attractive for the pension fund and is set to commence in 2023. The estimated total capital cost for Stage 4 is $850 million. The combined equity cheque for the overall project (consisting of all three stages), assuming 80% debt financing, would miss equity investment threshold, the PPP strategy is intended as the first step in a strategy to privatize Toronto's entire water and wastewater system, valued at $28 billion. Further, diligence into early stages of the project would decrease the investment costs for subsequent stages, somewhat justifying the deviance from current asset sizing strategy. Regardless, a shift to a more active sourcing strategy will carry increase costs over the current strategy; however, the potential for increased deal flow at attractive risk-adjusted returns should more than offset the increased transactional costs at early stages of implementation.

"WITH INVESTMENT OPPORTUNITIES IN NEARLY EVERY INFRASTRUCTURE ASSET CLASS, CPPIB NEEDS TO NARROW ITS SCOPE TO THOSE AREAS THAT ARE MOST LIKELY TO PROVE SUCCESSFUL."

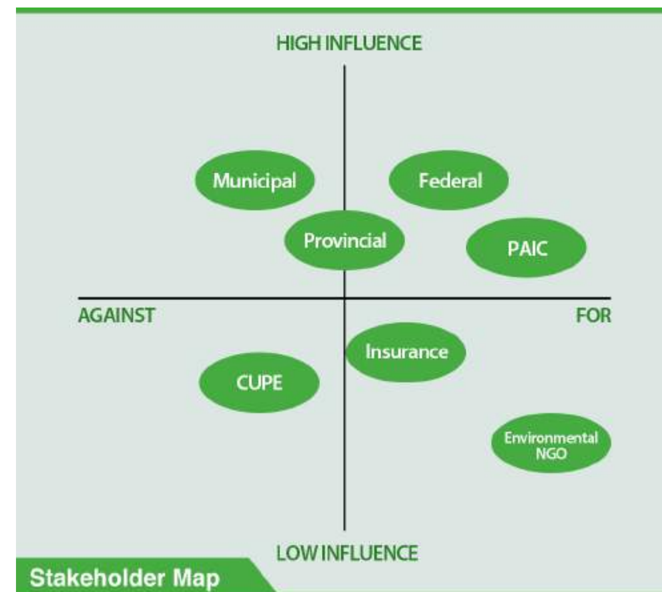
By constructing the fourth stage, CPPIB is also afforded the flexibility to structure the deal as a concession, with CPPIB operating and maintaining the asset for additional years after construction is complete. Additionally, Toronto is one of the few municipalities in Ontario that has yet to convert its water and wastewater payment systems into a full-cost pricing model. Stage 4, beginning in 2023, also provides an opportunity to negotiate for a change in the billing structure for wastewater assets, a necessary step for privatization.

But how?

While CPPIB stands to benefit from asset privatization within Canada, its ability to affect change in government policy is constrained by a relative lack of lobbying experience. Thus, CPPIB must identify other stakeholders that it can rally to its cause and lobby the government and public on its behalf.

There are many parties that stand to gain from improvements to Toronto's wastewater infrastructure, with the insurance industry being near the top of that list. Flash flooding during the summer of 2013 in Toronto placed a large burden on insurers as insurable damages amounted to an estimated $850 million. Not only will Canada be dealing with more frequent natural disasters caused by climate change, but the effects of these unanticipated events will be amplified by aging municipal infrastructure; a trend that would adversely impact insurers financial performance, making them a strong potential ally.

Other stakeholders, such as the Public Interest Advocacy Centre (PIAC), a non-profit organization that researches public consumer services to ensure alignment with the best interests of Canadians may prove effective partners, as CPPIB's ability to deliver wastewater services at a potentially lower cost than the government in the future would benefit consumers. Looking at the different stakeholders, PIAC has the most influence over the municipal government, and the municipal government ultimately decides how to structure such a deal. CPPIB should pursue the support of PIAC to lobby the Toronto municipal government.



Stakeholder Map

CPPIB can create partnerships with certain stakeholder groups to ease lobbying efforts

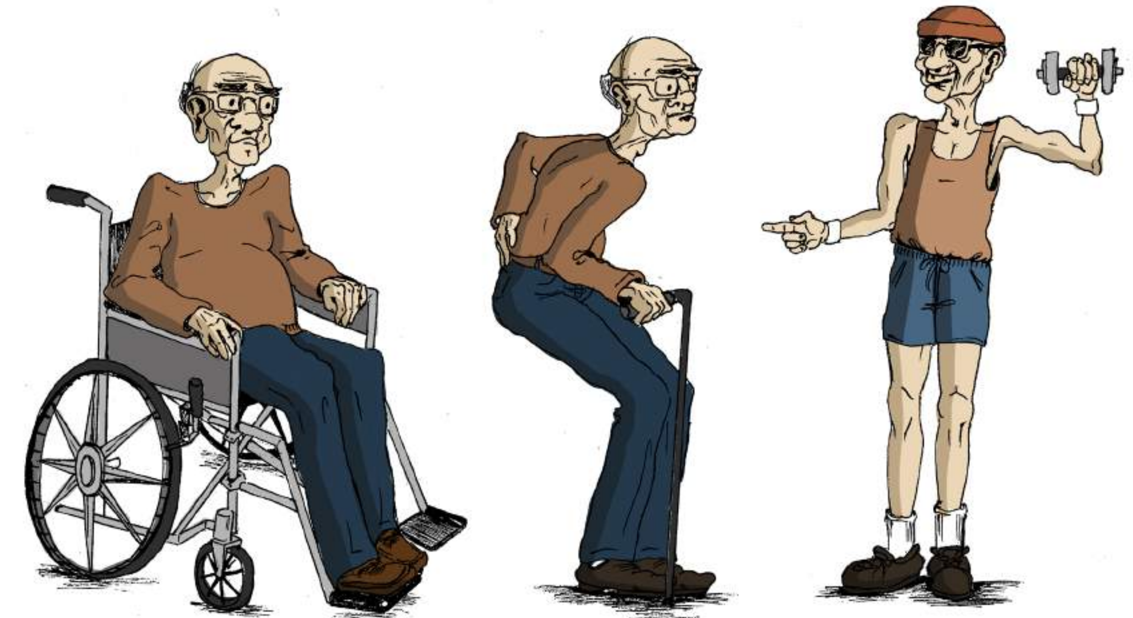
> **"CPPIB CAN GAIN ACCESS TO A WIDE ARRAY OF ATTRACTIVE INVESTMENT OPPORTUNITIES THAT OTHER GLOBAL PLAYERS WILL HAVE DIFFICULTY ACCESSING."**

The Bigger Picture

In the future, it is likely that Toronto's pricing model will be modified to align with neighboring municipalities' full-cost recovery systems. Historically, the municipal government has used tax dollars and subsidies from higher levels of government to fund the day-to-day operations of these assets. Using this revenue model and a PPP structure for the DRCWP, the added average monthly cost per residential household would be approximately $15. This extra cost would cover upgrading and renovating the existing assets and would allow CPPIB to operate and maintain the assets for a 40-year concession period with constant re-evaluation and government oversight.

While this investment is only $1.2 billion, Toronto's overall water and wastewater system has an estimated asset value of $28 billion. There is plenty of room for potential future acquisitions within Toronto Water for CPPIB. Using the DRCWP investment as a trial run, CPPIB should piece by piece begin to privatize the entire asset. While the process will not be easy or quick, CPPIB has a long investment time horizon and the potential benefits are large. Further, there will be opportunities for CPPIB to purchase neighboring municipalities' water assets, offering opportunities or cost rationalization. Finally, CPPIB can use the DRCWP as a project template for other wastewater and infrastructure deals across the country.

While infrastructure investors seek ever-further corners of the globe, with ever increasing risk, in the pursuit of returns that only continue to fall, CPPIB has the opportunity to break from the pack. With the abundance of aged infrastructure in different asset classes and geographies within Canada, CPPIB can gain access to a wide array of attractive investment opportunities that other global players will have difficulty accessing. While it will require a new approach to sourcing deals, it may be the only approach that CPPIB can take to find investment opportunities in infrastructure with sufficient risk-adjusted rewards.



'TIL DEATH DO US PART

How Insurers can de-risk the impact of increased life expectancy

By Felix Boisse & James Hammond

What happens when machine grows smarter than man? At this point, an unimaginable increase in problem solving occurs as machines improve faster and faster, leading to an explosion in inventive capacity. This theoretical point is known as the "technological singularity", anything beyond which is impossible to predict. It would fundamentally change human destiny and potentially radically extend human life. Experts in artificial intelligence say this point could occur in 2040, others say not at all. Despite disagreement, the risk exists. What is an insurance company selling annuities to do to de-risk its business against this threat?

Annuity products are sold with the assumption that life expectancy will follow a linear and somewhat predictable path. To best shield from the prospect of technological singularity, insurance companies should actively monitor nascent technologies that could fundamentally alter the length of human life and affect the profitability of the annuities business. Insurance companies should also take steps to refocus operations away from annuities by bolstering their core life insurance segments.

Longer Living

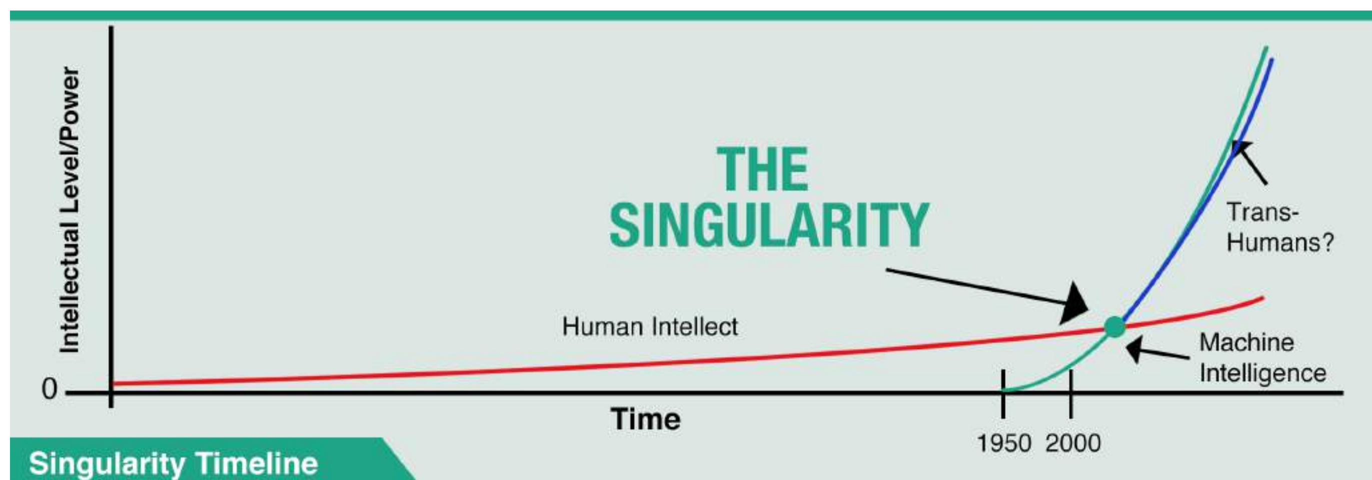
Life expectancy has increased significantly over the last two centuries. In the 19th and early 20th century, increases in life expectancy were due to reductions in death rates at younger ages as living standards improved and diseases were eradicated. In the second half of the 20th century and the start of the 21st century, life expectancy increases have been fuelled by mortality reductions at a later age due to medical advances and improvements to elderly health services. Regardless of the reasons, this increase in life expectancy has a significant impact on the temporal-based financial product dealing insurance industry.

General actuary opinion suggests that the increases in life expectancy will soon reach an upper bound. In fact, the Canadian Institute of Actuaries ("CIA") has even proposed base mortality improvement rates of only 1% for ages 60 to 90 and 0% for ages 100 and over. Given that the financial well-being of insurance companies relies heavily on the accuracy of these projections, the assumption that life expectancy will not exceed some upper bound exposes insurance companies to significant risk if this proves to be incorrect.

Boundless Life

Contrary to actuarial opinion, many theorize that life expectancy will not hit an upper bound in the near future. Technological singularity believes that humans will transcend biology through the application of artificial intelligence, genetic engineering, nanotechnology, and robotics. Ray Kurzweil, the mogul behind speech recognition technology and Director of Engineering at Google, believes that this point is rapidly approaching and technology will be fully integrated within human cells and organs by mid-century. The integration of technology into human life has the potential to push life expectancy towards unforeseen levels.

While this theory may seem futuristic, genetic therapy and organ printing are currently being studied in labs with fairly high levels of success. For example, researchers at Spain's National Cancer Research Center have genetically altered cancer-ridden mice to live up to 45% longer. The Wake Forest Institute for Regenerative Medicine has successfully grown and transplanted human organs with patients' own cells. Technological improvements have also allowed 3-D printing to create human blood vessels to replace damaged ones.



Singularity Timeline

Rise in human intellect could be driven by integrating with machines in the future

Observers like Kurzweil argue that new technologies and artificial intelligence will sustain life expectancy growth and will provide capacity for further acceleration. If this phenomenon were to occur, the potential implications for insurance companies would be enormous, representing a seismic shift in its fundamental operating assumptions.

Present Value of Future Cash Flows

Insurance companies would be the most exposed group to increases in life expectancy, with annuity products being the most adversely affected segment. Annuities are streams of payments to policyholders, generally paid annually until death. Inherently, annuities are susceptible to longevity increases, as cash outflows become longer-dated. As annuity products are currently structured, their profitability would be severely impaired by an increase in the general life expectancy. Annuity tables currently employ backward-looking mortality rate statistics.

Even if pricing models were to evaluate technological singularity as a real risk, insurance companies would be hard-pressed to sell annuity products at inflated prices. To justify purchasing expensive annuities, consumers would also need to buy into the possibility of longer life. It can be implied however, that Canadians on a whole have little respect for the longevity thesis, as demonstrated by low savings rates and minimal Registered Retirement Savings Plan ("RRSP") contributions.

Meanwhile, another insurance product stands to profit off of this theoretical situation. In contrast to annuities, life insurance is positioned to benefit from increased life expectancy, as death claims will be distributed at later dates and policyholder premiums accrue for longer durations. Policies like term insurance, which provide coverage for a defined period, would expire more frequently without a death claim. Furthermore, the lack of consideration for this shift by consumers means that they are unlikely to clamour for lower premiums to compensate for lower insurer risk.

Boundless Life?

There is great uncertainty associated with a theoretical event, in that it may never occur, or will occur so far in the future that it is irrelevant to today's decision making. Further, the technological singularity does not account for the impact of increased rate of heart disease and diabetes due to the obesity epidemic, or for the potential impact of changing weather patterns caused by global warming. Actuarial science professionals are much more likely to consider the situation holistically.

"INSURERS HIGHLY EXPOSED TO THESE LONG-TERM FINANCIAL LIABILITIES WOULD DO WELL TO PREPARE FOR THE UNKNOWN FUTURE"

Will life expectancy reach an upper bound in the near future? Even given the actuarial science professionals' considerations, it is difficult to rule out longer lifespans completely given the inherent uncertainty of technological innovation. So the best that we can say to answer the question is "maybe". Insurers highly exposed to these long-term financial liabilities would do well to prepare for the unknown future.

Risk Mitigation

Canadian insurers such as Great-West Life Co. and Manulife should start to decrease their annuities businesses and look to acquire additional life insurance assets. Two noteworthy competitors, Sun Life Financial and Industrial Alliance Insurance Inc. (IAG), have recently employed this strategy through the sale of their US annuities businesses to Guggenheim Partners, a Private Equity firm. As Great West Life Co. or Manulife look to exit their positions, private equity firms present themselves as strong potential buyers. Despite this, Great-West and Manulife might be best to wait until interest rates increase before they exit their positions, as current lower rates will depress valuations.

Growth in Patent Filing

The dramatic rise in annual patent filing in the last two decades

The possibility of the singularity is still far off, if coming, and will not be included in valuations for many years, buying insurance companies some time.

In addition, insurers should look to acquire additional life insurance assets. These would strengthen large Canadian insurers' cost advantage over any potential small competitors and eliminate the risk of new low-priced entrants. An example of an insurance company that would be a strong acquisition target is IAG. The life and health insurance provider, based in Quebec City, would provide additional life insurance exposure, geographic diversification within Quebec, and a refocus away from fixed annuities. The valuation is also attractive, as IAG currently trades at 2.1x its tangible book value, with compound annual sales growth of 7.7% between 2009 and 2012. These figures compare to 6.1x and -0.5% for Great-West and 2.0x and -10.3% for Manulife.

Better Information

While employing mitigation tactics to minimize losses in the case singularity theorists are correct, insurers may lose out on the potential upside if they act to mitigate a problem that does not really exist. In the extreme case that the opposite situation were to present itself, insurers would actually be faced with decreasing profits as a result of a fully mitigant strategy. This situation presents insurance companies with the following thought: mitigation tactics might resolve the symptoms, but they definitely don't address the underlying problem of uncertainty.

When it comes to the estimation of life expectancy, perhaps the most important consideration for any insurance company, is that it seems that the actuarial practices of the past alone, may not be enough to provide insurers with sufficient information to make decisions going forward. This is illustrated further by the fact that current actuarial data used in their calculations is the 5-10 year trailing mortality rates, insinuating that insurers need better, forward looking information.

Manulife Financial and Great West Life should therefore partner with each other and other members of the insurance industry to create a joint research and threat monitoring agency. The agency would be mandated to monitor the progression of technologies aimed at increasing life expectancy. Through such monitoring and research, the insurers would have better information from which to make their decisions.

The introduction of a research and monitoring agency also presents the partnering insurance companies with a potential opportunity. Since the agency's primary role will be to sense the first instance of life expectancy increasing technology, or the approach of the singularity, the insurers would also be exposed to early information regarding the development of what could be massively successful technology, with implications for their annuities business. Insurance companies could then use this position to invest directly in the technologies, thereby ensuring they reap the profits from an increase in life expectancy twofold: from the higher profits earned on life insurance products and through the gains made through the investment itself. Investments in technologies that may increase life expectancy would act as a hedge for risk against the uncertainty associated with mortality rates, which formulate the basis for many insurance companies' products.

The Meaning of (Longer) Life

While the potential impact of longer life expectancy could dramatically undermine insurance companies' business models, acting to fully mitigate that impact exposes insurers to potential upside loss and even potentially decreasing profits in extreme cases. This illustrates that the real problem is not "What if life expectancy doesn't stop increasing?" but "Why don't we know if life expectancy will stop increasing?" The insurance industry is a slave to uncertainty, but by establishing the proper research and monitoring resources, insurers can break the shackles and perhaps even profit in doing so.

THE SECOND COMING OF SECOND MARKET

THE SECOND COMING OF SECOND MARKET

How SecondMarket can fill the hole left by Facebook and establish itself as a unique trading platform for investors and companies

By Alex Keszthelyi & Kevin Russell

It was 11:00 AM on Thursday May 18th, 2012. Traders huddled around their screens, eager to participate in the world's largest internet IPO in history. It was intended to begin a new era of market confidence, but instead was plagued by technical glitches, confusing investors about the status of their trades. When the dust settled at 4:00 PM, Facebook's stock had cost the NASDAQ $40 million. But a few blocks away, there was even greater cause for concern. SecondMarket, a firm that supports private company stock trading, had lost the crown jewel that accounted for a third of the company's 2011 revenues. This should have been SecondMarket's opportunity to come out of Facebook's shadow and rest all doubts about its business model. Instead, SecondMarket turned its back on the offering that brought it fame, and has since made misguided efforts to fill the hole that Facebook left behind.

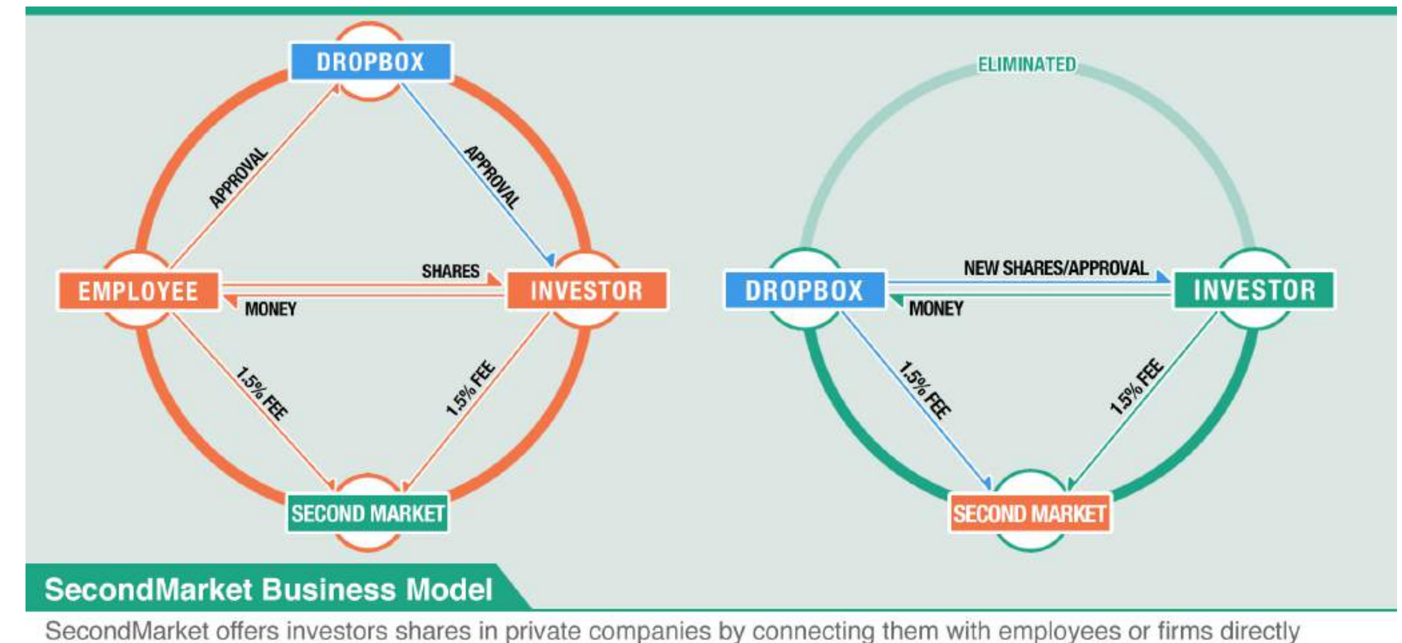
A New Place to Trade

Founded in 2004 by CEO Barry Silbert, SecondMarket acts as an online exchange for illiquid assets. Originally established to address the need for liquidity of restricted stock units, SecondMarket soared to new heights in 2009 when its platform began supporting trades in private company stock. This new offering made SecondMarket akin to a New York Stock Exchange (NYSE) for private companies, allowing current and former employees of private corporations to sell their stock ownership to accredited investors. When high-profile internet companies such as LinkedIn, Dropbox, and Facebook entered the platform, SecondMarket gained the attention of investors around the world. These corporations had a huge impact on SecondMarket's top-line growth: Facebook accounted for a third of the $558 million total trade revenues in 2011.

Similar to trading platforms such as the NYSE, SecondMarket earns a fee when servicing a trade. SecondMarket's specialization in illiquid assets commands between 3% and 5% per share traded, substantially higher than traditional trading platforms. Despite premium prices, accredited investors continue to exhibit eagerness for these unique opportunities. SecondMarket accounted for 75% of the $9.3 billion 2011 worldwide trading volume of private company stock.

But Now That Facebook is Public...

Before Facebook's official IPO in early 2012, SecondMarket cut its workforce by 10% in anticipation of a decrease in demand for private stock trading on its platform. With substantial investor hype and a large number of equity-holding employees contributing significant trading volume, Facebook had an unparalleled impact on SecondMarket relative to other private companies traded on its platform. Given this impact, investors have questioned the sustainability of SecondMarket's platform. In spite of the criticism, Silbert has continued to expand SecondMarket's reach by offering a Bitcoin Investment Trust (BIT) as well as tools for convenient fund management and student loan issuing. As exciting as digital currencies or back office administration work may be, these new offerings represent fateful missteps that have distanced SecondMarket from what it does best: trading private stock.



SecondMarket Business Model

SecondMarket offers investors shares in private companies by connecting them with employees or firms directly

BIT by the Bitcoin Bug

In 2013, SecondMarket introduced BIT, an open-ended investment that allows investors to gain access to the underlying value of Bitcoin without owning or storing the virtual currency, much like the relationship between the SPDR Gold Trust and gold. SecondMarket is primarily a trading institution and as such has no applicable expertise to act as a money manager that offers trusts in extremely volatile currencies. SecondMarket must also contend with a recently registered competing fund offered by the Winklevoss twins, infamously known for their battle with Mark Zuckerberg over the origins of Facebook. This fund plans to charge an expense ratio of around 0.5%, undercutting the 1.5% entry and exit fee and 2% holding fee system imposed by SecondMarket's offering. SecondMarket's BIT offers the same exposure to the digital currency, but lacks the cost efficiency that passive investors desire.

This focus on different product lines also distracts SecondMarket from servicing the current demands of its investor list. The company has been unable to satisfy investor demand since Facebook's IPO. From Q2 of 2012 onwards, the amount of transactions demanded was five times greater than those that were processed. SecondMarket needs to reduce its product mix and focus more on its primary competency as a trading platform. By narrowing its scope, SecondMarket can keep doing what it does best and avoid confusing its valuable investors.

Being Second to None in the Secondary Market

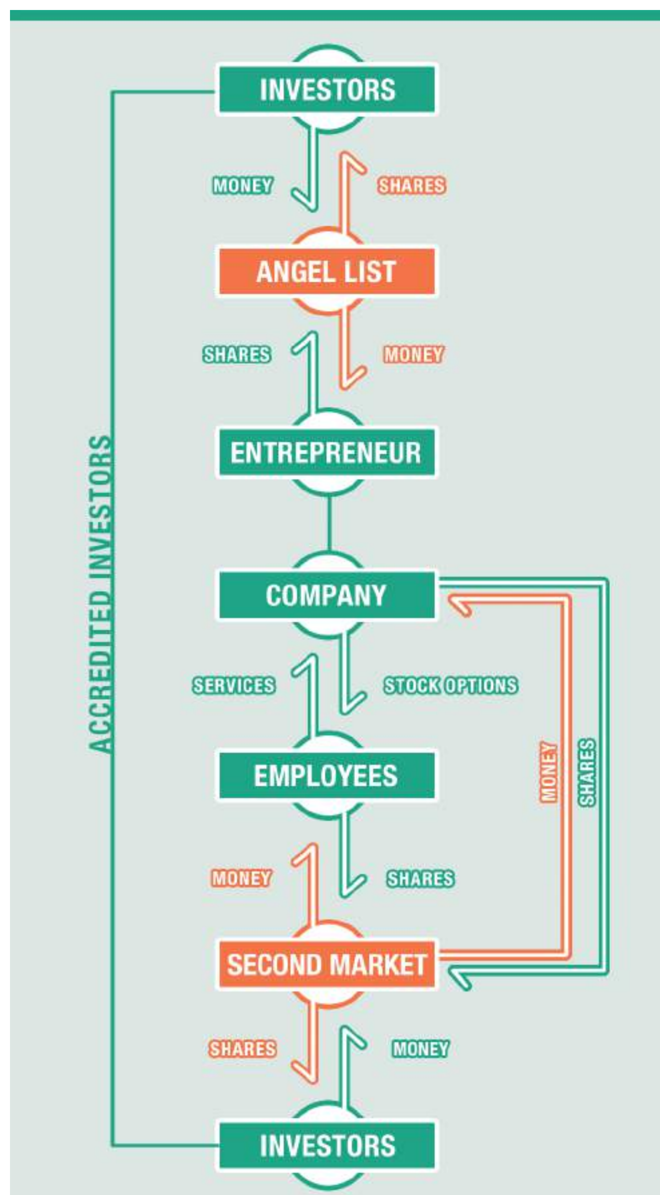
Before considering new opportunities SecondMarket should first address the present issues in its private company stock trading platform. As SecondMarket's investor base and demand for its trading services continues to grow, the company will need to increase the number of companies listed in order to generate more transactions.

To accomplish this, SecondMarket should seek to merge with the crowdfunding site AngelList to solidify a pipeline of private companies that are traded on its platform. A core function of AngelList is to set up aspiring entrepreneurs with accredited investors to raise money for their ventures. As different components of the US JOBS Act are ratified, an increasing amount of small businesses and start-ups will solicit funds from investors. Since this act promotes and allows for companies to stay private longer, the demand for private company transactions will only increase as employees of private companies seek avenues to liquidate their stock.

> **"SECONDMARKET SECOND GUESSED ITSELF AND STRAYED FROM ITS CORE COMPETENCIES"**

AngelList's premium positioning in the crowdfunding market aligns with SecondMarket's strategy of providing its investors with reputable and growing businesses and ideas. After start-ups receive funding on AngelList, they could then gain direct access and exposure to an even broader investor base for additional funding through SecondMarket. AngelList primarily consists of technology companies that use stock options and cash to attract top talent to work for them. If these employees then require liquidity for their vested stock options, SecondMarket can act as the medium to liquidate their options through its trading platform. AngelList's involvement from the time of a start-up's inception allows SecondMarket to discover the next Facebook or Twitter earlier in the growth stage.

Initially, the overall transaction frequency will increase only minimally due to the start-up nature of AngelList companies.



Re-vamped Company Pipeline

The AngelList acquisition solidifies the private company pipeline

In the long-term, this will be offset by the maturation of AngelList businesses as their shareholders develop a need for liquidity.

More Attractive Options

SecondMarket can also improve its company pipeline by targeting larger firms that can benefit from liquidity for their subsidiaries. Large technology firms such as Microsoft have had trouble attracting top talent due to the limited compensation that they can offer. Microsoft can offer a competitive base salary, but the potential upside on its stock options do not compare to that of growing technology firms like Dropbox.

SecondMarket could let companies like Microsoft use its platform to support stock and option trading in Microsoft's subsidiaries. For example, Microsoft wholly owns Yammer, a social networking site for business. When attracting talent for Yammer, Microsoft offers its own stock options, which have limited upside compared to a potential stock option in its growing subsidiary. SecondMarket will provide a trading platform for a portion of Yammer's shares and allow Microsoft to offer stock options in Yammer to attract the most sought after talent. Yammer's employees can then use SecondMarket's platform to reach accredited investors and achieve liquidity. This would be attractive to prospective employees as they will be provided with the substantial upside of a start-up firm and the liquidity and credibility of a blue chip firm.

Researching New Opportunities

Another possible avenue to increase SecondMarket's company pipeline is to provide private companies with new value add services. Currently, SecondMarket provides its clients with capital raising and sales and trading services, yet does not offer research support. By partnering with a research team, SecondMarket could help investors cut through the clutter of the many offerings on its site. Research also helps listed companies: if a research team backed the prices of the attractive private startups, the valuations of these companies may be more accurately reflected in the market. This will promote confidence and facilitate equity analysis, allowing investors the chance to look at more investment opportunities thus promoting an increase in trading volume.

To provide its investors with research backing, SecondMarket should seek to partner with a research firm such as NYPPEX, a leader in private stock research. Over 625 leading worldwide institutions rely on NYPPEX for secondary private market insights and pricing. They could also partner with Preqin, a comprehensive private research firm that focuses on alternative investments. Although SecondMarket could develop its own in-house research team, the cost of developing a comparable calibre research team over a few years would greatly exceed the benefit of focusing on the demand of its current investors. Adding a pre-established world-class research arm to its portfolio will make SecondMarket an even more appealing trade platform, more effectively meeting the growing investor appetite for unique investment opportunities.

From Second to First

Instead of using the Facebook IPO as an opportunity to emerge from Facebook's shadow, SecondMarket second guessed itself and strayed from its core competencies, but there is still time to get back on track. Re-emphasizing its private market platform can lead to more transaction opportunities for its investors, and potentially improve cross-selling with other product offerings. By focusing on its core product offering, SecondMarket can become the one-stop shop for illiquid assets and can solidify private company trading as a mainstream activity on Wall Street.

DESTINATIONS GATE ARRIVAL
INDUSTRY IMPACT OW FASTER
GLOBAL ASSIGNMENTS OW FASTER
SENIOR CLIENT CONTACT OW FASTER
CAREER DEVELOPMENT OW FASTER
MAKE PARTNER OW FASTER

GET THERE FASTER

Some people know precisely where they want to go. Others seek the adventure of discovering uncharted territory. Whatever you want your professional journey to be, you'll find what you're looking for at Oliver Wyman.

www.oliverwyman.com/careers

With offices in 50+ cities across 25 countries, Oliver Wyman is a leading global management consulting firm that combines deep industry knowledge with specialized expertise in strategy, operations, risk management, and organization transformation. The firm's 3,000 professionals help clients optimize their businesses, improve their operations and risk profile, and accelerate their organizational performance to seize the most attractive opportunities. Oliver Wyman works with the CEOs and executive teams of Global 1000 companies.

DISCOVER
OUR WORLD

THE IVEY HBA BUSINESS STRATEGY MAGAZINE

www.iveybusinessreview.ca