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Dear Readers,

Thanks for reading the Rady Business Journal. We have an excellent issue for you this year, with many fascinating stories and insights. But what will be the theme for this year’s edition? Cloud computing? Wireless health? Lean start-ups? Actually, we saw not one, but two patterns emerge in the development of this issue.

**Rady Is What You Want It to Be**

The interesting thing about publishing a business school magazine is that no one wants to write articles for a living after graduation. We found that the value proposition to the authors has to be personal, and the stories they write have to reflect their intrinsic interests. And so, like the school itself, the Rady Business Journal is a reflection of the diverse interests and talents of its students. You’ll read explorations of bio-diesel, interviews with inspirational entrepreneurs and advice about DIY summer internships. We didn’t tell people what to write, they wrote what they wanted to; and as a result, the articles are spontaneous and genuine.

**Next Year’s Edition**

Our chief focus for this year’s Rady Business Journal was next year’s Rady Business Journal. Because both the journal and the school are so new, the chief challenge facing everyone from staff to club leaders to this editorial board is one of continuity and structure. We have addressed this, adding incredibly smart and ambitious members of the class of 2013 to our staff to focus on the growth and improvement of the publication.

We hope you enjoy this latest iteration of the Rady Business Journal.

Thank you,
The Editorial Staff of the RBJ

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**Banking and the Internet**

by Mike Taylor

Banking-business woes are as high as they’ve ever been. Bonuses at large Wall Street firms are plummeting as Occupy Wall Street protestors give voice to a profound public mistrust of financial institutions. Meanwhile, implementation of the Dodd-Frank Wall Street Reform and Consumer Protection Act contributes additional regulatory uncertainty. Amid all the turmoil, the Bank of Internet (BOFI) is thriving.

Helmed by CEO Greg Garrabrants, BOFI is on an expansionist tear. The Internet banking firm has not reported a quarterly loss since November 2008. It currently employs more than 200 people, up from 90 in June 2010, and carries a base of 36,000 customers, deposits of $1.6 billion and total assets exceeding $2.2 billion.
The bank is currently headquartered in an unassuming office just east of Del Mar, California, right next door to its only physical branch (a move to La Jolla, California is planned for sometime in 2012). The décor is Spartan — just a few potted plants at the entrance, and an absence of paintings or posters on its walls. The unassuming look gives credence to the bank’s main proposition: it costs a lot less to run a bank without having to maintain thousands of retail branches, as institutions such as Wells Fargo or Bank of America do; and BOFI can pass those savings on to its high-credit customers in the form of low interest rates and fees.

Curiously, this austerity idea was born during the Internet boom of the late 1990s, when now-defunct companies such as Pets.com and Webvan were scrambling to deliver just about any service over the Internet, at seemingly any cost. BOFI founders Jerry Englert and Gary Evans saw an opportunity to deliver products similar to those found at the major banks, but without the overhead. A charter was issued in July 2000, and in March 2005 the company went public. Since then, shares have delivered a 45 percent return, handily besting banking big boys JPMorgan Chase (up 5 percent), Wells Fargo (up around 1 percent), and Bank of America (down 82 percent).

Like other branchless banks, Bank of Internet does not believe that retail branches are an advantage. In fact, they’re a source of unnecessary costs. According to Garrabrants, it costs somewhere between $150 and $200 a year to maintain a checking account. And as he explained, “People don’t want to pay.” Because BOFI skirts this fee by skipping the brick-and-mortar branches altogether, the company possesses a “fundamental inherent structural advantage” that can lead to more attractive rates for consumers, technological innovation or simply higher profits.

When the housing market was at its peak in 2007, Bank of Internet was avoiding the California housing market. The subsequent collapse just as mortgage troubles became apparent. High credit standards, coupled with a common-sense approach to lending, have allowed Bank of Internet to sidestep the worst of the housing downturn and lend to qualified borrowers whose options were slim in the low-liquidity times of the credit crisis.

But a fussy attitude toward borrowers — lending exclusively to extremely creditworthy customers — hasn’t quenched Bank of Internet’s motivation to innovate in other areas. Garrabrants prided himself on the company’s banking platform, touting email- and phone-based money transfers, unlimited ATM reimbursements and data-driven customized rewards (such as coupons that automatically transfer to the user’s credit card and ring up at the point of sale).

All those bells and whistles, of course, can and probably will eventually be replicated by competitors. In the meantime, however, Bank of Internet offers some attractive propositions. Checking accounts with the bank can yield up to 1.25 percent interest annually, a market-leading rate. Although Dodd-Frank has just about every other banker concerned about implementation of new rules and higher costs associated with following them, in one respect BOFI is turning the new law to its advantage. Regulation Q allows banks to award interest to business checking account customers, and now BOFI is rolling out a business banking group to serve both San Diego and the national market.

Going forward, the company is concerned with maintaining its high standards as it manages a serious expansion. “I spend a lot of time worrying about the culture, worrying about making sure that we’re maintaining the proper environment for people to be able to achieve, be able to work hard, those sort of things,” said Garrabrants. That, coupled with Dodd Frank — related uncertainty and global sovereign finance concerns that continue to hang over the financial services industry, serves as a reason for caution as BOFI continues to expand.

Markowitz & Timmerman: On Finance Today
by Michael Krause

For many investors, this post-financial crisis period seems even more perilous than the meltdown itself, compelling us to re-examine the very basis of the investment strategies the professional money-management industry espouses. As such, in this article, two of the Rady School’s most accomplished professors of finance hasted out some issues related to this topic.

Nobel Laureate Harry Markowitz (HM) provides valuable insights on finance and related matters, and Professor Allan Timmermann (AT) offers his views on the global economy as a result of recent instability in Europe. In addition, Timmerman makes some relevant points about risk premiums, which are, perhaps, the most crucial variables determining stock prices.
Because portfolios become difficult to diversify in crises, is there a good way to dynamically manage investments in the face of a calamity?

HM: I have an article in The Investment Professional (The Journal of the New York Society of Security Analysts) titled “During Crises: All Correlations Go Towards One: Of Course!” [The journal] changed the title “Portfolio Theory Under Pressure,” but the article itself is almost untouched. To illustrate the point made in that article, suppose that the world worked according to William Sharpe’s “One-Factor Model.” That assumes that return on any security is its alpha plus its beta times an underlying factor plus an idiosyncratic random term. For such a model, a crisis is a time when the underlying factor makes a large downward move. In this case, systematic risk swaps idiosyncratic risk. Ext ante (before the fact) you make your estimates of betas, the volatility of the factor, and the volatilities of idiosyncratic terms. As long as the movement in the market, and the individual returns to various securities or asset classes, are consistent with your betas and other estimates, then what you see is what you should have expected. In particular, a portfolio with a high beta gets hit hard; one with a lower beta gets hit less hard in crises, but does not do as well on the average over the long run, assuming both portfolios are efficient. The short answer to your questions is: if you don’t like such large downward movement in the times of crises, pick a portfolio which is lower on the mean-variance efficient frontier.

Given that the European Union is in crisis, can you take us through a thought experiment of what happens to Europe and the rest of the global economy in the event of a disbandment of the euro?

HM: If you don’t like such large downward movement in the times of crises, pick a portfolio which is lower on the mean-variance efficient frontier.

AT: Were the euro to get replaced with a system of national currencies, this would likely follow on the back of one or multiple sovereign defaults. The associated losses for European banks and the uncertainty surrounding individual banks’ balance-sheet exposure could bring the European bank system to a standstill, with very little national or international lending activity happening over a period of time. This could lead to a severe recession in Europe that might spill over to other parts of the world through reduced international trade and financial linkages. Another consideration for international spillover effects is the negative wealth shocks following from depletion in the value of European assets held by non-European companies and investors. In this situation, a key question is how effective the ECB (European Central Bank), perhaps in conjunction with other central banks, would be in providing short- and long-term liquidity, and how orderly the dissolution of the euro could be handled. Another question is how high yields the former euro members would have to pay to raise money on bonds denominated in the new currencies, which would determine their ability to pay back current and future loans. What are your thoughts on the long-term effects of recent European Central Bank moves?

AT: The Long Term Refinancing Operation (LTRO) has created some breathing rooms for the European economies, lowered market volatility and contributed to the recent mini rally we have seen in the stock market. However, I don’t believe it is a solution to the long-term issues. Market reports suggest that it is predominantly Italian and Spanish banks that have taken advantage of the new money. Suppose some of those banks have used the new money to bail out banks, and the need for further pressure on European government finances in a situation where many countries have already seen their debt ratings downgraded.

Some Final Thoughts From Harry Markowitz

What are the accomplishments you are most proud of in your career? Do they all have a common thread uniting them?

I had a book published recently called “Selected Works,” which has what I would consider Markowitz’s greatest hits. Of these, I am particularly proud of “Portfolio Theory,” “Sparse Matrix Techniques,” “the SIMSCRIPT Programming Language,” a 1952 paper called “Utility of Wealth,” a paper I wrote with Haim Levy on “Mean-Variance Approximation to Expected Utility,” work with Erik van Dijk published in a paper on “Single-Period Mean-Variance Analysis in a Changing World,” and a paper that I wrote solo called “CAPM Investors Do Not Get Paid For Bearing Risks.”

In our previous discussions, your love for music, particularly that of Johann Sebastian Bach, came up. As well, your recitation of the poetry of Robert Frost will forever stick in my mind. What role have the arts played in your life? Do you play any instruments?

I have an interest in great artists, especially the Impressionists, and architecture. But I have a passion for music. I played the violin in my high school orchestra, but gave it up when I went to college. Recently I took it up again. I am not a very good violinist; I play for my own entertainment. I enjoy Shakespeare, especially live performances rather than reading his plays. I also enjoy poetry, especially Robert Frost, Robert Browning and Shakespeare.

If J.S. Bach were to have a second career away from music, what discipline do you think he would have excelled in?

I presume that J.S. Bach would have been great at math, especially the kind of abstract math that connects many specific applications. If I were to get a Ph.D. in a real-world discipline, I would say that if I had to choose one to pursue, I would have taken economics. But the most important thing in economics is to be able to think in an accurate way about the present and the future. So in the end, I don’t think what I have done in economics has been as useful as what I would have done in economics. But of course, that is because I have never done it.
The Navy flew a jet with algal oil.

Why can’t I buy it at the pump?

by Jeff Sherin and Eric Norman

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as prices as high as $4.60 per gallon have driven U.S. drivers mad, inspiring consumers to wonder if there might be an easy-to-use, economical alternative to fuel. Could the answer lie in a simple marine plant that is abundant, cheap and carbon neutral, algae? In 2011, both a Navy F/A-18 fighter jet and a Continental Airlines Boeing 737-800 aircraft flew using biofuel made from algal oil mixed with standard jet fuel.

The History of Algae as a Fuel

Major investment in the conversion of algae to biofuels began in 1978 with the creation of the Aquatic Species Program. The main impetus for the program was a response to the oil shocks of the 1970s and the United States’ subsequent push to reduce dependence on foreign oil. The program continued despite the decreasing price of oil in the early 1980s, but was canceled in 1996, largely based on the conclusion that algae production was too expensive in comparison to the cost of oil.

As the price of oil climbed in the early part of the 21st century, billions of dollars poured into private-sector algae companies. San Diego, California attracted a significant portion of this investment, leveraging its moderate climate and research base at the University of California, San Diego to attract new companies such as Sapphire Energy and Synthetic Genomics, along with more established firms such as General Atomics.

But while the industry as a whole has continued to innovate while reducing costs, no company has yet achieved commercial-scale production of algal transportation fuel. There have, however, been some smaller successes, such as Solazyme’s 2010 delivery of 20,000 gallons of algae-derived shipboard fuel to the U.S. Navy. What is not known, though, is the cost of the algal fuel. If algae is to compete, it must do so against the production cost of oil, which has a 100-year head start as far as technology and distribution are concerned.

Algae’s Challenges

Each strategy involves complex processes of harvesting, extracting and refining the algae lipid into a deliverable fuel that can drop into a gas tank, and each option presents its own challenges and costs.

Based on a 2009 Seed Science study conducted for the British Columbia Innovation Council, the fermentation process produces the most economical fuel from algae at a cost of approximately $9 per gallon. Some companies have made claims of higher lipid content, which would drive the cost as low as $4 per gallon by creating twice as much oil from the same amount of algae. However, these yields have not been achieved at commercial scale.

One concern is that the growth rate of algae is inversely proportional to the amount of lipid production, which means that using a fast-growing strain has a low lipid content and vice versa. Being able to quickly grow algae with a high lipid content is an unsolved challenge. La Jolla’s Synthetic Genomics is hoping to resolve this challenge by genetically engineering algae.

Genetic modification may also be useful in reducing the cost of extraction. Currently, the desired oil resides inside the algae and has to be removed, killing the algae. Researchers are trying to develop algae that “excrete” the oil, which would reduce the cost of drying the algae and extracting the oil.

Algae’s Advantages

Deriving oil from algae has many advantages over other biofuels such as corn and sugar-based ethanol. For one thing, algae is not directly involved in our food chain. It also grows much faster, utilizes a higher percentage of the sun’s energy than corn or sugar (approximately 3 percent vs. 1 percent), can grow in wastewater and is capable of producing oil with a higher energy content than ethanol.

Research has focused on three main strategies to grow algae. The first two (raceway and photobioreactors) rely on photosynthesis, converting CO2 and sunlight to oil, while the third utilizes fermentation, which requires feedstock such as sugar cane.

The Low Cost of Gasoline

Although most consumers these days consider gasoline to be a considerable expense, Martin Sabransky (Rady MBA 2006), the CEO of algae company Cellana, pointed out that oil is “less expensive than bottled milk.” In fact, in one San Diego neighborhood, Ralphs supermarket sells Alfa Dena milk for $5.49 a gallon, while Chevron charges $4.25 a gallon for a regular unleaded. According to the U.S. Census, from 1984 to 2009 the average American household spent less on gas than on food, housing, home utilities, health care and entertainment.

The low cost of gas is what makes it difficult for algae to compete. And while many of us are used to thinking of the cost of petroleum as the price we see at the gas station, the true cost of production is much less expensive. What we pay at the pump includes taxes, plus additional costs for refining crude oil into petroleum and trucking it to the local gas station. According to the California Energy Commission, these costs are approximately one-quarter to one-third of the retail price. Oil made from algae also needs to be refined and transported. So to properly compare algal oil from a consumer standpoint, at the very least we need to add in these costs.

However, genetically modified strains could present new complications in production. The European continent has been especially timid to purchase food products using these modified agricultural products, and their markets may not wholeheartedly accept algal products that have been genetically altered.

Other innovations are taking place in the area of cost cutting — co-locating with power plants that can provide inexpensive CO2, for example. Solazyme is co-locating its fermentation plants with cheap feedstock providers such as sugar cane growers in Brazil.

However, the most significant detriment to the acceptance of algae as a fuel is the fact that gasoline is far less expensive.
We should also remember that the market price of crude oil is highly volatile, which means that it can be relatively inexpensive at times. As recently as 2009, crude oil cost less than $1 per gallon. To compete with this fluctuation, companies producing fuel from algae would have to be able to survive these times as well, and not just spring into existence whenever oil hits $5 per gallon.

Higher-Value Algae Products

As it turns out, many algae companies have figured this out and are pivoting into higher-value product markets. Yossie Hollander, a successful entrepreneur who donated $5 million to Cornell to address the energy needs of developing countries, explained, “You can get more money per ton of fish food produced from algae than for a ton of oils for transportation.” This article’s authors can verify this, having been to the Sephora cosmetic chain to try Solarymex’s skin-care line, which costs the equivalent of $10,000 a gallon!

The trend toward higher-value products will likely push the time scale back even further, as companies focus on developing algae strains that produce more protein and specialty oils such as Omega-3. Hollander continues, “The bottom line is this current trend will never lead to economically viable algae for oil replacement.” Barring significant breakthroughs, it appears that algae-based fuel cannot achieve cost parity at any significant scale in the near future. The current production cost of fuel is simply too low.

Thus, while the trillion-dollar fuel market may whet investors’ appetites, companies such as Cellana are targeting higher-value products like Omega-3 oils and feedstock. In 2010, Dutch conglomerate DSM paid $1.09 billion to purchase Martek Biosciences, supplier of over 90 percent of the algae-derived Omega-3 oils in the United States.

Seeking the Fourth Generation of Algae Production

Taking into consideration the current market price for oil, algae cannot be viewed as a competitive threat at present, or even in the near future. However, oil carries with it many indirect costs. According to research from the Oak Ridge National Laboratory, loss due to gross domestic product (GDP) shocks and wealth transfer cost the U.S. an average of $684 billion per year over the last decade. Therefore, it is probably best that companies continue developing more cost-effective ways to harvest energy and other competitive fuels. Perhaps the model will evolve similar to that of the petroleum industry, where a barrel of oil is refined into high-value kerosene and low-value tar, with gasoline somewhere in the middle.

The best hope is for a fourth generation of algae production to be developed. Previous generations have dropped the price from $100 to $50 to $10. If the next generation drops the cost of production to $1 to $5 per gallon, it can be competitive, particularly if the costs of carbon and other indirect costs of oil are considered. Dr. Stephen Mayfield, director of the San Diego Center for Algae Biotechnology, looks toward existing mass agriculture as a model, suggesting that the next model is “going to be something that looks like a rice paddy.”

Many look to the evolution in corn yields as inspiration for the potential of algae. In the 20th century, scientists were able to increase yields from 20 bushels per acre to nearly 140. Algae companies hope to use modern techniques to advance at a quicker pace. To achieve this goal, they should continue exploring innovative ways to reduce costs and achieve efficiencies of scale, while lobbying to have externalities such as carbon production included in the price of gasoline. In the meantime, expect to find more Omega-3 oils being produced directly from algae.

### Table: Advantages and Challenges

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<th>Process</th>
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<td>Raceway</td>
<td>• Low capital costs&lt;br&gt;• Evaporative cooling (outside) maintains temperature</td>
<td>• Difficult to regulate chemistry&lt;br&gt;• High likelihood of contamination&lt;br&gt;• Difficult to scale up</td>
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<tr>
<td>Photobioreactor</td>
<td>• Higher surface to volume ratio</td>
<td>• Difficult to scale up&lt;br&gt;• High likelihood of contamination&lt;br&gt;• Very high capital cost&lt;br&gt;• Requires temperature maintenance&lt;br&gt;• Requires periodic cleaning</td>
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<tr>
<td>Fermentation</td>
<td>• Achieves high biomass concentrations&lt;br&gt;• Easier to maintain optimal conditions for production</td>
<td>• Competes for feedstock with other biofuel technologies and possibly host supply (sugarcane)&lt;br&gt;• Scaling up to achieve efficiency of scale</td>
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Origins of the Team
GoFundMe was founded by CEO Brad Damphousse and CTO Andy Ballester. Damphousse graduated from Emerson College in Boston with degrees in integrated marketing and new media management. Ballester graduated from the University of Illinois at Urbana-Champaign with a degree in computer engineering. They worked on dozens of projects together at the same company in the mid-2000s. Realizing each other’s talents — Damphousse’s design proficiency and Ballester’s technical expertise — they decided to formally go into business together in the summer of 2008 by creating a website called Createafund.com.

Createafund was an online platform where users could create any sort of fund. The first version’s process was slow, and the team needed to figure out how to monetize the project. They came up with the strategy of offering monthly subscriptions to larger organizations and a “light” version for individual fund starters.

After monitoring these two segments, it became apparent that there was a larger market opportunity in the light version. To meet the demands of this user segment, Damphousse and his team decided to break off and rebrand the site by creating GoFundMe. They felt that the rebranding better catered to the users of the light version, and it proved to be a success as their growth began to rise steadily and user engagement increased.

Marketing GoFundMe
With the website’s popularity increasing, Damphousse and Ballester began to market GoFundMe as a crowdfunding/donation website. For each user transaction, GoFundMe charged a 5 percent transaction fee, while donors were not charged anything.

The company’s metrics serve to gauge user experience, and the founders aim to eliminate barriers for users. For example, one of their greatest growth opportunities was switching from using PayPal as their primary payment platform to WePay, which is an alternative platform that also offers online payments. They found that with PayPal, users had to do more work to complete a transaction, which often discouraged them from using the website or making donations. They performed an A/B testing analysis and integrated WePay’s platform as a payment system. The results were clear: WePay won, but PayPal still remained available to users who were more familiar with it.

Crowdfunding and Its Users
When Damphousse and Ballester first started GoFundMe, their advertising was targeted to nonprofit organizations looking for an easy channel to accumulate their donations. However, as they grew, they found that users were visiting the website to collect donations for a multitude of purposes.

Take Jennifer Haron, for example. She wanted to surprise her husband with a trip to New York City for his birthday. Within three weeks of using GoFundMe, she was able to reach 92 percent of her $1,000 goal. And then there’s German Cadenas, who was admitted into Arizona State University’s Ph. D. program (in psychology). Due to Cadenas’ international status, he would have had to pay full out-of-state tuition. By using sites like YouTube and other blogging platforms, he advertised his page with GoFundMe and was able to raise $19,540 (as of March 2012), nearing his goal of $25,000.

Online crowdfunding has become increasingly popular with sites like Kickstarter.com and Fundly.com. Kickstarter is a pledge-based crowdfunding model for personal projects, where investors have a stake in their investments. Fundly.com is a similar crowdfunding platform that targets the same market as GoFundMe. They also allow the funding of any cause.

The San Diego Technology Scene and the Entrepreneurial Spirit
Startups like GoFundMe are on the forefront of the emerging San Diego technology startup scene. It is often thought that to be a successful technology company, a move to the San Francisco Bay area is essential. So why did GoFundMe start in San Diego? According to Damphousse, not buying into San Francisco and “being here in San Diego, helped us cultivate an attitude of creativity/creation, rather than competition.”

San Diego Sport Innovators
Turning Ideas Into Enterprises
by Drew Beal and Barrett Fisher

San Diego Sport Innovators (SDSI) may sound like they’re investigating new ways to play old games, but their real goal is to help entrepreneurs turn their ideas into enterprises. SDSI is a rapidly growing trade organization that aims to grow Southern California’s business community by inspiring sports innovation.

To that end, they recruited former basketball superstar and San Diego, California native Bill Walton to lead the organization as executive chairman. In conjunction with a dedicated support staff, Walton helped the organization’s network grow from four to 44 companies in its first 18 months.

The most significant indicator of SDSI’s staying power may be that the organization is being fostered by CONNECT, a regional program that catalyzes the creation of innovative technology and life sciences products in San Diego County by linking inventors and entrepreneurs with the resources they need for success. Since 1985, CONNECT has helped develop more than 3,000 companies; and several industry-specific business accelerators have spun out of CONNECT to become stand-alone entities, including BIOCOM, CommNexus and CleanTECH San Diego.

SDSI plans to add their name to that list. CONNECT has agreed to incubate SDSI as an action and sports trade organization, which speaks volumes about where the sports industry is headed in Southern California. The argument can be made that SDSI is itself a startup success story. Having proven to the sports business community that there is enough activity in the industry to have a dedicated trade organization, SDSI seeks to help others find their own path to success.

In a recent presentation at the Rady School of Management, Walton explained the ideals of the SDSI by saying, “It adds me in a world driven by greed and selfishness, that when people make it to the promised land … far too often they turn right around and pull the ladder up behind them — as opposed to turning around and putting that hand down and out, extended, and helping up the next guy and saying, ‘come on, you’re with us, let’s go!’ And that’s the beauty of what we do at SDSI. We help the next generation, we help our current teammates and we help the service providers who make the deals possible.”

SDSI Springboard
If individuals have viable sports business ideas, their acceptance into the SDSI program hinges upon three variables: Is there a market for the product/service, is there a mentor available that fits a particular need, and are the individuals coachable? Modeled after CONNECT’s proven structure, the SDSI Springboard program is available to companies of all sizes. The first step: Individuals make a 15-minute pitch to a team of Entrepreneurs in Residence (EIRs) about their business, attempting to convince them of the potential that is waiting to be unlocked.

“The principal criterion is, are they coachable?” said Bob Logan, technology executive and current EIR. “Because if they’re not, then we’re all wasting our time. It’s not going to work.” If people have terrific business ideas, but are unwilling to accept productive criticism, they’re unlikely to find mentors willing to show them the way. On the other hand, passion for an idea or concept can go a long way toward...
developing an un tapped market — even if one isn’t immediately apparent. Once accepted into the Springboard Program, businesses begin the process of polishing their business plan while receiving tools and resources that touch upon areas such as finance, marketing and branding.

**SDSI Chalk Talk**

Frameworks are a major component of the SDSI package. These are business-oriented educational seminars put on by business leaders, for business leaders. They’re like crash courses in entrepreneurship, without the bankruptcy.

Brad Beren, co-founder of Boostamont Mountainboarding, found the Chalk Talk Frameworks very helpful. “The presenters all brought a different subject matter and a different flair, and I learned a lot from each.”

**Time-outs with SDSI**

Another innovative element of the SDSI is its relaxed approach to networking events. In contrast to the atmosphere at a CONNECT wine (think business suits and political correctness), SDSI networking events (known as Time-outs) tend to be looser in nature (think sandals and beer). Beren said he was introduced to Craig Dawson of Sports Insurance Solutions at a Time-out, and the two companies initiated a business partnership in late 2011.

**SDSI Angels**

The goal of companies that go through SDSI Springboard is to refine their business plans to the point where they feel comfortable pitching for capital funding. Graduating from SDSI Springboard makes a company eligible to present their business at a funding event. SDSI Capital Forum is a yearly event that allows five to seven polished sports companies to make presentations to venture capitalists and private investors.

Having transplanted to San Diego from New York, Catalano is now immersed in the heart of the sports community. According to Hale, “SDSI serves to marry the traditional CONNECT community to the local sports community.”

**Who Makes Up SDSI?**

**Bill Walton**

After successful careers in both basketball and broadcasting, Walton now serves as the executive chairman of SDSI. Born and raised in San Diego, Walton has a deep investment in the future of the town’s thriving sports community. Stop by an SDSI event to catch one of his trademark motivational speeches, where he is likely to encourage you to “quit your job and follow your dream!”

**Lisa Freedman**

With experience organizing large-scale sporting events such as the Super Bowl and the Olympics, Freedman brings an invaluable set of skills to the SDSI family. As SDSI’s executive director, Freedman is responsible for dealing with the broad sports community, event planning and general strategy. It’s significant that given Freedman’s extensive experience, she makes the claim that there is “no other trade organization in the United States focusing specifically on the sports community.”

**Garrett Hale**

Hale gained his management experience in the San Diego community, so he is quite familiar with the local business environment. Now serving as program manager and assistant to the executive chairman at SDSI, Hale has played a huge role in developing SDSI’s relationship with the action sports community. According to Hale, “SDSI serves to marry the traditional CONNECT community to the local sports community.”

**Renne Catalano**

Having transplanted to San Diego from New York, Catalano is now immersed in the heart of the SDSI community. She runs the SDSI Springboard program, maintains the membership and also serves as the SDSI senior program coordinator. She recently mentioned how inspirational it is to work with the entrepreneurs. “It’s contagious. I love that part of my job.”

**Could You Be an EIR?**

The majority of Entrepreneurs-in-Residence are ex-CEOs or executive-level industry veterans. Many of these individuals have experience in growing and/or founding a company and have successfully prepared companies to pitch for capital. The success of SDSI hinges upon having available resources to help startups and midsize organizations, and the organization is actively seeking to grow their pool of mentors.

Having achieved success in their former positions, the most eligible EIRs are either retired or between jobs. They are passionate about mentoring a startup and providing advice on a company’s business model. Rob Logan explored several ways to integrate himself into the San Diego business community, and felt strongly about the positive work being done at SDSI. “It’s one thing to network and glad hand people,” Logan says, “it’s another thing to sit across the table and do real work.” It’s the abundance of opportunities to do such real work that makes getting involved with the SDSI so rewarding.
A Different Crop of Businesses Take Root
by Elizabeth Han

It must seem odd that a basic element of nutritious food companies has historically faced controversy about obesity is a matter of debate. But there's no disputing the rise of businesses such as Whole Foods and Kashi, which make a point of disclosing their sourcing practices for ingredients. As the food culture in the U.S. changes, momentum could build for scrutinizing the quality of ingredients. “If this is the case, then Kashi is in a strong position because it already pays close attention to detail and ensures that its products live up to the Kashi brand promise,” said Professor Jenny Darroch. Darroch is a visiting professor of marketing at the Rady School of Management and regularly teaches classes at the Drucker School of Management at Claremont Graduate University.

Her analysis of Kashi’s brand promise zeros in on a core value. “When I looked at Kashi’s marketing material,” she wrote, “you get a real sense of passion behind the brand and it seems that the folks who work at Kashi truly believe in what they do.”

The label “crunchy” is a good fit for the La Jolla-based natural-foods company, which specializes in healthy breakfast items. Not quite “hippie” yet a close cousin to “granola,” “crunchy” captures the progressive attitude of Kashi and its larger surroundings. As the Rady Business Journal (RBJ) staff discovered on a trip to Kashi’s offices, the company is true to its beachy La Jolla roots — serious about nutrition and health, but not preachy or uptight about it. A certain laidback attitude pervades the office décor — a ping-pong table in the kitchen, a rock-star setup in the common space and photos of employees’ pets and luking adventures. Yet there’s no mistaking the sense of purpose that Kashi’s staff brings to developing and marketing its unique products.

“We want to be a brand that’s leading the way, that’s setting trends within the health and nutrition landscape,” said Michelle Raab, senior manager of consumer insights. “What is striking about Kashi is its emphasis on authenticity: even the individuals featured in their television commercials are actual Kashi’s employees.”

Raab added, “When the campaign first started, customers would say, ‘Do you really know that person? — revealing how people thought the employees in commercials were paid actors.”

Raab would respond, “Yeah, I was in a meeting with her for four hours today; I know her well.” Raab’s position in the consumer insights area makes her keenly attuned to the opinions and behavior of the company’s target market, whom she described as knowledgeable about nutrition and intent on pursuing healthy lifestyles. Kashi considers its customers to be educated and sophisticated, and their level of savoir-faire is only enhanced by the great equalizer of the 21st century: digital media. The ability to instantly assess the credibility of a company’s nutritional claims marks a departure from the past, when verifying or debunking information took time and expertise. “Consumers are changing the game and demanding more from brands like us because they have the ability to access more information in real time,” Raab said. “They could be in the store, not know what an ingredient is in the product, Google it right there on the spot, and if it doesn’t meet their needs, they’re not going to buy it.”

As Raab explained, the firm aims to not simply respond to the market, but to open new spaces in it. “A lot of times what we’ve learned is that consumers can answer what they want right now. If it’s something new … and they haven’t heard of it or they’re not familiar with it, they can’t really evaluate it,” she said. After all, consumer-insights research can only go so far when a firm is trying to invent new foods to eat. “What we have to do is also just go with our gut and say: ‘You know, we want to be pioneering’ … Sometimes you just have to lead the way and customers will come.”

Kashi employees get inspiration by reviewing reports on flavor trends around the world — in particular, the offerings in Australia, the U.K. and Canada trend to fall in line with Kashi’s forward-thinking orientation. They also consider gaps in their product lines, new products from other firms and any risk of cannibalizing their own business. And where there’s risk, there’s data analysis.

Raab frequently references company databases that are crucial to evaluating new food concepts as well as potential advertising campaigns. And the units that populate these studies are the focus group participants whom Kashi enlists to evaluate both the flavor of new products and advertising messages.

The results from these studies are cross-tabulated, helping Kashi identify related trends. For example, if 60 percent of participants rate a product as being too salty, and if overall they like the product significantly less than other people, then Kashi will review the salt content. The company’s methods help isolate the effect of certain ingredients on a product’s flavor and add a level of rigor to its analyses. It brings that same measure of precision to loadings that are crucial to evaluating new food concepts and advertising messages. The firm aims to not simply respond to the market, but to open new spaces in it. “A lot of times what we’ve learned is that consumers can answer what they want right now. If it’s something new … and they haven’t heard of it or they’re not familiar with it, they can’t really evaluate it,” she said. After all, consumer-insights research can only go so far when a firm is trying to invent new foods to eat. “What we have to do is also just go with our gut and say: ‘You know, we want to be pioneering’ … Sometimes you just have to lead the way and customers will come.”

Kashi’s early strategy of differentiation involved creating unabashedly healthy foods from a blend of whole grains. It pioneered a grain mix that is now a standard ingredient in many of its diverse products. The firm’s consistent focus has paid off, making it seem as if the company were ahead of its time in creating a new flavor of innovation.

Back in 1984, when Kashi launched its first product, a breakfast puffed rice puffed rice, who could have predicted that the firm would become mainstream other than the usual early adopters? After all, the name “Kashi” probably sounded too “exotic” to most consumers back then. Over the past three decades, though, the food industry has evolved considerably in terms of its openness to diversity. Now, businesses such as Chipotle, Trader Joe’s, and Whole Foods verify which are associated with healthy food — practically flaunt their nontraditional approaches and use of exotic-seeming ingredients. Indeed, the very label of America itself has become a place of increasing diversity. It cannot be a coincidence that America’s food culture has changed along with its demographics.

Larger social issues play a role in scenario-planning analyses for food companies that aim for palatable as well as profitable products. These issues include cultural diversity, high demand for more nutritious food, and increasing consumer awareness of ingredients. As the comfort zones of American consumers shift, companies must be nimble and adapt — while maintaining credibility. For food companies that aim to connect with consumers by promoting healthy lifestyles, a key intangible asset has to be authenticity.
After receiving her Ph.D. in Biochemical Engineering from INSA/University of Toulouse, Marquet embarked on a 25-year career in the biotechnology industry. Among other things, she directed development at Vical Incorporated, patented novel methods for DNA production and most notably founded Althea Technologies. She was the winner of the 2005 Regional Ernst & Young Entrepreneur of the Year award in the life sciences category, and Althea Technologies received several “Best Companies to Work For” awards from the San Diego Business Journal.

We sat down and talked to her about her road from lab to market.

You’re an inspiration to scientists and business people alike, but how do you perceive yourself?

Let me start out by giving you some background. I grew up in a very small country called Andorra, which is between France and Spain. I went to France for high school and college, and then I decided to get a Ph.D. in biochemical engineering. It was the beginning of the recombinant DNA revolution and the use of cloning techniques to make proteins, which led to the founding of companies such as Genentech and Amgen.

It was all very new at the time, and I was fascinated by that. When I finished my Ph.D., I joined a company in Strasbourg [France] called Transgene. Transgene was the only biotech company in Europe at the time, so there were people from all over the world, including the U.S., who were coming to this company to become involved with recombinant DNA technologies. This created a very interesting melting-pot environment to work in. Even before my time at Transgene, I was very interested in the U.S., particularly California, so after working with Transgene for three years, I decided it was time to make the move.

My husband, who was at the Pasteur Institute at the time, also felt that it was the right time to move to California. It was a bold move because I had to quit my job. Everyone told me that I was insane to go through with the idea. That must have been quite a transition!

Yes, and the surprising thing to me was how quickly I was able to not only find a job, but find a job that was much better than the one I had previously.

Moving back to the question you were asking before, one of the main qualities you need to start and build your own business is that you have to be bold sometimes. You have to make decisions when everybody else is telling you that you’re wrong, stupid; and if you feel it in your gut, you have to go ahead regardless.

Do you feel that the conservative decision making valued in scientific fields is at odds with such bold moves?

Yes, that’s a very good point. The training to become a scientist requires analytical and logical decision making. Having the two together can be rare.

When I came to California, I was able to find a job and obtain a green card, and I was very grateful to San Diego for giving me the opportunity. In fact, today, I am still good friends with the gentleman who gave me my first job. We had dinner in December, and he reminded me that [when he first met me], I was literally sitting at his doorstep with my résumé. Which brings to mind another quality — persistence!

As I advanced in my career and had the opportunity to work at several biotech companies, mainly in product development, such as Amylin and Vical, I found out that technical skills took me to a certain place, but what really helped me advance in my career were people skills. I seemed to be able to delegate tasks to other people. I was able to motivate my group and get things done.

“When you’re a successful entrepreneur, you have to be able to be at 30,000 feet; you have to have a vision of who you want to be and what you want to do.”

From lab to market. From scientist to CEO. These terms represent the dreams of the students at the Rady School of Management, and they also describe the life of Dr. Magda Marquet.
“Remind yourself of your vision on a daily basis and you will make it.”

Let me give you an example: If you’re just spending your day making grand plans and strategies but then you don’t deliver, you will run out of cash, right? If [on the other hand], you are really operationally driven and focused on execution, you will not be able to motivate your team or you may not be able to go and sell to your customers. You really need to be wearing both of these hats of vision and execution to be successful, which is not easy.

How did you manage yourself when you were switching between those different hats? How did you deal with the stress? Was it truly by fire?

Sometimes it was trial by fire; let me be honest [laughs]. However, one of the things I did [to deal with stress] and still do, is exercise and practice yoga every day. It has definitely helped me stay sane. I think that daily meditation can also be helpful. When you start a business, there is a lot of chaos. There is a lot of enthusiasm as well, and it is a lot of fun; but it’s also chaotic, at least in my experience. It’s a bit like having a new baby!

Besides the excitement involved in starting your own business, can you describe some of the other unexpected aspects that you faced starting off?

There are certainly a lot of surprises. Some things that you expect to happen never do, yet other things that you would never believe could happen, do. For instance, our expectations were completely shattered when we found out who would invest in the business. We had an “A” list with the people we were sure would invest, a “B” list with people who we thought might invest and a “C” list with the people who we did not know at all who we hoped might be interested. As it turned out, no one from the “A” or “B” lists invested. It was all "C." There are a lot of surprises like that when you are starting a business. It’s the same for figuring out who will be your customers. Those who you think will be a definite fit may not work out for whatever reason, but then others come who you didn’t expect.

Then there are a lot of surprises regarding your products. When we started the company, one of the main things we wanted to be was a re-agent and services company. We wanted to create a DNA purification kit, and we succeeded in putting together a DNA purification kit that worked really well. We called it "Anaconda" because it resembled the coiling of the DNA helix. The product worked well, it was beautiful and it had incredible graphics. However, our background was scientific, so we didn’t know anything about marketing. As a result, when we started selling this product, our competitors were killing us.

One time we were trying to sell a kit to the Sanford-Burnham Institute, and we had convinced someone there to really test it. We had a technician working with them all day. But when they were ready to buy another kit, Qiguan, who was our biggest competitor at the time, took the Burnham lab out to lunch, and so there went our sale. We failed because we highly valued our product, but didn’t realize that what matters most is how other people value the product. You can fall in love with your own product, but if you don’t stay in touch with your customers needs, you are bound to fail. Unless you’re Steve Jobs, of course, but that’s a completely different story.

When we failed with our first product, which was a fiasco, we learned that marketing is very important. Of course it is important to have a good technical product, but the way you market your product is key. I would say that in some ways, it is even more important than the technical features. So even though we failed with this product, that failure was a good lesson.

To what extent do you feel your personality as an entrepreneur influenced the character of your business?

I’m going to put my grain of salt in here because I love to talk about culture. Even from the beginning, it was very important to us to create a great culture — not just a company that was successful financially, but a company where people would be happy, a place where people wanted to be, a fun place to be and grow. This doesn’t happen by chance. It has to start at the top. It is very important, and as a leader, you have to pay attention to it on a daily basis.

You have to realize, it’s not about you. If you think it’s only about you it’s going to be a tough ride. Maybe you won’t fail, but sooner or later you will have to realize that it’s not about you; it’s about your employees, your customers, your investors and the community. If all of these people are doing well, then you will probably do well, but if you don’t have their support, the road ahead will be fraught with challenges. Very often when you start a company, you’re just so obsessed with achieving difficult goals and worrying about the bottom line that you forget that. The bottom line that you forget that is that he’s paid so much attention to culture in his company. We also read a book about the culture of Southwest Airlines called “Nuts!,” which gave us a lot of good ideas. By reading these books, I realized that it is not so important what you do, but how you do it.

It sounds like if you had it all to do over again, you’d do it the same way.

Yes, I don’t have many regrets. I may have made mistakes, but I have to admit I always learned something from them. And at the end of the day, starting and building a business is a great adventure in personal growth. There were plenty of moments during the journey when we began to feel like it was too hard, it wasn’t worth it and we weren’t going to make it. In those times, I guess it would have been nice to have known everything would turn out well, but those are the times you just have to work through. Like the stock market, the path is definitely not a straight line, but you keep going. Remind yourself of your vision on a daily basis and you will make it.
As the national deficit continues to dominate the headlines, budget cuts seem to be inevitable for the Department of Defense (DoD), which makes up approximately 20 percent of total federal spending. Yet given the continued political wrangling, there remains a wide range of possibilities for the size, scope and timeline of such cutbacks. Among the options available, a reduction in military infrastructure will most likely be included. Accordingly, the White House has recommended forming a Base Closure and Realignment Committee (BRAC) for both 2013 and 2015 to cut excess military bases that are deemed no longer necessary. Included in those cuts could be thousands of San Diego, California jobs.

While the biotechnology and high-technology sectors have grown considerably over the past two decades, the DoD remains San Diego’s single largest employer, with over 136,000 on the payroll. Despite great strides in economic diversification, the Gross Metropolitan Product (GMP) of San Diego County is still heavily dependent on both military installations and manufacturing from defense contractors that together contribute $35 billion locally, according to the San Diego Military Advisory Council (SDMAC). This reliance makes the county particularly sensitive to changes in the DoD budget.

San Diego’s Military Synergy
With the largest port in the Navy’s inventory and the most populated of all Marine Corps bases, San Diego is home to one of the highest concentrations of military personnel in the world. The 3.5 percent of San Diego residents currently on active duty starkly contrasts with the 0.5 percent of all Americans serving the same role.

The deep-water port, easily accessed training ranges and ideal weather for aviation training made San Diego a natural choice for the Department of the Navy, which first set up shop in the early 1900s. Over the years, San Diego became host to the top Navy and Marine Corps leadership on the West Coast, as well as the preponderance of maritime forces that support the U.S. Pacific Command.

Defense contractors who had direct access to the end user brought an economic engine to the region that became stronger as more retirees stayed in the area to work for these defense firms. Growth remained stable until the late 1980s, but San Diego — once considered a recession-proof economy — felt the effects of budget cuts as the Cold War began winding down. By the time General Dynamics dismantled Missile Park in Kearny Mesa in 1995, taking 17,000 jobs with it, the armed services had endured a 30 percent reduction in force over a seven-year period.

Nevertheless, San Diego emerged from the declining defense budgets and multiple BRACs as the primary location for Navy and Marine Corps personnel on the West Coast. The commitment to San Diego from the Department of the Navy has brought and maintained a defense industry cluster that has evolved alongside the Pentagon’s focus and mission.

The BRAC Process
Since 1988, the DoD has convened five separate BRACs in order to create cost-saving efficiencies, primarily through consolidation of military installations. The first Base Closure and Realignment Commission was formed in 1988 to close excess bases amid the Cold War drawdown with a purpose of providing a “fair process that will result in the timely closure and realignment of military installations inside the United States” and ultimately reduce unnecessary spending. To date, there have been five BRACs formed — in 1988, 1991, 1993, 1995 and 2005 — accounting for a total of 120 major bases closed, another 88 major bases realigned and nearly $100 billion in savings. In past rounds, the Pentagon has been given six years on average to implement the plan.

History of the BRAC in San Diego
In each of the previous five commissions, bases within San Diego County have either been under consideration for closure or
The 1988 BRAC marked the beginning of the Navy's West Coast consolidation, with the decision to close Hunter's Point in San Francisco Bay. The ships stationed at the naval shipyard were dispersed to other bases along the coast, of which San Diego gained one cruiser, two destroyers and two frigates, along with 1,500 jobs.

The next BRAC round, in 1991, followed an adjustment to the public law that governed the process. From San Diego's perspective, it was once again a net gain, this time to the tune of 5,000 military and civilian jobs. Two local naval R&D facilities closed, but Naval Base San Diego was the primary beneficiary of the closure of Naval Station Long Beach.

In 1993, San Diego once again lost the BRAC process with a net gain of over 5,000 jobs for the area. While the Navy left NAS Miramar for NAS Lemoore near Fresno, the Marine Corps took over control of the air station with jets, helicopters and additional jobs from MCAS Tustin and El Toro in Orange County. Meanwhile, the Navy continued expansion at Naval Base San Diego and NAS North Island with the arrival of additional ships and civilian depots from NAS Alameda in Oakland. The biggest loss of the round for San Diego was the closure of the Naval Medical Center, where over 3,000 total jobs were realigned in order to centralize medical training in San Antonio. The loss was largely offset by the continued growth of Naval Base San Diego, which received ships and personnel from base closures in Texas and New Orleans. Including other minor adjustments to local bases, San Diego ended up with a net loss of 2,804 jobs from the process.

What to Expect for the Next BRAC

An upcoming BRAC round may have a very different feel from those in the past. This time around, the defense budget is facing mandatory cuts and the potential for sequestration, where the military budget would be cut by a certain percentage across the board if Congress does not agree to deficit-reduction measures. Furthermore, there may be an increased focus on closing overseas bases, which is done outside of the BRAC process but may have a very large impact on the American bases to which personnel return.

The future BRAC round could at least indirectly affect all 11 of the Navy and Marine Corps centers in the country; however, only a few could reasonably be considered for closure based on perceived redundancy.

SPAWAR plays an integral role in the direct connection between the military and local defense contractors; however, San Diego is not its only location. SPAWAR Systems Center (SSC) Atlantic in Charleston, South Carolina, performs a similar role on the East Coast; and as such, SPAWAR may be under further consideration for consolidation by the next BRAC, which may add or remove thousands of local civilian jobs depending on the pendulum swing.

The Naval Aviation Depot (NADEP) at North Island serves a critical role for naval aviation and is the only one of its kind on the West Coast; however, there are other NADEP locations in Jacksonville, Florida, and Cherry Point, North Carolina. Similar to SPAWAR, NADEP North Island may stand to gain or lose a number of civilian jobs from a BRAC review.

Although the San Diego County Regional Airport Authority’s proposed measure to use Marine Corps Air Station (MCAS) Miramar as a joint-use civilian and military airport was defeated, the primary purpose was military alignment rather than cost concerns. In a process that began in 2002, it was the first BRAC that resulted in a net loss of jobs for the San Diego region. There were a number of minor adjustments to the San Diego military bases in the 2005 round, but the largest drain was from the Naval Medical Center, where over 3,000 total jobs were realigned in order to centralize medical training in San Antonio. The loss was largely offset by the continued growth of Naval Base San Diego, which received ships and personnel from base closures in Texas and New Orleans. Including other minor adjustments to local bases, San Diego ended up with a net loss of 2,804 jobs from the process.

The 2005 BRAC in San Diego

The 2005 BRAC was a change in process from the previous rounds. The Secretary of Defense declared that the U.S. military required a “transformation through Base Realignment and Closure” to update the Pentagon’s new strategic initiatives. Therefore, its primary purpose was military alignment rather than cost concerns. In a process that began in 2002, it was the first BRAC that resulted in a net loss of jobs for the San Diego region. There were a number of minor adjustments to the San Diego military bases in the 2005 round, but the largest drain was from the Naval Medical Center, where over 3,000 total jobs were realigned in order to centralize medical training in San Antonio. The loss was largely offset by the continued growth of Naval Base San Diego, which received ships and personnel from base closures in Texas and New Orleans. Including other minor adjustments to local bases, San Diego ended up with a net loss of 2,804 jobs from the process.

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End State

Congressman Brian Bilbray, representative of the 50th Congressional District, which includes MCAS Miramar, does not think San Diego will be targeted during the next round. "San Diego has taken some hits, but we've always gained from every BRAC process that I've seen, and mostly because we've got the synergy to provide more bang for the buck. We're able to provide more national defense for dollars spent." He continued, "I don't fear a BRAC in any way. I do fear a major reduction from the sequestering if we are not flexible and innovative about how we address that." Clearly sequestration could have a huge impact on San Diego, where a 10 percent cut across the board would result in an economic loss of over 13,000 jobs as well as millions of dollars in defense contracts. Congresswoman Susan Davis agreed that sequestration would be problematic for San Diego and the military. Davis, who lobbied in 2005 for the removal of MCWR from the BRAC closure list, said that "we absolutely have to be prepared for both of those rounds if that is the way it proceeds.

Larry Blumberg, the director of the San Diego Military Advisory Council (SDMAC), lamented the delayed arrival of three aircraft carriers that had been scheduled to homeport in San Diego by now: "We have a three-car garage, and if you look out the window, there are no cars in the garage." Blumberg also said that "the economic impact of a carrier homeporting is really significant for the area and would essentially offset many of the potential cuts the area could face.

Ruben Barrales, president of the San Diego Regional Chamber of Commerce, expects the business community to be as involved as it was during the last process. In 2005, "there was an effort mobilized to help support the region in understanding sequestration and bring some attention to it," he said. "In that round, the costs to the military were 70% of the total cost, and the rest was civilian. This time, the civilian share may be as high as 80%, so we have a bigger obligation to the region, every dollar now counts.

Although sequestration was an issue for the county, there is no expectation that San Diego will face a major cut to its military presence. San Diego's long history as a military town may not be in jeopardy, but there has been a base in San Diego County considered by every commission thus far. The process has served to consolidate the military on larger bases, which will continue to benefit the county as a whole, as any loss of a smaller base will most likely be offset by a gain at one of the larger locations. But given the political process, there is always a wild card in the mix, and in this game the stakes include thousands of local jobs.

Prior BRAC rounds occurred at the dusk of the Cold War, when military budgets and force structure were shrinking. The 2005 BRAC round occurred in a post-9/11 environment with our armed forces deployed in combat in Iraq and Afghanistan with stable or increasing force structure and defense budgets.”

- 2005 BRAC Commission Report
Unpacking the Golden Parachute

by Carlos Uribe

A t the Rady School of Management, certain professors tend to answer crucial questions with the response, “It depends.” This is an interesting approach, as it basically says, “Well, there’s no one cookie-cutter solution to any issue; no one answer solves all problems; and many factors have to be considered, weighed and accounted for.” It also implies that we should draw our optimal strategy from the goals and resources we have at hand. Different approaches to those two factors — goals and resources, that is — will render varying conclusions.

As an example, dissatisfaction with the exorbitant salaries of certain executives compared to levels of performance is an issue that the business world could confront using the pragmatic approach described above. But is the solution as simple as paying CEOs less? Well … it depends.

Goals of Executive Compensation

The main goal of executive-compensation packages is to assure that a company is able to attract and retain the kind of talent that will grow the firm’s profitability and overall value. This is achieved by offering a package appealing enough to bring in the market’s prime candidates.

Corporations, which act on the decisions made by their boards of directors, also attempt to keep the firm’s costs at a reasonable level. Their aim is to provide a structure that aligns the interests of shareholders with that of the company as a whole. Such structures reward the CEO when performance matches or surpasses expectations, but penalizes the executive when this goal is not met. Boards of directors expect this carrot-and-stick process to inspire executives to work as diligently as reasonably possible and to tailor one’s risk preference to the level preferred by shareholders.

However, boards do not always find it easy to achieve optimal objectives. Michael J. Berghof, former CEO of TransTechology, current director of Fresh Del Monte Produce and Pro-Dex and professor at the Rady School of Management, said, “The main problem is that objectives are established with foresights and then they are judged in hindsight.” Therefore, boards need to find a system that allows them to create compensation packages that offer rewards from a hindsight perspective, even if they have to create the plan early on — that is, with foresight.

Rather complicated incentive systems are currently in place in the corporate environment. Such systems claim to divide the pie into different slices, making parts of it grow or shrink based on a firm’s performance. This creates a link between pay and performance, while bulletproofing a minimum amount of compensation from the external and unmanageable fluctuations of the market.

Business Circumstances

Currently, boards of directors in various industries have been selecting the goals and bonus-triggering thresholds based on their best possible estimates of what good performance should look like. To do so, boards use all the information available to them, including hiring outside consultants. This process is usually a priority for the board, since a goal that is not finely tuned will result in either overwhelmingly challenging tasks … or the converse. The issues that will likely arise if incentives are not in alignment with expectations is that CEOs will be either pushed toward risk, taking chances in an attempt to reach unrealistic goals, or they will take the easy way out with respect to what their boards have requested without having to invest themselves fully in the success of the firm. Evidently, the entire incentive system must be instituted before different compensation levels are put into place relating to a CEO’s performance. However, an area of concern would be that the information the board is using to create the system is based on events and circumstances that occurred in the past — that is, they are using this information to build a scenario for how the future will look.

Even if no one likes to admit it, most individuals — and those involved in high-level business are no exception — do not particularly excel at forecasting the future, as Nassim Nicholas Taleb (a professor of risk engineering at NYU) explained in his popular book “The Black Swan.” Therefore, it would be reasonable to expect that the actual level of task difficulty assigned to the executive by the board will not exactly be the intended one. Increasing market volatility and specific industry fluctuations will shift this difficulty level, either raising the bar to unreasonable levels of hardship, or lowering it enough so that corporations end up compensating CEOs for mediocrity.

Proposed Solution

A proposed solution to improve overall performance would be to set compensation as a function of living indicators, which would track the difficulty of the task assigned to the executive and adjust the goals set up for him/her so that they are both realistic and challenging. By doing so, it would allow for a reasonable creation of the compensation amount to improve the expectancy (the belief that one’s effort will result in attainment of desired performance goals) and instrumentalities (the belief that a person will receive a reward if the performance expectation is met) of the executive. This approach would ultimately support the desired level of risk-taking and effort expressed by management, since the executive’s performance would be paired to an accurate picture of the world, rather than a projection that could be outdated.

A determination needs to be made with respect to what is deemed to be an optimal level of complexity in the compensation-setting framework. This is an interesting approach, as it basically says, “It depends.”

Business Circumstances

Determining the optimal level of performance will need to be decided by looking at the current competitive landscape, as well as the available competitive advantages, distribution of revenue (weighing down especially lucky or unlucky segments or divisions) and so on. This adaptation will not solve all the problems surrounding the issue of executive compensation, but it will be a step toward a more equitable treatment of high-level executives. It is hoped this will allow for not only improving short-term corporate performance and adjusting risk preferences of CEOs, but demystifying the challenges that such positions entail, and the value that one talented individual can bring to the table.

As Ken Wbeschler, an expert in executive compensation for the Radford Group, said, companies across the board are working toward matching task difficulty with compensation-triggering goals. “Everything [in the world of executive compensation] is becoming relative to your peers. . . sometimes just not losing money is good enough.” If a company is operating in a market where heavy losses are being witnessed all around, it would make sense not to demand high profit growth, maybe a zero net income at the end of the year is a reason to celebrate.

Even if, in many cases, the performance of a defined peer group is a fairly acceptable proxy for difficulty at the CEO level, what about when it is not? There are more than a few circumstances that can make an observer restless about this simple metric. What happens if the company has no similar competitors to measure against? What about firms trafficking through new market opportunities? Which peers should be considered when evaluating a zero-revenue firm (typically in some scientific field)? What about the case of mediocrity, or simple failure to execute properly on the competitor side? Wouldn’t this make it easier for the company in question to reach predetermined goals? If so, shouldn’t these goals be updated (that is, increased, and not reduced by the competitor’s failure to succeed)?

It is believed that peer groups can be used to track task difficulty, but is not quite enough, we need to find other variables to complete an equation that determines our objectives. The nondefinitive answer will once again be “it depends.” But what is certain is that the level of performance that would earn bonuses for CEOs and other executives can be better defined as a factor of a few observable relevant variables. Comparisons to peers can be a very helpful approximation, but they don’t tell the whole story. Potentially relevant factors may include technological or scientific developments (or failures), market conditions, regulatory frameworks, performance of substitute products, capitalization of acquired competitive advantages, distribution of revenue (weighing down especially lucky or unlucky segments or divisions) and so on. This adaptation will not solve all the problems surrounding the issue of executive compensation, but will be a step toward a more equitable treatment of high-level executives. It is hoped this will allow for not only improving short-term corporate performance and adjusting risk preferences of CEOs, but demystifying the challenges that such positions entail, and the value that one talented individual can bring to the table.
CEO Tanya Maslach on Her Path to Entrepreneurship

By Danielle Berman

Tanya Maslach is the founder and CEO of GOTRIbal, a unique organization dedicated to connecting and empowering women through endurance sports. She was recently nominated by the San Diego Business Journal as one of the “Most Admired CEOs.” It is easy to see why GOTRIbal, which launched in 2010, has since captured the hearts of women across the globe who are looking to build relationships through healthy, active lifestyles. As Maslach put it, GOTRIbal isn’t about “racing.” It’s about journeys that positively impact women, their families and their communities. Below, Maslach discusses her success as an entrepreneur.

How did you decide to build your own company?

I saw a huge hole in the market. Women were pushing the explosive growth in endurance sports. They alone were changing the marketing, sales and development plans for the running and fitness shoe/apparel, biking and race categories, and improving their bottom lines year over year; but there was no resource that served them with educational, entertaining and empowering experiences in a community setting. Before I started GOTRIbal, I selfishly wanted to mentor a woman in another city that didn’t offer women the rich resources in endurance sports like San Diego did. I couldn’t find a quick way to find that woman ... so I built a community that would forever be a place for other women to find and give mentorship, expert advice and support.

Is entrepreneurship in your blood?

You mean besides sushi and gnocchi? Seriously, though, I think it is. Wherever I’ve gone, in science or business, I’ve always thought, “How can this be done better?”

Why is the endurance-sport space important to you?

It’s where I see women having the most impact in the area of changing health in America. It’s not about racing. It represents a simpler opportunity for women to live active, healthy lifestyles and, by doing so, positively impacts their self-confidence, power and influence on their families’ way of life. And besides that, you can’t beat the ridiculous outfits we have the pleasure of squeezing our bodies into every once in a while. There’s so much room for the fashion industry to come in and play!

When building your business, did you have doubts along the way? How did you deal with them?

Oh, never. Okay, really? Anybody who says they didn’t doubt along the way is ... Steve Jobs! Before speaking at the espnW Summit, where I sat on a panel with Microsoft, Blogger and Sugar Inc., I had a panic moment of “What am I going to say that’s better, more important, more valuable ... etc.?!” I turned to my board of advisers. They’re like my personal coaches, cheering squad and mentors. Only they are also wicked smart, extremely accomplished and have great hair. Another time I was going to pitch my company to a group of potential investors, and as I rolled through the car wash, I started to wonder what I was doing and if it was truly valuable. I knew I couldn’t go to a pitch not believing in my own creation. So I called up a GOTRIbal member in Colorado. Just picked up the phone and called her. I asked her why she enjoyed being a member, why it was so valuable to her. (After that call she told me to cut the crap and go kick some butt.) I try to practice what I preach to GOTRIbal members — surround yourself with people [who] believe in you and your mission, ask for their support often and with sincerity and then pay it forward when you can.

How do you market GOTRIbal?

We market using a variety of channels, but at this early stage it’s been primarily organic. We have an “Ambassador Squad” of women, ages 19 to 55, that reflects our membership base’s age range and ability; and they are our social connectors and chief evangelists. They are constantly spreading the news, stories and highlights of the women, and their accomplishments and journeys, with their networks.

We have an “Expert Coach Team” of sport psychologists, triathlon coaches, run coaches and more that are accessible to women around the world whenever they want. They publish content and connect via our website, newsletter and our Facebook page to support women in their athletic journeys and [their] desire to live an active lifestyle.

We have strong relationships with partners in and out of our industry who … allow us earned media spots to highlight the impact of our company’s services for the women members. Also, our partnership with a world champion athlete, who was undefeated in her career as an Ironman distance triathlete, has been integral to us reaching and connecting with audiences we would have not reached out to before.

What keeps you motivated?

The stories I hear about how women’s lives are positively transformed by their interactions with GOTRIbal members and fans. Women I’ve met who, because of a GOTRIbal scholarship, are now running along the same river walks where they were physically abused years ago. Or women who’ve left abusive partners in order to get strong in mind and body, losing pounds and shedding self-destructive relationships in the process. I love seeing the collective power of active, healthy women chip away at society’s obesity problem, by living and breathing a lifestyle that changes their friends’ and families’ beliefs in what is possible.

What advice would you give to someone who wants to start his or her own business? Three things:

1. Relationships and character matter more than anything. Who you are, who you hire, who to build the company with and who invests in your company. It isn’t just the number of people who know you, but the quality and character of the people who are in your circle. Don’t be afraid to not connect with some people.

2. The day three bad things happen to your business in one day is a good day. Be ready to celebrate the seemingly mundane: like getting a return call after trying to reach an all-important contact, or the moment a customer could successfully use your website to buy your product (bonus: if it successfully ships).

3. Be ready to flex: your model, your plans, your ideas for what works, who’s “the best for the job” and even your role in the company.

Currently, GOTRIbal members include swimmers, triathletes, runners, and cyclists from San Diego to Sydney. The company hopes to continue expanding worldwide, providing a supportive network for the more than 60 million women engaged in endurance sports.

“surround yourself with people [who] believe in you and your mission, ask for their support often and with sincerity and then pay it forward when you can”
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