

**STRATEGIC ANALYSIS OF
A RESORT BASED
RETAIL OPERATION**

by

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ABSTRACT

Terwiel Holdings is a small retail business operating at Sun Peaks Resort, a four-season resort in the interior of British Columbia. The business is facing the decision as to whether to grow, stay the course, or sell.

This project is a strategic analysis of the business, including an organizational overview, an external analysis, an internal analysis, a financial analysis and an identification of strategic alternatives for Terwiel Holdings.

The outcome of this analysis is that Terwiel Holdings should continue to operate at its current size and structure, while improving and fine-tuning the information management and financial management aspects of the business. Improvements in these areas will provide the foundation from which future growth can take place, or upon which a solid exit strategy can be built.

Keywords: business, strategy, retail, small business

DEDICATION

To George, Justin and Elli, who have given up so much, while supporting me completely.

Also to my parents, for creating an environment that nurtured curiosity and a love of learning.

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1 INTRODUCTION

Terwiel Holdings is a small business operation established in 1998. It has grown to encompass three retail stores at Sun Peaks Resort, a major four-season resort northeast of Kamloops in the North Thompson area of British Columbia. Sun Peaks Resort has been on a growth trajectory since 1992 when it was purchased by Nippon Cable of Japan. In 1998 Terwiel Holdings entered the business market at Sun Peaks Resort as an owner/operator venture, run by Anne and George Terwiel.

The three businesses belonging to Terwiel Holdings are operating smoothly, though not as profitably as the Terwiels would like, so some important decisions are required. Up until this time Terwiel Holdings has been operating as a lifestyle business. Profitability has not been a major concern as the business was meant to provide an income for George and to support a more favourable tax position for Anne. Sun Peaks Resort is expanding its base lands operations to include a new “East Village,” so further retail space will become available at the resort. At this time, there are 5 options that Terwiel Holdings would like to explore:

1. Stay the course
2. Grow the business by building a new store in the East Village
3. Enter into a joint venture
4. Sell one or two of the current stores
5. Exit the business.

This business strategy paper will describe the current operation of Terwiel Holdings and will seek to identify a strategy that will allow the owners of Terwiel Holdings to move into the future in a strong financial position, while enabling a mountain resort lifestyle for the Terwiel family. A recommendation to pursue one of the five options listed above will be the result of this analysis.

2 BACKGROUND

2.1 Sun Peaks Resort

Sun Peaks Resort is a growing four-season mountain resort area northeast of Kamloops BC. The ski hill was established in the early 1960s as Tod Mountain and was operated as such until 1992, when the property was purchased by Nippon Cable Company Ltd. and renamed Sun Peaks Resort. Nippon Cable mapped out an aggressive expansion plan for Sun Peaks that will see the resort develop into the second largest ski resort in western Canada, behind Whistler-Blackcomb, with an 18-hole championship golf course, a network of hiking and mountain biking trails, and a myriad of other recreational opportunities. The four-phase plan for growth involves the recreational development as well as the establishment and growth of a mountain village including full service hotels, condo-hotels, pensions, and a variety of restaurants and retail shops. Sun Peaks Resort is currently in Phase 2 of its four-phase build-out plan and tremendous growth is planned over the next 10 years.

Real estate options include single-family homes, duplex-zoned lots, townhouse complexes, condominiums and commercial space. Nippon Cable retains ownership of the recreation area and is a partner in several of the hotel properties. All other real estate has been sold to businesses and individuals to create a diversified ownership pool. A business and marketing association, Tourism Sun Peaks, coordinates the activities of all of the separate businesses.

3 ORGANIZATIONAL OVERVIEW

3.1 Relationship with Sun Peaks Resort and Governing Bodies

Sun Peaks Resort Corporation is a privately held company. The company owns the base lands around Tod Mountain, the mountain upon which the resort has been constructed, and has a crown lease for the slopes where terrain has been and continues to be developed for skiing (alpine and cross-country), snowboarding, tubing, hiking and mountain biking. Sun Peaks Resort Corporation operates the lift system; designs, cuts, grooms and maintains the slopes; and runs several business units including: real estate sales, a utilities company, the golf course and golf shop, the rental shop (skis, boards, bikes), a hard-goods retail shop, two soft-goods retail shops, and several food and beverage outlets. Sun Peaks Resort Corporation is a partner in the Delta Sun Peaks Resort Hotel.

Sun Peaks Resort Corporation has utilized a coat-tail development strategy, whereby the initial businesses were owned and operated by Sun Peaks Resort Corporation, and a development plan was put in place that would encourage individual entrepreneurs to start businesses within the resort area, subject to being consistent with the development plan. The resort owners felt that this would create the vibrant business environment that a “company town” is unable to duplicate. There are currently 55 businesses operating at Sun peaks Resort, including accommodations, property management and real estate companies, services, restaurants and shops.

All resort businesses pay dues to Tourism Sun Peaks, the marketing body associated with Sun Peaks Resort Corporation. Tourism Sun Peaks (TSP) operates the Central Reservations System that allows tourists from around the world to make their holiday bookings. TSP markets the resort nationally and internationally via broadcast, display, electronic and print media and by attending trade shows across Canada, and in the US, Europe and Australia. They are also responsible for organizing and hosting familiarization trips that bring world media, special events and convention business to the resort. TSP brings together Sun Peaks Resort Corporation (SPRC) and other resort businesses for monthly meetings for the purpose of planning, developing product, and discussing concerns, and can act as a liaison between SPRC and individual business owners if an issue requires resolution.

All of the individual businesses are completely dependent upon Sun Peaks Resort for customers. By road, Sun Peaks Resort is located 45 minutes northeast of Kamloops, and 4 hours northeast of Vancouver, British Columbia. Were it not for the resort, very few people would ever venture into the area. At this time, none of the independent businesses at the resort have the pull to attract customers on their own. For this reason, involvement with TSP is critical; each business must understand the plans of SPRC in order to appropriately plan for their own business. Businesses must support TSP in their effort to bring guests to the resort.

The Sun Peaks community is governed by the Sun Peaks Mountain Resort Improvement District (SPMRID), the first improvement district of its kind in British Columbia. It operates under letters patent signed by the provincial government, and answers directly to the provincial government on matters such as taxation, the operation

on the fire department, garbage collection services, snow clearing and roadway maintenance, valley trails and parks. The Thompson Nicola Regional District (TNRD) oversees the development of land and adherence to the 25-year plan signed by Sun Peaks Resort Corporation, the TNRD and the provincial government. It is hoped that, in time, there will be enough of a permanent population to gain municipal status in order to simplify governance. As a result of the current governance structure, resort businesses may find themselves dealing with SPRC, TSP, SPMRID, the TNRD and/or the provincial government at any given time. Dues are paid to TSP, and taxes are paid to SPMRID and the TNRD, collected on their behalf by the provincial government.

3.2 Terwiel Holdings

Terwiel Holdings encompasses three retail stores at Sun Peaks Resort. The three stores occupy three separate leasehold properties and were developed independently. Willow Tree Gifts and Lone Wolf Gallery occupy space leased from the same property owner. There is an option available to purchase one or both of these two properties. Tree Line Studios is leased from Delta Hotels and the option to purchase the space does not exist.

Willow Tree Gifts was purchased in the spring of 1998 as a turnkey operation, though considerable development was necessary to bring stock and staffing to profitable levels. Adjacent to Willow Tree Gifts in the Sundance Lodge is Lone Wolf Gallery, purchased in the fall of 1998, also as a turnkey operation with development requirements. The interior dividing wall between Willow Tree Gifts and Lone Wolf Gallery has been opened up so that the two stores can essentially be operated as one retail outlet with a single staff person required. Willow Tree Gifts features lower-priced products aimed at

children, teens, cost-conscious consumers and souvenir hunters. Lone Wolf Gallery offers mid-priced, distinctive products with an outdoor theme.

In the spring of 2003 Terwiel Holdings began construction on Tree Line Studios, a leased space located in the new Delta Hotel. It opened for business in the fall of 2003 as the only art gallery located at Sun Peaks Resort, featuring the work of high-quality local artists, and artists and artisans with a connection to the BC interior. Products include original and limited edition works, art cards and mountain photography. Together the three stores encompass the low-, mid- and higher-end markets available at Sun Peaks Resort.

3.3 Key personnel

George Terwiel, COO, is in charge of the overall operation of all three stores. He is involved in all aspects of the business including buying, staffing, merchandizing and the sale of larger-ticket items. George directs and mentors the new manager, who currently oversees all three stores. Anne Terwiel, CEO, is concerned with long-term and strategic planning, financial management, staff training, and is peripherally involved in staffing and buying decisions. Both George and Anne work directly on the sales floor when necessary, conduct staff meetings and liaise with hoteliers and the business community at Sun Peaks Resort.

Anne and George recently elevated one of their long-term employees to the position of manager. The manager will assist in all operational matters, in particular, scheduling, staffing, ordering, accounts payable and payroll. This will take some of the

daily operational pressure off of George and allow him to focus on the bigger picture, including the development of store information technology.

The size of the sales staff varies seasonally; however, there are 5 core staff members who are employed on a year-round basis. Several of the core staff have been employed by Terwiel Holdings for more than 5 years. During the busy winter season the staff grows to 10 individuals, whereas in the summer 7 or 8 employed. The sales staff is responsible for sales, customer service and store cleanliness/ organization.

3.4 Products and services offered

3.4.1 Willow Tree Gifts

Willow Tree Gifts offers well-priced gifts and souvenirs serving the low-end of the market. All of the items for sale in Willow Tree Gifts are very well priced; most items are well under \$50, and the average price is \$20. These products are aimed at the youth market (children, teenagers and early twenties) in the winter and the bus-tour market in the summer (55 years +: price, size, and durability are important considerations). They have a shorter product life cycle due to fads and popular trends, and for the most part, guarantees are not offered. Product turnover rates must be high, and sale pricing is applied to products that remain unsold after 60 days. Products include:

- Costume jewellery
- Glassware
- Collectibles
- Travel Accessories
- Greeting Cards
- CD's
- Plush Toys
- Children's Games
- Bath Accessories (soaps, body lotions)

- Home Decor
- Christmas Decorations
- T-shirts

3.4.2 Lone Wolf Gallery

Lone Wolf Gallery stocks mid-priced gifts and objets d'arts, serving the mid-range of the market. Items sold in Lone Wolf Gallery average between \$50 and \$100 and are of good quality. Products have a longer life cycle, though still reflect fashion and trend influences. Items remaining unsold after 90 days are put on sale to encourage turnover between seasons. Some guarantees are offered, and attractive packaging and “stories” attached to products become important sales tools. The target market is the regional and long haul market, with customers between the ages of 30-60 in the middle-income bracket. Products include:

- Leather Goods
- Home Décor
- Art Prints
- Costume Jewellery
- Hand-carved Wooden Objects
- Intarsia
- Bear-theme Products
- Western-theme Products
- Jackets & Sweaters
- Caps, hats and gloves

Willow Tree Gifts and Lone Wolf Gallery both have a rustic feel with pine plank flooring and display cases supported by vertical pieces of naturally shaped wood. The design is meant to mimic the natural, outdoor environment. Wall colours are fall colours, a muted rust-red in Willow Tree and pine green in Lone Wolf. Both stores are designed to encourage browsing, with pathways between displays winding through the stores. The

background music is an eclectic mix of the CD's sold in the store. The overall atmosphere is relaxed and soothing.

3.4.3 Tree Line Studios

Tree Line Studios offers original art and high quality reproductions, serving the high end of the market. Tree Line Studios carries items ranging from \$50 to \$25,000, with an average price of \$350. Products have relatively long life cycles, guarantees are standard, and sale pricing is rarely used. Packaging, display and product histories are critical. The target market is over 40 years of age and in an upper income bracket. Many customers are building homes at Sun Peaks Resort and are purchasing art for those homes. The Kamloops market is also well represented in the customer base. Products include:

- Original Paintings
- Limited Edition Prints
- Inuit Art
- Fine Jewellery
- Serpentine Sculpture
- Carvings
- Stonework and Pottery

As with the other two stores, the design of Tree Line Studios uses colours and textures of the mountain environment, however the feel is less rustic. Large beams made of reclaimed wood form the display cases, with stained glass and copper hardware complementing the pine green walls. Background music is a careful selection ranging from classical through jazz to softer rock from great bands of the last 4 decades. The music is recognizable and mellow, encouraging shoppers to spend lots of time browsing through the store.

4 EXTERNAL ANALYSIS

4.1 Customer analysis

4.1.1 Who are they?

Terwiel Holdings' customers are local residents and visitors: individuals, couples and families who have journeyed to Sun Peaks Resort for the day, the weekend or a longer stay. The Terwiels serve customers from diverse demographic groups: young, single people with very limited incomes (under 25); single professionals (25-35); couples and families (30-50, plus kids); and retirees (50+). Customers come from Sun Peaks itself, Kamloops, throughout the Pacific Northwest, North America and around the world. They arrive by personal vehicle, bus, airplane or train.

During the spring and fall the Terwiel's stores serve golfers, hikers and cross-country mountain-bikers, but the bread-and-butter clients are bus tourists and professionals attending conventions. They tend to be over 40 and conservative in their tastes.

Summer business caters once again to golfers, hikers and cross-country bikers, but downhill mountain bikers and families are added to the mix. At this time the Terwiels add products suited to younger and "funkier" clients.

During the winter the market includes skiers, snowboarders and other mountain adventurers. Families are an important part of the market as they are the main group marketed to by the resort itself. Also important are the people who have winter homes in

the resort. The Terwiel's products have the largest range at this time, serving children, young adults, parents, professionals and retirees.

In the summer, 50% of visitors are from the destination market, 35% regional and 15% are from the local market (Tourism Sun Peaks 2005).

The destination market makes up 19% of the winter business with 35% being regional and 46% local visitors (Tourism Sun Peaks 2005).

Table 1: Market Segments (Distance Travelled), Summer vs. Winter

Visitor Category	Summer	Winter
Long-haul	50%	19%
Regional	35%	35%
Local	15%	46%

Source: Tourism Sun Peaks Annual Report, 2006

Table 2: Market Segments (Visitor Type), Summer vs. Winter

Visitor Category	Summer	Winter
Tour & Travel	Bus Tours, Specialty Groups, FIT's* & fly-drives	Groups and FIT's
Groups	Corporate & association meetings; retreats & conferences; incentive travel; special occasions, weddings and reunions; public & private school visits	Public & private schools & universities; ski & recreation clubs and councils; weddings, reunions and special occasions, retreats; military; seniors
Individual Travelers	Getaways, adventure, family vacations, festivals, golfing, fishing, mountain biking, VFR's**	Families, school holidays, weekend getaways; seniors

* FIT = Families and Individual travellers

** VFR= Visiting Friends and Relatives

Source: Tourism Sun Peaks Annual Report, 2006

Bookings of accommodations at Sun Peaks Resort are made up of 60% regional (BC, Alberta, Washington and other "Rubber tire" markets) and 33% long haul markets:

other Canada; other US; and international including Germany, Australia, United Kingdom, and Holland (Meadfield Consulting 2003). Japan and Korea are emerging as a strong market (Tourism Sun Peaks, 2006). These customers stay a minimum of three days and up to 3 weeks.

4.1.2 Customer Motivation

Customers of Willow Tree Gifts are looking for souvenirs or mementos of their time at Sun Peaks Resort. Younger customers (children and teens) are looking for something fun or funky, particularly wearable products that they can display to friends and family upon their return home. Many of these items have the Sun Peaks name prominently displayed. Older customers are looking for gifts, often for grandchildren or for people looking after their pets. It is less important to these customers to have the Sun Peaks name on the item.

Customers of Lone Wolf Gallery are often seeking gifts for friends and family members, or interesting items for their own homes. It is not important to these customers that the Sun Peaks name is present on the product. Memories of their trip to Sun Peaks are captured in the nature of the item as most of the stock reflects the mountain environment in some way.

Both Willow Tree Gifts and Lone Wolf Gallery attract casual shoppers who are looking to spend money on something to commemorate their trip. They want to make a purchase if they find the right item. The non-gift buyers are motivated by their need to capture holiday memories; to own an item that causes them to reflect upon their experience at Sun Peaks when they look at it in the future. The gift buyers are motivated

to find just the right present for friends or family, and often require help from the sales staff and reinforcement that they have made the right selection. They have a need to feel appreciated by the receiver of the gift.

Customers of Tree Line Studios are motivated by aesthetics, beauty and scarcity. They react on an emotional level to the art objects displayed, which creates a desire to purchase. Knowing the work is either one-of-a-kind or limited edition motivates the customer to buy immediately, creating impulse buying situations upon which we can capitalize. Excellent customer service and follow-up helps to alleviate any post-purchase remorse that may occur, and contributes to create satisfied, long-term customers.

4.2 Competitor Analysis

The resort retail industry differs greatly from the urban retail setting; resort retail businesses are in competition with every other resort business, no matter the type, for the discretionary holiday expenditure of resort visitors. In the winter, guests may choose to spend their “extra” money on a meal, a dogsled ride or a souvenir of their trip. In the summer an extra round of golf or a chairlift ride may consume the dollars that might have been spent in a retail store.

Terwiel Holdings competes for tourist dollars with all other retail businesses in the resort. Sun Peaks Resort Corporation owns Sun Peaks Sports and John Tod Trading Company, both corporate logo stores selling apparel and souvenirs, and the Helly Hanson Store selling sport-specific technical clothing. Sun Peaks Resort Corporation and the Terwiel Holdings are the only two businesses operating more than one retail outlet, so are

the only businesses of size. Therefore Terwiel Holdings operates in a duopolistic environment.

The strengths of Sun Peaks Resort's corporate stores as a triumvirate consist of:

- buying power leading to volume discounts and pricing flexibility, including aggressive sale pricing to move old stock
- excellent location at high-profile points within the village
- exposure in Sun Peaks Resort marketing materials
- the ability of store managers to attend trade shows across North America to locate new and interesting stock
- exclusive use of the "Sun Peaks Resort" corporate logo on souvenirs and apparel.

These strengths mean that Terwiel Holdings:

- cannot attempt to enter into price-based competition with this competitor but must differentiate themselves in other ways
- must keep lease holders happy to ensure their continued occupation of retail space in excellent locations
- must ensure the outside look of their stores is as appealing as the inside to capitalize upon walk-by traffic
- must maintain excellent relationships with artists and distributors to ensure their stock selection is interesting and of high quality
- and must be intelligent in designing name drop and designs that mimic but do not infringe on Sun Peaks Resort's corporate logo.

Weaknesses of Sun Peaks' corporate stores include: high turnover amongst supervisors and staff, resulting in staff that are frequently early in their training process and less knowledgeable in terms of product offerings. New managers are struggling to build relationships with distributors well into busy seasons causing communication problems and ordering glitches. Terwiel Holdings' ability to retain staff for the long-term ensures excellent product knowledge and communication with customers, artists and distributors. Also, the fact that the owner/manager is often on-site supports both continuity and ongoing training, fostering excellent relationships throughout the supply chain.

Sun Peaks Resort Corporation has a very large staff, so it is extremely difficult to bring them all together in one place at one time. Important communication that should be heard by all is often heard directly only by a few, who are then expected to pass information along to other staff. Intra- and interdepartmental communication has long been a problem for this business as it has such a diversity of departments. Designing a communication structure that works across departments as different as lift maintenance and restaurants, across staff who work early in the morning while others work late into the evening, across seasonal versus four-season departments, and between full-time, seasonal and part-time staff is a difficult proposition. Terwiel Holdings is a 365 day-per-year operation with owners who are involved in the daily operation of the business and a small staff. Communication is facilitated via: staff meetings attended by all staff when the store is closed; daily communication either in person or by telephone with the owner, through a communication booklet that staff are expected to read at the start of their shifts

and contribute to as their shift progresses; and a through a procedure book that is constantly updated to reflect changes in the business.

While Sun Peaks Resort Corporation is the most intense competitor, there are other businesses competing for the same discretionary dollar. A small arts and crafts store offering handmade crafts, jewellery and clothing is located across the village stroll from Lone Wolf Gallery and Willow Tree Gifts. The charm of this store is that it is owned and operated by the artist who makes the jewellery. The artist operates the shop with her partner, and perhaps one other staff member during busy times. This enables excellent communication and customer relations and allows for custom orders of jewellery and other hand-made products. However, the shop is very small and this type of business is very labour-intensive in relation to the financial return. They are at a cost disadvantage as there aren't any economies of scale to capitalize upon, no volume buying from low-cost manufacturers to offset the high cost of hand-made items, and other fixed costs are disproportionate to the size of the small shop.

Rocky Mountain Chocolates, located adjacent to Tree Line Studios, is also a competitor for the discretionary dollar of visitors to the resort. Rocky Mountain Chocolates is a franchise operation featuring high quality chocolates and other sweets. While they don't sell souvenirs, Rocky Mountain is a direct competitor in the low-priced gift market. Rocky Mountain Chocolates has the advantage of corporate backing, with recipes, packaging, policies, procedures, marketing and legal/accounting services looked after by the franchiser. There is a high cost to this support, however, with the franchisee paying a yearly fee plus a portion of their profits and a marketing fee to Rocky Mountain Chocolates head office. Add to this that those leasing space in the Delta Hotel also pay a

percentage of their profits to the hotel and Rocky Mountain Chocolates is losing a high percentage of profits to other corporations. Finally, strict policies as to the look of the store and products carried by the store mean that the franchisee cannot respond to local business conditions and local taste. While there are many successful products, and the store is busy, there are products they must carry that don't make sense in the Sun Peaks Resort business environment.

Jardine's and McSporties are sports and apparel stores in the village, carrying a combination of ski and snowboard equipment, sport accessories and clothing. Jardine's leans more toward the fashion and apparel side of the outdoor sports market while McSporties does greater business with hard goods. Jardine's competes with Willow Tree Gifts in the t-shirt, hat and vest market in the summer time, however, their hours of operation are limited and the store fixtures are not inviting, the store having been designed for maximum use of space rather than aesthetics. In the winter Jardine's is almost exclusively oriented toward ski, snowboard and outdoor adventure technical clothing at a price where customers must have a strong intention to purchase. Jardine's has a flagship store in Kamloops that has been a mainstay of the Kamloops sports and apparel business since the 1960s so they are well known and have a strong local following. The owners, a husband and wife team, benefit from being second-generation retailers, having acquired a great deal of expertise in the operation of retail businesses. The owners divide their time between the Kamloops and Sun Peaks store. They were very enthusiastic about entering the Sun Peaks marketplace, having been involved in selling skis, snowboards and outdoor gear for many years. They entered with a large store occupying two side-by-side properties, one side devoted exclusively to the sale and rental

of skis, boards, helmets, goggles and gloves, the other devoted to technical clothing and fashion. Their summer hard-goods business switched to the sale and rental of mountain bikes. They even entered into the tourist excursion market, offering Hummer Tours of the 2003 forest fire-burned area and ATV tours during the summer. Unfortunately one of the owners is experiencing health issues, so during the past year Jardine's has pared back their operations considerably, focusing on the clothing and accessories market. It is still up for discussion as to whether they will offer any hard goods during the winter season at all. This is a competitor that Terwiel Holdings must remain watchful of, as Jardine's has been able to reinvent itself year-to-year based upon the current interest of the owners, the business environment and market trends. They have a solid financial foundation and relationships with a large and diverse group of distributors, so could easily move into the souvenir apparel and jewellery market currently occupied by Willow Tree Gifts, Sun Peaks Sports and John Tod Trading.

McSporties focuses on the sale of ski equipment and accessories and really does not occupy the visitor gift market. Within the hard goods niche, McSporties specializes in high-quality equipment, especially race equipment, and has a strong local following. The owner has 25 years of sports-related retail experience and is committed to supplying the high-end skier market. He will not vary from this position. Terwiel Holdings views McSporties as a complimentary business in that their product mix is completely different, and McSporties refer people looking for art and gifts to the Terwiel's shops, and the Terwiels send customers to McSporties.

Several food and beverage establishments round out the commercial core of the village, ranging from coffee shops to high-end restaurants. All of the retail space

currently available at the resort is occupied; however, several new spaces will become available upon completion of the new Delta Residences in June of 2007. Further retail space will be built when the East Village development gets underway in 2008.

In terms of market share, Terwiel Holdings has 100% of the art gallery and high-end gift market at Sun Peaks. They have 70% of the mid-range gift and costume jewellery market, and 35% of the low-priced gift and souvenir market, as most of the shops offer a range of small souvenirs. Terwiel Holdings is very satisfied with their market share in these areas. However, they have limited share in the sale of Sun Peaks-labelled clothing as all of the sports stores carry clothing. They estimate their share of this market to be 10%. They would like to increase that to 25% over the next 2 years.

While the other businesses at the resort are rivals, they are also necessary in order to drive the demand for shopping at Sun Peaks Resort. Mushinski and Weiler (2002) found that “certain retail establishments in a place are dependent on other retail activities in the place. These inter-dependencies are important” (page 75). Mushinski and Weiler found that “regression results indicated that such interdependencies exist, and are particularly significant on the supply side” (page 84).

Terwiel Holdings’ rivals also include retail shops in other resorts as many of the visitors to Sun Peaks, especially those from outside of British Columbia, travel to other resorts while they are in the Province. Sun Peaks Resort is part of a marketing consortium that includes Sun Peaks, Silver Star, Big White and Apex, all within a three-hour drive of each other and frequently visited as part of a circle tour. In the summer many of the bus tourists and other vacationers visit Sun Peaks, Banff, Jasper and Whistler as part of a loop tour, so Terwiel Holdings compete against retail stores in those resorts as well.

Finally, given that 43% of the winter business and 15% of summer business is driven by the local population (from Kamloops and the surrounding area), Terwiel Holdings competes with gift shops and galleries in Kamloops. Mushinski and Weiler's study looked at the likelihood that "nearby areas could serve simultaneously as a source of demand and a source of competing supply for retail stores in a place" (page 75). They looked at a number of communities in the intermountain west region of the USA, a topographically and demographically similar region to the Thompson Okanagan, with smaller isolated communities serving as their point of comparison. Mushinski and Weiler found that "the supply-side effect (the number of establishments in a neighbouring area) is generally statistically significant. The demand effect was present but not generally statistically significant. Their results suggest that "population in neighbouring areas draws away potential demand in the place, highlighting the importance of spatial competition in retail development" (page 76).

4.3 Total Potential Market, Demand Analysis and Factors Affecting Growth

The Terwiels are retailers; thus they operate within the retail industry. However, Terwiel Holdings is also inextricably linked to the tourism industry with business being impacted by demand at three levels; the tourism industry as a whole, demand for the product offered by Sun Peaks Resort and demand for retail products within the resort. If one looks to the end of the supply chain, travel decisions are made first at the industry level, second at the resort level, and finally at the level of the individual business. Shifts in tourism industry demand have a huge impact on Terwiel Holdings; therefore, a look at the tourism industry is called for. A more thorough analysis of the retail industry will

follow. An examination of the retail and tourism industries as a whole, as well as the demand for travel to Sun Peaks Resort, is necessary in terms of evaluating market potential.

4.3.1 The Tourism Industry

Terwiel Holdings is highly connected to the tourism industry. The World Tourism Organization defines tourism as “the activities of people travelling to and staying in places outside their usual environment for leisure, business or other purposes.” (WTO Website). The Tourism Industry is made up of all of the businesses that support those activities.

The Canadian Tourism Commission (CTC) divides the tourism industry into 8 sectors: accommodations; transportation; festivals and events; attractions; food and beverage; tourism services (including retail); travel trade; and travel media. By their definition Terwiel Holdings is in the tourism services (retail) sector of the tourism industry. Their sector of the tourism industry is very attractive in that tourism retail contributes 11% to the GDP of the tourism industry as a whole, and leads the industry in GDP growth at 3.4%. In 2001 the tourism industry employed 7% of British Columbians, and 16% of those jobs are in tourism retail positions. The growth rate of tourism retail jobs in 2001 was 7.1%. Jobs in tourism are expanding at a more rapid pace than in the economy as a whole.

Canada is seen as a very desirable destination by the World Travel and Tourism Council (WTTC). In 2002 the WTTC rated 212 countries on 8 different measures, and Canada was in the top 25% on 4 of those measures: infrastructure (3rd overall),

technology (25th), human resources (8th) and social environment (15th). Other measures included: price competitiveness (89th); human tourism (47th); environment (37th) and openness (36th).

Tourism industry demand is very elastic and is driven by numerous factors including cost of living, changes in income, exchange rates, political stability (i.e. war), health concerns (i.e. SARS), regulation/ deregulation of airlines and other modes of travel, and the like. Travel products are normal goods; therefore as income increases there should be an overall increase in tourism. However, the tourism industry competes with other forms of recreation and entertainment for the disposable income of its participants, so complements and substitutes become very important.

Once people make the decision to spend their money on travel, they need to determine where they will go. Ratings such as the above help to drive demand for Canada's tourism products.

4.3.2 Resort Level

At the resort level, demand is driven by things within the resort's control such as pricing, marketing campaigns, availability of hotel rooms, hosting national events, etc. As well, demand is heavily impacted by things outside of the resort's control, such as:

- weather (snow / no snow), forest fires and other climatic events
- airline industry decisions (international flights to Kamloops, ability to clear customs in Kamloops)
- health issues (SARS, BSE, West Nile Virus)

- the political environment (China preferred visitor status, First Nations land claims)
- the economic environment (currency exchange rates, success of target market economies).

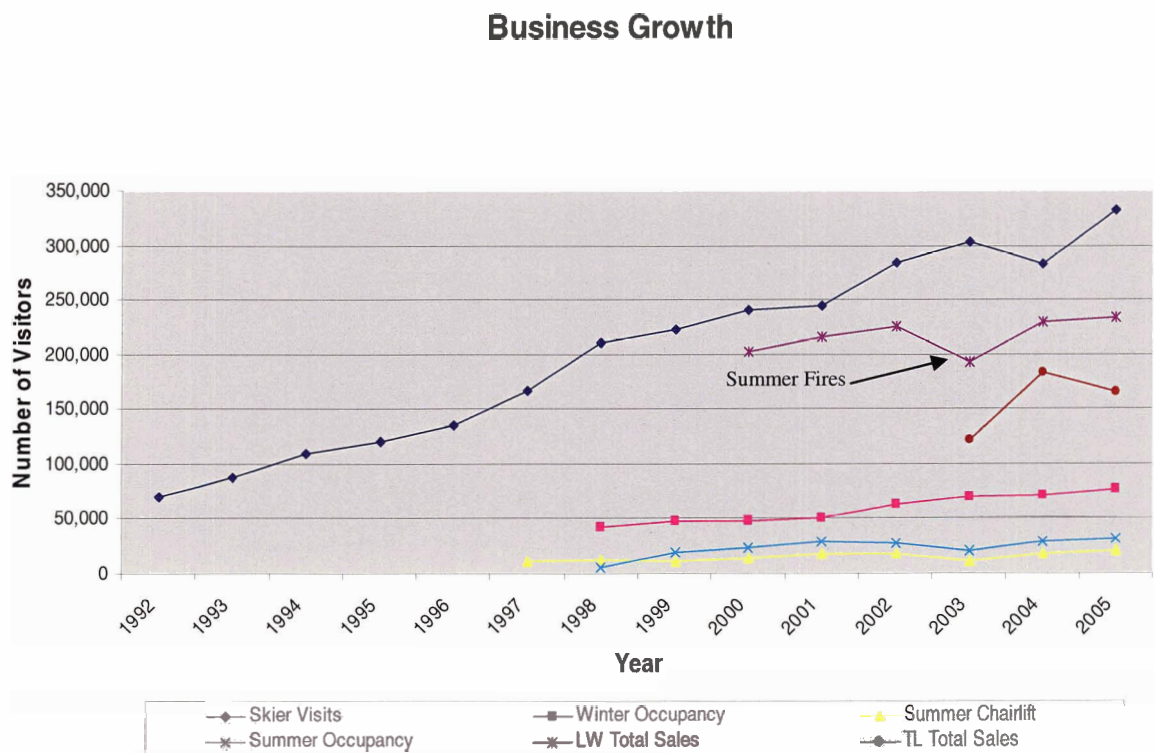
The internet has had a great impact on people's ability to choose their desired tourism product at the last minute, based upon up to date information about things like weather conditions and snow conditions. If they check the Sun Peaks website and don't like what they see, they will choose another location.

The Canadian Tourism Commission reports that ski and snowboard vacations are becoming more popular than ever, with an 11.3% increase over the long-term average of all ski seasons since 1978 (CTC, September 2003, page 18). Similarly, golf is by far the most popular sport in North America, played by 7.4% of the population over the age of 15 (Statistics Canada). In fact, Sun Peaks Resort hosts 8 of the top 25 sports preferred by Canadians.

Advance bookings have been increasing every year as the Sun Peaks Resort product becomes more well-known and trusted. Knowledge and trust are key ingredients to demand at the resort level. Sun Peaks Resort attained an 87% satisfaction level ("Yes, I will return") on the Canadian Ski Council Demographic Survey. For summer, Sun Peaks Resort is projecting 63% growth in occupancy and 36% growth in chairlift sales. For winter they project 20% growth in occupancy and 4% growth in skier visits. These lofty projections are based upon the premise that over the past years the resort has been rocked by fears surrounding SARS, BSE, terrorism, and forest fires, as well as a First Nations land dispute. In terms of these types of occurrences, 2006 has been very quiet, and apart

from the impacts of war in Iraq and Afghanistan there aren't projected to be disasters that will keep people away from the area or make them choose not to travel. Also driving demand is new, twice-daily air service between Seattle and Kamloops; the completion of the conference centre in the Delta Hotel, the largest hotel conference centre in the BC Interior; the completion of the back nine holes of the golf course; and participation in US consumer and groups shows, ski councils and club events.

Figure 1: Business Growth 1992-2005



Source: Tourism Sun Peaks Annual Report 2006

4.3.3 Individual Business Level

There is substitutability amongst all of the rival businesses at Sun Peaks Resort as each visitor has some money to spend on a souvenir from Sun Peaks but is not loyal to any business in particular. Their demand for a particular gift or souvenir is very elastic.

While they really want to purchase something with which to remember their trip, visitors have not developed loyalty towards any particular product or business, nor do they necessarily know what they wish to purchase. Price often drives the decision, particularly with the low to middle income earners. Demand is less elastic with products of higher price and higher quality.

The goal of Terwiel Holdings is to occupy top-of-mind positioning in the souvenir, gift and art markets at Sun Peaks Resort. They have chosen a focused differentiation strategy – offering unique and/or distinctive products to Sun Peaks Resort visitors. Their competitive advantage is in the scope and variety of the products that they carry. Terwiel Holdings has purchasing power, relative to other businesses at the resort, in that they deal with distributors who are able to supply at least two of the three stores, allowing them to purchase more product from individual suppliers. This gives them a price advantage as well as flexibility in delivery times and longer terms. These two aspects are crucial to the resort retail market. Critical to Terwiel Holdings' business is that they hire and retain skilled, knowledgeable staff who are excellent customer service providers. They spend a lot of time training staff so that their personal selling skills are exceptional.

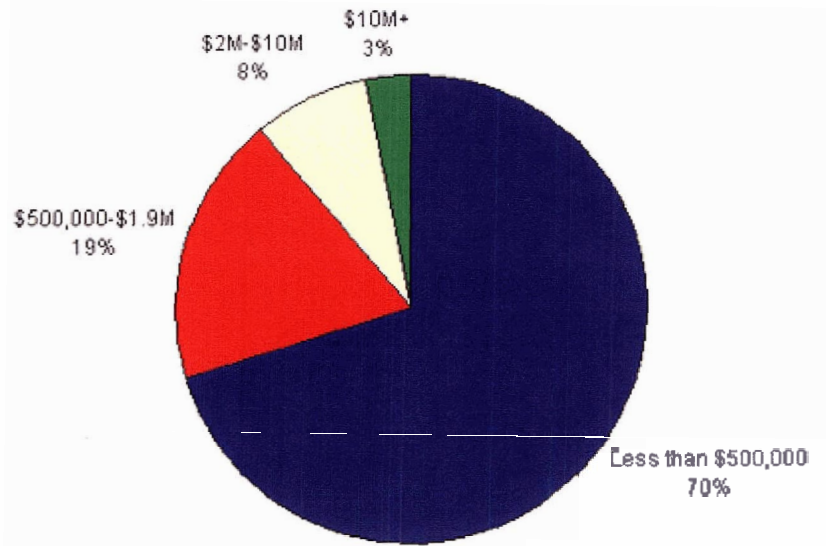
Terwiel Holdings creates value by purchasing products that are related to the mountain environment, but more importantly, that have a "story." They train staff to tell the stories to interested customers, and the combination of individual attention and product history increases customers' willingness to pay. In the art gallery, Treeline Studios, willingness to pay is created through the aforementioned, and through scarcity. Most of the work is original and one-of-a-kind, so if it sells it is gone.

4.3.4 The Retail Industry

The retail industry exists almost every place on earth and is characterized by businesses that range from open-air kiosks and tiny, one-room shops to massive multi-national corporations. Retail outlets span the continuum from wide ranging department stores with a huge diversity of stock, to specialty stores carrying a particular kind of stock, devoted to serving a particular type of customer. The three stores owned by Terwiel Holdings operate in the general merchandise subcategory of the retail industry, in that each is stocked with a variety of products, from clothing to giftware to art.

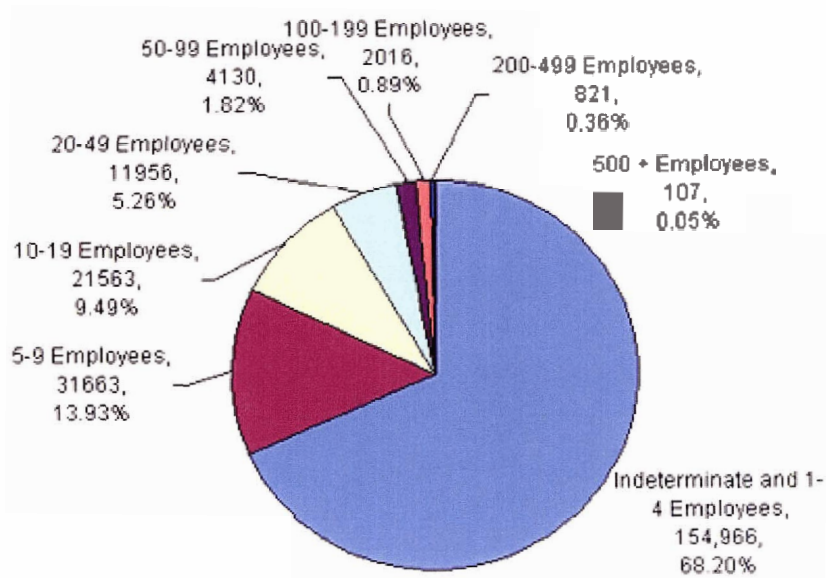
In March of 2006 Canadian retailers did over \$32 billion in business, up 5.9% from March of 2005. BC retailers experienced 5.4% growth over the same time period, reaching over \$4.3 billion in March of 2006. Over 5% growth per year is expected for the next few years in BC. In 2003 general merchandise stores, excluding department stores, did over \$2 billion in business. With an average gross margin of 24.6%, that means BC general merchandise retailers (excluding department stores) netted almost \$500 million (Statistics Canada). Figure 1 shows that, while the industry is large and earning substantial revenues, only 11% of retail businesses are generating more than \$2 million of sales per year. Fully 70% of retailers are small businesses generating less than \$500,000 in sales.

Figure 2: December 2000 Retail Establishments by Sales



Source: Statistics Canada, Canadian Business Patterns, December 2000, special run, adjusted by RCC.

Figure 3: 2004 Canadian Retail Establishments by Employee Size



Source: Statistics Canada, Canadian Business Patterns, June 2004, Retail Council of Canada (2006), pg 4.

Retailing is Canada’s second largest employer and BC’s largest, with 11.8% of Canadians and 12% of British Columbians employed in the retail labour force in 2004 (Retail Council of Canada). “Despite its size and scope, the majority of retail businesses

have 1 - 4 employees,” (Retail Council of Canada, 2006, page 4) with “72% of all retail businesses employing less than 5 persons,” (Industry Canada, 2001, page 1).

When one discusses the retailing industry, one can make a distinction between those businesses that compete on price and therefore employ a cost-based strategy and those that compete in specialty markets utilizing a differentiation strategy. “Over the past decade, three new marketing strategies have brought about a revolution in the retail industry: membership club/warehouse/big box retailers, power centres and superstores,” (O’Connor, 1999, page 2). All of these employ a cost-based strategy. In order to remain successful, differentiators must carve out a protected niche for themselves, choosing a focus that will bring about strategic and operational competitive advantages that will allow them to sustain profitability in the face of their large competitors (Aaker, 2001). Terwiel Holdings occupy the submarket that is small specialty or niche market retailing, employing a differentiation strategy.

In order to be a successful differentiator one must not only have a deep understanding of the business environment in which one competes, but also an intimate knowledge of the market one serves. Market size, growth prospects, profitability, cost structure and trends must be analysed in order to determine market attractiveness and understand market dynamics.

Customer analysis is critical. Demographic and psychographic analysis is a starting point, but must be followed up with a comprehensive look at the motivations, needs and expectations of likely customers. The customers of a differentiator are generally seeking a special or unique experience, a one-of-a-kind product, or a high level of quality and service. “Quality is based in large part on the perceived competence,

responsiveness, and empathy of the people with whom customers interact,” (Aaker, 2001, page 160). Niche-market differentiators are well positioned to provide such quality, given the small size of many of their establishments.

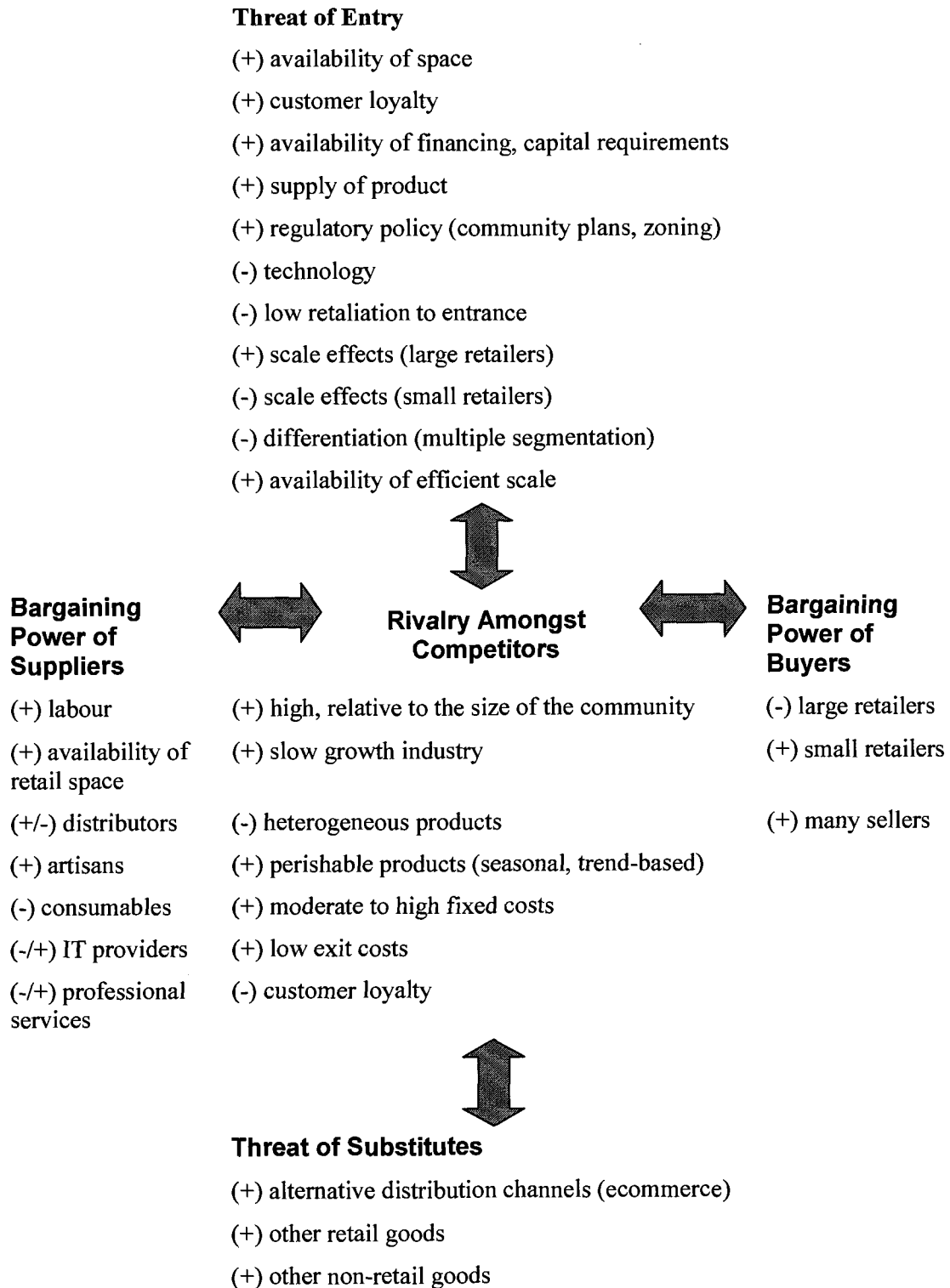
As a whole, the retail industry is a mature industry, where gains in one business are made at the expense of another. Upstart businesses can enter the market with a great new idea and quickly gain market share, but as soon as the idea proves profitable new entrants will enter the market, diluting profits and inevitably necessitating a cost-based strategy. By virtue of their ability to serve a specialty or niche market, differentiators can be insulated from this cycle and, with acumen, can create a profitable business for the long-term.

4.3.4.1 Five Factor Analysis

In order to analyse an industry, a five-factor analysis, based upon Michael Porter’s Five-Factor model of market profitability (in Aaker, pg. 83), is a useful tool. A five-factor analysis looks at variables in five areas: rivalry amongst competitors, the power of suppliers, the power of buyers, threat of entry and threat of substitutes. Variables are not considered in isolation, but in terms of how they interact with one another, thus illuminating issues and informing the attractiveness of an industry. The following analysis looks at businesses that employ differentiation strategies within the retail industry.

Figure 4: Five factor analysis: Retail Industry key variables

(+) = adds to rivalry, (-) = subtracts from rivalry



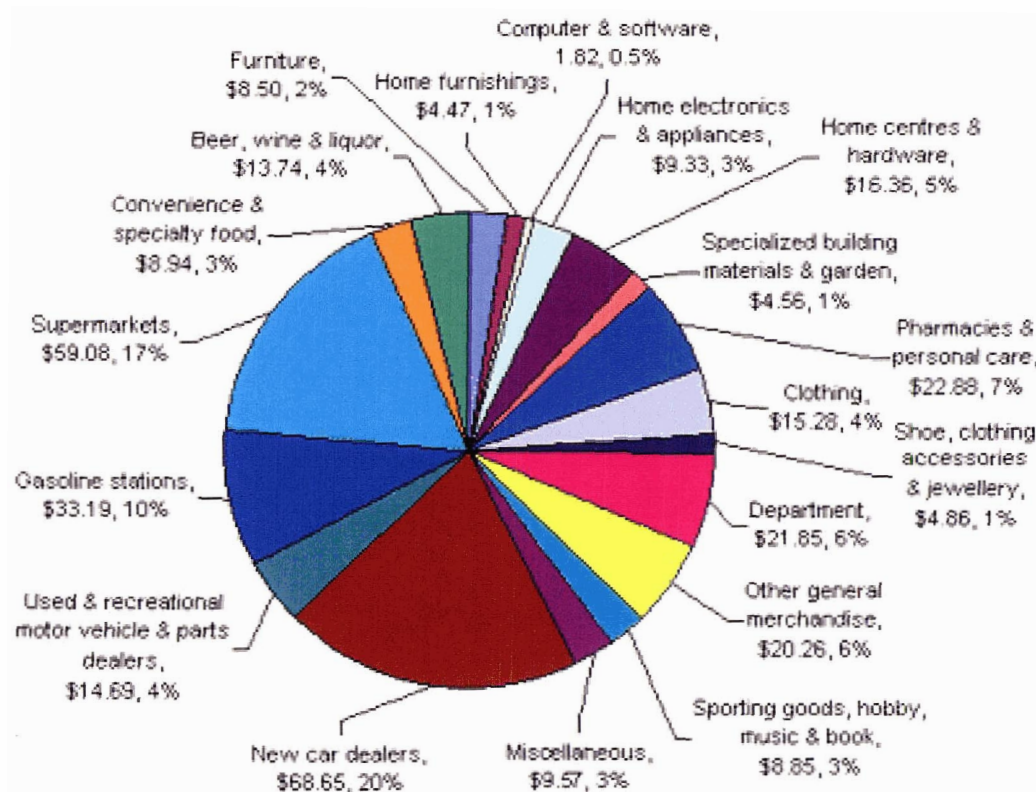
4.3.4.1.1 Rivalry Amongst Competitors within the retail industry

Rivalry is intense amongst retailers as there is a high concentration of businesses in this industry. In 2004 there were 227,222 retail establishments in Canada and 30,280 in BC. Almost 9% of all business establishments in BC are in the retail sector, ranking as the 4th highest percentage of business establishments (Retail Council of Canada). Most retail businesses are small businesses with high owner involvement, ensuring a high level of commitment to the success of the business, but adding to their vulnerability.

Fixed costs are moderately high relative to revenues, though compared to industries such as mining, telecommunications and airlines, fixed costs are low. However, for small retailers with a minimum of financial backing, fixed costs may be perceived as high. This increases rivalry and the likelihood of price wars as small retailers struggle to cover their fixed costs in a competitive environment.

Within the retail industry there is a very wide spectrum of product offerings, with rivalry occurring amongst firms with similar strategies (cost-based vs. differentiation) and similar offerings. The greater the number of firms in a given location within a specific submarket, the greater the rivalry. The literature generally divides the industry from 10 to 20 sub sectors. Figure 5 provides an example of the division of the retail industry by store type.

Figure 5: 2004 Retail Sales by Store Type



Source: Retail Trade, Statistics Canada Catalogue # 63-005-XIE, Retail Council of Canada, 2006, page 2.

Exit barriers exist in the form of lease contracts, property ownership, and contractual obligations (i.e. IT systems), but given the current economic climate and shortage of retail space, exit barriers are currently fairly insignificant. The larger the retailer, the more difficult it is to exit as larger space may be less flexible or more difficult to turn over, and obligations to employees, especially unionised employees, may cause great expense. For smaller retailers, liquidators will purchase unsold stock and property can be sold, leased or sublet, and there may be obligations to just a few staff, so small retailers have the ability to exit without incurring huge losses.

4.3.4.1.2 Threat of Entrants

There are few barriers to entry in the retail industry, so generally the threat of entry is high. Barriers to entry include a shortage of retail space (as will be discussed in the power of suppliers section), customer loyalty, supplier power (distribution channels) and the availability of financing.

Location is exceptionally important to a specialty or niche market retailer, so space not only needs to be available, but available in the right place. Entry into an underserved specialty market isn't as difficult as entry into an area with an established specialty retailer, as specialty retailers generally earn a high level of customer loyalty. Small retailers with a specialty interest must carefully assess the business environment that they are about to enter to ensure that established retailers with a loyal customer base are not in close proximity. While growth can be achieved by capturing the customers of competitors this is a risky strategy to pursue, especially if the first mover has built in switching costs via loyalty programs, long-term commitments or specialized knowledge (Aaker 2001). "An existing base of loyal customers provides enormous sustainable competitive advantages," (Aaker, 2001, page 168).

Attracting financing can also be a barrier in that there is a higher rate of business failure in the specialty or niche part of the retail industry in particular, making it a risky investment. The five C's that bankers use in making the decision as to whether to extend credit are: *capacity* to meet repayment obligations; *capital* in terms of equity; *collateral*, with enough value in assets to use as security; *character* of the business and the owners; and *conditions* related to the market and the industry (Industry Canada 2006). While leasehold improvements and stock make up a large part of a small retailer's investment,

they are not available to be used as either equity or collateral. As a result, money for the purchase of leasehold improvements and stock must be financed via avenues other than debt. Many niche market stores are fairly small businesses, unattractive to venture capitalists. All this means that new entrants need to be strongly self-financed. In fact, 35% of retail operations use the owner's savings to fund the business, one of the highest of all industries (Industry Canada). Because smaller retailers are funding their businesses with equity, they are paying more for financing than the many businesses that are able to utilize debt financing, the least expensive form of financing.

Supplier power also forms a barrier to entry in that suppliers are choosy about who can sell their product. A newcomer, lacking a track record and references, has a difficult time attracting suppliers of reputable products; therefore, the distribution system can be a significant barrier to entry. Cash-strapped new retailers often have to pay COD for product, while established retailers may negotiate long terms with their suppliers, giving them the advantage of selling the products before payment is due. This eases the financial burden on established retailers and gives them an advantage over new entrants.

4.3.4.1.3 Power of Suppliers

Supplier power differs depending upon the variable under consideration. Suppliers can be those who provide the means of operating a retail business, such as labour, purveyors of retail space and providers of consumables. Suppliers also create and/or distribute products to be sold within the retail space.

Labour has a large and increasing level of power. Mark Startup, president and CEO of Retail BC, has been quoted numerous times stating that “the most pressing issue for retailers today is the BC labour shortage,” (Retail BC, 2006). There is a multi-

industry labour shortage looming (many would assert that it's already here) as a direct result of demographics. "Concern over labour shortages is common to all [industries] but some face disproportionately bigger challenges to find workers with the right skills," (CFIB, 2006, page 3). The construction, transportation and retail industries are particularly challenged by long-term vacancies (CFIB, 2006). As a result, potential employees have the luxury of a great deal of choice in terms of possible employers. Employers must understand that employees are looking for much more than a paycheque; they are looking for jobs and careers that afford a measure of flexibility and a life-work balance. They seek meaning, social interaction, learning environments, and the feeling that they are contributing to their workplace and their communities. Differentiators, by their nature, should fare better than their cost-based cousins in such an environment as they generally provide employment in areas of interest and expertise. However, they will be competing for scarce labour with many other industries that have histories of higher pay, more stable employment, and comprehensive benefits packages. Retailers are going to have to come up with innovative strategies to attract and keep staff.

The 2006 British Columbia economy is hot, and as such, land values are increasing and vacancy rates are low. This translates into power for those holding land, increasing prices for both lease and purchase arrangements. Suppliers of retail space have the power to set rates as they see fit, and the bargaining power of business owners is low. Those who are currently into long-term arrangements are fortunate; those who are attempting to enter into the retail market, or whose agreements are up for negotiation, and finding themselves in a position where the balance of power strongly favours the supplier

of space. Fortunately for the Terwiels, with their specific situation, this factor is mitigated by the need of the major landlord to have successful, diverse retail operations.

The power balance favours retailers in terms of consumables. Switching costs are low and consumables are commoditized to the point that price is the driver for decision-making. Even in smaller centres there is a ready supply of bags, boxes, paper products, till tape, etc. Retailers can choose differentiated, business-specific suppliers, whose value-added services include delivery, monthly invoicing, and stock management (consumables stock); or big box office stores (Office Depot, Staples) where low cost is the benefit. Decisions may be based upon scale and scope of purchases; convenience, price, quality, level of service provided, and retailers may use several businesses to maintain their supply of consumables.

In terms of product supply, the power of the retailer varies by product and distribution method. Large networked retailers wield a great deal of power over their suppliers, bargaining on price, the use of linked computer inventory systems for just-in-time delivery, and increasingly, negotiating contracts whereby the supplier is responsible for shelf space management and the provision of promotional materials.

Smaller niche market and specialty retailers may have different levels of bargaining power with each different supplier. Retailers hold the balance of power with multi-product distributors who travel over a large region trying to get their products into stores. Often this relationship becomes fairly collegial, where it is in the best interest of both parties to get the best products for the store's market at the best price in correct quantities. As these relationships develop, the retailer may insist on longer payment terms, whereby they are able to sell most of the stock prior to having to make payment.

Specialty retailers dealing with individual creators of product, artists for example, may find that the supplier is in total control, both in terms of cost and availability, especially if their product is in heavy demand. In the case of hand-made items, the artist is only capable of producing a certain amount of product and the retailer must wait their turn. Higher demand for the product may increase the cost to the retailer; the retailer must in turn pass along the higher price to their customers. Artists and artisans are particular about who can carry their product and how it is displayed, and if their work is in demand, will remove their product from a store if they are unhappy with the situation. Specialty retailers must work with their artisans in order to maintain a mutually beneficial relationship.

Whether buying from distributors or creators of product, once a product line has been brought into a specialty store there are switching costs involved if the product is no longer to be carried. Retailers make investment in terms of display stands and shelf space, an investment which is lost when the product is no longer displayed. Customer expectation must be carefully managed if they have come to expect that a certain specialty or niche-market product will be available and it suddenly is not.

Finally, IT providers and providers of professional services having varying power. Initially, the sheer volume of IT companies, accountants and lawyers make the power in this area very low. However, once a retailer chooses a particular supplier, there are high switching costs associated with making a change.

4.3.4.1.4 Power of Buyers

Buyers have a lot of power in the retail environment, especially in smaller stores where each customer's purchase makes up a greater proportion of total sales to the

business than is the case in large stores. Customers with power will bargain on price, service or both, potentially reducing profitability. Smaller specialty stores deal with very powerful customers as there is often a limited number of potential customers interested in their particular area of specialty.

Clearly there are a greater number of issues downstream than upstream in terms of supplier / buyer power. While the virtue of a customer focus is widely extolled in business literature, a wise retailer must be very attuned to downstream distribution issues in order to remain profitable.

4.3.4.1.5 Threat of Substitutes

The threat of substitutes is high in the retailing industry. There are a number of potential substitutes to purchases made in specialty or niche market retail stores. E-commerce as a substitute to in-store shopping is a definite threat, though specialty retailers count on the fact that their customers are looking for “high-touch” service and the knowledge and expertise of service staff that cannot be replicated on the internet. Given that many specialty retailers sell luxury goods, substitutes may be other luxury or discretionary products outside of the retailer’s specialty, or alternate products within the specialty. An example would be the customer of a store that sells fairly expensive non-automobile Ferrari products, such as Ferrari laptops, clothing lines, cell phones, steering wheel covers, etc. Someone interested in Ferrari products may also be interested in auto racing; therefore a substitute to the purchase of a Ferrari product might be tickets to an auto race. Wall Street analysts have expressed concern at the “migration of consumer dollars from the retail industry to travel, entertainment and other non-store spending,” (Rubinstein, 1997, page 2). Sharp retailers will be also aware of non-retail substitutes

competing for the discretionary income of their customers and will have to sell consumers on the value of their products.

4.3.4.2 Key Issues

Most of the key issues impacting the retail industry have been mentioned in the five-factor analysis. The ability to attract and retain labour is a make or break issue in this labour-intensive environment. Retailers will have to be cognizant of the supply of labour in any plans to open or expand retail operations.

Margins are tightening in this competitive industry, so greater attention must be paid to cost control, return on assets and sales per square foot (Rubinstein). Fortunately data collection and measurement tools are built in to point of sale technology, allowing retailers constant access to this type of information with the click of the mouse. The trick is for retailers to actually use this data in their day-to-day and long-term decision-making.

Product selection and strategic focus are key issues for differentiators. Differentiators must be vigilant against being seduced into trying to compete on price in an environment seems to be overwhelmingly price-conscious. A strong focus on core competencies, high value activities and differentiated product offerings will keep niche market retailers on a successful path.

While staying with a strategic focus, differentiators must remain nimble in order to be agile enough to change when change is necessary. Blindly sticking with what has worked in the past will lead to business downfall in the current volatile retail environment. Niche market retailers must have one eye on big-box, cost-based retailers,

one eye on internet retailers and their brains solidly rooted in strategy in order to inform their business decisions.

4.3.4.3 Industry Attractiveness

Given intense rivalry, a high threat of entry and of substitutes, and powerful suppliers and buyers, the retail industry does not appear to be an attractive industry. Rubinstein (1997) suggests that “fresh thinking is needed in several maturing areas to revitalize growth,” (page 2). He asserts that market share gains will become more difficult for large specialty retailers, known as category killers by virtue of their size and pricing structure. In his article, “Which retail properties are getting market share,” O’Conner discusses the economic and social benefits that big box stores purport to offer coming at the expense of established “Main Street” businesses. While customers are price conscious, convenience and service are becoming of ever-greater importance. The Internet has a persistent influence on price conscious shoppers, but cannot offer the high-touch, high-service environment of a niche-retailer. “While success will come quickly for those Internet retailers who offer merchandise that sells well long distance, items that sell better with a human touch will never become a huge [internet] success story,” (O’Connor, 1999, page 4).

In a competitive market such as retailing a business must have something that insulates it from its competitors in order to survive. While one might question the appeal of the retail industry as a whole, the small specialty or niche market store is an attractive proposition in a less than attractive industry. Their differentiation strategies allow them to develop core competencies that insulate them from many of the issues discussed in this paper. Industry Canada (2001) expresses that smaller specialty stores are thriving in

many sectors, though the “Canadian retail industry has witnessed a series of fundamental changes in recent years,” (page 2). Small retailers that offer value-added aspects such as outstanding service, unique products, an interesting shopping environment, an excellent location, or a combination of these are well positioned to remain profitable in a changing retail environment. Terwiel Holdings focuses on all of the aforementioned value-added aspects. Combined with a highly positive outlook for the Canadian tourism industry in general, and for winter sport in British Columbia in particular, Terwiel Holdings is in an excellent position for future growth.

5 SWOT ANALYSIS

Given their business environment, projections for Terwiel Holdings must be based upon the business and marketing projections of Sun Peaks Resort. Sun Peaks Resort must base its projections on what is happening provincially and nationally in terms of tourism, and the provincial and national tourism industry are heavily impacted by provincial, national and international economic and political factors. Therefore, any analysis of future business for Terwiel Holdings must take all of these factors into account, and additionally, must pay attention to overall retail industry trends and projections. A SWOT Analysis was undertaken to explore all of these areas.

Table 3: SWOT Analysis

STRENGTHS	WEAKNESSES
<p>Terwiel Holdings</p> <ul style="list-style-type: none"> • Human resources management skills • Financial management of the three stores, focusing on cost-control and inventory management • A unified management team with very strong skills in several key areas including training and strategy • Excellent training offered as a response to a key threat: the shortage of workers. • Partners, committed to the success of the stores, now have 8 years of retail experience, and have weathered forest fires, low snow years, First Nations protests, lack of financing opportunities and other challenges • Excellent terms (90 days) with most suppliers • An excellent mix of price points and 	<p>Terwiel Holdings</p> <ul style="list-style-type: none"> • Complete reliance on Sun Peaks Resort and their marketing strategies to bring tourists to Sun Peaks, which provides the major customer base for the stores. At this point there is not an issue with Sun Peaks' ability to market, however, the weakness is in the Terwiel's ability to market themselves separately from the resort • Issues related to seasonality in terms of customers, products and availability of staff • Superficial use of computerized data captured during transactions, though this is improving • Marketing to Kamloops residents, by both the resort and the Terwiels

<p>diversity of stock, at levels that don't require intense further build-up</p> <ul style="list-style-type: none"> • Location in two of the busiest hotels in Sun Peaks Resort 	
<p>Sun Peaks Resort</p> <ul style="list-style-type: none"> • A four-season resort with ever-shorter and busier shoulder seasons • 2004/05 skier visits from international markets increased by 26%. Australia is now the top market for winter tourists • The UK market, a key emerging market, grew by 95% in winter 04/05, a trend that is predicted to continue • Central reservations increased bookings by 13% and room nights by 7% • The Ice Wine Festival, Music in the Mountains, Quilting in the Mountains and a myriad of other special events opens the resort to a new and different market • Various winter activities, including, snow mobile tours, dog sled tours, snow shoeing, tube park, sleigh rides, ice skating, heated outdoor pool, etc. attract non-skiers to the resort • Strong relationships with regional, provincial and federal DMO's are maintained 	<p>Sun Peaks Resort</p> <ul style="list-style-type: none"> • Kamloops airport offers limited access. Horizon Air is flying in from Seattle only on the strength of guarantees offered by Kamloops businesses, and predominately by Sun Peaks Resort. Air Canada only services Kamloops with Dash-8's. To really grow their business, Sun Peaks Resort needs jets that will accommodate larger numbers of visitors • Lack of differentiation from other excellent interior resorts • Intense competition for market share from other destinations, both domestic & international
<p>Tourism Industry</p> <ul style="list-style-type: none"> • Domestic tourism spending rose by 4.1% in 2005 in Canada as a whole 	<p>Tourism Industry</p> <ul style="list-style-type: none"> • US Market wants to visit Canada "sometime in their lives," but lacks a sense of urgency • Last-minute booking trend makes planning difficult, with many booking within 1-3 weeks of arrival • Increased value of Canadian currency encouraging Canadians to travel in the US, and US residents to stay home
<p>Retail Industry</p> <ul style="list-style-type: none"> • Retail sales surpassed \$5 billion in BC in 2005 and trend in coming years looks strong • BC consumers outspend all Canadians except Albertans. BC and Alberta are 	<p>Retail Industry</p> <ul style="list-style-type: none"> • Reported upturn in retail spending largely fuelled by growth in large-ticket items, such as automobile sales

our strongest markets	
<p>Economy</p> <ul style="list-style-type: none"> • Increasingly high disposable incomes in BC and Alberta drive greater capacity to purchase • BC economy grew at a healthy rate in 2005, with strong expansion forecast for 2006, 2007 & beyond • Balanced growth is driving BC economy, with improvement in 6 of 7 indicators making up BC's Economic Index. Employment was the #1 contributor to gains. Retail spending was 2nd. Both are good news for us. The province's economy grew at a healthy rate in 2005 and entered 2006 at a healthy pace. 	<p>Other</p> <ul style="list-style-type: none"> • The changing nature of communications make traditional forms of advertising less effective, and new forms of advertising are largely unstudied, so it is difficult to determine where to spend limited advertising dollars

OPPORTUNITIES	THREATS
<p>Terwiel Holdings</p> <ul style="list-style-type: none"> • Development of shoulder-season business as the resort develops in this area • Better utilization of computer data and reports to make sound, timely business decisions • Marketing to Kamloops residents to come and shop at The Terwiel's stores 	<p>Terwiel Holdings</p> <ul style="list-style-type: none"> • Staff shortage as the trend toward low unemployment continues. Retailing provides jobs to 12% of the provincial workforce. Many of these workers are mobile and will move toward areas with the highest pay. The resort retail industry historically pays less than other areas, and the cost of living is higher, so there may be a drain of employees from resort areas
<p>Sun Peaks Resort</p> <ul style="list-style-type: none"> • The Asia-Pacific market travelling to Sun Peaks is expected to grow by 19.5% between 2005 and 2008 • Runway expansion for Kamloops Airport will allow jets to fly into the city • Arrival of WestJet and other regional carriers • Business travel in Canada continues to grow – Sun Peaks is marketing hard toward business & conference customers • Growth in summer season business – summer occupancy rates projected to reach close to 45% of winter 	<p>Sun Peaks Resort</p> <ul style="list-style-type: none"> • Whistler has lowered prices with a new overall pricing strategy and will be aggressively pursuing lost market share. Sun Peaks is no longer competing in a different price arena, making Whistler a direct competitor for the first time • Big White and Silver Star, the main competition in the interior of the province, have been purchased by the same owner. This owner is pouring millions of development dollars into both resorts.

<p>occupancy rates</p> <ul style="list-style-type: none"> • New “back-nine” holes make the golf course 18 holes, much more attractive to the golf destination market • Recently approved 2% accommodation tax will be utilized to market the resort • Proposed new highway east from the resort to Chase/Shuswap provides a significantly shorter trip to those coming by car from east of Kamloops. • Leveraged partnerships, such as Ski BC and the Interior Ski Area alliance help to promote BC and interior resorts to the world • Tourism Sun Peaks’ messaging strategy focusing on the advantages of an interior vacation rather than price point will attract higher-spending consumers to the resort 	
<p>Tourism Industry</p> <ul style="list-style-type: none"> • 2010 Olympics – a training centre strategy will attract teams, media and supporters before, during and after the games • Strong provincial & federal government support for the tourism industry – provincial goal to double tourism by 2015 • Canadian Tourism Commission has a new and improved brand and marketing strategy to bring visitors to Canada for the first time, and to encourage them to return • Domestic travel projected to grow by 10% between 2005 and 2008 • Asia-Pacific region currently supplies 12% of international tourists to BC, and Asian tourism is expected to grow dramatically over the next few years • China gives Canada “approved destination status,” CTC opens office in Beijing • Korea is a strongly emerging market • Expansion of Vancouver’s Trade & Convention Centre • Improved tourism research by Tourism 	<p>Tourism Industry</p> <ul style="list-style-type: none"> • Western Hemisphere Travel Initiative involves new passport rules for US travellers, which may dampen travel from the US as only 20% of Americans hold passports. Passports will be required by June 2008. Impulse travel will be impacted • Political instability/terrorism and perceived threats make travel unattractive, particularly for US travellers • Global warming, changing weather patterns

Sun Peaks, CTC, Tourism BC and universities allows for better decision-making	
Retail Industry <ul style="list-style-type: none"> Banking internet technology allows for greater customer ease and involvement 	Retail Industry <ul style="list-style-type: none"> High oil prices add cost to shipping, making retail products more expensive
Economy <ul style="list-style-type: none"> Tourism is BC's 3rd largest source of export earnings, after forestry and energy products The service industry is poised to account for a greater share of BC's overall foreign trade. Tourism is considered an export, service industry. Tourism accounts for \$4 billion annual export earnings 	Economy <ul style="list-style-type: none"> High Canadian dollar relative to the US dollar may cause cost conscious US consumers to stay at home Decline in the British Pound relative to the Canadian dollar may slow the increase in the number of tourists from the UK. High fuel costs impact both drive and fly markets by increasing cost There is a slowdown in the US economy projected for 2007. This may weaken demand for Canadian tourism products, and inhibit travel.

5.1 Terwiel Holdings

The great strength of Terwiel Holdings is the partnership of Anne & George Terwiel, long-time local residents who are involved in many aspects of Sun Peaks Resort. As such they are well known by the local market, and come in contact with many of the tourists at the resort, influencing them to come to the stores. The Terwiel's personal strengths will be discussed further later in the paper. The stores were each chosen for their excellent location, ensuring high visibility and traffic flow. Another strength includes 90-day terms with most suppliers, which can be extended to 120 days through credit card payment, enabling most stock to be sold before payment must be made. Having worked to build up stock as new stores were acquired, Terwiel Holdings now has an excellent mix of stock at a range of price points that does not require further build up. The focus can shift to managing stock to ensure that only excellent movers are taking

valuable shelf space, and energy can be devoted to improving the financial aspect of operating the business.

The greatest weakness of Terwiel Holdings is their complete reliance on the marketing of the resort by Tourism Sun Peaks (the resort marketing arm) to bring potential customers their way. Many other factors are also out of their control, most importantly weather, other environmental issues and politics. The partners have weathered many challenges since purchasing their first store in 1998, including: a low-snow year (2004/05); summer forest fires causing resort evacuations and resort closure on two separate occasions (2003); and First Nations Protests (2001, 2002) which intimidated tourists and brought about negative media exposure.

Terwiel Holdings must carefully manage the seasonality of their business cycle, in terms of fluctuations in the number of customers to the resort, the availability of employees through the various seasons, and the seasonality of stock. They instituted a computerized stock management and sales system a year and a half ago, but have been using the data captured during transactions at a very superficial level. It is important to dig deeper into what the system can do for them.

Finally, a large challenge has been the inability to use stock or leasehold improvements as security, causing financing to be a huge issue. The Terwiels have had to be persistent and creative in order to raise the financing needed to build this business. Financial management has not been their strong suit, and a focus on this area over the next few years will be critical.

There are many opportunities for Terwiel Holdings to explore. The resort is going to great lengths to develop shoulder season business, targeting the business and

conference markets for spring and fall. Stronger marketing to these customers once they are in the resort will drive business into the Terwiel's stores. The Terwiels are looking for ways to market the stores to Kamloops residents in order to make them think of Sun Peaks and their stores when they think of shopping for unique gifts and art. Finally, better utilization of financial and sales data will help them to manage the stores more effectively.

The largest threat to the business, next to the weather, is the looming labour shortage. Terwiel Holdings is already experiencing staff shortages due to the low local unemployment rate. Labour shortages in all regions and all industries are predicted over the next decade, so human resources management will be critical to the success of the business.

5.2 Sun Peaks Resort

Sun Peaks Resort has experienced continuous and significant growth during the past decade, with the exception of the forest fire summer of 2003. It is a four-season resort with diminishing shoulder seasons, catering to a variety of markets. Significant markets include BC, Alberta and Washington, Australia, the UK and Europe, and increasingly, the Asia-Pacific market. Tourism Sun Peaks' central reservations department increased total bookings by 13% and room nights by 7% in 2005. A variety of winter and summer activities are available including: skiing, snowboarding, nordic skiing, snow mobile tours, dog sled tours, snow shoeing, sleigh rides, ice skating, tubing at the tube park, mountain biking, golf, hiking, nature tours and interpretation, ATV tours, and swimming. This level of variety ensures that non-skiing, non-golfing

customers are attracted to the resort, as does the myriad of festivals and special events put on by the resort during the course of the year.

A great strength of Sun Peaks resort is its ability to partner with a number of organizations. Marketing partnerships have been forged with other interior mountain resorts to market the BC interior nationally and internationally, both in the ski and golf industries. Sun Peaks Resort has created and maintained strong relationships with regional, provincial and federal destination marketing organizations (DMO's). These relationships are critical to the effective marketing of the resort. Business partnerships with Intrawest, Fairmont Hotels and Golf Kamloops have brought growth to the mountain as well.

A major weakness for the resort, and therefore for Terziel Holdings, is the Kamloops airport. A short runway and an outdated beacon system combined with Kamloops' propensity for low valley fog in winter, limit access for the fly-in market. Air Canada flies small Dash 8's in to Kamloops, limiting the number of tourists, and the amount of baggage, through the Kamloops airport. Tourism Sun Peaks is the driver of an active lobby group calling for lengthening of the runway and the installation of a current beacon system to allow jets to land in Kamloops. They are also part of a business group that successfully brought in Horizon Air with daily flights from Seattle, and that is negotiating with West Jet and other regional carriers to provide service to Kamloops.

There is intense competition in the resort industry, both regionally and provincially. It is difficult to differentiate Sun Peaks Resort from other interior resorts. Whistler has undertaken an aggressive pricing policy to recapture market share, so Sun Peaks can no longer differentiate from Whistler on the basis of price. Internationally, US

resorts are actively marketing to Canadians now that the Canadian dollar is stronger, and Japanese resorts are targeting the lucrative Australian ski market.

Sun Peaks Resort has decided upon a messaging strategy that focuses on the advantages of an interior vacation rather than dropping prices below Whistler's aggressive price stance. The resort realizes that marketing experiences rather than price points will bring customers to the mountain.

Two solid growth projections indicate positive opportunities for Sun Peaks businesses. Projections for the Asia-Pacific market to grow by 19.5% over the 2006-2008 business cycles are very positive, as is the growth in summer season business, with occupancy rates reaching 45% of winter rates in the summer of 2006. Completion of the back 9 holes on the golf course last season brought Sun Peaks up to 18-hole championship status, and a new road east of the resort to Chase will mean better access for drive-in tourists coming from the east. This is wonderful news, as bus tour traffic is Terwiel Holdings' bread and butter during the spring, summer and fall. Sun Peaks receives many tour groups travelling from Banff and Jasper through to Vancouver, and the new road will mean that these tours do not have to go out and back on the same road. This is a huge asset in terms of marketing the resort to new tour groups, and to increasing business with current groups, and is very significant to Terwiel Holdings, as bus tourists shop when they are in the resort, more than other customer groups who may be busy with outdoor activities.

Finally, the recently approved 2% accommodation tax will be allotted to Tourism Sun Peaks to be utilized in further marketing of the resort. However, the changing nature of communications makes marketing decisions difficult. Traditional forms of advertising

are less effective and new forms, such as internet marketing, haven't been studied enough to have been proven effective, so it will be difficult to determine where to spend those advertising dollars.

5.3 The Tourism Industry

The Canadian tourism industry is in increasingly good shape. Domestic tourism spending rose by 4.1% in 2005 in Canada as a whole, with higher increases in British Columbia. Opportunities in BC abound, not the least of which is the 2010 Olympic Games. The BC government has developed a training centre strategy that will attract tourists, teams, media and supporters before, during and after the games. Sun Peaks is already benefiting from this strategy. The Austrian National Ski team has signed a five-year contract for early season training at the resort. For the month of November the Austrian superstars live and train at the mountain, bring a huge support team and international media exposure. Money to develop the training centre came from Sun Peaks Resort Corporation, the Austrian team, and provincial and federal dollars related to Legacies Now and the 2010 Olympics.

There is strong provincial and federal support for the tourism industry. Provincially, the goal is to double tourism to the province by 2015. Federally, the Canadian Tourism Commission has recently rebranded Canada as a destination and is aggressively marketing Canada to the international market.

Domestic travel is projected to grow by 10% between 2005 and 2008, and international growth figures are strong. The Asia-Pacific region currently supplies 12% of international tourists to BC and is expected to grow dramatically over the coming years.

The Canadian and Chinese governments have signed an agreement in principle, and are hammering out the final details to give Canada “Approved Destination Status,” opening the door to the Chinese market. This is great news for BC tourism operators as the Vancouver International Airport is the most convenient gateway airport on the west coast of the continent. Other exciting news for BC operators is the expansion of Vancouver’s Trade and Convention Centre that will bring larger international conferences to BC, exposing more of the world to the benefits of a vacation in British Columbia.

There are some weaknesses and threats to the tourism industry that must be paid close attention during the business planning process. The Western Hemisphere Travel Initiative enacted by the US may dampen visits from the US, especially impulse travel. Passports will be required to be carried by all air passengers to and from the US in 2007, and by ground arrivals by 2008. Only 20% of Americans currently hold passports. Political instability, war and terrorism, even when not on American soil, are perceived as very real threats to US travellers. Canada is seen as a safe destination, but US travellers don’t feel any sense of urgency to travel in Canada. They want to travel to Canada “sometime” in their lives, but it doesn’t have to be now.

Within the tourism industry as a whole there is a strong trend toward last minute booking, with many visitors booking within 1-3 weeks of their arrival. This makes planning difficult, and means that businesses competing on price can offer last-minute discounts to entice tourists their way. Those not competing on price must seek strategic avenues to get their message out, encouraging last minute, impulse buys.

Finally, changing weather patterns are playing havoc with the tourism industry as a whole. Storms, lack of snow, too much snow, heat, drought, etc. make leaving home a

less attractive option. Whether the weather is worse or less predictable, or whether increased media attention to weather issues is the driver, weather is perceived as very important in terms of the decision to travel at all, and where to travel once the decision to travel has been made.

5.4 The Retail Industry and the Economy

Retail sales surpassed \$5 billion in British Columbia in 2005 and the trend in coming years looks strong. BC consumers outspend all other Canadians except Albertans. This is good for Terwiel Holdings as their largest market is drive in visitors from BC and Alberta. The fact that these tourists are big spenders and have their own vehicles to transport their purchases home increases the likelihood that they will shop while at the resort. Increasingly high disposable incomes in BC & Alberta drive a greater capacity to purchase as well.

The BC economy grew at a healthy rate in 2005 with strong expansion forecast for 2006, 2006 and beyond. Balanced growth is driving the BC economy, with improvement in 6 of the 7 indicators making up BC's economic index. Employment was the strongest contributor to 2005 gains and retail spending was second. Both of these factors are good news for Terwiel Holdings as employed people take vacations.

Tourism is BC's 3rd largest source of export earnings, after forestry and energy products. The service industry is accounting for a greater share of BC's overall foreign trade. The tourism industry accounts for \$4 billion in export earnings annually.

There are some weaknesses and threats on the horizon. The increased value of the Canadian dollar means that the US is now more affordable for Canadian travellers. There

is pent-up demand for American tourism product in the Canadian market, and mountain resorts in Colorado, Idaho and Utah are actively marketing to Canadian tourists. Conversely, US travellers are not finding Canada to be the great deal that it once was, so BC is seeing a drop in US price-sensitive customers. A decline in the British Pound Sterling relative to the Canadian dollar may slow the increase projected in the number of visitors from the UK.

High oil prices are a problem for both the tourism and the retail industry. High fuel costs add to the cost of goods, and to the cost of travelling to the resort whether by car, bus or plane. High oil prices, international competition and many other factors combine to put pressure on the US economy, which is projected to slow down in 2007. This may weaken the demand for Canadian tourism products and inhibit travel.

Given the SWOT analysis, strengths and weaknesses are identified that will inform the strategic direction that the Terwiels will take. Strengths in their ability to manage people will help the Terwiels to offset the threat of the impending labour shortage. Weaknesses in the financial position of Terwiel Holdings impinge upon the ability to sell one or all of the stores at a price that would compensate the Terwiels for the time and effort they have put into the business. Opportunities that are available within both the tourism and retail industries point to the ability of Terwiel Holdings to grow into the future, as long as they plan to deal with impending threats on the horizon.

6 INTERNAL ANALYSIS

6.1 Business strategy

Terwiel Holdings is a differentiator. Value to customers is provided via: excellence in customer service provided through knowledgeable, well-trained staff and a high level of owner-involvement; interesting stock of limited availability; pre-eminent location on the main street of a busy, growing village; and, a relationship marketing strategy involving customers and suppliers along the continuum of the business decision-making process, increasing loyalty on both sides of the supply chain. These value-adding characteristics create sustainable competitive advantages for Terwiel Holdings.

6.2 Functional Description

In terms of a functional description of Terwiel Holdings, they are a resort retail operation generating sales in the low, medium and high ends of the market. They employ a differentiation strategy based upon product type and market segment. There is a distinct difference between the summer and winter market and stock is changed seasonally to reflect that difference.

6.3 Relational Description

Relationally Terwiel Holdings is integrated with: commercial suppliers, distributors and individual artists; Sun Peaks Resort Corporation, the large, primary business in the area; Tourism Sun Peaks, the resort marketing arm; and the Sun Peaks small business community, through a loosely-structured business association. The

purpose of the business association is to maintain a balance of power between small businesses and the large resort corporation. Maintaining positive relationships with all of these entities is critical to the success of Terwiel Holdings.

Terwiel Holdings is part of a system that begins with product manufacturers, and flows through a distribution system (input) and a transformation process (their ability to merchandise effectively), to the end user, or customer (output). The complexity of the system depends upon the product. When dealing with original art, Terwiel Holdings has a two-step system; from artist to the store and from the store to the customer. When dealing with products manufactured overseas the distribution system can have many steps. While the business may be an independent entity it is inextricably linked to this system. Nadler & Tushman's "congruence model of organizational behaviour is based on the degree to which components fit together," (Nadler & Tushman, page 45). Terwiel Holdings continues to deal with artists and distributors who are congruent with our structure. Those that do not fit are let go regardless of the quality of the product. Nadler & Tushman conclude that "[organizational] effectiveness is driven by the relationship among components (congruence) rather than by the inherent characteristics of individual components," (page 53). This has certainly been our experience.

6.4 Ecological Description

Until now Terwiel Holdings has utilized what Gouldner (in Thompson) identified as a nature-based system. Business grew in response to the growth in the number of visitors to Sun Peaks Resort. This strictly organic model allowed the Terwiels to respond quickly to changes in the operating environment, which has a high level of uncertainty. Lack of snowfall and extremely cold temperatures have impacted business in the winter,

while forest fires and heavy rainfall have threatened summer business. An unstable political climate in terms of First Nations land claims has also had an impact on business. In *Organizations in Action*, Thompson describes organizations that either “avoid uncertainty to achieve determinateness, while others assume uncertainty and indeterminateness,” (page 493). While Terwiel Holdings cannot avoid uncertainty, they can take steps to control that which they can control, so the Terwiels have begun to rationalize in-store systems and procedures, thereby disallowing variables under their control from impacting their core systems. However, Terwiel Holdings must embrace the self-stabilizing nature of an open system and allow the organization to be a “problem-facing and problem-solving phenomena,” (Simon-March-Cyert in Thompson, page 494).

6.5 Organizational Competencies

While neither owner brought any retail experience to the creation of Terwiel Holdings, they did bring a wealth of ski- and tourism-industry knowledge to the table. Both parties have been involved in the ski industry, teaching and coaching, for over 25 years and continue to do so. Working with clients on the snow allows the Terwiels to assess their market on an individual basis, throughout the season and over the years, with a variety of demographic and psychographic groups. This forms an integral part of their market information-gathering process. Both parties also attend ski industry conferences once or twice a year in order to increase their knowledge in terms of trends, opportunities and threats presented by the industry.

George Terwiel was trained as a Power and Process Engineer and as a Millwright, and worked as an engineer and millwright for a number of years prior to the purchase of Willow Tree Gifts. This training ensures that George is expert at analysis, design and the

creation of efficient and effective processes. This can be seen both in terms of the flow of people and the strategic location of stock throughout the stores, and in policies and procedures related to the efficient use of time and resources throughout store operations. George is excellent at trouble-shooting: seeing problems before they occur and steering clear of those problems; or once a problem has occurred, at analysing and correcting the root cause of the problem rather than correcting symptoms.

Anne Terwiel was trained as a teacher and worked for a number of years in the public school system in both elementary and high schools. Anne worked in the hospitality industry as a teenager, and in the resort industry as a ski instructor while going to university. She remained involved with the tourism industry on a part-time basis while teaching in the Lower Mainland, and upon moving to Kamloops, combined her teaching and tourism industry experience with the creation of The Staff Development Company, a training consulting business aimed at tourism industry employers. This experience and further education led Anne to secure a teaching position in the School of Tourism, Business Management Department at Thompson Rivers University (TRU). The current tourism and business research and information, available via TRU, is invaluable to Anne in her role as strategist and long-term planner for Terwiel Holdings. Her teacher training and experience are utilized in staff training, both in the development of training programs and in their utilization.

Both George and Anne are adept communicators and truly enjoy spending time with people. George developed the story-telling strategy utilized in the sale of products in order to bring products alive for customers. He also ensures that the stories of the artists who create the pieces are displayed prominently wherever possible.

The Terwiels have recently hired an information technology specialist to improve their rather cursory use of the powerful computer programs they have at their disposal. Improvements in stock, sales statistics and financial record keeping will be implemented immediately, with training for all staff in this area. A staff person with a technology focus was necessary to make up for a shortfall that the Terwiel's feel they have in this area.

The senior staff person has recently been elevated to the position of manager to allow George to move from a very operational role into a role that allows him to spend more time with the big picture, ensuring the efficient interaction between the three stores, and between Terwiel Holdings and their business environment. George is committed to the creation of a comprehensive procedure manual that captures as many business processes as possible. This manual will serve as a point of reference, allow for more standardized training, and most importantly, will encapsulate the system used by Terwiel Holdings. In the event of the creation of a new store or the sale of the existing stores, the system will be easily replicable, creating additional value for Terwiel Holdings.

In summary, organizational competencies include communication, process flow, product and customer flow, problem-solving, training, first-hand knowledge of ski, tourism and retail industries, information technology, a strong marketing focus (external [relationship], internal and interactional), and a replicable system.

6.6 Organizational culture

Organizational culture represents a set of shared values, behavioural norms and activities designed to develop and support those values and norms. Above all Terwiel Holdings values people and all activities are designed to consider the needs and wants of

customers and staff as the primary driver in decision-making. Customers are greeted individually, warmly and with sincerity upon entering the store. Customers determine the level of staff interaction they desire while spending time in the store. Customer follow-up is an integral part of the sales strategy for purchasers of limited edition and original items to ensure the development of repeat business. Representative customers are consulted in terms of buying decisions or decisions to drop products, and customer satisfaction is monitored continuously. This value system is communicated to staff via training and mentoring, and a reward system to ensure excellence in customer service is being instituted.

The management style of Terwiel Holdings is designed to nurture excellence with customers by providing an exceptional work environment for staff. Given that the current labour shortage is expected to last for a number of years, Terwiel Holdings must be the employer of choice at Sun Peaks Resort in order to compete effectively for staff with larger businesses that can offer more perks and higher wages. To that end, effective two-way communication between staff and the Terwiels is of paramount importance. Employees are encouraged to share ideas for improvements to the stores, to bring forward product ideas, and to think creatively in confronting challenges. Staff members are given autonomy in terms of decision-making and are empowered to solve problems on their own. The Terwiels share with the staff their plans for the future, and details of where they are today, so that employees have a clear understanding of organizational goals.

Careful communication of the value of serving both customers and each other lead staff to adopt courtesy and positive communication as the normal behavioural standard when dealing with any human being associated with the store, be they customer,

fellow staff member, distributor or artist. Efforts by staff on behalf of the people they are dealing with me are currently rewarded with a sincere thank you. The Terwiels are working to develop a reward system that will recognize staff that go to great lengths in the service of others.

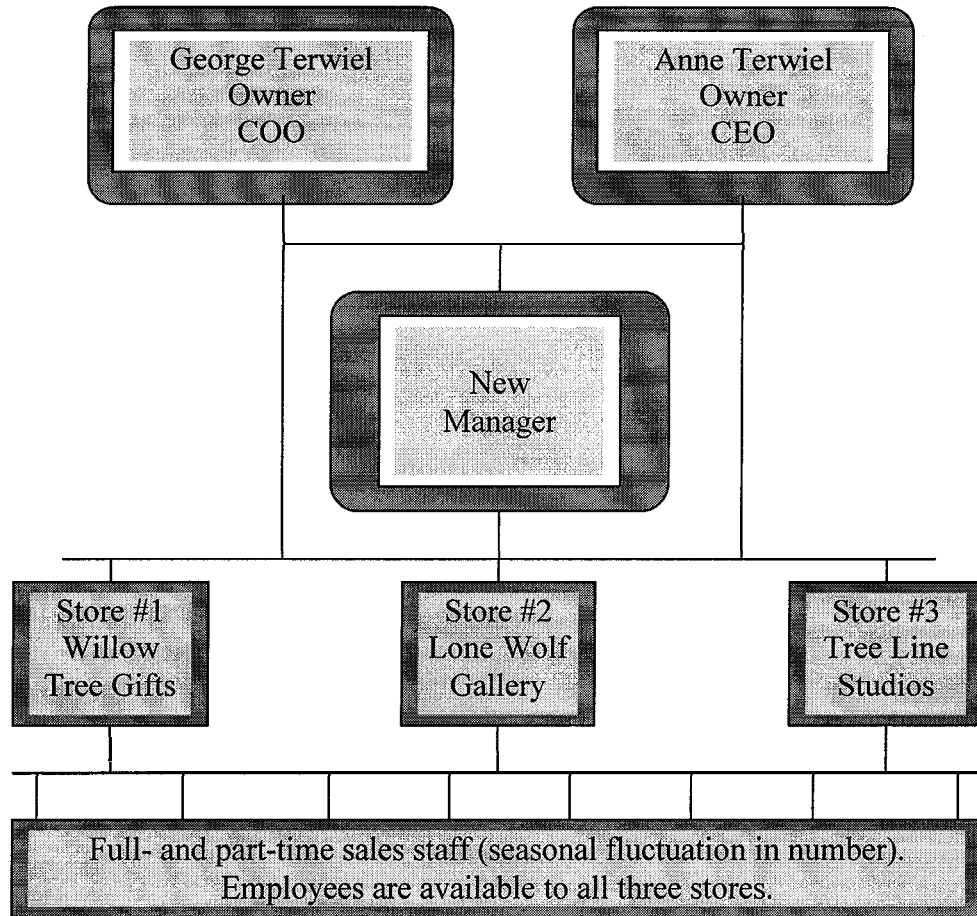
The activities of the Terwiels are designed to symbolize the respect and courtesy deserved by those coming in contact with any of their stores. They are in regular face-to-face or telephone communication with customers, employees, artists and distributors. Faxes and emails are used solely for technical communication. Family is an overarching theme in the lives of the Terwiels. They take opportunities to spend time with their family, and other the staff is encouraged to do the same. The weekly work schedule is viewed as important, but not set in stone, and a system is in place for staff to fill their shifts with other staff should it be required for any reason.

6.7 Organizational structure

During his lecture of April 15, 2005, Dr. Mark Frein asserted that “organizational forms are the lived and physical embodiment of business strategy.” If that is the case, then the study of organizational structure should allow insight into the strategy of an organization, and the strategy chosen by an organization should be supported by the structure. A lack of congruence between structure and strategy would be an indicator of problems within the organization.

6.7.1 Current Formal Structure

Figure 6: Organizational Chart for Terwiel Holdings



6.7.2 3-D Model of Organizational Assessment

Utilizing the 3-D model of organizational assessment, Terwiel Holdings' hierarchy is comprised of three levels (see organizational chart). The manager's position is new, created to allow the owners to step back from the day-to-day operation of the stores and enabling them to take a wider, longer-term view (helicopter view). Though they are a relatively flat organization, integration (coordination) is an area that requires

improvement. A look at the organizational chart reveals overlap in the responsibilities of the owners and the manager; the manager appears to be in a box, which accurately depicts her reality. Improvements in this area will be addressed later in the paper.

Authority is centralized utilizing a consultative-participative approach. While input is solicited from staff and is considered invaluable, the final decisions on all matters of importance rest with the owners. The division of labour is vertically differentiated, with administrative control increasing at each level. It is the Terwiel's intention to delegate more administrative responsibility and decision-making authority to the manager as she becomes more comfortable in her new role. Her training will focus on this area. There is some natural horizontal differentiation amongst the sales staff as we utilize their innate talents and interests in specific areas, for example merchandizing, computer work, or product research. These roles are not defined as areas of responsibility, however, and individual staff do not have authority over these areas.

Sales staff is responsible for sales, customer service and store cleanliness/organization. The more senior staff undertake some of the repeat-ordering. There is not formal differentiation in the roles of the sales staff. They are trained to work in all three stores in order to increase the flexibility of the work force. Training includes use of the computer system (which is consistent throughout the organization), sales training (including story-telling, the major sales strategy), and excellence in customer service.

There is aggressive competition for staff at the resort, as Sun Peaks is located almost an hour away from an urban centre and has limited staff housing potential. Smaller businesses such as the Terwiels' cannot offer the free seasons passes and comprehensive benefits packages offered by Sun Peaks Resort Corporation and the large

hotels. We chose our full- and part-time, year-round staff from the rural area adjacent to Sun Peaks Resort, and find that, while many of these individuals haven't much resort or retail work experience, they are hard-working, reliable, personable people who can be trained in customer service and sales. This overlooked employee market has served us very well over the years. Seasonal staff arrives at the resort looking for a few months work, and their arrival coincides with an influx of resort visitors during the summer and winter high seasons. Prospective seasonal employees often have a variety of customer service and/or retail experience, and many have worked in other resort settings. They are aware that they are a valuable commodity and have their choice of employers, so we carefully nurture our reputation as the best small business employer at Sun Peaks.

6.7.3 Current Informal Structure

Because Terwiel Holdings is a small, hands-on operation the informal structure closely mimics the formal structure, however, informal norms certainly exist amongst the sales staff. Terwiel Holdings is intentionally a flat organization, with only three layers from sales floor to executive suite. They do not formally differentiate between full-time and part-time or seasonal sales staff because each staff member is so critical to the successful operation of the business. While it may seem typical that seasonal staff would be deemed less valuable, they are vital to the ability of Terwiel Holdings to operate in busy seasons and they are hard to come by as the entire resort competes for scarce, seasonal employees. In attempting to be the employer of choice, Terwiel Holdings treats seasonal staff as well as long-term staff. Informally, however, cliques inevitable arise and a hierarchy is formed with long-term, full-time staff at the top, long-term part-time staff in the middle and shorter-service staff at the bottom. *In Designing Organizations*

that have a Good Fit, Nadler & Tushman state that “influencing organizational behaviour is at the centre of the leadership role,” (page 39). Therefore, the Terwiels are ever-vigilant to deconstruct this counterproductive informal structure to ensure that their seasonal staff will stay with them the entire season.

6.8 Prescription for Future Growth and Stability

The Terwiels began with their first store seven years ago and during their growth have developed what Beer refers to as *habits of business*. Beer asserts that these “habits of business become institutionalized, and over time, a culture is developed that reinforces historically successful business and administrative practices,” (Beer, page 312). The Terwiels have reached a stage where they have outgrown past practices and must redesign the organization. “Organizational fitness depends on the capacity of leaders to confront and learn from internal tensions,” (Beer, page 314). A current source of internal tension is the role that will be fulfilled by the new manager. Given that the business began with the two owners doing everything from financial planning to sweeping the floors, the habits of business include the tendency on the part of the COO and CEO to micromanage. The manager must be taken ‘out of the box’ that is so visible in the organizational chart. The CEO and COO have to relinquish day-to-day control, and it is important that they learn to delegate authority and responsibility to the manager. The steps being taken in this direction harkens back to Taylor and his first principle of scientific management: gathering together the collective knowledge of the operation of the stores and “recording it, tabulating it, reducing it to rules, laws and formulae,” (Taylor, page 65). In the development of their operations manual the Terwiels are formalizing the knowledge that is in their heads, evaluating it, and putting it to paper.

Care must be taken, however, that in creating an operations manual the Terwiels differentiate between the Taylor's rules, laws and formulae and the industrial setting from which they sprang, and the customer service oriented environment they strive to nurture in their stores. The 'rules' must not come at the expense of the service environment. The Terwiels will have to pay close attention to the impact of formalized procedures on the ability of the staff to think creatively, act autonomously, and provide excellent service.

In his *Note on Organization Structure*, Nohria states that organizational structure "enables members of the organization to coordinate their activities through integrating mechanisms such as hierarchical supervision, formal rules and procedures, and training and socialization" (page 1). A procedure manual and manager's manual are being created to standardize core processes and allow a sharing of knowledge. The CEO, COO and manager are part of this process, allowing for training, socialization and formative evaluation to take place. A positive evaluation of the manager will increase the level of comfort of the CEO and COO, allowing them to relinquish control. "An effective strategy for change entails creating a guiding coalition and getting it to work together as an effective team," (Kotier, 1995a in Gill, 2003). Creating knowledge and trust between the CEO, COO and the manager will help to build an effective management team.

The American Management Association states that the keys to successful change "are first and foremost leadership, followed closely by corporate values and communication," (in Gill, 2003, page 3). In essence, the CEO and COO are handing their managerial roles to the new manager and taking on a leadership role. "Decentralizing authority that maximizes organizational flexibility requires leaders to be enabling rather

than directive,” (Taylor et al, 2002). The Terwiel’s goal is to enable the manager to take on greater responsibility and authority in the daily operation of the organization.

Communication of structural and strategic modification is now the major area of focus in moving toward successful change. “Effective integration is as important as careful differentiation.....The choice of coordination mechanism depends upon the degree to which integration [coordination] issues are routine versus exceptional,” (Nohria, page 2). Because the Terwiels are standardizing and routinizing core business practices, written and verbal communication of those procedures via procedure manuals and careful training (the coordination mechanism), will allow for greater decentralization. The appropriate “allocation of different decision rights ensuring the appropriate degree of decentralization of decision-making authority” (Nohria, page 2), will allow for more effective use of the new organizational structure.

Once Terwiel Holdings has effective vertical differentiation and coordination the next step will be to examine more formal horizontal differentiation of sales staff. Perhaps a case could be made for specialization of staff for each store. Beyond allowing staff to explore areas of interest and innate ability (for instance computers, merchandizing) perhaps areas of necessary expertise should be identified, and staff trained or hired to fill those areas. A first step has been taken in this direction with the identification of a staff member with excellent information technology skills. Acknowledging such expertise will necessitate a restructuring of the compensation system in order to reward such expertise appropriately.

The changes detailed above are a first step in creating greater congruence between organizational structure and strategy for Terwiel Holdings and their three retail

businesses. Staff will have greater clarity in terms of areas where they have some latitude versus areas where they must 'follow the book.' The manager will have both greater responsibility in the day-to-day operation of the business and the authority to act upon those responsibilities. The CEO and COO will be released from operational concerns, enabling them to take on a leadership role, to conduct effective planning, and to take a wide-angle, long-term view of the organization. This view will enable the Terwiels to make strategic decisions in terms of the operation of the business, as well as informing decisions regarding the future sale or growth of the business.

7 FINANCIAL ANALYSIS

The Terwiels expected that it would take 5 years from the time of purchase for each store to become profitable, so benchmark years are 2004, 2005 and 2007. 2005 is the first year to show a positive net income. Unfortunately financial statements are consolidated; they do not break out each store separately, so it is not possible to determine whether the first store was profitable at its five-year threshold, and whether each store is profitable or not on its own. The Terwiels are able to look at gross margins for Tree Line Studios separate from Lone Wolf / Willow Tree. Lone Wolf Gallery and Willow Tree Gifts are often operated as one store; therefore, their bookkeeping is completed as if the two are one operation.

7.1 Gross Margins

In terms of gross margins, the trend over the past three years follows:

Table 4: Gross Margins

	2005	2004	2003
Lone Wolf / Willow Tree			
Sales	\$234,130	\$229,650	\$183,375
Cost of Goods Sold	95,102	133,131	118,244
Gross Profit	139,028	96,519	65,131
Gross Margin	0.6	0.42	0.35
Tree Line Studios			
Sales	\$165,490	\$183,600	\$121,280
Cost of Goods Sold	96,857	105,946	80,423
Gross Profit	68,633	77,654	40,857
Gross Margin	0.42	0.42	0.34

Source: Terwiel Holdings Financial Statements

Gross margins for Lone Wolf / Willow Tree have risen over the past three years, indicating that sale prices are rising faster than variable costs. In the retail industry pricing strategies are very important to the overall profitability of the firm, in terms of the ability to cover costs and the ability to attract customers. Lone Wolf Gallery and Willow Tree Gifts have a diverse mix of stock items that change seasonally. The Terwiels have been playing with their pricing in Lone Wolf Gallery in order to capture as much profit as possible from each item sold, while not pricing themselves out of the market. The manipulation of pricing is indicated by the ascending gross margin, as is the fact that the Terwiels are improving in their buying ability and do not have to use sale pricing to move stock to the same extent that they did in the past.

Tree Line Studios experienced an increase in their gross margin from 2003 to 2004, and it remained flat from 2004 to 2005, indicative of stability in pricing strategy. Tree Line Studios has higher end products which do not change seasonally or year-to-year. Artists are involved in pricing decisions as they want some control over the price of

their work in the marketplace. The deal offered to original artists supplying high-quality, high-priced goods is generally 60% to the artist, 40% to the store. For smaller items the split is 50/50. Sale pricing is not often utilized. Now that they have a track record of success, the Terwiels are considering negotiating a 50/50 split with all artists in order to increase the profitability of Tree Line Studios. They will also increase the percentage of limited edition stock in the store, stock which, while selling at lower prices, allows for much higher mark-ups. These changes will cause an increase in the gross margin for Tree Line Studios.

7.2 Other Ratios

The following ratios apply to all three stores together, and have been chosen for analysis because they are meaningful and useful.

Table 5: Performance Ratios

Ratio	Formula	2001	2002	2003	2004	2005
ROE (%)	Earnings/Shareholder Funds x 100	-6.79	-0.87	5.74	6.17	16.12
RONA (%)	EBIT/Net Assets X 100	15.99	7.80	13.08	8.37	9.40

Source: Terwiel Holdings Financial Statements

Return on Equity is a measure of performance in all aspects of the operation of a business. The ROE for Terwiel Holdings has been steadily improving, leaving negative returns behind as of 2002. Given that the Terwiels hope to make a minimum of 10% on their investment, the return on equity of 16.12% earned in 2005 is very positive. ROE is made up of three components: profit margin, asset turnover and financial leverage. All three of these metrics will be looked at in more detail later in the paper. The increasing

ROE means that we Terwiel Holdings is becoming more effective in the utilization of the Terwiel's capital. Given that the Terwiels are the sole investors in the stores, and that much of their personal equity is tied up in the stores, an increasing ROE is very good news: their investment is generating a desirable return.

Return on Net Assets helps to assess profitability in terms of the utilization of operating assets. Because Terwiel Holdings is heavily debt financed, RONA provides a view of performance that avoids the effects of financial leverage and offers a more accurate picture of performance. RONA has been quite variable for Terwiel Holdings over the past 5 years, resting at a comfortable 9.4% in 2005. Because RONA measures earnings related to assets, changes can be indicative of increasing or decreasing earnings, or increasing or decreasing assets. In 2001 Terwiel Holdings earned RONA of 15.99%, indicative of high earnings relative to a smaller asset base. In 2002 and 2003 Terwiel Holdings added significantly to its asset base with the construction, outfitting and stocking of Tree Line Studios. Terwiel Holdings is not an asset-intensive business, so additional assets have not been required since 2003. Therefore, due to depreciation and slightly lower stock levels, the asset base is now lower than it was in 2003, causing RONA to decrease. Additionally, the 2003 RONA of 13.08% is artificially high, as variable costs were low in 2003 due to the closure of the business during the summer forest fires. This meant that wages and other variable costs decreased, as did lease costs due to the fact that the landlords generously allowed the Terwiels to forego lease payments for 2 months as a result of forced business closure. Taking these two factors into account, Terwiel Holdings is seeing a positive trend with regard to RONA.

Table 6: Profitability Ratios

Ratio	Formula	2001	2002	2003	2004	2005
Net Profit Margin (%)	EBIT/Sales	12.20	7.16	9.55	4.05	4.51
Gross Margin (%)	Gross Profit/Sales	46.99	64.24	57.03	44.78	50.94

Source: Terwiel Holdings Financial Statements

The net profit margin points to the profitability of the business. Changes in the margin are caused by changes in costs and sales values relative to each other. Terwiel Holdings' net profit margin was fairly unsteady though relatively high between 2001 and 2003. The margin fell from a high of 12.2% in 2001 to a low of 4.05% in 2004, and increased slightly to 4.51% in 2005. This volatility points to a lack of good control over costs, and changing inventory levels. Though the gross profit has grown steadily each year from 2001 through 2005, EBIT has been capricious. Clearly cost control is an area requiring improvement, something recognized by the Terwiels. In 2005 they undertook an aggressive campaign to bring the cost of operation under control, in particular: wages, which had been steadily increasing; bank charges which were out of control; insurance, which had not been well-researched; and dues and fees, the amount of which seemed inordinate. The slight improvement in net profit margin in 2005 is a reflection of development in this area, though more improvement is needed.

The gross margin has fluctuated by 19 percentage points over the past five years, though both gross profits have increased steadily. The gross margin indicates profits made on sales, so erratic sales have a direct impact on this margin. Fluctuating sales are sometimes out of Terwiel Holding's control. Variables such as snow conditions, currency exchange rates, group tour bookings (especially bus tours, the summer staple) can be planned for but not controlled. The Terwiel's response to changes in sales due to these

variables must be fine-tuned in order to bring the financial implications of these fluctuations under some control. The gross margin must be watched closely as a small change in percentage can cause a large change in profitability. The average gross margin over the past five years is almost 53%; the Terwiels would like to return it to the 60% region that it was in 2002, prior to the building of Tree Line Studios.

Table 7: Asset Management

	Formula	2001	2002	2003	2004	2005
Asset Turnover	Sales/Total Assets	1.05	1.01	1.11	1.49	1.52
Net Operating Asset Turnover	Sales/Net Operating Assets	1.31	1.09	1.37	2.07	2.08
Fixed Asset Turnover	Sales/Fixed Assets	4.46	3.27	4.63	6.85	7.99
Inventory Days	Inventory x 365/COGS	213	228	614	394	228

Source: Terwiel Holdings Financial Statements

It is very interesting to examine the relationship between total asset turnover, net operating asset turnover and fixed asset turnover. Even though Terwiel Holdings is not an asset-, or capital-intensive company, given the amount of debt financing they have undertaken the Terwiels must ensure that they are making the most of their assets. A look at the ratios indicates that fixed asset turnover is relatively high and increasing, signalling that lack of capital-intensity. In 2005, for every \$1 of fixed assets, Terwiel Holdings generated \$7.99 in sales. While Terwiel Holdings is utilizing their fixed assets well, their asset turnover and net operating asset turnover are low and illustrate a very slow upward trend. These ratios are low, indicating that perhaps the Terwiels are not generating a sufficient volume of sales in relation to operating assets.

Table 8: Liquidity and Financial Leverage

	Formula	2001	2002	2003	2004	2005
Liquidity						
Current Ratio	CA/CL	1.41	2.3	1.8	1.2	0.5
Finance						
Leverage (Gearing)	Debt/Capital Employed	1.29	1.79	1.44	1.33	1.00
Interest Cover	EBIT/Interest Expense	1.15	1.09	0.84	0.72	1.17

Source: Terwiel Holdings Financial Statements

The areas of liquidity and financial leverage are of great concern to the Terwiels as they have been intensive in their use of debt financing to get these three stores off the ground. The current ratio is a measure of the short-term solvency of a company, and should be compared year over year and with companies in the same industry. The Bay, Wal-Mart and Sears have current ratios of 2.23, 0.92 and 1.83 respectively, so Terwiel Holdings has been in the ballpark in terms of current ratios in the retail industry. However, the Terwiel's current ratio has been fluctuating from a high of 2.3 in 2002 to a low of 0.5 in 2005. The low current ratio of 0.5 in 2005 is misleading due to a restructuring of the debt of Terwiel Holdings. In an attempt to reduce interest charges, all of the debt which had been reported as long-term debt was shifted to current debt in the shape of a lower-interest demand loan, causing a huge increase in current liabilities. If, for the sake of comparison, that amount is taken out of current liabilities, then the current ratio of Terwiel Holdings for 2005 becomes 1.3, a slight improvement from 2004. Liquidity is an area that Terwiel Holdings must address. Timing of purchases and payments for those purchases also impact the current ratio. The Terwiels bring in a lot of stock at the beginning of November that must be paid for at the end of December given

60 day terms. Increasingly those terms can be stretched, allowing for payment in January, carrying an increased accounts payable into the new fiscal year. The other reason that Terwiel Holdings' current ratio is low is that all sales are cash or equivalent – debit cards or consumer credit cards being the only options other than cash. Therefore accounts receivable are rare.

Terwiel Holdings' leverage is falling, although they are still more heavily leveraged than they would like given the number of business variables that are outside of their control. The Terwiel's goal is to strike a balance between relatively inexpensive debt financing, paying down debt in the face of rising interest rates, and maintaining stock levels. Given that their gross margin in 2004 was 64%, it's difficult to argue against borrowing money at prime +1%. However, Terwiel Holdings cannot use stock as equity, so financing is based upon leveraging personal assets and that feels tenuous to the Terwiels at this time.

Given that the levers of performance include profit margins, asset turnover and financial leverage, one must endeavour to strike a balance whereby the assets necessary to support the business are available with the appropriate financing that the business might have an enviable profit margin. Tinkering with one lever at the expense of the others may throw the business out of whack, and cause a delicate business to go under. This will be the Terwiel's challenge over the next several years. The original owner of Army & Navy, Samuel Cohen, once said that if he had a choice between buying stock and putting money in the bank he would always buy stock, and that if he could sell it for more than the cost of financing it he would use debt financing wherever possible. His motto was "get the goods sold; there's always more to follow."

For a small business like Terwiel Holdings, it is critical that they manage their resources well, and make appropriate decisions in terms of levels and pace of growth, in order to remain in business. In the first five years they grew the business too quickly in terms of the resources available to support that growth. The Terwiels must now bring that pace under control, stabilize the business, and put it on a more solid footing.

7.3 Required Rate of Return

Given the nature of small business, the risks associated with it, and the high failure rate of small businesses, the Terwiels would hope that over a ten-year period (1999-2009) they would see a 10% rate of return. The 10% rate is lower than one would expect from a 10 year investment elsewhere in this day and age, but there are reasons other than financial returns for the Terwiels to invest in and continue to operate these stores. Given that they have put \$329,500 into the stores, a 10% return over 7 years would put the present value of the stores at \$642,000, and at \$854,600 over 10 years. However, major investments were made 7, 6 and 4 years ago, so the expected growth in total investment will be under \$600,000 by this time.

7.4 Market Value and Book Value

Given the current real estate market at Sun Peaks Resort, the Terwiels believe, very conservatively, that they would be able to sell the stores for \$900,000 (\$300,000 per store), plus the cost of existing stock. This estimate is based on the fact that there are two stores of similar size currently for sale at Sun Peaks Resort; one is asking slightly below \$1million, the other slightly above \$1million. While both would appear to be over-priced in the extreme, there haven't been any businesses sold at the resort for a number of years,

so there isn't another figure for comparison. The conservative figure assumes the necessity of a quick sale, and is based upon discussion with realtors at the resort who have experience representing businesses. However, in the calculations of WACC and EVA, a market value of \$530,000 has been used. This reflects an estimate of the actual amount of money the Terwiels have put into the stores over the past 7 years; an estimate because, in the early years, the record-keeping in this area was not comprehensive, and a "best guess" must be made. The book value of \$329,446 represents the figure in our financial statements.

7.5 Cost of Capital

The cost of capital has been determined using the following formulae:

$$\text{Cost of equity} = \text{Risk-free rate} + \text{Beta} (\text{Risk market rate} - \text{Risk-free rate}) = 10.24\%$$

$$\text{Cost of Debt} = \text{Pre-tax cost of debt} \times (1 - \text{Tax rate}) = 6.13\%$$

$$\text{WACC} = \text{Cost of Equity} \times (\text{equity/debt} + \text{equity}) +$$

$$\text{Cost of Debt} \times (\text{debt/debt} + \text{equity}) = 8.92\%$$

The risk-free rate of 4.09% reflects the average rate for 10 year bonds as declared by TD bank. The risk equity premium of 5.91% was determined by subtracting the risk free rate from the 10% minimum rate of interest the Terwiels are willing to accept on their investment in the stores. The beta of 1.04 is an average beta based upon data amassed on specialty retail and retail operations by the Stern School of Business at NYU (New York University). A beta of more than one is indicative of risk; a beta of 1.04 indicates that Terwiel Holdings' business is slightly risky, and if it were a publicly traded business, its shares would move with slightly more volatility than the stock market. The

tax rate of 22.58% is also based upon NYU information, and differs only slightly from the tax rate of 22.4% that was calculated specifically for Terwiel Holdings. The WACC for Terwiel Holdings business is 8.92%. This is the minimum rate of return that Terwiel Holdings must earn to meet their return expectations; the minimum amount that the business must earn to ensure that the Terwiels don't look elsewhere to invest their money.

7.6 Economic Value Added

Economic value added (EVA) is the return generated by the company beyond an investor's required return. The Terwiels have stipulated that their required return is 10%. Analysis of the EVA for Terwiel Holdings indicates that the business added value every year between 2001 and 2004. The following table illustrates the amounts by which the business created value:

Table 9: Economic Value Added

	2001	2002	2003	2004
EVA	\$11,569	\$40,654	\$38,260	\$2,211

Source: Terwiel Holdings Financial Statements

WACC and EVA can help to answer three pressing questions the Terwiels have about their business:

1. Should they expand their business?
2. Should they purchase the real estate that they currently lease?
3. Should they sell the stores?

Both expanding the business and purchasing the store space would increase debt, as the Terwiels do not have access to equity to fund either option. Given that the last expansion effort caused EVA to drop for a couple of years, and given that there is risk associated with the retail business in general and resort retail specifically, now does not seem to be the right time to expand or increase debt. A positive trend in EVA over 2005 and 2006, added to the addition of value in 2004, could indicate that expansion might be warranted, however, an assessment of the risk in terms of interest rates and the Terwiel's ability to carry additional debt would have to be carefully undertaken.

The addition of value over the past few years indicates that the Terwiels should not sell their businesses at this time, though the real estate market and business climate at Sun Peaks Resort makes selling a reasonable option. Value was created in 2001, when the business had been operating for three years, was destroyed over 2002 and 2003 during a time of expansion and a compromised business environment, and was created again in 2004. I hope an analysis of 2005 Financial Statements will illuminate the same positive creation of value, and if it does, that will be a strong signal to stay the course for at least another year.

Year-to-year comparisons of value creation (destruction) are very instructive in terms of evaluating past business decisions, allowing an analysis of the wisdom and impact of those decisions. Therefore, EVA analysis is an excellent learning tool for a business manager. It will also help in making future business decisions in terms of evaluating the opportunity cost, risk and impact of various business options.

8 IDENTIFICATION OF STRATEGIC ALTERNATIVES

8.1 Sustainable Competitive Advantage

8.1.1 Assets and Competencies

Terwiel Holdings has a number of assets and competencies that set it apart in the market in which it competes, many of which have been discussed earlier in this paper. The greatest asset is the management team of Anne and George Terwiel, whose diverse skills complement each other and provide for a well-rounded approach to managing the business. The Terwiels choose to compete as differentiators, necessitating the selection of high quality products; the nurturing of a high quality, people-oriented environment where staff, suppliers and customers are the prime area of focus; and the development of effective business procedures that allow staff to perform at their best. As indicated earlier in this paper, the Terwiels have the knowledge and skill to do all of this effectively. The main competitor, Sun Peaks Resort Corporation, has proven to be efficient in selling high volume at low cost. Because of the size of their staff and the breadth of products they carry, the corporate stores cannot nurture and train their staff in the same way that the Terwiels can. The smaller competitors have not developed their skills around staff training and retention, and new entrants would take a considerable amount of time to develop their staff to the same level as the staff of Terwiel Holdings, so this competitive advantage is sustainable for the Terwiels. Adding to this sustainability is the fact that Anne Terwiel is involved in teaching and research around the development of human

resources, so remains on the cutting edge of theory and practice as it is developed in this area.

Another competitive advantage possessed by Terwiel Holdings is the selection of artists and artisans who supply their stores. The Terwiels have chosen the best local artists and artisans and have developed excellent business relationships with them. It would be difficult for a new entrant to find a critical mass of high quality local artists to stock their store as the Terwiels have cornered the supply side of this market. While many wonderful artists exist in the province and elsewhere, high quality artists producing work reflective of Sun Peaks Resort and the North Thompson area of the province, the type of work that sells very well at the resort, are few and far between. Therefore, this advantage is sustainable, as long as the Terwiels continue to seek out new and developing artists working in the area.

The location of the stores of Terwiel Holdings in the core of the village is a definite advantage. Due to topography and land use agreements the resort base lands are constrained to developing in an eastward direction only. The village day lodge, lift ticket sales and the base of the two busiest lifts are located to the west of the Terwiel's stores. The village ski way (winter) and walkway (summer) is located directly in front of the stores, so everyone staying to the east must pass the Terwiel's stores on their way to the main collection area of the mountain. The stores sit on opposite sides of the village square where concerts and activities take place winter and summer. No matter which direction they approach the square, visitors must pass by one of the Terwiel's stores. Finally, the stores occupy space in established, high-quality hotel properties. Tree Line Studios is in the most prestigious hotel in the resort, and there will not be another hotel of

its size or quality built, as per the established development plan. As such, this advantage is sustainable.

Finally, the Terwiels have developed shops that service the entire spectrum of the retail art and gift market at Sun Peaks Resort. Sun Peaks Resort Corporation does not have an interest in serving the high-end gift and art market, and competes on price alone in the lower end of the market. Smaller competitors compete for one aspect of the middle range of the market (jewellery, chocolates, etc.) but do not offer a range of products. It would be difficult for a new entrant to develop the market range that the Terwiels have been able to develop over their 8 years of operation.

Aaker (2001) identifies the top 32 sustainable competitive advantages (SCAs) of 248 businesses studied. Of the top 10 SCAs identified, Terwiel Holdings exemplifies the top 4 and 3 others: 1) reputation for quality; 2) customer service and support; 3) a high profile in their location; 4) the ability to retain good management and operational staff; 7) customer orientation; 8) product-line breadth; and 10) installed base of satisfied customers. Two of the top 10 don't apply to Terwiel Holdings' type of business: 5) low cost production; and 9) technical superiority (though computer systems used to track customers, purchases, suppliers and profitability might fall under this heading). The 6th top SCA identified, financial resources, is an area that Terwiel Holdings is lacking and is working hard to develop. Other SCAs identified in the study that Terwiel Holdings most typifies are: 11) segmentation / focus; 12) product characteristics / differentiation; 18) pioneer entrant / first-mover advantage; 19) operations adaptable to customers; 22) shared vision / culture; 23) strategic goals; 25) location; 27) enterprising / entrepreneurial; and 31) good distributor relations.

8.1.2 Capabilities-Based Competition

Aaker (2001) states, “capabilities-based competition suggests that the key building blocks of business strategy are not products and markets but, rather, business processes. Investment in building and managing a process that outperforms competition and can be applied across businesses can lead to a sustainable advantage” (page 141). George Terwiel is working hard to develop processes that can be duplicated by all three stores and that, should a fourth store be in the future, could be applied there as well.

The Terwiels feel that well-developed processes will add value to the stores. Should a sale be necessary, the new owner would have well-developed processes in place that would allow the business to be carried on seamlessly. These processes will become a critical part of any offering for sale, and are part of the Terwiel’s value creation strategy.

9 CONCLUSION

The purpose of this strategic analysis was to determine the future direction of Terwiel Holdings. It was stated that the Terwiels have 5 options:

1. Grow the business by building a new store in the East Village
2. Sell one or two of the current stores
3. Exit the business
4. Enter into a joint venture
5. Stay the course

The foregoing analysis verifies that Terwiel Holdings has a number of sustainable competitive advantages related to key personnel, the competitive environment, the business location and business strategy. Financial improvements are necessary in order to put the business on sound footing for the future, and the Terwiels have begun to make these financial improvements.

The first option, grow the business by building a new store in the East Village, is not a viable option at this time. The Terwiels are still carrying a heavy debt load related to the completion of Tree Line Studios in 2003. They must ensure that their finances in order before considering any future expansion.

The second option, sell one or two of the current stores, could be an option for the Terwiels to entertain. If Terwiel Holdings returns to a tenuous financial position, the cash infusion generated by the sale of one or two of the stores could keep Terwiels Holdings

operating. There are, however, economies of scale and scope that exist in operating the three stores which would be lost or diminished with the sale of one or two stores. There is also a challenge in selling the stores that will be discussed in terms of option three.

The third option, exit the business, may not be a viable option at this time if the Terwiels wish to recover their investment of time and money since 1998. While there are many positive indicators for future performance, the stores are not yet providing income for the Terwiels. They do not own the properties in which the stores are located, and the stores have yet to show a strongly positive net income. That said, the only real value the Terwiels have to market is related to the leasehold improvements, the fixtures and the inventory. The Terwiels would have to locate a buyer similar in character to themselves: someone who is willing to pay for a lifestyle business, who is enthusiastic about having a business at Sun Peaks Resort, and is willing to watch net income and shareholders equity grow slowly over the years. Given the positive trend in many of the financial figures and ratios related to the business, the Terwiels would be wise to spend their energy improving the financial situation of the stores so that there is some real value to offer potential investors.

Option four, take a partner or form a joint venture, suffers from the same problem as the last two options. It would be difficult for the Terwiels to take a partner who would be willing to adequately compensate them for the risk, hard work and time they have put into developing the stores. However, if the Terwiels require an infusion of cash and wish to remain involved in the business, taking a partner might be one way to accomplish that.

The fifth option, stay the course, is the most palatable option at this time. The Terwiels are very happy with the way the stores are progressing and realize that an

inordinate amount of pressure was put upon the business with the addition of Tree Line Studios, pressure that may have slowed the generation of value for Terwiel Holdings. However, the reward in being part of the business community of Sun Peaks, and the education and challenge involved in improving the financial situation of Terwiel Holdings, is non-financial compensation that the Terwiels place a great deal of value in.

As a result of this analysis, the recommendation is that Terwiel Holdings continue to operate Willow Tree Gifts, Lone Wolf Gallery and Tree Line Studios as they have, making the necessary improvements to information management and financial management discussed earlier in this paper. The Terwiels need to set the businesses up so that, should they opt to sell or take a partner in the future, there is obvious value in the businesses, which will allow for a measure of financial compensation commensurate with the work that has been put in to developing the stores. A thorough analysis of the performance of each business on its own must be undertaken on an annual basis, looking again at the 5 options presented and determining if the businesses are still on the right track. Finally, at all times, the Terwiels must adopt a strategic view of the operation of the business, ensuring that they continue to play to their strong areas of sustainable competitive advantages, develop further areas of strength, and improve on identified areas of weakness.

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