

CHAPTER 1

INTRODUCTION

The Business Policy Game was designed as a strategic management simulation to provide a challenging, complex decision-making exercise. As a strategic management simulation, it requires participants to define and articulate their corporate missions, set objectives, develop strategies to realize the objectives and create operating policies to ensure that operating decisions support the strategy. Participants are also responsible for making quarterly operating decisions for each of the functional areas of finance, marketing and production and to integrate those decisions for the purpose of meeting the firm's overall goals and aspirations. Participation in the simulation requires that a student of business administration review information and techniques that have been learned in other courses and/or in practical on-the-job experience, and put into practice many of the principles of management decision making and strategic planning. To be successful, participants need to adopt the viewpoint of top management in the simulated business firm which they operate. They must specify carefully the goals and objectives which guide their firm's operation. The participants are required to make quarterly decisions concerning the operations of their manufacturing firm as they compete with the management teams of other firms in the industry.

The Business Policy Game is not intended to duplicate any actual industry. Rather, the simulation model was designed to include general relationships that might exist in any competitive industry. One might say it is generic. Participants need to utilize their knowledge and experience in order to make certain deductions about the economy in which they are operating and about general relationships which exist within the simulation. These deductions must be combined with knowledge about specific relationships and with the participants' beliefs about the actions that competitors are likely to take. A set of decisions ideally would follow from utilizing a combination of different types of data analysis, forecasting techniques and development of strategies and policies to meet the goals and objectives of the firm. (See Figure 1-1.)

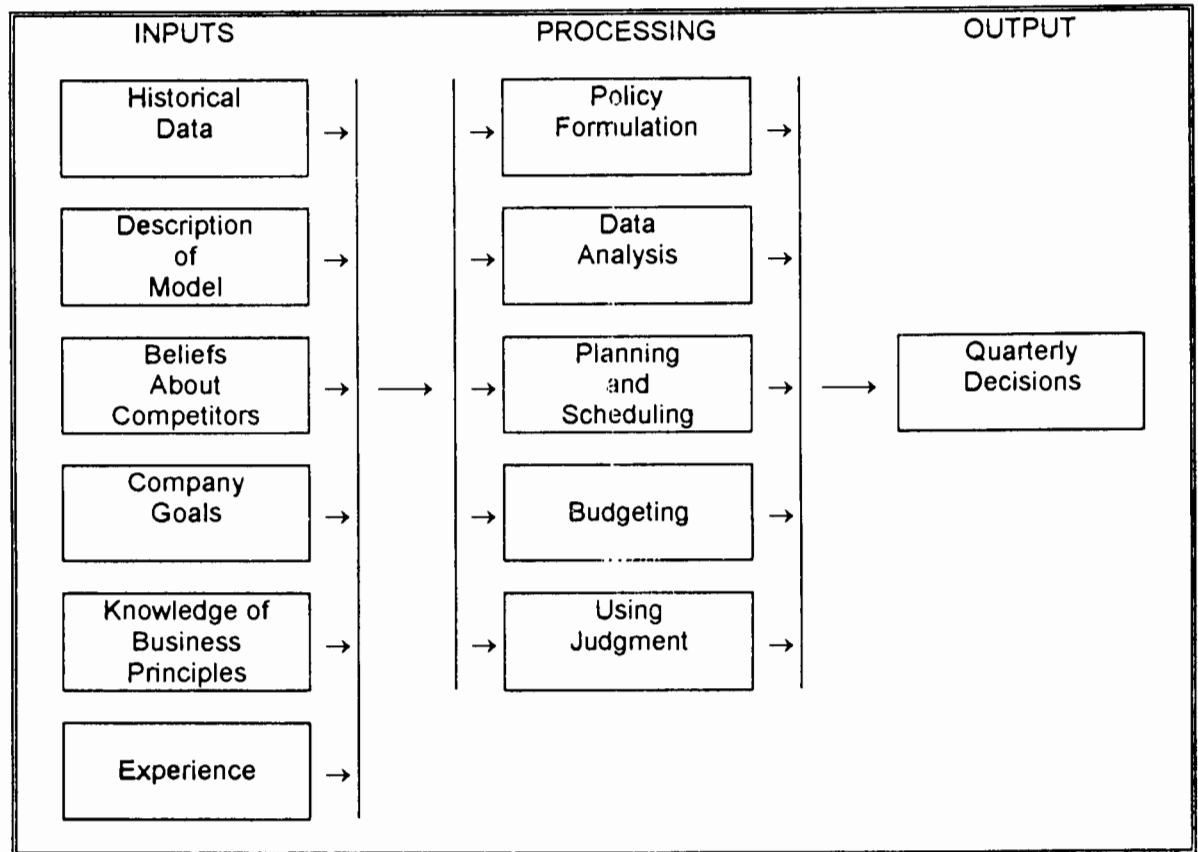


FIGURE 1-1
Flow Chart of Activities in Preparation for
Making Decisions in *The Business Policy Game*

The Simulated Environment

You will be a member of the management team of a simulated manufacturing company. Your company's corporate headquarters is located in one of three domestic market areas. Three subsidiaries handle operations in the other two domestic areas and in Sereno, a simulated country in Latin America. Each of the two countries has a different economic environment reflected in differing growth rates of gross domestic product (GDP). Different inflation rates are reflected in separate consumer price indexes (CPI). A different social and legal environment results in different demand characteristics for your product, different tax structures and different employment practices.

The computer program used to process the decisions made by competing teams includes definitions of certain relationships that have been abstracted from the economic environment of the business world. This abstraction, or model, does not purport to include all of the relationships that exist. To do so would make the simulation too complex to handle. The relationships included are those that contribute significantly to the degree of realism required to provide a plau-

sible simulation. These relationships are outlined and described in subsequent sections of this manual. A description of the rules which must be followed in order to participate successfully in the simulation also is included.

Some of the relationships that exist in the simulation and the rules for dealing with the relationships will be described only in general terms. These relationships are comparable to those in the business world that are subject to uncertainty and thus not completely specified. For example, if a manufacturer lowers the price of a product, sales of the product normally increase. The magnitude of the sales increase cannot be known with certainty. Thus, only the general relationship between price and sales volume will be described in this manual. The actual effect of a specific price change must be estimated by observing the relationship between price and sales volume which exists in historical data and by experimentation with the price variable during the course of the simulation.

Other relationships will be described in more precise terms in later chapters. These relationships are subject to less uncertainty in the business world. Cost functions, accounting relationships and methods of deriving various entries in the income statement, cash flow statement and balance sheet are included in this group. The cash balance at the end of the quarter, for example, is equal to the previous quarter's cash balance plus total cash receipts less total cash payments. Explicit descriptions concerning the constraints required by the simulation model also are provided, which the participants may consider to be "rules of the simulation." One such rule, for example, states that only one plant may be built in any marketing area.

During the course of the simulation, the participants will encounter a variety of business and economic situations and administrative problems. In order to cope successfully with these problems, the participants will find it necessary to engage in economic forecasting, sales forecasting and profit planning. Cash flow analysis and capital budgets must be prepared. Production planning and scheduling must be accomplished. Cost analysis, pricing, policy formulation and the development and implementation of marketing programs will be necessary. In addition, participants must prepare and analyze financial reports, cash flow statements, cost and sales analyses reports and informational reports regarding competitors and the economic situation. Most participants will find it necessary to review basic textbooks and materials from this and other courses, and to draw from their past experiences in order to complete these activities effectively.

Preparing for Action

The Business Policy Game will require a heavy investment in time on the part of the participant—TANSTAAFL. (There ain't no such thing as a free lunch.) This investment should be a prudent one, however, as participation in the simulation should significantly increase overall understanding of the operation of business enterprises. The more you put into the exercise, the more you will get out of it.

In order to participate effectively in the simulation, one must understand the relationships within the simulation model as well as its rules and constraints. Sample historical data from the

previous two years of the firm's operation, prior to your management team's tenure, are shown in Appendix C.

These data also are found in Historical Data for Years 1 and 2 (Report J) of your firm's reports for Year 2, Quarter 4, which will be provided to you by your game administrator. The historical data in your Year 2, Quarter 4 reports will differ from that in Appendix C if your game administrator is using a different economic environment.

Study the data thoroughly for relationships which will help the firm in managing its resources. Economic forecasts and sales forecasts must be made, and plans must be formulated for the firm's continued operation. It should be obvious that these tasks require the delegation of specific responsibilities to different team members. Thus, members of each firm should organize to perform the management function effectively.

Getting Ready for the First Decision

Before preparing the first set of decisions and after carefully reading this manual, you and your colleagues are urged to complete the following set of activities and planning reports:

1. Organize your management team. You should assign members of your team to corporate offices and other critical posts, decide upon specific decision-making procedures to be followed, and divide the work load among the various members of your firm. Unless the simulation administrator prescribes an organizational structure, you may design the organization of your management team. Your organizational structure and your ability to work together as a management team will be important ingredients in the success of your firm.

You should weigh the advantages and disadvantages of various organizational structures when designing your organization. Company officers for a functional organization might include president; vice-presidents of finance, marketing and production; vice-president for economic and sales forecasting; and corporate secretary for recording policies and decisions. A geographical structure might replace the functional heads with subsidiary managers for each of the market areas.

Some teams find centralized decision making to work well. Various company officers will normally make recommendations to the president regarding the operations of their particular departments. However, the final decision-making authority rests with the president. Other teams prefer to vest their decision-making authority in the management team as a group. Recommendations are provided by the various officers of the firm, but the actual decisions are made by the officers as a group. Still other teams find a decentralized form of organization to be effective. Final decision-making authority is vested with the head of the unit responsible for the decision. Under a decentralized functional organization, the marketing decisions would be made by the vice-president of marketing, production scheduling decisions by the vice-president of operations, etc. Alternatively, decisions for each market area would be made by the general manager of the

subsidiary in the area. Coordination of overall decision making would be undertaken by the president, and conflicts would be resolved by the president of the firm.

You should prepare an organization chart that shows the lines of authority in your firm's organization and the position in the organization of each member of your firm. Then, fill in the Corporate Charter, located on page iii in the front of this manual, with your company name and the name and position title of each member of your team. The Corporate Charter should be turned in to your simulation administrator.

2. Prepare a forecast of expected levels of economic activity by country. Your firm's sales will be affected by the general level of economic activity in each country in your industry world. As real gross domestic product (GDP) rises, you can expect sales to rise, too, and as real GDP falls, sales are likely to fall at the same time. GDP forecasts for each country are included in your quarterly reports. A forecast of real GDP will be helpful in estimating future sales. Specific suggestions for preparing such a forecast are contained in Chapter 6.

3. Prepare a sales forecast by market area. Production scheduling, plans for investment in new plant(s) and in equipment, expected cash receipts and selling expenses all are affected by the volume of sales your firm realizes. Suggestions for preparing sales forecasts by market area using the Sales Forecast Work Sheet can be found in the "Forecasting Sales" section of Chapter 6.

4. Prepare a production schedule. Production must be scheduled for the first decision period as well as planned for subsequent quarters of business operation. Production planning will depend upon your firm's expectations of sales volume. The completed plan will provide the basis for determining production facility requirements. Suggestions for preparing production plans using the Production Plan Work Sheet, together with descriptions of production costs and production possibilities, are found in the "Operations Planning and Scheduling" section of Chapter 7.

5. Prepare an investment plan. Alternative methods of expanding productive capacity and their associated costs may be analyzed using numerous financial tools. See Chapter 8 for a description of the alternatives. The nature of the expansion that your firm undertakes will depend upon your production plan.

6. Prepare a capital budget. Capital is required to finance any planned expansion. The Capital Budget Work Sheet, discussed in the "Capital Budgeting" section of Chapter 9, may be used to analyze alternate sources of funding for your firm.

7. Prepare a cash budget. Sufficient funds must be provided to finance the expenses and cash outlays required by your operations and investment plans. Sources of funds and cash requirements are outlined in Chapter 9. Suggestions for preparing the Pro Forma Cash Flow Work Sheet also are included under the "Cash Budgeting and the Cash Flow Statement" section of Chapter 10.

8. Prepare *pro forma* financial statements. Your projected balance sheet may be used to analyze how the composition and levels of assets and liabilities affect your financial condition.

Your expected level of profitability is an important means of judging the success of your firm's planned operation. You should evaluate your decisions prior to submitting them by preparing a *pro forma* income statement and balance sheet. Income Statement and Balance Sheet work sheets, along with suggestions for their preparation, are found in the "Profit Planning and the Income Statement" and "The Balance Sheet" sections of Chapter 10.

9. Formulate mission and objectives and outline initial strategies and policies. As you complete the planning activities outlined above, tentative policies should be developed for the operation of your firm and for the decisions which must be made on a quarterly basis. We suggest that you state these policies explicitly in written form for future reference. As the simulation proceeds, you probably will decide to revise your policies based upon the experience gained from the operation of your firm and the changing conditions of the dynamic business environment.

We recommend that your firm be very specific in the formulation of mission, objectives, strategy and operating policies. A corporate objective to "maximize profits" is laudable but provides little guidance for strategy and policy formulation and is of little value as a standard for achievement. At the end of the first year of the simulation, or any other year for that matter, you will have little idea whether profits were in fact maximized or whether you fell short. It would be better to seek an objective of, say, "15 percent after-tax return on equity." Then you could judge your achievement more adequately after a year's experience and take corrective action where necessary.

You may view many of your operating policies as decision rules to be followed in specific situations. An example of a specific policy might be: "Ignore price reductions by competitors when they amount to less than ten cents per unit, but when the reductions are greater, match their price immediately." Avoid such generalizations as "charge a fair price that is consistent with production costs and with competitors' pricing policies." That's pure cotton. The clear formulation and statement of your policies will help to assure the consistency and stability of your firm's operations and will save you a considerable amount of preparation time during the decision periods as you participate in the simulation. See Chapter 4 for additional help in the development of mission and objectives and the formulation of strategies and policies.

The simulation administrator may require written reports on some or all of the above activities as part of the material used to evaluate team performance. Work sheets, contained in Appendix D, can be used to facilitate the preparation of some of the reports. It is suggested that a most effective way to present the work sheets is to develop a decision-support system. The work sheets in spreadsheet template format are available on the disk enclosed with this manual. When we refer to work sheets, we are referring to the paper forms in this manual. When we refer to spreadsheets, we are referring to the spreadsheet templates of the paper work sheets. A decision-support system can be developed relatively easily by using these spreadsheet templates.

Your initial reports will provide a good basis for a more extensive strategic business plan and policy manual that the administrator may require after you have gained some experience with the simulation.

Submitting Decisions

The next step is to formulate and submit an actual decision set for the first period of your firm's operation under new management, Year 3, Quarter 1. The simulation administrator will specify the **date** and **time** when your decisions are due. It is important that your firm's decisions be submitted prior to that time. Failure to do so may hold up the simulation run. More likely it will result in the decision submitted for your firm during the previous period being used as the decision for the current period. Such action normally would not be in the best interests of your firm. Chapter 2 outlines the decisions that must be made and describes the decision form. Copies of the decision form are included in Appendix D.

We hope that the experience of participating in *The Business Policy Game* will be both enjoyable and rewarding. More importantly, though, it should be a meaningful and challenging educational experience. The amount of serious effort that you put into the analysis, planning, and decision-making activities of the simulation will determine how much the simulation will contribute to your education. Remember TANSTAAFL!