CHAPTER 4

DEVELOPING THE STRATEGIC PLAN AND SELECTING STANDARDS OF SUCCESS

Your simulated firm may be viewed as a single business corporation or as a strategic business unit (SBU) of a diversified corporation. In either case, you are calling the shots without interference from above. Your responsibility is to stake out the direction the firm will take in terms of its mission, develop realistic goals and objectives, create a strategy which will enable your firm to attain its stated goals and successfully implement its strategy. Your reward could be mega-salaries and a golden parachute.

Mission

The firm's mission serves as the crystal ball for the organization. It describes the business of the firm and the type of business it is aspiring to become. The mission deals with the scope of activities performed and the purpose of the activities. The mission statement may focus upon products and/or services being provided, major ingredients in a line of products, central technology of an organization, customer groups served, customer needs, etc. (Thompson and Strickland, 1992). Be sure to leave your rose-colored glasses home when you develop the mission statement. This one requires some realistic thought.

Defining Goals and Objectives

The manner in which the performance of your simulated firm is evaluated will depend, in part, upon your ability to meet the goals and objectives that your firm has set. We recommend that your firm explicitly develop a written set of goals upon which your management can agree very early in the simulation. The simulation administrator may require your firm to submit a

written document defining your goals and objectives, along with the strategies and policies which you have formulated to achieve these goals and objectives.

Many students, and business managers as well, tend to define their goals and objectives in very general terms. For example, an objective might be "to make a satisfactory profit on a minimum investment in physical and financial assets." While this may sound fine on the surface, a closer examination reveals that this statement really doesn't provide very much guidance for the operation and evaluation of your company.

Explicit Definition

Strategic goals and objectives should set the hurdles for your firm to jump when pursuing its mission. They provide the specific level of accomplishment desired. If you don't know the exact height of the hurdle, how high should you jump? Imagine the glory and fame obtained from jumping five feet to clear a one-foot hurdle, or consider the possibility of jumping three feet to clear a ten-foot brick wall.

We think of goals as desired long-term performance levels and objectives as short-term performance targets. Both goals and objectives state **what** is to be achieved and **when** it is to be accomplished (Quinn, 1980). Your strategic goals and objectives should contain the following four components (Hofer and Schendel, 1978):

"1. the goal or attribute sought

2. an index for measuring progress toward the goal or attribute

3. a target or hurdle to be achieved

4. a time frame within which the target or hurdle is to be achieved."

We urge your firm to provide explicit definitions of your goals and objectives. An explicit definition can be made either in absolute or in relative terms. Examples of absolute definitions include:

1. Maintain a rate of return on stockholders' end-of-Year 2 investment in your company's stock (goal) of at least 20 (hurdle) percent (index) through Year 7 (time).

2. Maintain a growth rate for assets (goal) of at least 5 (hurdle) percent (index) each year (time).

3. Generate sufficient sales to maintain a share of the market (goal) equal to at least 30 (hurdle) percent (index) by year five (time).

Examples of comparative statements of objectives (relative to competitors) include:

1. Attain a larger (hurdle) share (implicit index) of the market (goal) than any of our competitors by Year 5(time).

2. Maintain a net return on the book value of owners' investment (goal) at least equal (hurdle) to the median return (index) of the industry through Year 7 (time).

Your firm's objectives and goals may be defined in terms of some of the quantitative measures that have been described or in some other terms that your management may prefer. They should, however, be related to the variables that actually are included in the simulation model. Realizing a company objective of "maintaining high morale," while a noble objective, could only be partially inferred from reported results by examining, perhaps, the turnover rate in salespeople. Your firm does not actually have overt control over most working conditions which affect employee morale.

After goals and objectives have been set for your business, goals and objectives need to be set also for the functional areas of your firm. The goals set for the finance, marketing and production functions must reinforce and be consistent with the goals set for the business. Similarly, the functional-area objectives should lead toward the realization of the functional-area goals.

Your goals and objectives should appear reasonable, and their realization should be possible in light of the historical data available to you. It is possible that your firm may wish to revise its hurdles after you have gained several quarters of experience with the simulation. However, give your goals some time to work before you give up on them. Changing goals every quarter will lead you in circles, and you run the risk of becoming the last of the big wheels with no destination!

Formulating Strategies

Once your objectives and goals have been defined, it is important to formulate strategies for attaining those objectives. Operating without a clear strategy is like driving in an unfamiliar state without a road map. Both are only recommended for the extremely faithful. A strategy is a plan for utilizing the firm's resources to attain your stated goals. Your firm's strategy should be set forth explicitly so that it will provide guidance for day-to-day operations by your management team and its subordinates. One test of the clarity of your strategy is to ask yourself how another management team would operate your firm if the other team was provided with only your firm's written statement of its goals, objectives, strategies and policies. Would they make similar sets of decisions in your absence? If the answer is affirmative, your document probably is acceptable. If not, it's back to the drawing boards.

You may want to think of strategy as (Hofer and Schendel, 1978):

the fundamental pattern of present and planned resource deployments and environmental interactions that indicate how the organization will achieve its objectives.

The four components of strategy which follow from this definition are:

1. Scope: products offered and market segments served.

2. Resource deployments: planned use of funds, equipment, materials, personnel, etc.

3. Competitive advantage: unique position created relative to competition by the scope and resource deployment decisions.

4. Synergy: added advantage obtained by the specific combination of resources and/or scope decisions.

As you develop your strategy, include all four components to strengthen your final plan. Interrelationships which might go unnoticed when simply planning for resource utilization become important elements. The resulting strategy should enable your firm to interact successfully with its environment.

There are a number of generic strategies which your firm may follow. The strategies consist of the combinations of the following three dimensions: scope of your market, types of competitive weapons used and segmentation of the market (Chrisman, Hofer and Boulton 1988). The scope can either be narrow (serving one market) or broad (serving more than one market). The competitive weapons consist of price, user benefits and some combination of price and user benefits. User benefits are created through product development, product availability and promotion. The market may either be segmented (using different competitive weapons in different markets) or unsegmented (using the same competitive weapons for all markets).

To develop your firm's strategy, select a generic strategy and then tailor the dimensions to your specific environment. For example, scope will specify the market areas in which you plan to compete. Your competitive weapons consist of price, product model, product quality, advertising and sales force. You may choose to segment your markets or treat all market areas alike.

In addition to general business strategy, your firm needs to develop functional-area strategies in finance, marketing and production. The guiding forces behind functional-area strategies are functional-area goals. Functional-area strategies consist of the plans made by the functional areas to meet the functional goals discussed above. Functional-area strategies taken together determine the success of your firm's overall business strategy.

Setting Policy

Company policies are the internal, working rules of the organization. They are guidelines developed by management to set limits for, or otherwise control, day-to-day tactical decision making and other actions of subordinates. Policies may be used to simplify the decision-making process by eliminating specific alternatives from consideration. For example, if your company has a policy of not introducing a new product until at least two new models are available, no time would be spent debating whether to introduce a new product if only one new model were available.

We again want to caution you against using vague generalities when developing policy. "Maintaining a reasonable price for our product in relation to production costs and competitors' pricing activities" does not provide much guidance for your marketing department as it sets product prices. A more useful policy might be "to maintain a markup of 50 percent over production cost, with the constraint that in no event should the wholesale price exceed that of the highest-priced competitor by more than 5 percent." Other examples of an explicit pricing policy might be "to maintain a markup of 40 percent over production costs plus transportation costs to each market area without regard to competitors' pricing policies," or "to match competitors' prices in each market area without regard to markup over production cost." Hopefully these examples will provide you with a starting point for the development of your firm's specific policies.

Keep in mind that the purpose of developing policies is to enable your firm to meet the objectives which the management team has set for the firm. Policies are tools for management to use in the day to day operation of the firm. Policies should be formulated for each of the decision areas for which your firm will be responsible (described in Chapter 2). As the simulation progresses and your firm obtains additional information concerning conditions in the industry and the activities of competitors, you may wish to revise your existing policies.

Even though your initial policies may be revised during the simulation, they will be valuable in providing guidance and direction to your management team and subordinates as decisions are being made. Policies serve as management's stabilizer. Your firm will discover that establishing clearly defined policies will save much time in the decision-making process. If top management decides to adopt a specific policy when faced with a management issue, the next time the issue arises the decision will simply follow the established policy. Management can spend its time on analysis and the development of new policies rather than rehashing the same issues over and over.

Strategic Plan

The simulation administrator may ask your firm to submit a written strategic plan. The plan may be due prior to the start of the simulation, may be developed during the course of the simulation or may be considered as part of a term project for your firm's management.

In order to complete a strategic plan, your firm must conduct a situation analysis. This consists of a thorough examination of the industry, the competition and your firm. The plan then flows from the findings of the situation analysis. We like to include this analysis as a supporting part of the strategic plan. However, your administrator may decide to include only the actual plan itself. The components of our full strategic plan (including the situation analysis) follow:

I. Situation Analysis

A. Industry

1. stage of life cycle
2. structure: description of important factors which shape the industry
3. driving forces: forces which change the industry structure
4. economics: cost, price and profit relationships
5. key success factors: key requirements for success in the industry
6. problems: current or potential problems facing the industry

B. Competition

1. intra-industry

   a. rivalry among existing competitors
   b. threat of new competitors - existing products & services
   c. threat of competitors in other industries offering substitute products & services
   d. bargaining power of suppliers
   e. bargaining power of customers

2. individual competitor

   a. company 1: position in industry
   b. company 2: position in industry
   c. etc.

3. forecasted changes in competitive conditions

C. Company

1. past performance - significant ratios

2. current conditions

a. external opportunities
b. external threats
c. internal strengths
d. internal weaknesses

3. significant issues and problems which must be faced

II. Strategic Plan

A. Mission statement

B. Business level

1. goals & objectives
2. strategy

C. Functional level

1. finance

a. goals & objectives
b. strategy
c. policies

2. marketing

a. goals & objectives
b. strategy
c. policies

3. production

a. goals & objectives
b. strategy
c. policies

D. Implementation plan and action timetable. Include *pro forma* financial statements showing your expectations of achieving your goals and objectives.

At a minimum, the plan should consist of your mission statement; your business-level goals, objectives and strategy; your functional-area goals, objectives, strategies and policies; and an implementation plan. Each element of the plan should be well thought out and should be integrated with all of the other elements of the plan. The plan serves as your operations map.

Your firm's performance will be judged according to how well your management team competes with the management teams of the other firms in your industry. This evaluation will be based, in part, upon your firm's ability to set and achieve reasonable goals. During the evaluation process, comparisons will be made with other companies in the industry regarding profitability, efficiency and financial standing. Certain ratios and quantitative measures will be received regularly in the computer-generated quarterly reports. These will be described below.

There also is a subjective element to performance evaluation requiring a judgment of the quality of planning and goal-setting activities, the quality of the plans and goals themselves, the faithfulness of the company's management in meeting goals and objectives, and the ability to submit successfully to board or shareholder reviews. Some of these qualitative factors are discussed in the last section of this chapter.

Avoid End Play

At times, teams involved in a simulation exercise such as *The Business Policy Game* are tempted to adopt an unofficial strategy which is referred to as "end play." This strategy calls for the allocation of the firm's resources in such a manner as to build the best relative position among the competitors during the final period of the simulation. This procedure ignores the quarters preceding and following the final quarter of the competition. In fact, the firm often is left in a position from which it would be impossible to continue. As end play involves only the final quarter or two of play, it really does not have much impact upon final team standings given the total number of quarters upon which evaluations are based. Thus, it is basically a fruitless exercise. A word to the wise! As "end play" is unrealistic in the business world, it is frowned upon and likely will result in a penalty during the final evaluation of a firm's performance.

Even though you have been told that the simulation will continue only for a definite number of quarters, you should take the attitude that your firm's operations will continue well beyond that time. Even if you plan to sell your interest in the company when you retire, you are likely to receive the greatest return on your investment if your firm's plans have been laid out in such a manner as to take maximum advantage of the situation existing at the end of the period. If this is done, successors will continue to have a commanding position in the industry and the greatest likelihood of continued, profitable operations. Again, we emphasize that an end-of-play strategy is unwise and is likely to hurt your relative position in the industry as well as downgrade your firm's performance when final evaluations are made.

Profitability

The profits of a business firm usually are considered to be for the benefit of the firm's owners or stockholders. If a firm is profitable, it is reasonable to expect that the wealth of individual stockholders should increase as a result of that profitability. The wealth of a stockholder can be increased in two ways: through appreciation in the market value of stock and/or through

receipt of dividend payments. Realization of a satisfactory growth in stockholders' wealth requires the firm's management to conduct its activities in such a manner that the combination of dividend payments and appreciation of the firm's stock meets the financial requirements of the firm's stockholders.

Rate of Return on Stockholders' Investment (Investor ROI)

Given that the firm stays healthier when stockholders are willing to invest in its stock, one overall goal of your firm ought to focus on providing some level of additional incremental wealth to your stockholders. This especially should be the case if we assume that you and other members of your management team purchased a majority interest in your firm's common stock at the end of Year 2 in order to gain control of its management. Obviously, then, dividend payments and stock price appreciation would benefit your management team as stockholders in your firm. Dividends and appreciation can be considered as incremental returns on your initial investment at the end of Year 2. One way to compare the incremental return on your stock investment with those of stockholders in other competing firms is to compute and compare the rate of stockholder return on initial investment. You may wish to set a goal of a minimum rate of return on your stock investment or to attempt, at least, to realize a rate of return for your stockholders as great or greater than stockholders of competing firms may realize.

This rate of return may be considered as an overall measure of profitability to your stockholders on their initial investment. In addition, it should be noted that the ability of a firm to pay regular dividends and maintain an increasing stock price is dependent upon its ability to show regular earnings. Potential stock purchasers in *The Business Policy Game*, as in the business world, will put a premium on earnings growth and thus will tend to bid up the market price for a fast-growing company's common stock.

The rate of return on stockholders' initial investment will be computed at the end of each quarter and will be reported as Investor ROI in the Quarterly Industry Report. Investor ROI assumes a purchase of common stock at the end of Year 2, Quarter 4, and shows the time-adjusted return (stock price appreciation plus dividends) to the end of the quarter of the report. The computation is made by solving the following equation for r, the time-adjusted rate of return:

$$P_8 = \frac{P_n}{(1+r)^{(n-8)}} + \sum_{t=9}^{n} \frac{D_t}{(1+r)^{(t-8)}}$$

where D_t is equal to the dollar amount of dividends paid in quarter t, P_n is equal to the price of your company's common stock at the end of the most recent quarter, n. P_8 is the price at the end of Year 2 (the eighth quarter of historical data) when you began the simulation. The rate, r, is that discount rate that equates the discounted value of dividends and current stock price (discounted quarterly) to the initial stock price. The rate then is annualized by multiplying it by 4 and reported as Investor ROI. The relevant period for the calculations begins in Quarter 9 (Year 3, Quarter 1) when you take over the management of your firm.

Other Ratios

While the rate of return on stockholders' investment provides an overall measure of profitability, it is by no means the only one. Profitability can be considered in relation to the historical, or book value, of the owners' investment in a business or in relation to the dollar value of sales that the business has made in a given period of time. These profitability ratios will be reported quarterly in the industry reports.

The net profit margin on sales (Income to Sales) shows the percentage of profit from each sales dollar. The return on equity (Income to Equity) reflects the percentage return on funds invested by stockholders and earnings retained in the business. Quarterly income and sales are used for ratios in Quarterly Industry Reports. The ratios are restated using annual income and sales for the Annual Industry Report.

Other ratios are reported regularly. These reflect such things as efficiency of asset use, efficiency of operations and soundness of financial condition. See the Quarterly Industry Report in Appendix C for examples.

Ratio analysis can be a useful way to compare a firm's performance with some standard. Standards of performance that may be used include absolute norms, criteria reflecting the performance of other firms in the same industry, or standards derived from the historical performance of the firm for which the ratios are computed. Some analysts use rule-of-thumb standards with which to compare ratios of different companies. For purposes of *The Business Policy Game*, however, it probably will be more useful to you (and to those who will judge your firm's achievement) to compare your company's performance with your own historical record and with the performance of other companies in your industry. Your ability to increase your firm's rate of return on invested capital, for example, and to increase it more rapidly than that of the other companies in your industry will reflect favorably upon the quality of your management.

Financial Standing

permanente

Three different credit ratings are possible for firms competing in *The Business Policy Game*: superior (Number 1), preferred (Number 2) and average (Number 3). Credit ratings are reported in the Quarterly Industry Report. Each firm starts the simulation with a preferred credit rating (Number 2). During the course of the competition, this rating may be improved to a superior rating or reduced to an average rating according to the way the firm handles its financial affairs. The credit rating is a composite figure that reflects demonstrated ability to meet a company's financial obligations and the likelihood of continuing to meet those obligations in the future. Interest rates on bank loans and new bond issues, as well as the selling price of new common stock issues, are determined, in part, by a firm's credit standing.

In *The Business Policy Game*, credit analysts normally recompute and assign new credit ratings only once each year, at the end of the fourth quarter. A shortage of cash which necessi-

tates emergency borrowing, however, usually will result in the immediate reduction of a firm's rating during the quarter in which the emergency borrowing occurs.

Factors Affecting Credit Ratings

Many factors normally are considered by a credit analyst in judging the financial standing of a business firm. Among those that will be used to determine your firm's credit rating are the demonstrated ability to:

1. Meet repayment obligations on bank loans and other commitments, and avoid emergency borrowing.

2. Show significant growth of total resources as reflected in the value of total assets.

3. Increase the market acceptance of your product as shown by an increasing share of the market.

4. Show a reasonable return on the book value of owners' investment in the firm (Income to Equity).

5. Pay a reasonable proportion of profits to stockholders in the form of dividends. *The Business Policy Game* stockholders expect to receive a growing stream of dividends amounting to between 30 and 60 percent of earnings.

6. Maintain a capital structure that shows a reasonable relationship between borrowing and net worth (Bonds to Equity).

7. Generate sufficient profits so that there will be a comfortable margin over and above the bond interest requirements (Interest Coverage).

The Business Policy Game analysts will consider your performance on these measures over an extended period, rather than just looking at a single quarter's performance. As in the business world, the management of your simulated firm will have no direct control over the determination of its credit rating. You may, however, influence the analysts' decision by control of the various items shown above. The precise way that these various factors actually influence the determination of credit ratings in the simulation will have to be determined by experimentation and observation.

Qualitative Standards

Successful performance in the various quantitative measures that commonly are considered as reasonable standards for business success is important, but by no means the only way in which success can be measured. In addition, your management team probably will be judged on the way in which you are able to accomplish your goals and the manner in which you may have

reached the level of performance shown by the quantitative measures. These latter judgments are more qualitative and subjective in nature.

At the beginning of this chapter it was suggested that you should prepare a written statement of your strategic business plan. The quality of these statements is important, and the way in which you utilize your knowledge and understanding of management theory and are able to integrate your knowledge of the functional areas of business will contribute to development of superior reports. You likely will be judged on the quality of the reports themselves, including how realistic your goals and objectives may be in the light of the economic environment in which you are operating. In addition, you may be judged on your success in actually realizing the goals that you have set for yourself.

How well has your management group done in developing an effective organization and in working together as a team? This is a question that must be asked after you have completed the simulation and one that should be addressed by your group from the beginning. In a very real sense, your ability to work together effectively will tend to determine how well you are able to accomplish your goals and how you are likely to stand in relation to the quantitative measures of success. There can be a real synergistic effect when several individuals can become a community working together toward common goals.

An overall strategy for your firm is important and your ability to integrate strategies for marketing, production and finance is a hallmark of success. But also you need to ask these questions, because those who judge your success will almost surely ask them:

1. "Is your marketing strategy effective and well-implemented?"

2. "Are your production plans and strategies effective and well-implemented?"

3. Is your financial strategy effective and well-managed?"

Finally, appearances are critically important to those who look at your work and are likely to be judging your performance. This applies in business organizations as well as to almost any form of interpersonal or inter-organizational relationship. The style and professionalism of your reports will have a marked impact on the way in which you will be judged. The poise and professionalism of your team members as they relate to others are important. Team members need to be able to relate professionally to each other, to members of other teams (your competitors), to the simulation administrator and to others who may be judging your performance. Your written and oral communications with each other, and with those outside of your management team, will be used to form the bases of many kinds of judgments about you and how well you have done.

References

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