

## **CAPSTONE® BROAD DIFFERENTIATION**

This practice exercise will help you understand the relationships between business strategy, tactics, functional alignment, and the Capstone® simulation. We will use the Digby team for this example. (During the practice rounds, each company is assigned a different strategy.)

You will execute your plan by inputting the decisions described below. At the same time, your competitors will execute their assigned plans. The practice exercise will take three rounds. As each round is processed, you will evaluate the results and then input the next round's assigned decisions.

Upon completion of the practice rounds, the simulation will be reset to the beginning. You can then create and implement your own strategic plan for the actual competition.

### **Executive Summary**

The Digby team will adopt a Broad Differentiation strategy, maintaining a presence in every segment. We will gain a competitive advantage by distinguishing our products with an excellent design, high awareness, and easy accessibility. We will develop an R&D competency that keeps our designs fresh and exciting. Our products will keep pace with the market, offering improved size and performance. We will price above average. We will expand capacity as we generate higher demand.

### **Vision Statement**

Premium products for the industry: Digby brands withstand the tests of time. Our primary stakeholders are customers, stockholders, management, and employees.

### **Research And Development (R & D)**

We will keep our existing product line, maintaining a presence in every segment. Our goal is to offer customers products that match their ideal criteria for positioning, age, and reliability.

### **Marketing**

We will spend aggressively in promotion and sales in all segments. We want every customer to know about our superb designs, and we want to make our products easy for customers to find. We will price at a premium.

### **Production**

We will grow capacity to meet the demand that we generate, avoiding a second shift when possible. After our products are well positioned, we will investigate moderate increases in automation levels to improve margins, but never at the expense of our ability to reposition products and keep up with segments as they move across the perceptual map.

### **Finance**

We will finance our investments primarily through stock issues and retained earnings, supplementing with bond offerings on an as needed basis. When our cash position allows, we will establish a dividend policy and begin to retire stock. We are somewhat adverse to debt, and prefer to avoid interest payments. We expect to keep assets/equity (Leverage) between 1.5 and 2.0.

### **PRACTICE ROUND 1**

Follow the decisions below. After the practice rounds are complete and the competition rounds begin, you are free to choose a different strategy; you are not obligated to continue as a Broad Differentiator.

#### **R & D Round 1**

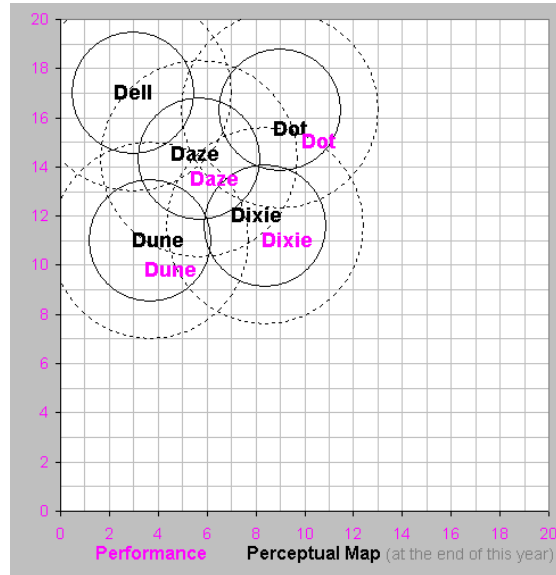
Daze – Improve positioning and reduce age. Hold reliability (MTBF) steady. Example: Increase Daze's performance by 0.8 and reduce size by 1.0.

Dell – Leave positioning alone, allowing the product to age further. Hold reliability (MTBF) steady. Example: No change required.

Dixie – Improve positioning and reduce age. Hold reliability (MTBF) steady. Example: Increase Dixie’s performance by 1.2 and reduce Size by 1.0.

Dot – Improve positioning and reduce age. Improve reliability (MTBF) to enhance demand. Example: Increase Dot’s performance by 1.2, reduce size by 0.5 and increase MTBF by 1000 hours.

Dune – Improve positioning and reduce age. Hold reliability (MTBF) steady. Example: Increase Dune’s performance by 0.5 and reduce size by 1.2.



Perceptual Map from the Research & Development Spreadsheet: Product names in black indicate the product’s current location, names in magenta indicate the product’s revised position (with slight revisions, the names will overlap). Names of newly invented products appear in magenta.

**Important:** Make certain that the projects complete during this year before December 31st. Under the rules, a new project can only begin on January 1st. If these projects do not complete before the end of this year, you cannot begin follow-up projects next year.

**Marketing Round 1**

Daze – Increase price, promotion budget, and sales budget. Forecast unit sales near last year’s level because our product will not be revised until late this year. Example: Price \$29.00, promotion budget \$2000, sales budget \$2000, and sales forecast 1100.

Dell – Increase price, promotion budget, and sales budget. Forecast decreased unit sales due to the price increase. Example: Price \$24.00, promotion budget \$2000, sales budget \$2000, and sales forecast 1400.

Dixie – Increase price, promotion budget and sales budget. Forecast unit sales near last year’s level. Example: Price \$39.50, promotion budget \$1800, sales budget \$1800, sales forecast 400.

Dot – Increase price, promotion budget and sales budget. Forecast unit sales near last year’s level. Example: Price \$34.50, promotion budget \$1700, sales budget \$1700, sales forecast 450.

Dune – Increase price, promotion budget and sales budget. Forecast unit sales near last year’s level. Example: Price \$34.50, promotion budget \$1800, sales budget \$1800, sales forecast 380.

**Production Round 1**

Production schedules will plan for eight weeks of inventory. That is, have enough inventory on hand to meet demand eight weeks beyond the sales forecast. This requires a 15% inventory cushion ( $8/52 = 0.15$ ). For example, suppose Marketing forecasts demand at 1000, and you have 100 units in inventory. You want  $1000 \times 115\% = 1150$  available for sale. Since you have 100 on hand, you would schedule 1050 for production.

If you cannot meet demand, sales go to competitors. Therefore, you want to plan for the upside as well as the downside. Your proforma balance sheet will forecast about eight weeks of inventory. You hope that your actual sales will fall between your sales forecast and the number of units available for sale.

For each product, schedule production using the formula:

$(\text{Unit Sales Forecast} \times 1.15) - \text{Inventory On Hand}$ .

Make no improvements to capacity or automation at this time.

### **Finance Round 1**

Your fiscal policies should maintain adequate working capital reserves to avoid a liquidity crisis. Working capital can be thought of as the money that you need to operate day-to-day. In Capstone® working capital is current assets (cash + accounts receivable + inventory) - current liabilities (accounts payable + current debt). If you run out of cash because your sales are unexpectedly weak, an Emergency Loan will be issued.

Here are some guidelines to help you avoid an Emergency Loan. Your proforma balance sheet predicts your financial condition at the end of this year. Make conservative sales forecasts. Do not rely on the computer prediction. Override it with a forecast of your own. If you are conservative, it is unlikely that your worst expectations will be exceeded. Next, build additional inventory beyond your conservative expectations. This forces your proforma balance sheet to predict a future where your sales forecast comes true and you are left with inventory. (If you sell the inventory, that's wonderful.) On the Finance spreadsheet, issue stock, bonds or current debt until the December 31 Cash Position for the upcoming year equals at least five percent of your assets, as displayed on the proforma balance sheet. This creates an additional reserve for those times when your worst expectations are exceeded and disaster strikes.

As you gain experience with managing your working capital, you will observe that the guidelines above make you somewhat "liquid," and you may wish to tighten your policy by reducing cash and inventory projections. That is fine. The better your marketing forecasts, the less working capital you will require.

Pay a dividend between \$0.50 and \$1.00.

Do not issue current debt. If you are short of cash issue stock.

Save decisions (select "directly to the website").

### **PRACTICE ROUND 2**

#### **R & D Round 2**

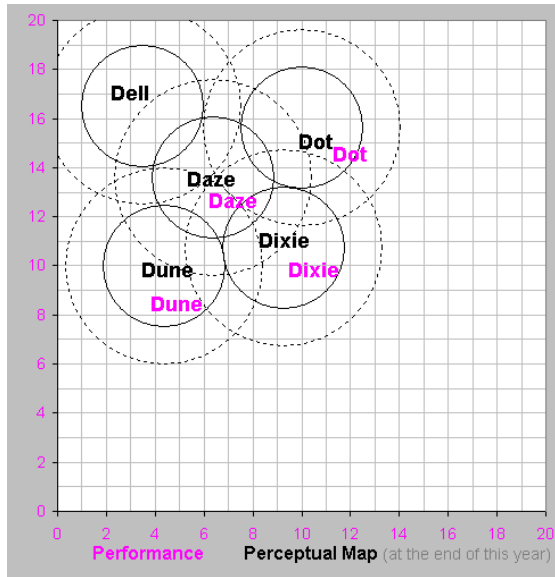
Daze – Improve positioning and reduce age. Hold reliability (MTBF) steady. Example: Increase Daze's performance by 0.9 and reduce size by 0.9.

Dell – Leave positioning alone, allowing the product to age further. Hold reliability (MTBF) steady. Example: No change required.

Dixie – Improve positioning and reduce age. Hold reliability (MTBF) steady. Example: Increase Dixie's performance by 1.2 and reduce size by 1.2.

Dot – Improve positioning and reduce age. Improve reliability (MTBF) to enhance demand. Example: Increase Dot's performance by 1.4, reduce size by 0.5, and increase MTBF by 1000 hours.

Dune – Improve positioning and reduce age. Hold reliability (MTBF) steady. Example: Increase Dune's performance by 0.4 and reduce size by 1.4.



**Marketing Round 2**

Daze – Hold price high, increase promotion and sales budget. Forecast sales as an improvement from last year. Example: Price \$29.00, promotion budget \$2200, sales budget \$2200, and sales forecast 1500.

Dell – Hold price high, increase promotion and sales budget. Forecast moderate unit sales growth. Example: Price \$23.50, promotion budget \$2200, sales budget \$2200, and sales forecast 1700.

Dixie – Hold price high, increase promotion and sales budget. Forecast unit sales near last year’s level. Example: Price \$39.00, promotion budget \$2000, sales budget \$2000, sales forecast 420.

Dot – Hold price high, increase promotion and sales budget. Forecast improved unit sales. Example: Price \$34.00, promotion budget \$1800, sales budget \$1800, sales forecast 500.

Dune – Hold price high, increase promotion and sales budget. Forecast improved unit sales. Example: Price \$34.00, promotion budget \$1800, sales budget \$1800, sales forecast 450.

**Production Round 2**

For each product, schedule production using the formula:

$$(\text{Unit Sales Forecast} \times 1.15) - \text{Inventory On Hand}$$

Make no improvements to capacity or automation at this time.

**Finance Round 2**

Look at the proforma balance sheet, and add together your cash and inventory accounts. Apply the following rule of thumb. Keep between 15% and 20% of your balance sheet assets in cash plus inventory. You do not care about the mix, but you do want to have adequate reserves to cover unexpected swings in inventory.

Adjust your cash position to meet the guideline from Round 1. If you are cash poor, issue additional stock or additional bonds. If you are cash rich, pay dividends.

Do not issue current debt.

Save decisions (select “directly to the website”).

**PRACTICE ROUND 3**

**R & D Round 3**

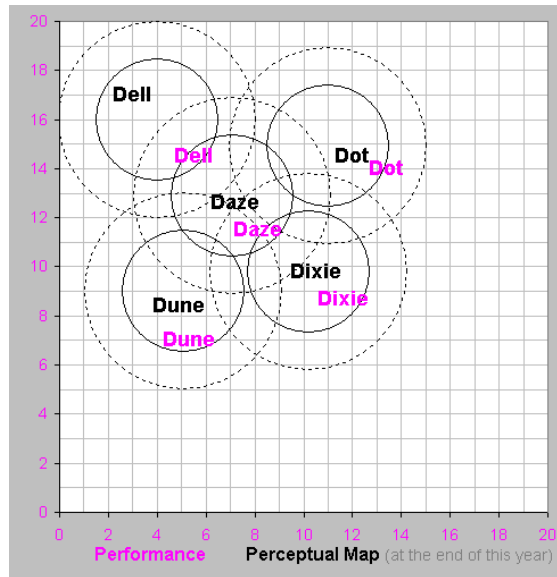
Daze – Improve positioning and reduce age. Hold reliability (MTBF) steady. Example: Increase Daze’s performance by 0.9 and reduce size by 0.9.

Dell – Reposition Dell to the current leading edge of the Low End segment. This will take 1.5 to 2.0 years, and it will sacrifice both positioning and age. It is necessary, however, to keep Dell within the Low End segment in the long run. Example: Increase Dell’s performance by 2.5 units and reduce size by 2.5 units.

Dixie – Improve positioning and reduce age. Hold reliability (MTBF) steady. Example: Increase Dixie’s performance by 1.1 and reduce size by 1.1.

Dot – Improve positioning and reduce age. Hold reliability (MTBF) steady. Example: Increase Dot’s performance by 1.4 and reduce size by 0.5.

Dune – Improve positioning and reduce age. Hold reliability (MTBF) steady. Example: Increase Dune’s performance by 0.4 and reduce size by 1.4.



### Marketing Round 3

Daze – Hold price high, maintain promotion and sales budget. Forecast reduced sales as Daze will not emerge from R&D until late in the year. Example: Price \$28.50, promotion budget \$2200, sales budget \$2200, and sales forecast 1700.

Dell – Hold price high, maintain promotion and sales budget. Forecast moderate unit sales growth. Example: Price \$23.00, promotion budget \$2200, sales budget \$2200, and sales forecast 1800.

Dixie – Hold price high, maintain promotion and sales budget. Forecast unit sales near last year’s level. Example: Price \$38.50, promotion budget \$2000, sales budget \$2000, sales forecast 420.

Dot – Hold price high, maintain promotion and sales budget. Forecast improved unit sales. Example: Price \$33.50, promotion budget \$1800, sales budget \$1800, sales forecast 650.

Dune – Hold price high, maintain promotion and sales budget. Forecast improved unit sales. Example: Price \$33.50, promotion budget \$1800, sales budget \$1800, sales forecast 600.

### Production Round 3

For each product, schedule production using the formula:

(Unit Sales Forecast X 1.15) - Inventory On Hand

Daze – No change required.

Dell – No change required.

Dixie – No change required.

Dot – Buy 150,000 units of capacity by entering 150 in the Buy Sell Capacity cell.

Dune – Buy 150,000 units of capacity by entering 150 in the Buy Sell Capacity cell.

**Important:** There is a one year lag between purchase and use of new capacity and automation for both new and existing products.

### **Finance Round 3**

You may have cash on hand to cover your plant and equipment investment. If not, issue stock to cover the shortfall.

Look at the proforma balance sheet, and add together your cash and inventory accounts. Apply the following rule of thumb. Keep between 15% and 20% of your balance sheet assets in cash plus inventory. You do not care about the mix, but you do want to have adequate reserves to cover unexpected swings in inventory.

Adjust your cash position to meet the guideline from Round 1. If you are cash poor, issue stock. If you are cash rich, pay dividends and buy back stock.

Do not issue current debt.

Save decisions (select “directly to the website”).

### **SUMMARY CONSIDERATIONS**

Your instructor may want you to play another practice round. If so, continue the Broad Differentiation vision.

Having executed the plan for two or three rounds, you are now in a position to analyze it. Consider the following questions:

What are this plan’s strengths? Weaknesses?

How will competitors respond to your actions?

How can you influence competitors to avoid competing with you directly?

Which performance measures support this plan?

What is the long range potential of this plan? Its future sales volume? Its future profitability?

How can you best coordinate this plan as a team?