



Lecturer's Help Desk

Axel SELL

**CASE STUDY
ON THE CONNECTION BETWEEN
STRATEGIC AND TACTICAL PLANNING**

Abstract

The author investigates strategic planning, which focuses on the general decisions of an enterprise in the field of market segments, procurement, management styles, etc. The author proves that, in opposition to strategic planning, tactical planning is a permanent, continuous task, which focuses on tight interrelations between the labour market, procurement and distribution and the financial sector and the state.

Key words:

Strategic planning, tactical planning, strategic analysis.

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1. Introduction

The starting point is the situation of an enterprise, which has four product groups that had different turnover growth rates in the past. The enterprise's management has changed and placed the previous direction on test stand.

We will give a short draft of the specific aspects of strategy setting.

2. Values and Fundamental Principles of the Top Management

The management wants to stay in the previous market, because the enterprise has benefited self-esteem and security from experience. It is envisaged to present itself as a modern enterprise with an attractive promising product range. In the past, research and development have not been performed on a large scale. This implies that more resources than the enterprise has are required and risks would be included. Therefore, the improvement of the product range should be carried out without high costs for own research and development.

3. Environmental Conditions

There have been no dramatic changes in the external environment. However, the forecasted legislation indicates that in several years the third product group may not be sold due to stricter environmental standards. However, this stimulates other research intensive enterprises all over the world to create and patent new products. At present time, product group 3 is a substantial turnover bearer and contributes to a large part of the enterprise's profit. An omission without any compensation harms the enterprise's existence.

4. The Enterprise's Long-Term Intentions

The enterprise wants to stay in the market; the production capacities are still suitable and the management, at least, wants to ensure previous turnover. Since the enterprise does not carry out its own research, one can assume the licensed production based on modern technology.

5. Strategic Analysis: The Enterprise and Its External Environment

Positioning of the product groups seems rather unfavourable in the long-term perspective. Product group 3 is jeopardised by environmental standards, and product group 4 is sold in shrinking markets. In regards to product group 1, we are talking about an expanding market with growth rate of 20% and the product's market share of 10% in comparison to the biggest competitor. As for product group 2, its market share is 60% of the share of the greatest competitor. The overall market growth rate is approximately 25%. The market where product group 3 is sold is stagnant. Own relative market share is 50% compared to the greatest competitor. Finally, the market volume for product group 4 declined by approximately 15%. The enterprise itself is acting with a relative market share of 20%.

If we enter these four product groups in the Boston Consulting Group Box, then it is clear that product group 1 should be attributed to «Question Marks», product group 2 – «Stars», product group 3 – «Cash Cows» and product group 4 – «Dogs». Because of the expected environmental burden (obligation), the recommended disinvestments strategy for product group 4 will also be necessary in the medium-term for product group 3.

		Relative market share	
		Low	High
Market growth	High	Product Group 1	Product Group 2
	Low	Product Group 4	Product Group 3

The analysis of values and principles of the management shows the management's low propensity to risk. The enterprise should not decline, but it should produce at least at the same output level as before; in the past, the enterprise offered a fair product quality, and this quality has also to be guaranteed in future.

The analysis of the enterprise's strengths/weaknesses in comparison to its competitors reveals weaknesses in research and development; as for the production process, it is efficient or at least as good as in competing firms. The enterprise has skilled and motivated employees, high market shares in some product groups, and regular customers due to good customer care and the so-far good range of goods offered. The financial state is positive, and thus, expansion and renovation using own funds and credits are not excluded.

6. Strategy Definition and Evaluation

6.1 Finding the Strategy

The management and external consultants have undertaken brainstorming. The enterprise, as a seller, is well-known in the market, has an established circle of customers and does not see the necessity of developing something entirely new for diversification. The strategy should instead be directed to defending and carefully maintaining the market share partly by adjustment and renovation of the product range. According to Ansoff, this would be called the strategy of market penetration.

After long consultations, the following conclusion is reached: the enterprise should take care of the license for a new product, which will be environmentally friendly and will substitute former product group 3 in its market. Therefore, a cooperative strategy without the risk of its own research is preferred by the enterprise. New products could be produced after retrofitting and modernising the previous production plants. The former product range must be partly replaced in the third planned year. However, not all the product range has to be improved. It is noted that product group 1 is sold in a capable market (even for long-term), and one, because of good relationship with its customers, can reach a higher market share with only marginally changed specifications of the products. In order not to be cut off from innovation and to load production capacities, the enterprise should take care of the license for the subsequent product group, which will substitute ceased product group 4.

6.2 Specific Action

Two project managers (0.2 million per annum) should be appointed for the next three years. The managers' tasks would be detailed planning and implementation of the new product lines, as well as the liquidation of previous product groups 3 and 4. The managers will closely cooperate with the centralized corporate planning department and will have to collect data on the two projects to be integrated into the financial planning for the whole enterprise.

In the next step, product groups 1 and 2 are discussed. Both product lines will continue. However, in regards to product group 1, it should be foreseen that the turnover growth would decrease to 10% from 25% at the beginning of planning period 5 at the latest. This also holds for product group 2.

According to overall planning, the restructuring will take place in period 3. Then licensed products will replace product groups 3 and 4. In the second plan-

ning period, costs of dismantling and re-equipment of 0.5 million will be required. Furthermore, in period 2, the investment of 10 million into fixed assets will be required in addition to 5 million already provided for in tactical planning. When drawing the balance sheet in the second planning year, previous fixed assets of 10 million will be written off to a net book value of 1 million (indirect depreciation of 9 million) and will be sold at this net book value at the end of the year. Investment and retrofitting will take place in the second half-year of period 2. In the case of detailed planning, e.g. monthly planning, the concrete date of investment will have an impact on financing, since interest on additional loan capital will be charged only for the second half year and not for the whole year.

Taking financing into consideration, it will be necessary to postpone the deadline for loan capital repayment compared with previous planning by one year. That means repayment of 5 million in period 4 instead of period 3. In the second plan year, additional funds of 3 million will be registered as a credit, which have to be paid back in the next two years (2 million in the third planned year and the remaining million in the fourth planned year). The policy of distributing 50% of profits will be maintained up to period 4, after which the full distribution will take place. The turnover of the product, which will replace product group 3, is estimated to reach 15 million in period 3; however, the turnover is calculated on the basis of higher quality and environmental friendliness and is expected to grow by 10% in the subsequent years. The replacement product for product group 4 should be built up promotionally. The product's turnover should reach 5 million in the 3rd planning period and increase by 50% in relation to the initial data in period 4. Then the growth rate of 10% a year is forecasted, too.

The enterprise will pay license tax of 10% of net turnover. Additional project management costs in the next three years will be equal to 0.2 million per annum.

The expenditure structure of fixed and variable costs is similar to the former product groups 3 and 4. The percentage of other variable costs for product group 4 is smaller than before (by 50%) due to automatisations.

7. Strategy Evaluation

The pre-conditions from Kreikebaum (discussed in 10.7 for the evaluation of the strategy) are fulfilled by the detailed information on expected sales, required investment, etc. The core of the strategy is that obtaining a license could smooth away the discovered lack of growth rate in some business units, and the previous customers could be served with improved products.

In the following we will examine Day's questions to find out whether the strategy is valid or not:

1. *Does the strategy contribute to the creation of long-term competitive advantage?*

The enterprise possesses special competence in production and maintaining relationships with its customers. The enterprise will hold and partly improve this competence. However, obtaining the license would mean subsequent renunciation of own research and development, and no new competence is received here.

2. *How realistic are the central assumptions of the plan?*

There are supporting information about the market and its development over the last years. The licensed products have been tested and the assumed growth rates have realistically appeared.

3. *Is the realization of the plan ensured? Are there enough resources, employees' capabilities and the management's motivation to support the strategy?*

The strategy is introduced in consensus with the whole management; the employees have the required production experience and are interested in the implementation of promising product group. The financial need in resources (i.e. investment required) is significant. The final evaluation is possible only within the framework of the financial planning, where the data of medium-term planning is related to strategic actions. The more precise planning (see the planning schedules below) will show that a realistic concept of financing can be derived.

4. *Is the strategy contradictory in itself?*

The actions are transparent and no evident contradictions have been discovered.

5. *How sound is the strategy when taking into account specific developments? What are the risks?*

The license tax is considered to be subject to the turnover, and, therefore, no high risks have emerged due to the license agreement. Production facilities could be used alternatively for the production of other kinds of products, and, therefore, these investments also do not mean any extraordinary risk.

6. *How flexible is the strategy?*

It was already noted that the production facilities could be used in a flexible way.

7. *Will the strategy result in an increase of the enterprise's shareholder value?*

This question can only be judged in respect to alternatives available. What are the alternatives, the bench marks for the evaluation of this strategy? The strategic analysis has shown that product group 3, which has been considerable until now, is undermined due to tightened environmental standards. Product group 4 declines sensitively and reveals very small contribution, which falls into

negative at the end. According to table 50, for period 3 we got an estimated ROI of 26.3%. However, having in mind the negative trends for product groups 3 and 4, we are not allowed to extrapolate this ROI into the future. Without any fundamental change, the ROI would become smaller or even negative after period 3 and this situation might be the relevant benchmark. This aspect is discussed in the relevant literature on investment appraisal under the heading «with- and without principle» (see Sell, Project Evaluation, 1991, p. 116).

An alternative could be shutting the enterprise down and selling assets. In the case of this alternative, the costs of our strategy will be that we will not get cash inflow of the liquidation proceeds (after loan capital repayment). This foregone inflow may be considered opportunity costs. In addition we have retrofitting and project management costs as well as investment in fixed assets. These costs have to be compared with inflows from net turnover receipts (with the deduction of license fees and other expenditures for required inputs). In this scenario, strategy evaluation could be carried out according to the investment theory by an investment appraisal.

However, the evaluation could also be performed by showing the effect of the strategic measures in the liquidity planning table, the planned profit and loss account and planned balance sheet as well as by means of profitability indicators. Consequently, it becomes clear whether financing can take place and how it will occur.

8. Strategy Implementation and Strategy Control

Setting the plan in action is not part of the planning process, however, the basic assumptions about the implementation and related costs have to be included in the proposed plan of action and have to be included in cost estimates and thus are essential part of the evaluation.

9. Presentation in the Standard Planning Tables

The enterprise is currently in period «t» and is planning for the next eight periods on the basis of the previous period data and plan concepts for period «t». The data is obtained from medium-term financial planning and partly extrapolated. In some cases, especially for product group 3, knowledge that was acquired in the process of strategic analysis resulted in changes of forecast.

Table 1.

A Strategic Corporate Planning Example: Development of Business Units

	Periods										
	t-2	t-1	t	t+1	t+2	t+3	t+4	t+5	t+6	t+7	t+8
1	2	3	4	5	6	7	8	9	10	11	12
Product 1											
Net turnover	1.000	1.200	1.440	1.728	2.074	2.488	2.986	3.285	3.613	3.974	4.372
Raw materials	0.200	0.240	0.288	0.346	0.415	0.498	0.597	0.657	0.723	0.795	0.874
Component parts	0.100	0.120	0.144	0.173	0.207	0.249	0.299	0.328	0.361	0.397	0.437
Other variable costs	0.100	0.120	0.144	0.173	0.207	0.249	0.299	0.328	0.361	0.397	0.437
Personnel fixed costs	0.150	0.150	0.150	0.150	0.150	0.150	0.150	0.150	0.150	0.150	0.150
Other operating expenses	0.050	0.050	0.050	0.050	0.050	0.050	0.050	0.050	0.050	0.050	0.050
Contribution margin	0.400	0.520	0.664	0.837	1.044	1.293	1.592	1.771	1.968	2.185	2.423
Product 2											
Net turnover	5.000	6.000	7.200	8.640	10.368	12.442	14.930	16.423	18.065	19.872	21.859
Raw materials	1.500	1.800	2.160	2.592	3.110	3.732	4.479	4.927	5.912	7.095	8.514
Component parts	0.500	0.600	0.720	0.864	1.037	1.244	1.493	1.642	1.807	1.987	2.186
Other variable costs	0.500	0.600	0.720	0.864	1.037	1.244	1.493	1.642	1.807	1.987	2.186
Personnel fixed costs	1.000	1.000	1.000	1.000	1.000	1.000	1.000	1.000	1.000	1.000	1.000
Other operating expenses	1.000	1.000	1.000	1.000	1.000	1.000	1.000	1.000	1.000	1.000	1.000
Contribution margin	0.500	1.000	1.600	2.320	3.184	4.221	5.465	6.211	6.540	6.803	6.973
Product 3											
Net turnover	15.000	15.000	15.000	15.000	15.000	15.000	16.500	18.150	19.965	21.962	24.158
License						1.500	1.650	1.815	1.997	2.196	2.416
Raw materials	1.500	1.500	1.500	1.500	1.500	1.500	1.650	1.815	1.997	2.196	2.416
Component parts	2.250	2.25	2.25	2.250	2.250	2.250	2.475	2.723	2.995	3.294	3.624
Other variable costs	1.500	1.500	1.500	1.500	1.500	1.500	1.650	1.815	1.997	2.196	2.416
Personnel fixed costs	2.000	2.000	2.000	2.000	2.000	2.000	2.000	2.000	2.000	2.000	2.000
Other operating expenses	1.500	1.500	1.500	1.500	1.500	1.500	1.500	1.500	1.500	1.500	1.500
Contribution margin	6.250	6.250	6.250	6.250	6.250	4.750	5.575	6.483	7.481	8.579	9.787
Product 4											
Net turnover	10.000	9.000	8.100	7.290	6.561	5.000	10.000	11.000	12.100	13.310	14.641
License						0.500	1.000	1.100	1.210	1.331	1.464
Raw materials	2.000	1.800	1.620	1.458	1.312	1.000	2.000	2.200	2.420	2.662	2.928
Component parts	3.000	2.700	2.430	2.187	1.968	1.500	3.000	3.300	3.630	3.993	4.392
Other variable	3.000	2.700	2.430	2.187	1.968	0.750	1.500	1.650	1.815	1.997	2.196

	Periods										
	t-2	t-1	t	t+1	t+2	t+3	t+4	t+5	t+6	t+7	t+8
1	2	3	4	5	6	7	8	9	10	11	12
costs											
Personnel fixed costs	1.000	1.000	1.000	1.000	1.000	1.000	1.000	1.000	1.000	1.000	1.000
Other operating expenses	0.400	0.400	0.400	0.400	0.400	0.400	0.400	0.400	0.400	0.400	0.400
Contribution margin	0.600	0.400	0.220	0.058	-0.088	-0.150	1.100	1.350	1.625	1.928	2.260
Summary table											
Нетто-оборот	31.000	31.200	31.740	32.658	34.003	34.930	44.416	48.857	53.743	59.118	65.029
Net turnover	5.200	5.340	5.568	5.896	6.337	6.730	8.726	9.599	11.051	12.748	14.732
Raw materials	5.850	5.670	5.544	5.474	5.462	5.243	7.267	7.993	8.793	9.672	10.639
Component parts	5.100	4.920	4.794	4.724	4.712	3.743	4.942	5.436	5.979	6.577	7.235
Other variable costs	4.150	4.150	4.150	4.150	4.150	4.150	4.150	4.150	4.150	4.150	4.150
Personnel fixed costs	2.950	2.950	2.950	2.950	2.950	2.950	2.950	2.950	2.950	2.950	2.950
Other operating expenses	5.000	5.000	5.000	5.000	5.000	5.000	5.000	5.000	5.000	5.000	5.000
Fixed overheads				0.200	0.200	0.200					
Project management					0.500						
Retrofitting						2.000	2.650	2.915	3.207	3.527	3.880
License charges	2.750	3.170	3.734	4.265	4.690	4.914	8.732	10.815	12.613	14.494	16.444

Beginning in plan period 3, the previous product groups 3 and 4 will be substituted by the license production of the two new product groups. For the product groups the contribution margin is calculated. This shows the contribution of product groups to cover the whole enterprise's overheads and fixed costs as well as interest payments and depreciation charges. Fixed costs that could be attributed directly to product groups are still subtracted when determining the actual contributions of the different groups. The contribution margin that is related to the product groups is still negative for the new product group 4 in the third planned period (i. e. the first period of the license). This is due to low turnover, but it will become positive in the following periods like the new product group 3. Therefore, both product groups contribute to the enterprise's positive result.

Table 2.

**Expected Turnover and Production Costs without Interest
and Depreciation**

Item	Period							
	1	2	3	4	5	6	7	8
Turnover	32.658	34.003	34.930	44.416	48.857	53.743	59.118	65.029
Direct costs								
Raw materials	5.896	6.337	6.730	8.726	9.599	11.051	12.748	14.732
Component parts	5.474	5.462	5.243	7.267	7.993	8.793	9.672	10.639
Other variable costs	4.724	4.712	3.743	4.942	5.436	5.979	6.577	7.235
Personnel costs (fixed)	4.150	4.150	4.150	4.150	4.150	4.150	4.150	4.150
Fixed costs (operating expenses, advertising costs)	2.950	2.950	2.950	2.950	2.950	2.950	2.950	2.950
Fixed overheads	5.000	5.000	5.000	5.000	5.000	5.000	5.000	5.000
Project management	0.200	0.200	0.200					
Retrofitting		0.500						
License fees			2.000	2.650	2.915	3.207	3.527	3.880

Next, shown are the turnovers of the four business units, including the new production lines 3 and 4, and, in addition, the related costs inclusive of license fees and fixed costs for the whole enterprise.

In the case of investment, it is to be noted that a part of old fixed assets with the balance sheet net value of 1 million is sold. Acquisition expenses were 10 million so that corresponding items of fixed capital and accumulated indirect depreciation charges have to be adjusted. Loan capital repayment (5 million) should be postponed for one period in relation to medium-term planning. Furthermore, a raise of an additional credit of 3 million is expected; however, this credit could be repaid in the subsequent periods (2 million in period 3 and the remaining 1 million in period 4).

When calculating working capital and net working capital in the absence of other information on the new product groups, it is for granted to apply the same period of payment and minimum coverage time like in the one used for the old range of products.

The liquidity is ensured permanently. The forecasted investment and modernization expenditure are consequences for a financial tight in the second period. The financial tight can be eased through the obtainment of additional loan capital in period 2 and through the relatively high amount of cash / bank account available at the end of period 1.

Table 3.

Investment Plan and Available Assets

Item	Acquisition expense	Depreciation rate	Balance sheet value in period					
			1	2	3	4	5	
Real Estate	5.000	0.000	5.000					
Disinvestments gross				-10.000				
Disinvestments net				-1.000				
Fixed investment	30.000	0.100	20.000	15.000				
Working capital			3.400					
Liabilities			0.200					
Loan capital received				3.000				
Loan capital repayment					2.000	6.000		

Table 4.

Working Capital and Net Working Capital

Item	Minimum month of coverage	Turnover ratio	Basis of assessment	1	2	3	4	5	6	7	8
				5	6	7	8	9	10	11	12
Finished products	0.250	48.000	Variable costs	0.335	0.344	0.327	0.436	0.480	0.538	0.604	0.679
Raw materials	1.000	12.000	Annual consumption	0.491	0.528	0.561	0.727	0.800	0.921	1.062	1.228
Component parts	0.500	24.000	Annual consumption	0.228	0.228	0.218	0.303	0.333	0.366	0.403	0.443
Accounts receivables	1.000	12.000	Turnover	2.722	2.834	2.911	3.701	4.071	4.479	4.926	5.419
Working capital			3.4 in period t	3.776	3.933	4.018	5.167	5.684	6.304	6.996	7.769
working capital increase				0.376	0.157	0.084	1.150	0.517	0.620	0.692	0.773

Item	Minimum month of coverage	Turnover ratio	Basis of assessment	1	2	3	4	5	6	7	8
1	2	3	4	5	6	7	8	9	10	11	12
Liabilities (-)	0.250	48.000	Raw ma- teri- als, com- po- nent parts	0.237	0.246	0.249	0.333	0.367	0.413	0.467	0.529
Liabilities increase				0.037	0.009	0.004	0.084	0.033	0.047	0.054	0.061
Net working capital				3.539	3.687	3.768	4.834	5.318	5.890	6.529	7.241

Table 5.

The Profit and Loss Account for Periods 1 to 8

Items	1	2	3	4	5	6	7	8
A. Proceeds	32.810	34.261	34.936	44.541	48.953	53.960	59.452	65.478
Turnover	32.658	34.003	34.930	44.416	48.857	53.743	59.118	65.029
Interest income	0.152	0.258	0.006	0.125	0.096	0.217	0.334	0.449
B. Expenses	27.394	28.311	29.816	35.285	37.043	40.130	43.624	47.586
Raw materials ex- penses	5.896	6.337	6.730	8.726	9.599	11.051	12.748	14.732
Component parts ex- penses	5.474	5.462	5.243	7.267	7.993	8.793	9.672	10.639
Other variable costs	4.724	4.712	3.743	4.942	5.436	5.979	6.577	7.235
Fixed operating ex- penses	4.150	4.150	4.150	4.150	4.150	4.150	4.150	4.150
Fixed personnel costs	2.950	2.950	2.950	2.950	2.950	2.950	2.950	2.950
Retrofitting		0.500						
Project management	0.200	0.200	0.200	0.000	0.000	0.000	0.000	0.000
License charges			2.000	2.650	2.915	3.207	3.527	3.880
Interest	3.000	3.000	3.500	3.500	3.500	3.500	3.500	3.500
Depreciation charges	5.416	5.950	5.120	9.256	11.910	13.830	15.828	17.892
C. Pre-tax profit (A-B)	5.917	6.449	5.769	9.806	12.161	14.081	16.078	18.142
D. Business Income (Gewerbeertrag)	5.417	5.949	5.119	9.256	11.911	13.831	15.828	17.892
Profit before tax 0	0.500	0.500	0.650	0.550	0.250	0.250	0.250	0.250
50% of interest on long	1	1	1.3	1.1	0.5	0.5	0.5	0.5

Items	1	2	3	4	5	6	7	8
E. Business tax 16.67% of D	0.986	1.075	0.962	1.635	2.027	2.347	2.680	3.024
corporation income tax(C-E)	4.430	4.874	4.158	7.622	9.884	11.483	13.148	14.868
G. Corporation in- come tax (25% of F)	1.108	1.218	1.040	1.906	2.471	2.871	3.287	3.717
H. Profit after tax (F- E-G)	3.322	3.656	3.118	5.716	7.413	8.613	9.861	11.151
I. Dividend payments	3.323	1.828	1.559	2.858	7.413	8.613	9.861	11.151
J. Profit devoted to reserves	0.000	1.828	1.559	2.858	0.000	0.000	0.000	0.000

Table 6.

Liquidity Planning for Periods 1 to 8

Items	1	2	3	4	5	6	7	8
Turnover	32.658	34.003	34.930	44.416	48.857	53.743	59.118	65.029
Interest income	0.152	0.258	0.006	0.125	0.096	0.217	0.334	0.449
Property sale		1.000						
Investment	0.000	-15.000	0.000	0.000	0.000	0.000	0.000	0.000
Increase in work- ing capital	-0.376	-0.157	-0.084	-1.150	-0.517	-0.620	-0.692	-0.773
Increase of liabili- ties (increase +)	0.037	0.009	0.004	0.084	0.033	0.047	0.054	0.061
Raw materials consumed	-5.896	-6.337	-6.730	-8.726	-9.599	-11.051	-12.748	-14.732
Component parts	-5.474	-5.462	-5.243	-7.267	-7.993	-8.793	-9.672	-10.639
Other variable costs	-4.724	-4.712	-3.743	-4.942	-5.436	-5.979	-6.577	-7.235
Retrofitting		-0.500						
Project manage- ment	-0.200	-0.200	-0.200					
License charges			-2.000	-2.650	-2.915	-3.207	-3.527	-3.880
Fixed operating expenses	-4.150	-4.150	-4.150	-4.150	-4.150	-4.150	-4.150	-4.150
Fixed wages	-2.950	-2.950	-2.950	-2.950	-2.950	-2.950	-2.950	-2.950
Injection of capi- tal stock								
Injection of loan capital		3.000						
Loan capital re- payment		0.000	-2.000	-6.000				
Interest pay- ments	-1.000	-1.000	-1.300	-1.100	-0.500	-0.500	-0.500	-0.500
Business tax	-0.986	-1.075	-0.962	-1.635	-2.027	-2.347	-2.680	-3.024
Corporate in-	-1.108	-1.218	-1.040	-1.906	-0.000	0.000	0.000	0.000

Items	1	2	3	4	5	6	7	8
Income tax (25%)								
Dividends	-3.323	-1.828	-1.559	-2.858	-7.413	-8.613	-9.861	-11.151
Net cash flow	2.661	-6.320	2.978	-0.708	3.017	2.927	2.862	2.788

The planned balance sheet includes data from both the profit and loss account and liquidity planning. This presentation does not clearly show the existing high profit level as 50% of profits are distributed in the first periods and all profits are distributed in the subsequent periods due to high liquidity expectations. The profits, however, are shown in the profit and loss account.

There is a large amount of cash on hand which is placed by the firm at a relatively low interest rate (4%). An option for the capital owners is to draw surplus capital from the enterprise and use it for other purposes.

The profit and loss account shows a very positive development for the enterprise. Both the profitability of the turnover and the overall return on investment are very high. When calculating the overall return on investment we should separate the business result from the financial result of depositing cash on hand/bank account at an interest of 4%. Reducing the total capital of the enterprise (total assets minus indirect depreciation) by cash/bank accounts will result in net assets of 31.167 in period 4. Absolute return on investment in the understanding of the DuPont Pyramid system (i.e. profit minus interest income plus long-term loan capital interest paid) will reach 10.231 million pre-tax in period 4. This corresponds to a Return on Investment (ROI) of about 32.8%. In the 8th period, 19.769 million capital is required to get a return of 17.943 million, that means a ROI of about 90.8%.

Table 7.

The Forecasted Balance Sheet for Periods 1 to 8

Items	0	1	2	3	4	5	6	7	8
Real Estate	5.000	5.000	5.000	5.000	5.000	5.000	5.000	5.000	5.000
Fixed investment	30.000	30.000	35.000	35.000	35.000	35.000	35.000	35.000	35.000
Finished products	0.300	0.335	0.344	0.327	0.436	0.480	0.538	0.604	0.679
Raw materials	0.400	0.491	0.528	0.561	0.727	0.800	0.921	1.062	1.228
Component parts	0.200	0.229	0.228	0.218	0.303	0.333	0.366	0.403	0.443
Accounts receivables	2.500	2.722	2.834	2.911	3.701	4.071	4.479	4.926	5.419
Cash / bank accounts	3.800	6.461	0.140	3.119	2.411	5.427	8.354	11.216	14.004

Items	0	1	2	3	4	5	6	7	8
Accumulated loss									
Assets sum total	42.200	45.237	44.073	47.136	47.578	51.111	54.658	58.212	61.773
Capital stock	15.000	15.000	15.000	15.000	15.000	15.000	15.000	15.000	15.000
Reserves	5.000	7.000	7.000	8.828	10.387	13.245	13.245	13.245	13.245
After-tax profit	2.000	0.000	1.828	1.559	2.858	0.000	0.000	0.000	0.000
Loan capital	10.000	10.000	13.000	11.000	5.000	5.000	5.000	5.000	5.000
Indirect depreciation	10.000	13.000	7.000	10.500	14.000	17.500	21.000	24.500	28.000
Liabilities	0.200	0.237	0.246	0.249	0.333	0.367	0.413	0.467	0.529
Liabilities sum total	42.200	45.237	44.073	47.136	47.578	51.111	54.658	58.212	61.773

Table 8.

Rough Forecast of ROI

	1	2	3	4	5	6	7	8
Assets sum total	45.237	44.073	47.136	47.578	51.111	54.658	58.212	61.773
- cash/bank accounts	6.461	0.140	3.119	2.411	5.427	8.354	11.216	14.004
- Indirect depreciation	13.000	7.000	10.500	14.000	17.500	21.000	24.500	28.000
= Capital (C) Pre-tax profit	25.776	36.933	33.517	31.167	28.184	25.304	22.496	19.769
- interest income	5.416	5.950	5.120	9.256	11.910	13.830	15.828	17.892
+ interest payments	0.152	0.258	0.006	0.125	0.096	0.217	0.334	0.449
- Return (R)	1.000	1.000	1.300	1.100	0.500	0.500	0.500	0.500
ROI (R/K)	6.264	6.692	6.414	10.231	12.314	14.113	15.994	17.943
Assets sum total	0.243	0.181	0.191	0.328	0.437	0.558	0.711	0.908

We may conclude that the strategy is based on a convincing financial plan. The strategy ensures the enterprise's existence and profitability. However, as was demonstrated by the example of the former product group 3, we always have to be aware that conditions may change and some of our assumptions may prove wrong. Therefore, the main assumptions should be subject to regular checks and, if necessary, the plan should be promptly modified and updated.

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