

Developing a Strategic Management Assessment Framework for Small Firms

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Paper presented at “Managing for Unknowable Futures” 24th Annual ANZAM Conference, 7-10 December, Adelaide Australia.

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ABSTRACT

Research into the strategic planning behaviour of small firms has focused on the decision making of entrepreneurs and the impact that such activity has on firm performance. A review of the literature relating to strategic planning in small firms over the past 30 years suggests that there is a lack of consistency in the way in which strategy and planning are measured. This paper outlines the development of an assessment framework for examining the strategic planning behaviour of small firms and points to how this tool might be used in future research and applied to assisting small business managers.

Keywords: small firms, owner-managers, strategic planning, assessment framework.

INTRODUCTION

A review of the literature undertaken in the mid-1980s found very little attention had been paid to small business planning in the preceding three decades and that there were inconsistencies due to a lack of uniform methodology and measures (Robinson & Pearce, 1984). Further reviews of small firm planning and strategy undertaken since that time have indicated that, despite the passage of more than two decades, no consistent explanation of the formulation of strategy or the process of planning in the small firm has emerged due to a wide variation in the methodologies employed and a lack of consistent measures and definitions of small firm, planning, strategy and performance (Bouckennooghe, De Clercq, Willem & Buelens, 2007; Ireland, Webb & Coombs, 2005; Bergh, Hanke, Balkundi, Brown & Chen, 2007; Goy, 2006; Ratnatunga & Romano, 1997; Street & Cameron, 2007; Kraus, Schwartz & Reschke, 2005; Daily, McDougall, Covin & Dalton, 2002; Wood, 1999; Middleton-Stone & Greer-Brush, 1996; Tonge 2001a; 2001b).

The present study attempted to address this problem in part through the development of an assessment framework based on a validated set of scales that can be used in the analysis of small firm strategic management behaviour. For the purposes of this study a small firm was defined as one with fewer

than 250 employees and less than €50 million in annual turnover (OECD, 2004). The literature relating to the planning and strategy process within the small firm is discussed first, after which the development of the proposed framework and the measurement scales used in this tool are outlined. The potential usefulness of the framework and its further development is then discussed.

A LITERATURE REVIEW

The process of planning and strategy development in small firms has been examined from a variety of perspectives, with particular attention being given to the decision making and related activities of the firm's owner-manager or senior management team. The majority of small business owners do not plan, or at least they undertake planning in an informal rather than a formal manner (Posner, 1985; Rice, 1983), often relying on personal information sources and an idiosyncratic, rather than a systematic, strategy development process (Rice & Hamilton, 1979). Formal planning within a small firm is likely to be contingent on the characteristics of the owner-manager (e.g. education, professional experience, entrepreneurial orientation) and the size of the business (Cooper, 1981; Unni, 1984; Pelham & Clayson, 1988; Olson & Bokor, 1995; Woods & Joyce, 2003; Gibbons & O'Connor, 2005; Richbell, Watts & Wardle, 2006). Gibb and Scott (1985) suggested planning within a small firm is most likely to focus on the completion of a series of projects and how they are matched to the business's wider strategic goals. The need for planning to follow a clearly defined process that builds on the owner-manager's past experiences and knowledge of their market and customers has also been highlighted (Howard & Emery, 1985). In following a process in planning, the small business owner should avoid over planning and should trust their experience and intuition (Barry, 1998).

The value of planning to a small firm

Empirical research into the value of planning is somewhat mixed due to the methodological and definitional issues noted above. There is some evidence that formal planning in a small firm can be beneficial when it is focused on sales generation in the early start up phase, or on employee development and staffing in more mature phases (Robinson & Littlejohn, 1981; Robinson, Pearce, Vozikis & Mescon, 1984; Alpander, Carter & Forsgen, 1990). The more entrepreneurial the firm's

management team, the more likely they will be to engage in formal planning (Bracker, Keates & Pearson, 1988; Stewart, Watson, Carland & Carland, 1999) and it seems the quality of strategic decision making can be enhanced by increasing the formality of the planning process (Lyles, Baird, Orris & Kuratko, 1993; Baker, 2003). The success of the strategic planning process in small firms relies heavily on the skills and capabilities of the owner-manager or CEO, but planning alone is not enough to improve performance (Shuman, Sussman & Shaw, 1985; Maes, Sels & Roodhooft, 2005). As a firm grows, it gains sufficient resources to engage professional advisors who can improve its strategic management (Shuman & Seeger, 1986; Lussier & Pfeifer, 2001). However, the majority of small firms continue to use informal planning with success and many owner-managers rely on their experience and knowledge to apply intuitive, informal approaches to strategic planning (Spitzer, Alpar & Hills, 1989; Riesenau & Masurel, 1993). Although planning is often a response to uncertainty in the environment, when faced with environmental uncertainty many small business owners do not increase their planning activity (Yusuf, 2000; Yusuf & Nyomori, 2002; Yusuf & Saffu, 2005).

The most useful studies for determining the benefits of planning in a small firm are those involving a longitudinal analysis as the impact of planning must be viewed over time and strategic planning is, by its very nature, a long term process. Sexton and van Auken (1985) conducted a longitudinal study of 635 firms and found a positive relationship between operational planning and firm performance, with a link between strategic planning and success over time. The sophistication of the planning undertaken and the capacity of the owner-manager to undertake this planning also plays a significant role (Bracker & Pearson, 1986), although demonstrating a direct link between planning and financial performance is often problematic (McKiernan & Morris, 1994; Gibcus & Kemp, 2003). The characteristics of the owner-manager or senior management team appear to be critical to success (Merz & Sauber, 1995; Gabrielsson, 2007). Planning is likely to be triggered by external pressures, rather than internal factors and this may explain why planning is often not correlated with performance (Honig & Karlson, 2004). Owner-managers in small firms are often highly idiosyncratic about planning and strategy (Wiklund, Davidsson & Delmar, 2003) and, as the firm matures and its

management become comfortable with the status quo within their market or industry, the propensity for planning is likely to diminish (Gibson & Cassar, 2002).

The process of planning in the small firm

In addition to understanding the benefits of planning within a small firm, there is the equally important issue of how the planning process should be undertaken. There is no single theory of strategy formulation in a small firm, with any strategic planning process being highly dependent on the context in which the firm is operating (Chan & Foster, 1999). There is a view planning in small firms should focus on operational rather than strategic issues (Thurston, 1983). For owner-managed firms, the power of the owner to dictate future strategic direction makes strategic planning a highly personalised process (Goffee & Scase, 1985). Firms engaged in growth through innovation and new product development (NPD) will need to adopt different planning behaviours to those that are comfortable with existing products and market environments. Growth oriented firms will need to approach their strategic planning and marketing in a very systematic manner (McDougall, Covin, Robinson & Herron, 1994; Huang, Soutar & Brown, 2002; Lee & O'Connor, 2003). The NPD process will also require a firm to have a good cross-section of strategic and operational skills within its management team (Salomo, Weise & Gemunden, 2007; Huang, Soutar & Brown, 2002, 2004).

Owner-managers who achieve success in planning are likely to engage in it more frequently, but they will need to have sufficient organisational slack to provide resources to the process. Ultimately, however, it is the quality and not the quantity of the planning that matters (Shuman & Seegar, 1986). Small firms typically enjoy greater operational and strategic flexibility than larger firms, which can prove beneficial to the planning process (Verdu-Jover, Llorenus-Montes & Garcia-Morales, 2006). However, small firms are heavily dependent on their owner-manager's ability to sense the need for planning and strategy development. Entrepreneurial managers tend to make use of personal biases and heuristics in decision making and are attuned to the identification and pursuit of market opportunities (Jenkins & Johnson, 1997; Busenitz, 1999). They rely on personal networks in strategic decision

making (Julien & Lachance, 2001) and the quality of their decisions is contingent on their managerial competencies, particularly in financial management (McMahon, 2001).

Informal planning of an operational nature that focuses on projects seems to be the pattern for most small firms. As most small businesses are heavily dependent on continuous cash flow, the financial management and short term operations of the cash cycle are often of greater immediate importance than longer term strategic issues (Pelham & Clayson, 1988). Owner-managers can benefit from the application of strategic planning tools, particularly those that involve competitive benchmarking (McNamee, Greenan & McFerran, 2000). The use of key performance indicators (KPI) to guide performance can be highly beneficial to small fast growing firms, and this can be enhanced by having the owner-manager share such KPI data with employees (Upton, Teal & Felan, 2001). However, small business owners can also benefit from external environmental scanning (Beal, 2000).

Among the essential capabilities a small firm must possess in order to pursue different strategies is an owner-manager with an entrepreneurial orientation and the management skills needed to implement strategy. There is a clear role here for management education targeted at the owner-manager (Schamp & Deschoolmeester, 1998). The owner-manager of a small firm also needs to have a strong market or customer orientation, and a capacity to embrace innovation (Appiah-Adu & Singh, 1998). The ability of a small firm to use marketing planning to guide strategy and value chain management has been identified as a key to financial success (McLarty, 1998). An entrepreneurial and market orientation is also likely to benefit small firms that seek to engage in international operations (Knight, 2000). Thus, the role of the owner-manager is crucial to success of a small firm following any particular strategy, and the owner-manager must have a clear strategic vision that is focused on finding and maintaining a competitive advantage (Kim & Choi, 2000). However, owner-managers also need a capacity for more routine operational management. For example, in the adoption of new technology (a complex process for any firm), an entrepreneurial style of management is less beneficial than an administrative style (Gagnon, Sciotte & Posada, 2000). Benchmarking data and quality standards at both a national and international level can play a key role in guiding owner-managers and helping them set strategy (Stockdale & Standing, 2004). Strategic planning tools can also play a useful part in this process

(Aguilar, Mendoza, Krauth & Schimmel, 1997). Clearly a framework that provided information on these issues would be beneficial to small business researchers and the approach taken to provide this and the results obtained are discussed in the next section.

THE PRESENT STUDY

The antecedents to the present study can be found in the work undertaken by Hall (1992), who developed a framework for the successful strategic management and planning in small firms that had six primary dimensions relating to the firm's strategic focus and direction, marketing and customer orientation, ability to form strategic alliances, organisational culture, quality assurance management systems and control and reporting systems. The framework was developed through a qualitative methodology using British case studies. Mazzarol (1999) used Hall's questionnaire in a survey of small business owner-managers in Australia and identified 39 factors from the original 180 items. However, he did not use a confirmatory factor analysis as the sample size was relatively small. Building on Hall's (1992) and Mazzarol's (1999) work, this study sought to develop an improved measure of small business strategic planning through confirmatory factor analysis.

The Sample

A sample of 204 small business owner-managers was obtained from a cross-section of participants in a management development program run through a university outreach centre. The majority of the respondents were male (88%) and all of the firms had fewer than 200 employees and annual turnover of less than €50 million. The majority of firms (58%) were small, with fewer than 20 employees at the time of interview. The remainder were medium sized enterprises with between 20 and 200 employees. The management teams within these firms generally consisted of an owner-manager with no other formally configured top management team. Formal planning behaviour was also typical of that found in small businesses as only 28 percent reported having a written business plan. Despite this, informal approach to planning, most were seeking to engage in new business growth or new product development. For example, 85 percent intended to significantly increase their firm's production, 77 percent planned to launch new products or services, 45 percent (mainly retailers) planned to open new

stores or outlets and 30 percent planned to commence exporting in the next three years. Most had experience strong growth over the previous four years. Annual turnover across the firms had grown by 42 percent over this time period.

Scale Development

Six separate principal component (factor) analyses were initially undertaken using the 30 items from each of the six dimensions. The measure of sampling adequacy (MSA) suggested each of the sets of items had underlying dimensions as the MSA scores ranged from 0.80 to 0.90 (Hair et al., 2007). Factors with eigenvalues greater than one were retained and varimax rotation was used to obtain a simple factor structure. Forty seven factors were identified in this way. Subsequent confirmatory factor analyses (CFA) of the six dimensions suggested 88 variables should be retained and that 26 factors had good measurement properties. All of the retained factors fitted the data, had construct reliability (CR) scores that were greater than 0.70 and had acceptable average variance explained (AVE) scores as they were all at least 0.50, which suggested they were internally consistent and had convergent validity (Fornell and Larcker, 1981). Further, all of the retained factors had discriminant validity, as their squared correlations ranged from 0.10 to 0.40, all of which were less than the lowest retained AVE score (0.50) (Fornell and Larcker, 1981). Table 1 lists the retained factors within the initial six-part framework devised by Hall (1996) and shows the items that were used to measure each factor, as well as their chi-square fit statistics, construct reliability and AVE scores.

Insert Table 1 here

CONCLUSIONS

The results obtained suggest that, while Hall's (1996) original framework was developed qualitatively, the suggested dimensions have good measurement properties, which means these items can be used in quantitative studies of small firm strategic planning. However, the revised framework still requires 88 questions to be answered, which is likely to be a stumbling block to its future use. Consequently, future research is needed to establish the dimensions within the framework that impact

most on small firm performance as this will provide the information small firm researchers need to decide which aspects they should include in their various studies.

Despite these limitations the assessment framework provides potentially useful mechanism to evaluate the process of strategic management in the small firm. Owner-managers who complete the question items can review their scores on the six areas of the strategy framework and examine in detail how they scored against each of the 26 factors and their measures to gain insights into their management thinking and behaviour. In applied research the framework can be used to help small business owner-managers undertake a self-analysis of how their strategic and operational planning activities are undertaken.

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Table 1: Results of the Confirmatory Factor Analysis

Factors/Items	Chi-Square	df *	Sig.	# Items	CR **	AVE ***
<u>1: FOCUS & DIRECTION</u>						
Mission: <i>having a well defined business mission</i>	2.91	2	0.23	4	.92	.75
Vision: <i>having a clear strategic vision</i>	0.04	1	0.84	3	.74	.50
Core Skills: <i>knowing the key skills needed for business success</i>	0.64	2	0.73	4	.81	.52
Environmental Scanning: <i>for future opportunities & threats</i>	0.04	1	0.84	3	.77	.54
Key Resources: <i>ensuring a constant supply of key resources</i>	1.14	1	0.29	3	.74	.50
<u>2: CUSTOMERISING</u>						
Developing Customer Commitment: <i>customer loyalty</i>	0.33	1	0.57	3	.75	.50
Networking: <i>using strategic networking for business advantage</i>	0.01	1	0.94	3	.66	.39
Problem seeking/Problem solving: <i>solving customer problems</i>	0.05	1	0.83	3	.75	.51
Customer Delight: <i>customer satisfaction and customer referrals</i>	2.45	2	0.29	4	.83	.55
Market Development: <i>new business generation & market development</i>	0.32	1	0.56	3	.63	.36
<u>3. PARTNERING</u>						
Structure & Roles: <i>developing strategic partnerships with key people</i>	0.03	1	0.87	3	.84	.64
Customer Partnerships: <i>understanding customer needs</i>	0.05	1	0.83	3	.78	.55
Staff Partnerships: <i>employee commitment and loyalty to the firm</i>	1.00	2	0.61	4	.84	.57
Supplier Partnerships: <i>strategic partnering with key suppliers</i>	5.66	2	0.06	4	.84	.58
Support Network Partnerships: <i>using third party support networks</i>	0.32	1	0.57	3	.66	.39
<u>4. PERSONALITY</u>						
Values: <i>having a clear set of personal & business values to guide action</i>	2.23	1	0.13	3	.85	.65
Image: <i>developing & managing corporate image</i>	4.96	2	0.08	4	.88	.65
<u>5. QUALITY</u>						
Defining Quality: <i>viewing quality as a source of competitive advantage</i>	3.3	1	0.07	3	.76	.52
ISO9000: <i>having a commitment to formal quality assurance systems</i>	4.90	5	0.43	5	.83	.51
Changing Beliefs: <i>having the ability to lead change in the firm</i>	1.62	1	0.20	3	.80	.59
Premium Pricing: <i>having the ability to charge premium prices</i>	4.19	1	0.04	3	.83	.63

6. SYSTEMS

Critical Information: <i>internal reporting of critical information</i>	5.15	2	0.08	4	.89	.66
Information Systems: <i>use of information technology systems</i>	0.49	2	0.78	4	.82	.53
Financial Control: <i>financial management & control systems</i>	2.35	1	0.13	3	.78	.54
Key Indicators: <i>use of key performance indicators (KPI)</i>	1.50	1	0.22	3	.91	.76
Taking Action: <i>the ability to take action if required</i>	0.01	1	0.94	3	.84	.63

* When there were only three indicators, two of the error variances were made equal to provide the degree of freedom needed to assess fit

** CR is construct reliability (Hair et al. 2006)

*** AVE is average variance extracted score (Fornell and Larcker 1981)