JOURNAL OF SMALL BUSINESS STRATEGY

The Effect Of Operational And Strategic Planning On Small Firm Performance

Larry R. Watts
Joseph G. Ormsby
Stephen F. Austin State University

ABSTRACT

Unlike large corporations, small businesses face a multiplicity of problems that could spell immediate doom for the organization. As a result, an increasing body of research addressing small business problems has been noted in the literature. This research study investigated the effect of operational and strategic planning on small firm performance and found that both were positively related to performance. Practical implications of these research findings are provided for small businesses.

INTRODUCTION

The state of small firm planning literature has progressed rapidly over the past five years. Through the efforts of dedicated research teams our state of knowledge can no longer be considered "woefully inadequate" (12, p. 128). An accumulation of evidence has strongly suggested that small firms benefit from substantive, informal planning that incorporates outsider input (3, 9, 11). However, as noted by Robinson, Salem, Logan and Pearce, "a firm can be advised no more specifically than to 'engage in a high level of planning' or to 'plan regularly' or to 'include some written documentation' in the hope of achieving higher performance" (13, p. 20). Directly addressing the dearth of prescriptive information, Robinson, Salem, Logan and Pearce (13) and Robinson, Logan and Salem (10) investigated the specific planning activities that comprised effective small firm planning. Robinson, Salem, Logan and Pearce (13) found that a significant amount of the variation in performance was explained by high levels of involvement with the activities of analyzing possible changes among target customers, analyzing major competitors, setting sales targets, preparing cash flow projections, setting labor cost standards, and reviewing the adequacy of inventory levels. Robinson, Logan and Salem (10) found that extensive operational planning was strongly related to performance, while engaging in strategic planning alone was not. Even though engaging in strategic planning was not singularly related to performance, firms with both operational and strategic planning outperformed all remaining firms. Building on these two key studies, the intent of this investigation is to extend our understanding of the contribution of operational and strategic planning to small firm performance, and to assess the efficacy of specific planning activities.

METHODOLOGY

Sample

The target population for this study included all community banks operating in the mountain states of Arizona, Idaho, Montana, Nevada, Utah and Wyoming. Using the industry classification of community banks, 170 small independently owned and operated banks were identified. From these institutions, the Chairman of the Board was selected as the appropriate individual to receive the questionnaire. The study was limited to only small firms operating in one industry and one geographic region to control for extraneous influences on planning practices and performance outcomes.

Three mailings yielded 83 usable questionnaires (48.8 percent response rate). The target population of 170 community banks had an average asset level of $36.6 million, an average Net Interest Margin of 5.22 percent, and an average Return on Assets of 0.56 percent. The respondent population of 83 community banks had an average asset level of $32.6 million, an average Net Interest Margin of 5.20 percent, and an average Return on Assets of 0.61 percent. The substantial response rate (48.8 percent), and similarity of financial performance data suggested that a representative sample of the target population had been obtained. Furthermore, the average asset level of respondent banks, $32.6 million, when compared to the industry average of $194 million per bank suggests that respondents were small businesses.

Measures

Planning. To measure the planning practices of small firms, several techniques were employed to develop an appropriate instrument. First, the planning literature was surveyed to identify planning practices clearly associated with operational and strategic planning. The assembled list of activities were then grouped into related clusters of activities and submitted to a panel of small firm planning experts. The panel of experts assessed the content validity of the instrument and provided additions and corrections. After reviewing the recommendations of the panel, structured interviews were scheduled with a select number of small bank owners and managers. The interviews further refined the content, form and readability of the questionnaire.

To establish a firm's planning efforts, clusters of activities necessary for operational and strategic planning were assembled. The clusters of strategic planning activities were drawn from the work of Hofer and Schendel (6). As shown in Figure 1, these clusters include: (1) Assessing the firm's strategic position, (2) Identifying opportunities and threats, (3) Identifying resources and skills, and (4) Identifying strategic issues. Evidence that small firms engage in, and benefit from, these strategic activities has been provided by Bracker (1), Bracker and Pearson (3), Bracker, Keats and Pearson (2), and Robinson and Pearce (11). The clusters of operational activities were drawn from the work of Pearce and Robinson (8). As shown in Figure 2, these clusters include operational activities in: (1) Marketing, (2) Finance, (3) Personnel, and (4) Operations. Evidence that small firms engage in, and benefit from these operational activities has been provided by Robinson, Logan and Salem (10) and Robinson, Salem, Logan and Pearce (13).

To assess the extent of involvement with the activities, Fredrickson's (4, 5) concept of comprehensiveness was used. For each planning activity an associated measure of comprehensiveness was included. A firm that was very comprehensive in dealing with the activities might: (1) form a group of special members, (2) conduct extensive analysis, (3) allow unlimited expenses, (4) involve people with diverse backgrounds, and (5) consider all possible implications and options. On the other hand, a very non-comprehensive firm might rely on the ideas and experiences of one individual.

Figure 1. Strategic Planning Activities

Strategic Posture
- Assess the relative competitive position of the bank.
- Assess the financial condition of the bank.
- Assess the financial health of the bank.
- Assess the stage of the product/market evolution.

Opportunities and Threats
- Identify changes in the market and industry.
- Identify changes in the sources or conditions of supply.
- Identify changes in actions of competitors.
- Identify changes in environmental trends.

Resources and Skills
- Identify principle resources and skills.
- Identify major competitive strengths.
- Identify major competitive weaknesses.
- Identify major advantages over competitors.

Strategic Issues
- Identify the influence of market change on the bank.
- Identify the influence of industry change on the bank.
- Identify the influence of competitor change on the bank.
- Identify the influence of environmental change on the bank.

Figure 2. Operational Planning Activities

Marketing
- Identify the customer need to be filled by your service.
- Identify your market coverage and service levels.
- Identify the mix of advertising, media, promotion and personal contact.
- Identify your pricing approach.

Finance
- Identify sources of internal funding.
- Identify debt capacity.
- Identify sources of external capital.
- Identify liquidity requirements.

Personnel
- Identify staffing requirements.
- Identify training and development requirements.
- Identify promotion and compensation requirements.
- Identify employee performance requirements.

Operations
- Identify core deposit requirements.
- Identify equipment requirements.
- Identify product or service quality requirements.
- Identify capacity of your operations.

To indicate the extent of involvement with operational and strategic planning activities, the scores for each planning area were summed. With four clusters of planning activities, and four associated measures of comprehensiveness for each cluster (scored from 0 to 5), the resulting index could range from 0 to 80 for operational and strategic planning. A score of 0 would indicate no involvement in planning activities, while a score of 80 would indicate a very comprehensive involvement in all planning activities. As shown in Table 1, the actual range was between 17 and 77 for operational planning and between 14 and 77 for strategic planning. Computation of Cronbach's alpha for operational (0.7554) and strategic (0.8695) planning indicated an acceptable level of reliability.

Table 1. Summary of Planning Practices

	Mean	Standard Deviation	Minimum Value	Maximum Value
Operational Planning				
Marketing	12.5	2.93	4	18
Finance	12.4	3.63	2	20
Personnel	11.7	3.10	4	20
Operations	12.7	2.31	7	19
Strategic Planning				
Strategic Position	13.6	3.39	4	20
Opportunities & Threats	10.7	2.90	4	18
Resources and Skills	12.2	3.21	4	19
Strategic Issues	11.1	3.57	2	20

Performance. To measure organizational performance, an industry specific approach was used. As noted by Bracker and Pearson (3), this approach is recommended for planning research and avoids the use of meaningless performance measures. Industry experts and published documents were surveyed to determine the specific measures of success in the banking industry. Two performance measures, Net Interest Margin and Return on Assets, were identified from this process. Net Interest Margin was viewed as an important indicator of bank effectiveness in obtaining and lending funds to its customers. Net Interest Margin was defined as interest income less interest expense, as a percentage of average earning assets. Return on Assets, on the other hand, was viewed as an important indicator of efficient utilization of bank resources. To reflect the influence of planning on performance, four years of data were collected on each bank for both performance measures. This time period was consistent with the typical three to five year time period prescribed in the planning literature (12, 15), and served to define the target population as established banking organizations.

RESULTS

Planning and Efficiency

To accommodate analysis with two measures of the dependent variable, separate tests were conducted for each performance measure relative to the planning focus of interest.

Regressing Return on Assets separately on operational planning practices and strategic planning practices produced intriguing results. Operational planning evidenced a negligible relationship with Return on Assets ($F = 1.43$, $p = 0.2311$, $R2 = 0.02$), while strategic planning evidenced a significant, but weak, relationship with Return on Assets ($F = 8.01$, $p = 0.0059$, $R2 = 0.09$).

Operational components. The finding that operational planning was only negligibly associated with organizational efficiency was intriguing and prompted further inquiry. To explore its underlying nature, operational planning was disaggregated to reflect its component activities. Return on Assets was regressed separately on marketing, finance, personnel and operations activities. As shown in Table 2, personnel evidenced the strongest relationship with Return on Assets, followed in turn by finance, marketing, and operations. Apparently, comprehensive attention to the personnel activities of staffing, training and development, promotion and compensation, and employee performance standards are of basic importance to organizational efficiency. This finding would appear to verify the dictum that people are a business' most important asset. Comprehensive attention to financial and marketing activities were also important to organizational efficiency. Apparently, comprehensive attention to the financial activities helped reduce costs, while comprehensive attention to the marketing activities helped increase revenues. The negligible relationship between operations activities and efficiency is probably a result of industry influences. In the banking industry, state and federal regulatory agencies mandate banking practices, including reserve levels. Thus, core deposit requirements, capacity of operations, and product quality are externally controlled for this industry.

Table 2. Summary Table for Regression of Return on Assets on Planning Component Activities

Operational Planning

Component	SS	df	MS	R^2	F*	p
Marketing	0.0311	82	0.0311	0.04	3.36	0.0704
Finance	0.1099	82	0.1099	0.13	11.70	0.0010
Personnel	0.3049	82	0.3049	0.22	22.61	0.0001
Operations	0.0169	82	0.0169	0.02	1.93	0.1690

Strategic Planning

Component	SS	df	MS	R^2	F*	p
Position	0.0591	82	0.0591	0.08	7.13	0.0091
Opp/Threats	0.0708	82	0.0708	0.06	5.43	0.0223
Res/Skills	0.0686	82	0.0686	0.07	6.29	0.0141
Issues	0.0250	82	0.0250	0.02	1.92	0.1693

Strategic components. To further explore the relationship between planning and efficiency, strategic planning was also disaggregated to reflect its component activities. Return on Assets was regressed separately on the activities of identifying and assessing strategic position, opportunities and threats, resources and skills, and strategic issues. Of the four activity groups, assessing the bank's strategic position had the strongest relationship with Return on Assets, followed in turn by identifying resources and skills, identifying opportunities and threats, and identifying strategic issues. Apparently, comprehensive attention to identifying and assessing the organization's current position, opportunities and threats, and resources and skills are important to organizational efficiency. Understandably, an organization that knows where it is at, where it should compete, and what it has to compete with can more efficiently use its resources. The negligible relationship between identifying strategic issues and efficiency may be a result of industry influences, or more probably, the long-term time horizon of strategic issues.

Planning and Effectiveness

To assess the relative contribution of operational and strategic planning to organizational effectiveness, Net Interest Margin was regressed separately on operational and strategic planning practices. Both operational ($F = 122.78$, $p = 0.0001$, $R2 = 0.60$), and strategic planning ($F = 94.43$, $p = 0.0001$, $R2 = 0.54$) evidenced a significant relationship with Net Interest Margin. Inspection of the two coefficient of determination (R2) values suggested that when considered separately, operational planning contributed slightly more to the explanation of Net Interest Margin than did strategic planning. This, and the strength of the relationship between a summated measure of operational and strategic planning practices and Net Interest Margin ($F = 175.01$, $p = .0001$, $R2 = 0.68$), suggests that the influence of planning is cumulative. Thus, while operational planning and strategic planning are singularly important to performance, in combination they produce a more pronounced impact on organizational effectiveness.

Operational components. To further explore the relationship between planning and effectiveness, operational and strategic planning were further disaggregated to reflect their component activities. Net Interest Margin was regressed separately on marketing, finance, personnel and operations activities. As shown in Table 3, finance had the strongest relationship with Net Interest Margin, followed in turn by personnel, marketing, and operations. Apparently, comprehensive attention to all the operational planning activities is of importance to organizational effectiveness. Considering the industry-specific financial performance measures used to assess organizational effectiveness, this finding is understandable. With Net Interest Margin being calculated as the difference between interest income and interest expense divided by average earning assets, each of the operational planning component activities influence a portion of the equation. Comprehensive attention to financial activities and marketing activities influence the value of the numerator. Financial activities directed at reducing interest expense and marketing activities directed at increasing interest income, would both have a positive influence on Net Interest Margin by increasing the value of the numerator. Similarly, comprehensive attention to operational activities directed at controlling the level of assets would positively influence Net Interest Income by reducing the value of the denominator. Finally, comprehensive attention to personnel activities would positively influence Net Interest Margin by providing a competent staff to accomplish the various activities.

Table 3. Summary Table for Regression of Net Interest Margin on Planning Component Activities

Operational Planning

Component	SS	df	MS	R^2	F*	p
Marketing	2.5423	82	2.5423	0.78	292.8	0.0001
Finance	8.9670	82	8.9670	0.91	787.0	0.0001
Personnel	7.8730	82	7.8730	0.82	376.6	0.0001
Operations	0.6786	82	0.6786	0.49	77.4	0.0001

Strategic Planning

Component	SS	df	MS	R^2	F*	p
Position	3.8161	82	3.8161	0.87	522.4	0.0001
Opp/Threats	3.0042	82	3.0042	0.75	239.9	0.0001
Res/Skills	4.6835	82	4.6835	0.84	411.2	0.0001
Issues	12.1184	82	12.1184	0.92	964.9	0.0001

Strategic components. Net Interest Margin was regressed separately on the strategic planning component activities. Of the four activity groups, identifying strategic issues had the strongest relationship with Net Interest Margin, followed in turn by identifying strategic position, identifying resources and skills, and identifying opportunities and threats. Apparently, comprehensive attention to all of the strategic planning activities is important to organizational effectiveness. Considering that each activity group contributes information necessary for determining the future direction of the organization, this finding is reasonable. Understandably, an organization that knows its competitive environment, its competitive strengths, and where to compete can be more effective.

DISCUSSION

Conducted in the framework of contingency theory, the results of this study hold both practical and theoretical value. Consistent with the admonitions of Schendel and Hofer (14), Jauch and Osborn (7), and Shrader, Taylor and Dalton (15), this study took a limited domain contingency approach to the planning-performance relationship. The domain of this study was purposely limited to small, independently owned banks operating in a moderately dynamic environment. Research attention was focused on operational and strategic planning practices relative to industry specific financial performance measures. Within the confines of its domain, this study found a positive relationship between planning and performance. While these findings cannot be generalized to other settings, they do provide an incremental contribution to contingency theory. As noted by Shrader, et al., the complexity of the planning-performance relationship "makes research focusing on specific contingencies necessary before concrete conclusions and statements about planning and performance can be made" (15, p. 166).

The results of this study hold practical significance for the survival and success of small and growing businesses. The positive relationship found between planning and performance should be of particular interest to small business owners and managers intent on enhancing their firm's

performance. The relationship between planning practices and organizational effectiveness evidenced in this study would suggest comprehensively engaging in the basic operational and strategic planning activities. This does not mean to suggest, however, that the generation of highly formalized written documentation is appropriate. Rather, it means that the small firm owner/manager should devote adequate financial and human resources to both levels of planning activities. This would mean attending to the various planning activities by forming special groups as needed, involving people with diverse backgrounds, providing ample funding, conducting a thorough analysis, and considering many implications and options.

The relationships between operational planning and efficiency, and between strategic planning and efficiency, also offer practical suggestions. First, the finding that strategic planning, not operational planning, was significantly related to organizational efficiency verifies the value of strategic planning. This does not, however, suggest that emphasis be placed solely on strategic planning activities. Rather, it suggests the value of progressing beyond an operational perspective to include a broader strategic view of the organization and its environment. Apparently, attention to strategic planning activities facilitates a more efficient adaptation to the changing demands of the environment.

A final practical suggestion provided by the analysis would be to comprehensively attend to the personnel function of the organization. Small banks that comprehensively dealt with the personnel issues of staffing, training and development, promotion and compensation, and employee performance standards were significantly more efficient.

In conclusion, while the results of this study have been most encouraging, certain limitations must be recognized. First, the design of the study precludes any inferences of causality. Its non-experimental methodology and cross-sectional data are insufficient to establish temporal antecedents. Even though this study did empirically establish a relationship between planning and performance, it did not establish the causal sequence of the relationship. Therefore, while it might be reasonable to presume that increased involvement with planning activities leads to enhanced organizational performance, the relationship may be otherwise. Also, the ability to generalize the findings of this study to and across other populations is severely restricted. The intent, and design of this study focused on a narrow segment of a single industry operating in a specific geographical region. While these design parameters enhanced control over extraneous influences, they also reduced the generalizability of the findings beyond the target population. Claims of external validity beyond the target population would be spurious. Only through systematic replication and extension will the boundaries of applicability be established.

REFERENCES

1. Bracker, J. S. *Planning and Financial Performance Among Small Entrepreneurial Firms: An Industry Study* (Unpublished doctoral dissertation, Atlanta, GA: Georgia State University, 1982).

2. Bracker, J. S., Keats, B. W., & Pearson, J. N. "Planning and Financial Performance of Small, Growth Firms," Paper presented at the meeting of the Academy of Management, New Orleans, LA (August, 1987).

3. Bracker, J. S., & Pearson, J. N. "Planning and Financial Performance of Small, Mature Firms," *Strategic Management Journal* (Volume 7, 1986), 503-522.

4. Fredrickson, J. W. "The Comprehensiveness of Strategic Decision Processes: Extension, Observations, Future Directions," *Academy of Management Journal* (Volume 27, 1984), 445-466.

5. Fredrickson, J. W., & Mitchell, T. R. "Strategic Decision Process: Comprehensiveness and Performance in an Industry With an Unstable Environment," *Academy of Management Journal* (Volume 27, 1984), 399-423.

6. Hofer, C. W., & Schendel, D. E. *Strategy Formulation: Analytical Concepts* (St. Paul, MN: West, 1978).

7. Jauch, L. R., & Osborn, R. N. "Toward an Integrated Theory of Strategy, *Academy of Management Review* (Volume 6, 1981), 491-498.

8. Pearce, J. A., & Robinson, R. B. *Strategic Management: Strategy Formulation and Implementation* (Homewood, IL: Richard D. Irwin, 1988).

9. Robinson, R. B. "The Importance of 'Outsiders' in Small Firm Strategic Planning," Academy of Management Journal (Volume 25, 1982), 80-93.

10. Robinson, R. B., Logan, J. E., & Salem, M. Y. "Strategic Versus Operational Planning in Small Retail Firms," *American Journal of Small Business* (Volume 10(3), 1986), 7-16.

11. Robinson, R. B., & Pearce, J. A. "The Impact of Formalized Strategic Planning on Financial Performance in Small Organizations," *Strategic Management Journal* (Volume 4, 1983), 197- 207.

12. Robinson, R. B., & Pearce, J. A. "Research Thrusts in Small Firm Strategic Planning," *Academy of Management Review* (Volume 9, 1984), 128-137.

13. Robinson, R. B., Salem, M. Y., Logan, J. E., & Pearce, J. A. "Planning Activities Related to Independent Retail Firm Performance," *American Journal of Small Business* (Volume 10(2), 1986), 19-26.

14. Schendel, D. E., & Hofer, C. W. "Research Needs and Issues in Strategic Management," In D. E. Schendel and C. W. Hofer (Eds.), *Strategic Management: A New View of Business Policy and Planning* (Boston, MA: Little, Brown and Company, 1979, 515-530).

15. Shrader, C. B., Taylor, L., & Dalton, D. R. "Strategic Planning and Organizational Performance: A Critical Appraisal," *Journal of Management* (Volume 10, 1984), 149-171.