

# Strategy-making process and firm performance in small firms

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## ABSTRACT

*This paper argues that individual small firms just like large firms, place differing emphasis on strategy-making and may employ different modes of strategy-making. It offers a typology of the different modes of strategy-making that seem most likely to exist in small firms, and hypothesises how this typology relates to performance. It then describes the results of an empirical study of the strategy-making processes of small firms. The structural equation analysis of the data from 477 small firms with less than 100 employees indicates among other results that the simplistic, adaptive, intrapreneurial and participative modes of strategy-making exist in these small firms. Of these modes, the simplistic mode exhibits the strongest relationship with firm performance.*

Key words: strategy-making process; firm performance; small firms

Strategy-making processes have been described variously over the past 40 years, ranging from Mintzberg's (1973) adaptive and entrepreneurial modes, to Hart's (1991) generative and symbolic modes. What most of these authors have in common is recognition of the rational or planned mode as the predominant strategy-making process found in firms (Hart 1991; Mintzberg 1973; Robinson & Pearce 1983). This notion of rationality in strategy-making is, however, questionable in a small firm environment (Harris, Forbes & Fletcher 2000), especially within firms with less than 100 employees such as those investigated in this study.

Few studies have investigated and developed models of strategy-making in small firms (e.g. Cooper 1979; McCarthy & Leavy 1998, 1999). Where researchers have studied strategy-making in small firms, the research tends to be focussed on discovering the degree to which formal strategy-making processes are employed in these

firms (e.g. Matthews & Scott 1995; Robinson & Pearce 1983). Marsden and Forbes (2003) explain the latter situations by suggesting that the scholars who investigate planning in small firms are different from those who study strategy-making in general. Scholars interested in strategy-making in general seek to develop analytical models and concepts which are applicable to all firms, often independent of contingent factors such as size and industry. Scholars studying small firms are interested in the causes of performance variation, one of which may be strategy-making practices.

Understanding the exact nature of the strategy-making process that a firm uses is exceedingly important when the relationship between this construct and firm performance is investigated in order to ensure both scientific rigour and applicability to practice. Such studies are important since strategy-making processes may be the most important factor that determines the ability of a firm to

realise its strategic intent (Eden & Ackermann 1998) and the strategy-making process that a firm uses may have a profound impact on firm performance (Hart & Banbury 1994). In the past forty years, strategic management scholars have investigated the strategy-making processes of firms and their impact on firm performance (e.g. Hart & Banbury 1994; Miller & Friesen 1977). The resulting literature tends to focus on building models that explain, predict and facilitate the positive influence of strategy-making processes on the performance of the firm. An important question that researchers of strategy-making processes should ask is how generalisable to small firms are those models that explain performance in large firms? This question should be explored empirically.

Two issues arise from this brief introduction. Firstly, the importance of exploring the nature of the modes of strategy-making used by small firms is noted. Secondly, it is evident that the relationship between strategy-making process and firm performance should also be investigated in small firms. This paper aims to address both these issues by identifying the strategy-making processes that small firms use, and explain which approaches are more likely to lead to success. To this extent it provides a snap-shot of the state of strategy-making in small firms. It does not pretend to offer an all inclusive coverage of the field, but rather is an exploratory investigation into a field of study that has been under-investigated in small firms.

### **STRATEGY-MAKING TYPOLOGY FOR SMALL FIRMS**

Strategic management is a relatively new field of study that has evolved in creative and irregular ways over the past forty years. Within strategic management a distinct body of knowledge, namely that of strategy-making process, can be found. The strategy-making process has been defined as an organisation-wide phenomenon that involves decision making by top managers and/or other organisation members (Lumpkin & Dess 1995). Hart and Banbury (1994) explain

that this process is typically referred to in 'either-or' terms, for example either formal or informal, or either formulation or implementation. Different firms make strategies in different ways, and do not employ only rational or formal processes (Hart 1991). A set of approaches (or modes) to strategy-making process (e.g. Hart 1991; Mintzberg 1973) that are presented as complementary to each other, are called a typology of strategy-making processes. A bewildering array of such typologies of strategy-making processes has been developed over the past 40 years (Hart 1992). This proliferation of typologies has produced several problems for researchers in this area. According to Hart (1991: 99) the 'lack of methodological consistency and confusion over typologies that focus on similar phenomena from different points of view' are the most significant of these problems.

Nowhere is this problem as significant as in the research which investigates strategy-making in small firms. In fact, few of the models that were developed for large firms have been found to be applicable to small firms (O'Gorman & Doran 1999). This situation is further exacerbated by the fact that strategy-making research in small firms is mostly undertaken in larger small and medium enterprises (SMEs) with up to 500 employees in North America and Europe (Analoui & Karami 2002; Miller & Toulouse 1986; Ogunmokun, Shaw & FitzRoy 1999), which do not offer many solutions to smaller firms. These smaller firms have a unique nature, evidenced by resource constraints, lack of experience, and informal structures which often lead to a close proximity between staff (Matthews & Scott 1995). This section attempts to overcome the problem of relevance by exploring the existing typologies of strategy-making for modes that are likely to be relevant to small firms, typically those with fewer than 100 employees (Cameron & Massey 1999). In particular, the potential relevance of the rational, adaptive, command, intrapreneurial, participative, symbolic and simplistic modes are considered (Dess, Lumpkin &

Covin 1997; Hart 1991, 1992). At the end of the section a typology of strategy-making processes for small firms is provided in the form of Hypothesis 1.

Strategy-making theory and teaching initially centred on a model of *rationality*. Rationality, as explained by the early authors (e.g. Andrews 1971; Ansoff 1965), implies that the decision maker(s) analyse the firm and its environment, consider all the possible alternatives or strategies, evaluate the consequences from the adoption of each alternative, and select the most appropriate strategy. These processes are commonly considered as the only existing strategy-making process (e.g. Gibson & Cassar 2002). When authors discuss the absence or presence of strategy-making in a small firm without clarification, they are usually referring to either the compilation of the business plan for obtaining finance, or to a formal, rational strategy-making process. Even though rationality was, and to some extent still is, the dominant theoretical mode of strategy-making, some authors (e.g. Mintzberg 1973; Quinn 1978) question whether it is the only mode of strategy-making employed by firms. Although authors such as Hart (1991, 1992) find that the rational mode of strategy-making is very important to large firms, this paper argues that the rational mode may not be relevant to small firms at all. Instead, other modes of strategy-making may be more applicable to small firms, as discussed next.

Mintzberg (1973) and Quinn (1978) suggest that strategy-making may also be made in a less rational, step-by-step approach. Mintzberg (1973) terms this mode of strategy-making *adaptive*, Quinn (1978) *logical incrementalism*, and Mintzberg and Waters (1985) *emergent strategy*. This mode implies that top-management provides the broad direction that the firm will follow, but that the detail of that strategy emerges over time through the actions of the employees of the firm. For example, Harris et al. (2000) find that strategy-making in small firms is mainly emergent, adaptive and reliant on personal relation-

ships. Also, Chen and Hambrick (1995) explain that smaller firms are more responsive when attacked and implement their competitive reactions faster. This paper proposes that the adaptive mode of strategy-making indicates an active engagement of external stakeholders in the direction of the firm which is often employed by small firms because of their dependence on these stakeholders, which typically include customers and suppliers. This engagement may be less formal than when a rational strategy-making process is followed, but may nevertheless exhibit elements of strategic thinking, as suggested by Quinn (1980). Such strategic thinking is sometimes called the *vision* or an *umbrella strategy* (Mintzberg & Waters 1985).

As well as supplying direction to firms employing adaptive strategy-making processes, vision also provides direction to firms that employ *command* strategy-making practices. Hart (1992: 335) describes the command mode as a mode of strategy-making in which 'a strong individual leader or a few top managers exercise total control over the firm'. In this mode employees are seen as followers who carry out the commands of the leader without question. The opposite of the command mode is the *intrapreneurial* mode of strategy-making. Also termed the *generative* mode of strategy-making (Hart 1992), this mode implies independent behaviour by innovative employees who are encouraged and sponsored by top-management to experiment and take risks. However, the independent existence of the command and intrapreneurial strategy-making modes is questioned by some authors (e.g. Dess et al. 1997). The presence of top-managers who encourage and sponsor in the intrapreneurial mode implies some sort of induced (top-down) behaviour. This paper suggests, however, that it is likely the strategy may be generated emergently by innovative employees in some small enterprises, without strong direction from the owner or manager of the firm. Therefore it is likely that the intrapreneurial mode exists in such enterprises.

The intrapreneurial mode identifies one way in

which employees can be involved in the strategy-making process of the firm. In this mode employees generate ideas and therefore influence the strategic direction of the firm. But it seems as if this strong trend towards the involvement of employees in strategy-making may actually be a joint attempt by managers and other employees (Hart 1992; Parnell, Carraher & Holt 2002; Wooldridge & Floyd 1990). Dess et al. (1997) and Khandwalla (1976/77) call this mode of strategy-making *participative* or *democratic* and indicate that decision-making involves employees on different levels and across functions in the firm. This mode indicates that strategy-making occurs mainly from the bottom of the firm upwards, or in the case of organic firms, through teamwork. Participative strategy-making is not indicative of rationality, but rather of an informal but inclusive decision-making process. Participation is often conceptualised as being political in nature (Bourgeois & Brodwin 1984; Shrivastava & Grant 1985), but in very small firms it is unlikely to be the norm, supposedly because of the strong influence of the owner (Mintzberg 1973).

While a participative mode depends on a high level of involvement in strategy-making, often through political processes, the *symbolic* mode relies on a strong organisational culture, defined by a firm's vision, basic philosophy and values (Hart 1992). In a symbolic mode, vision and culture provide employees with a sense of how things are done in this firm, and strategy therefore follows culture. Lumpkin and Dess (1995) combine the command and symbolic modes of strategy-making and call it *simplistic* strategy-making. They describe the simplistic mode as characterised by 'single-mindedness, narrowly construed decision-making, and excessive attention to a specific internal strength or external opportunity' (1995: 1403). Small firm researchers allude to the existence of this mode. For example, in a study of 331 Australian small firms with less than 100 employees, Frost (2003) found that the use of strategic tools and a strategic plan was significant. But the range and depth of the tool

usage is disappointing, especially when compared to previous studies in larger firms, such as Clark's (1997). It is argued that this scaled-down version of rationality may point to the simplistic mode as more relevant to small firms.

The rational, adaptive, command, intrapreneurial, participative, symbolic and simplistic modes of strategy-making are found in most of the existing strategy-making typologies (Dess et al. 1997; Hart 1991). However, this paper questions the existence of a rational mode of strategy-making in small firms. This is supported by Matthews and Scott (1995) who found that small firms are unsophisticated users of strategic planning. It further agrees with Lumpkin and Dess (1995) that the command and symbolic modes are in effect the same mode of strategy-making than simplistic strategy-making. This argument is in line with the earlier suggestions by Hart (1992) and Mintzberg (1973) who suggest that it is entirely possible that some modes can be used at the same time by a firm, and therefore represent another mode of strategy-making. For this reason, only four modes of strategy-making, namely the adaptive, intrapreneurial, participative and simplistic modes will be used in this paper. Support for the use of some of these modes in small firms are found in the literature as indicated earlier, but for the most part this paper argues that these four modes are more suitable for small firms. For example, the use of blueprints of strategic plans developed by consultants, a practice often found in small firms (Bracker & Pearson 1985), is partially indicative of the simplistic mode (Lumpkin & Dess 1995). Strong ties with internal and external stakeholders, as often found in small firms (Harris et al. 2000), are indicative of participative and adaptive approaches, while intrapreneurial approaches are often touted as particularly relevant to small firms (Covin & Slevin 1989). Therefore, using the approach by Dess et al. (1997) to hypothesising about the strategy-making processes used by firms, a synthesis of the above research suggests that:

*Hypothesis 1.* Small firms will employ all or some of the simplistic, adaptive, intrapreneurial and participative strategy-making processes.

## STRATEGY-MAKING PROCESSES AND FIRM PERFORMANCE

Although the literature suggests the existence of the aforementioned processes in small firms, it is of little consequence if these processes do not have the potential to improve firm performance. Several studies (e.g. Hart 1991; Matthews & Scott 1995; Robinson & Pearce 1983) investigate the effect of strategy-making processes on firm performance.

This paper takes the stand that traditional rational processes will not be used significantly by small enterprises (Frost 2003) and that the most formal process that small firms normally employ is *simplistic* strategy-making. The general consensus seems to be that processes that are more rational in nature will be strongly associated with firm performance (Hart 1991). Agreement exists in the literature which deals with small firm planning. For instance, Miller and Toulouse (1986) found in a study of 97 small firms in Canada that successful small firms have more explicit strategies, longer planning horizons and more detailed decision analysis, that is, more rational processes. Van Gelderen, Frese and Thurik (2000) found in a study of Dutch small firms that formal processes will impact on performance and that performance will in turn lead to more formal strategy-making processes. In general it seems as if the support for a strong relationship between formal strategy-making and firm performance is quite conclusive (Robinson & Pearce 1983). This paper argues that this conclusion can be extended to the relationship between simplistic strategy-making and firm performance because of the formal nature, albeit in a scaled down version, of the simplistic mode.

Other authors look at the relationship between *adaptive* strategy-making and firm performance. Barney (1991) suggests that adaptive strategy-making is a rare and inimitable process that will

lead to competitive advantage. He is supported by Hart (1991) who found in a study of 916 firms of all sizes and industry sectors that the adaptive (transactive) mode of strategy-making is more highly associated with firm performance than the rational and generative (intrapreneurial) modes. But Van Gelderen et al. (2000) found that not only does adaptive (reactive) strategy-making lead to poor performance, but also that poor performance leads to reactive strategies. The support for the relationship between adaptive strategy-making and firm performance is therefore mixed and may depend on the conceptualisation of adaptive strategy-making in a particular study. The explanation for this contradictory evidence may lie in the definition of this mode. In this paper, *adaptive* strategy-making is defined as an active engagement with external stakeholders, rather than the logical incrementalism of Hart (1991) and Quinn (1980). When it is defined in this manner, it is essentially a reactive process and less likely to be correlated with strong performance (Miles, Snow & Meyer 1978). Therefore such a relationship is not proposed for this study.

Participative strategy-making also receives some attention in this regard. Parnell and Crandall (2001) raise the possibility that *participative* decision-making techniques may improve decision quality and therefore organisational effectiveness. Frese, van Gelderen and Ombach (2000) found that critical point (participative) strategy-making is the most highly related to firm success. This finding supports the study by Wooldridge and Floyd (1990) who found that participation in strategy-making is associated with improved firm performance. It seems highly likely that these results will be replicated in small firms where teamwork of any nature may offset the limitations resulting from a lack of resources.

Lastly, there has also been much debate about the performance outcomes of an *intrapreneurial* mode of strategy-making. Beaver and Jennings (2000: 4) posit that the 'relationship between enterprise performance, management actions (or inaction) and the value and contribution of strat-

egy is extremely tenuous and very difficult, if not impossible, to demonstrate conclusively'. Much of what has been written about intrapreneurial strategy-making and its performance implication in both the popular press and academic journals assume that intrapreneurial strategy-making will lead to growth and profitability for the firm (Peters & Waterman 1982; Covin & Slevin 1991). But others such as Dess et al. (1997) and Hart (1991) found empirically that it may impede performance. The above literature suggests that the simplistic or participative modes of strategy-making are strongly correlated with performance, but that such a relationship cannot be supported for the adaptive or intrapreneurial modes. It can therefore be argued that:

*Hypothesis 2.* The simplistic or participative modes of strategy-making will have a positive relationship with firm performance

## RESEARCH METHOD

An empirical study was conducted to test the hypotheses set out earlier. A questionnaire was designed to elicit the four modes of strategy-making and firm performance. Although a variety of contingency variables were also included in the questionnaire, this paper focuses only on the strategy-making and firm performance aspects of the study. In this section, a brief overview of the survey instrument and data-analysis is provided.

### Data collection

A questionnaire that contains scales identified through a literature review was mailed to 2000 small firms in New Zealand, chosen randomly from the Kompass database. Kompass is a global database of 1.9 million firms across 70 countries and can be used to generate a sample within a specific country. A total of 477 usable questionnaires were returned, entered into an Excel datasheet and analysed with the use of SPSS 11.5 and AMOS 5.

The firms that were selected from the database excluded farming operations, foreign owned firms

and firms with more than 100 employees, following the norms established by Cameron and Massey (1999). This number was deemed appropriate because, even though no internationally recognised definition of small firms using employee numbers exists, Ghobadian and O'Regan (2000) argue that firms with 250 employees can not only be considered small and medium enterprises, but that they can also be treated as a homogeneous grouping. From this an inference is made that a number of 100 employees is an appropriate limit to call a firm small.

The questionnaire was mailed to the owner-manager of each small firm, and a reminder was mailed one month later. Five hundred and four questionnaires were returned of which 477 were deemed usable. The average size of the respondent firms was 23 full time employees, averaging 33 years of age and indicating that they were mostly in the growth or maturity (90 per cent) of the industry life cycle. These firms were therefore clearly not startup firms. The manufacturing industry (31 per cent) followed by wholesale (14 per cent) and construction (ten per cent) were the industry sectors that accounted for the majority of firms.

### Measurement instrument

Strategy-making mode was measured with the Hart (1991) scale as modified by Dess et al. (1997). This scale was originally developed by Hart to test for strategy-making modes based on the two dimensions that he argued as 'central to [conceptualising] and understanding strategy-making processes: (1) top management 'intentionality'; and (2) [organisational] actor "autonomy"' (1991: 104). Dess et al. (1997) modified the scale and found that four modes resulted from their factor analysis. These modes are similar to the four modes identified earlier in this paper. Their scale consists of 25 items and is scored on a five point Likert scale, ranging from 1 'Strongly disagree' to 5 'Strongly agree'.

The dependent variable, firm performance, was measured by using the financial performance

scale developed by Covin and Slevin (1989) and Gupta and Govindarajan (1984). Respondents had to indicate the 'importance' of ten financial measures, namely sales level, sales growth rate, cash flow, return on shareholder equity, gross profit margin, net profit margin from operations, profit to sales ratio, return on investment, ability to fund business growth from profits, and overall firm performance, to the firm on a five point Likert scale. Thereafter they were asked to indicate their satisfaction with the firm's performance for the same ten performance measures. The 'satisfaction' scores were multiplied by the 'importance' scores and aggregated in order to compute a weighted average performance index for each firm. Weighing satisfaction with importance scores is the same method followed by Covin and Slevin (1989). The higher the aggregate score on this relative index, the better the perceived level of firm performance. Table 2 contains the Pearson's correlations and summary statistics for the dependent and independent variables.

### Data analysis

The data were investigated to ensure that they satisfied the underlying assumptions for parametric testing. It was concluded that the assumptions for random sampling, normality, linearity and homoscedasticity were satisfied. The measurement instrument was also tested for reliability and validity. Further data analyses were conducted using Pearson's correlations and structural equation modelling (SEM).

First, a *measurement model* for the four modes of strategy-making in Hypothesis 1 was developed and analysed with AMOS 5. The four modes of strategy-making were the result of a process in which alternative models of modes of strategy-making were compared through SEM. The four modes model did not only describe the data best but were also the only model in which all the modes had satisfactory Cronbach alphas. Second, *causal models* based on Hypothesis 2 were tested. The measurement instrument presented earlier contained 45 items in total. The

first 25 items of the strategy-making scale were used for the measurement and causal models as indicated in Figure 1. The 20 items from the performance scale were aggregated into an index as explained earlier and used in the causal model.

## FINDINGS

In this section the findings are presented based on the two hypotheses formulated earlier.

### Measurement model: Hypothesis 1

The measurement model was developed and analysed as a confirmatory factor analysis (CFA). To ensure internal reliability, the Cronbach alpha of each factor was also attained. AMOS uses the maximum-likelihood method. Each of the 25 items was allowed to load on its associated factor which was decided *a priori* (Byrne 2001) through a thorough review of the literature.

The regression weights for errors were set at 1.0. Items were connected to factors as proposed in the theoretical model. None of the factors comprised less than three items (Hair, Anderson, Tatham & Black 1998). Furthermore, the regression weight of the item that was expected to contribute most to each construct following the exploratory factor analysis (EFA) done to ensure reliability was also set at one, as was the regression weight of the factor that is expected to contribute most to the overall construct of strategy-making (for this factor, usually 'participation', no item had a regression weight of 1.0). The measurement model can be observed in Figure 1 if the performance variable is not considered. Table 1 reports the goodness-of-fit results for the measurement model.

As indicated in Table 1, the measurement model describes the data well and Hypothesis 1 can therefore be accepted. Therefore, small firms are likely to employ the simplistic, adaptive, intrapreneurial and participative modes of strategy-making.

### Causal models: Hypothesis 2

Pearson's product moment correlation coefficient

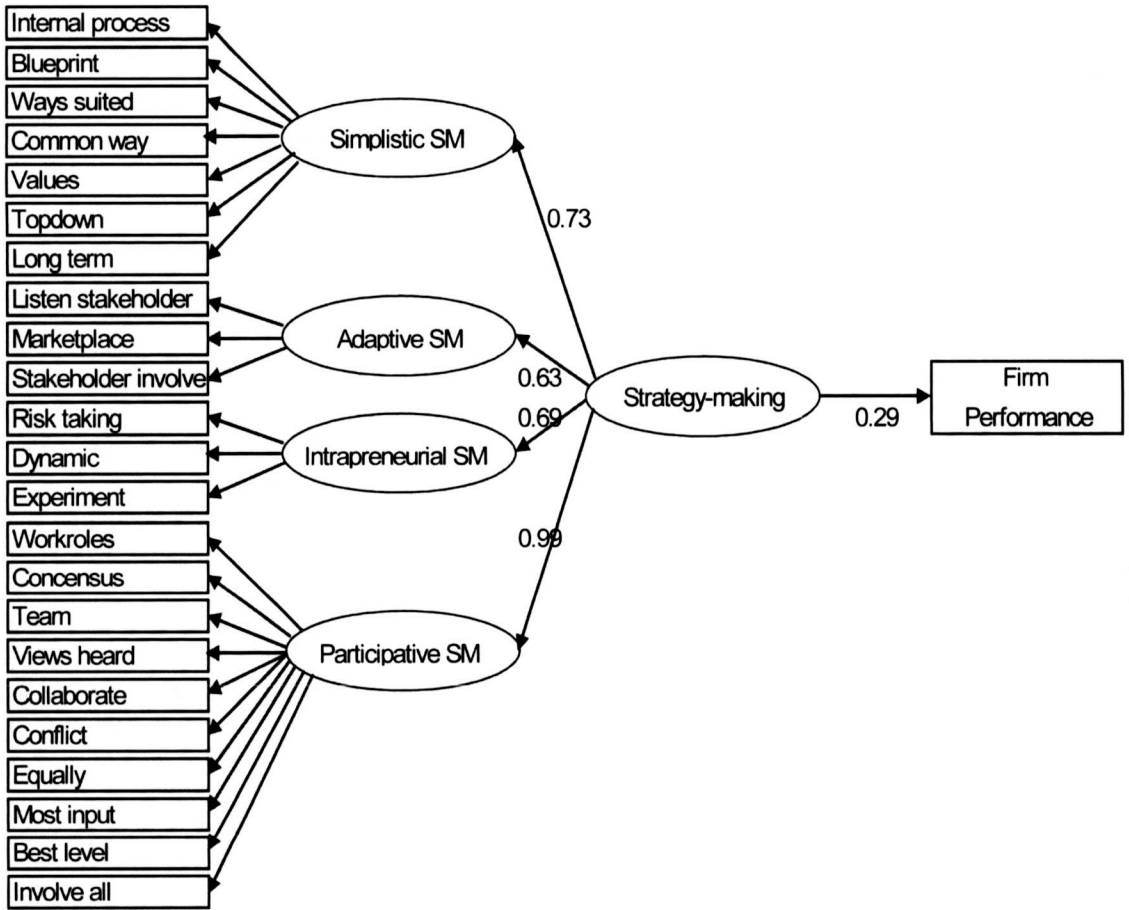


FIGURE 1: STRATEGY-MAKING – PERFORMANCE (STANDARDISED WEIGHTS SHOWN)

and SEM in AMOS were used to explore the relationships between the modes of strategy-making and firm performance. First, Pearson’s product moment correlations were used to investigate whether linear relationships exist (Table 2). A significant positive relationship was found between firm performance and the simplistic

mode of strategy-making. The relationship of the adaptive and participative modes of strategy-making with firm performance showed a lower, yet also statistically significant, correlation. Although these correlations are weak ( $r < 0.3$ ) they are nevertheless interesting. However, only a weak relationship was found between firm

TABLE 1: AMOS GOODNESS-OF-FIT RESULTS FOR THE MEASUREMENT MODEL

Goodness-of-fit Statistics	Results	Ideal values
$\chi^2/DF$	3.024	Below 5
P	0.000	Below 0.05
RMSEA	0.065	Below 0.08
CFI	0.856	Close to 0.90
PNFI	0.706	0.60 to 0.90
GFI	0.877	Close to 0.90



TABLE 2: PEARSON'S CORRELATIONS FOR MODES OF STRATEGY-MAKING AND FIRM PERFORMANCE

Modes of strategy-making	Number of items	Mean	Standard deviation	Performance index	Simplistic strategy-making	Adaptive strategy-making	Intrapreneurial strategy-making	Participative strategy-making
Performance index	20	6.99	1.93	1				
Simplistic strategy-making	7	3.75	0.52	.314(**)	1			
Adaptive strategy-making	3	3.29	0.66	.256(**)	.256(**)	1		
Intrapreneurial strategy-making	3	3.49	0.71	.106(*)	.181(**)	.346(**)	1	
Participative strategy-making	10	3.72	0.57	.255(**)	.439(**)	.460(**)	.551(**)	1

\*\* Correlation is significant at the 0.01 level (2-tailed). \* Correlation is significant at the 0.05 level (2-tailed).

performance and the intrapreneurial mode of strategy-making at the five per cent significance level. The latter result is consistent with the findings of Dess et al. (1997).

Next, causal modelling in AMOS was employed to investigate this relationship further. The measurement model developed for the testing of Hypothesis 1 was used as the basis for developing the three causal models that investigate the impact of mode of strategy-making on firm performance. In the first model the various modes of strategy-making were linked to firm performance through the strategy-making construct (Model 1 – indirect: see Figure 1).

In the second model, the various modes of strategy-making were linked to firm performance directly (Model 2 – direct). This was done to ascertain the individual effects of the modes of

strategy-making on firm performance as well as the direction of the strategy-making/firm performance relationship. In the third model, the arrow was also reversed to double check if performance is the dependent factor in Model 1 (Model 3 – indirect recurring). The results of the goodness-of-fit statistics for strategy-making – performance Models 1, 2 and 3 are found in Table 3.

The  $\chi^2$ , RMSEA and GFI values indicate that Model 2 is worse than Models 1 and 3. But the difference between Model 1 and 3 is totally insignificant, suggesting that the link between performance and strategy-making is bi-directional. The lower RMSEA values exhibited by Models 1 and 3 are indicative of the ability of a combination of modes to predict performance better than one mode at a time.

TABLE 3: A COMPARISON OF THE GOODNESS-OF-FIT STATISTICS FOR THE THREE STRATEGY-MAKING-PERFORMANCE MODELS

Statistics	Model 1: (indirect)	Model 2: (direct)	Model 3: (indirect recurrent)	Ideal value
$\chi^2/DF$	3.01	3.39	3.02	Below 5
P	0.000	0.000	0.000	Below 0.05
RMSEA	0.065	0.071	0.065	Below 0.08
CFI	0.836	0.807	0.835	Close to 0.90
PNFI	0.698	0.662	0.696	0.60 to 0.90
GFI	0.872	0.867	0.872	Close to 0.90

TABLE 4: SQUARED MULTIPLE CORRELATIONS FOR STRUCTURAL MODELS

Items	Model 1	Model 2	Model 3	Measurement model	SW
Adaptive	0.391		0.412	0.381	0.197
Participative	0.995		0.949	0.995	0.002
Intrapreneurial	0.475		0.480	0.482	-0.052
Simplistic	0.526		0.543	0.509	0.350
Performance	0.085	0.165			
Strategy-making			0.093		

When all the modes of strategy-making were considered together in Model 1, 8.5 per cent for the variance in the overall firm performance was explained by the combined modes of strategy-making (see squared multiple correlations (SMC) in Table 4). This is a reasonable multiple correlation considering that the modes of strategy-making only partially explain firm performance while the outcome thereof (the strategies) should have a more direct impact on firm performance. Note that the high SMCs of participative strategy-making in Models 1 and 3 are indicative of that mode's contribution to strategy-making and not to firm performance.

Although the goodness-of-fit statistics of Model 2 were not as good as for Models 1 and 3, they were good enough to be examined to see which mode of strategy-making contributed most to firm performance. The standardised weights (SWs) suggest that the simplistic mode of strategy-making contributes most to performance, followed by the adaptive mode of strategy-making. Participative strategy-making contributes little, while intrapreneurial strategy-making has a negative effect on firm performance. In total, 16.5 per cent of the overall variance in firm performance is accounted for in this manner. This result generally supports that of the correlations.

Collectively, these results suggest that simplistic strategy-making has the most significant relationship with firm performance ( $r = 0.314$ ,  $p < 0.01$ ) and also contributes most to firm performance in the structural model (SW is 0.35). Strong support for a similar relationship between participative strategy-making and firm performance was not

found, although significant but weak relationships between adaptive strategy-making and firm performance, as well as participative strategy-making and firm performance were found. Furthermore, the direction of the relationship between strategy-making and firm performance could not be established. These results provide therefore only partial support for Hypothesis 2.

## DISCUSSION AND CONCLUSIONS

Four conclusions appear evident from the results presented in this paper. First, this study questions the validity of past studies which judged that small firms do not make strategy, when in effect they were investigating primarily whether rational strategy-making occur. An exploration of previous studies (e.g. Matthews & Scott 1995; Robinson & Pearce 1983) that investigate the tenuous link between strategy-making processes and firm performance in small firms show that few studies entertain the idea that strategy-making processes do not have to be rational or even formal to contribute to firm performance. In reality, this paper suggests that pure rationality may not occur at all in small firms and that studies that investigate the use of strategy-making practices in small firms would be better off using a typology or taxonomy of strategy-making processes to explore it. In this regard, this paper provides an empirically derived taxonomy for the future investigation of strategy-making in small firms to researchers. This taxonomy consists of the adaptive, intrapreneurial, participative and simplistic modes of strategy-making.

Second, the most formal mode that emerges

from this study is the simplistic mode. This mode indicates a very limited, simplified approach which is largely driven by the owner/manager of the firm and is based on the previous strategy of the firm. The simplistic mode exhibits little/no analysis of the environment or possible future strategies. This mode is strongly correlated with firm performance. This relationship is much stronger than that found by Lumpkin and Dess (1995) in large firms which further supports the previous suggestion that this mode may be particularly suitable to small firms.

Third, a strong theme that emerges from this study is one of involvement of internal and external stakeholders in the strategy-making process. For example, whereas the literature (e.g. Mintzberg 1973) defines intrapreneurial strategy-making as a process driven by a strong leader, in small firms this mode is rather characterised by emergent strategies, formed through involvement and experimentation by employees, which leads to innovative ideas. This result is interesting because, read together with the results of the next two modes it indicates that small firms are heavily reliant on internal and external stakeholders and not as much on the owner-manager as theorised before by Mintzberg (1973).

The *adaptive* mode shows that adaptation in small firms is driven by the firm's responsiveness to its stakeholders. The firms that exhibit this mode therefore adapt to suggestions from, for example customers and suppliers, and these then influence the strategy of the firm. This take on adaptive strategy-making differs significantly from previous studies that define it as emergent strategy-making (Butler et al. 1979; Mintzberg 1973), external and internal adaptiveness (Mintzberg 1973), incrementalism (Quinn 1980) and learning (Hart 1992) and is more closely related to the interpretation of Miller and Friesen (1977) and Dess et al. (1997). Contrary to Hypothesis 2, adaptive strategy-making shows a significant relationship with firm performance. Miller and Cardinal (1994) argue that adaptive thinking could be a valuable way for small firm owner/

managers to avoid mistakes, something that these firms can ill afford. It is, however, also possible that close ties with external stakeholders may improve the product offering of a small firm, thereby increasing sales and improving performance.

The *participative* mode shows a very idyllic picture of a firm in which a large amount of cooperation, teamwork and values drive the strategy-making process. It should also be noted that the political aspects suggested by Mintzberg (1973) are absent from the strategy-making processes of small firms, most likely as a result of their non-threatening size, and lack of time, experience or need to engage in such activities. Rather than being driven by coercive politics, this mode is driven by values or culture. Although the modes representative of this involvement are not as strongly related to firm performance as simplicity, they are nevertheless related to it in varying degrees.

The final result of importance at this point is that SEM indicates a *reciprocal relationship* between strategy-making and firm performance. Although further analysis should be undertaken to explore this relationship, at this stage it suffices to state that it seems as if the use of strategy-making processes may have a positive effect on firm performance – something that strategic management scholars have argued for forty years (Khandwalla 1976, 1977). However, it also seems as if firms that perform better are more likely to engage in strategy-making processes (Gibson & Cassar 2005). This result is reasonable, given that it has been previously argued that time and money may be the reason small firms do not engage in strategy-making. If these issues are solved through high performance, and therefore increased resources, small firms may choose to engage in the activity which may then have a greater effect on performance. Conversely, it is also possible that a firm performs well through sheer luck (Khandwalla 1976, 1977) and then uses the resultant slack to invest in one or more modes of strategy-making, e.g. to become

more venturesome (entrepreneurial), or to engage stakeholders more (adaptive).

A number of limitations have to be kept in mind when reading the results of this study. First, the strategy-making modes in the measurement model suggested in this paper are comprehensive, but certainly not exhaustive. Second, the data analysis merely shows that some strategy-making practices are more strongly related to performance. The data cannot be interpreted as indicating that firms that do not perform as well do not engage in strategy-making at all. Neither does it suggest that small firms cannot perform well without employing these strategy-making practices (Covin & Slevin 1989). In effect, less than ten per cent of the variation in firm performance can be explained by the use of the suggested strategy-making practices in the suitable context and/or content. Third, since data were collected from New Zealand SMEs, the generalisability of the results to other settings is questionable. Further research in other settings or countries will have to be undertaken to confirm the results. Last, the cross-sectional design may be another limitation (Bowen & Wiersema 1999; Schwartz & Teach 2000). A longitudinal study may provide some additional advantages.

This study offers a number of implications for business practice. First, if it is true that small firms naturally engage in strategy-making practices, researchers and practitioners may find it valuable to study those practices and to develop tools to suit those small firms that will be of greater strategy-making value. Academics and tertiary institutions will be well advised to develop strategic management courses specifically designed for small firms, which should contain specially developed techniques and tools that are less time-consuming and expensive to use and more suited to small firms. Second, this study finds that small firm owner/managers who are concerned with the development of strategy-making processes in their firms can expect little benefit from employing highly rational processes, such as those taught in most business schools.

Instead, small firms should concentrate on exploiting the advantages that stem from their small size, such as developing their capabilities to be strategically aware (Hannon & Atherton 1996) and interacting with stakeholders with a view to considering suggestions on the strategic direction of the firm. Also important is the ability to generate a positive organisational culture and to employ this in the strategy-making process; the ability to communicate and work well as a team; and the ability to adapt quickly to changes in the environment. If small firms engage in these practices, firm performance is likely to improve. In the interim, this paper identifies four modes of strategy-making which represent a way of thinking about the range and complexity of techniques and issues that small firm owner/managers may consider when organising their firm's approach to strategy-making.

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