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## The Impact of Formalized Strategic Planning on Financial Performance in Small Organizations

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### Summary

*The relationship between formality of planning procedures and financial performance was examined for a sample of small U.S. banks. Small banks without formal planning systems performed equally with small, formal planners. Regardless of formality, each set of banks placed equal emphasis on all aspects of strategic decision-making except formalized goals and objectives. Results suggest that managers responsible for strategic planning activity in smaller organizations do not appear to benefit from a highly formalized planning process, extensive written documentation, or the use of mission and goal identification as the beginning of a strategic planning process.*

While there is a strong undercurrent of empirical support for a positive relationship between strategic planning and performance in business organizations (Ansoff, Brandenburg and Radosevich, 1971; Burt, 1978; Herald, 1972; Karger and Malik, 1975; Rue, 1973; Thune and House, 1970; Wood and LaForge, 1979), several contradictory findings have emerged. Grinyer and Norburn (1975) did not find a significant relationship between formal strategic planning and financial performance for 21 United Kingdom companies. Kudla (1980) surveyed 328 *Fortune* 500 companies and found no significant differences in the returns to shareholders achieved by planning and non-planning firms. Leontiades and Tezel (1980) found no association between the perceived value of planning (from chief executive officers (CEOs) and chief planning officers) and related performance measures for 61 *Fortune* 1000 firms.

These 'negative' studies have raised important methodological concerns about previous research on the planning-performance relationship. First, Kudla (1980) found that previous studies lacked control of extraneous, independent variables that could have influenced performance. 'These studies ignored general market conditions such as economic conditions and government factors that differentially affect all or most of the firms' (Kudla, 1980:7). Often, these studies did not control for inter-industry differences even though previous research (Beard and Dess, 1979; 1981) has suggested that 'industry' is a key determinant of the level of profitability. Indeed, Rue's (1973) study found no consistent differences between planners and non-planners in non-durable industries while finding that non-planners outperformed planners in service industries. Another major concern, particularly emphasized by Leontiades and Tezel (1980), is that the approaches of operationalizing formality of strategic planning in previous studies have been overly simplistic, arbitrary, and more a reflection of the researcher's opinion than the true character of the planning system.

Another major concern with this stream of research, whether the results have been favourable or unfavourable regarding the impact of planning, is the consistent bias toward large firm

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samples. For example, the banks examined by Wood and LaForge (1979) may well be representative of only 10–15 per cent of all banks operating within the regional banking industry they surveyed. A recent study by Lindsay and Rue, examining the effectiveness of strategic planning systems in relation to environmental complexity, sounds the ‘large-firm-bias alarm’ for such empirical research. They offer the following observations:

Another finding was that the degree of openness in long-range planning processes is directly related to the degree of environmental complexity for large firms, *but inversely related for small firms*. . . . The evidence obtained from this study suggests that *large business firms* in a variety of industries are attempting to ‘fit’ their long-range planning processes to their perceived environmental conditions, . . . and that *small firms should be considered as a separate class* in this and future related studies (1980:402).

They suggest, along with Hofer (1975), that firm size is an important contingency variable to consider in the design of effective strategic planning processes. This contingency, essentially ignored in previous strategic planning research, could easily be considered as one of the extraneous influences Kudla (1980) warned about.

Limited empirical research is emerging that examines the strategic planning–performance relationship in small firms. For example, Robinson (1982) found that strategic planning enhanced small firm effectiveness when the planning process incorporated the systematic utilization of outsiders. Several researchers (Buchele, 1967; Cohn and Lindberg, 1972; Gilmore, 1971; Robinson, 1980a; Steiner, 1967; and Still, 1974) have suggested that outsiders, short time horizons, minimum emphasis on goal identification, and informality were four key components of an effective small firm planning process. While attributed to planning by these authors, such variables may also reflect operating attributes which permit *small* firms to survive in a particular industry segment, e.g., flexibility and efficiency, centralized decision-making. Whether reflecting planning attributes or, more likely, operating attributes of a small firm setting that carry over into planning practices, these variables suggest that characteristics of effective strategic planning based upon previous policy literature, such as ‘formality’ investigated in the Wood and LaForge study (1979), may be inappropriate for small firms—the vast majority of the business population.

The present study sought to address this issue and at the same time to overcome some of the methodological deficiencies in previous planning–performance research by (1) employing a small firm sample, (2) controlling extraneous influences by limiting the sample to a single industry and one geographic competitive setting, (3) employing multiple, percentile-based performance measures, and (4) using a clearly definable measure of planning formality.

## METHOD

The data base for this study included all federal- and state-chartered commercial banks in South Carolina. These 85 banks were selected because (1) all are operating within the same basic environment and, equally important, (2) all 85 banks are considered small banks by banking industry standards.

### Assessing ‘formality’ of strategic planning

A questionnaire was sent to the president of each bank regarding the history of the bank’s strategic decision-making practices. This questionnaire was followed by a second mailing and

later by a phone call to assist in the completion of the research. Table 1 provides a copy of the questionnaire. Based on questionnaires used by Rue (1973), Rue and Fulmer (1973), Wood and LaForge (1979), Snyder and Glueck (1980a, 1980b) and Lindsay and Rue (1980), the first set of questions sought to categorize the degree of formality in the bank's strategic planning. Consistent with previous studies regarding the operationalization of *formality* of planning, bank presidents were asked to categorize their planning efforts for the previous five years according to the degree to which sophisticated written documentation emanated from the planning effort.

Table 1. Strategic planning questionnaire

*Question set I: Formality of the bank's planning process*

Check one statement from the following which was most true of your bank:

- \_\_\_(1) The bank had no written strategic plan covering at least three years into the future.
- \_\_\_(2) The bank had a written strategic plan which:
  - (a) covers at least three years into the future
  - (b) included the specification of objectives and goals
  - (c) included the selection of long-range strategies and
  - (d) included the determination of the future resources required.
- \_\_\_(3) The bank had a written strategic plan which incorporated all four elements of answer 2 (a-d) above plus:
  - (e) procedures for anticipating or detecting error in, or failures of, the plan and for preventing or correcting them on a continuing basis, and
  - (f) some attempt to account for factors outside of the immediate environment of the bank.

*Question set II: Degree of emphasis in bank's strategic decision-making process*

To what extent did your bank's strategic decision-making process emphasize the following concerns? (Circle one number for each part of this question.)

	Degree of emphasis			
	High	Medium	Low	No
(a) The concern of assessing risk through a scan of conditions in the bank's competitive environment.	4	3	2	1
(b) The concern for formulating goals and targets to be achieved in the competitive environment.	4	3	2	1
(c) The concern for selecting distinctive competencies in order to gain an advantage in the competitive environment.	4	3	2	1
(d) The concern for the determining of authority and influence relationships among bank subunits.	4	3	2	1
(e) The concern for the deploying of financial and physical resources to carry out the bank's strategies.	4	3	2	1
(f) The concern for monitoring and controlling the implementation of bank strategies.	4	3	2	1

The reason for this approach was twofold. First, it allowed the investigation of planning formality in a manner consistent with previous landmark studies cited above. Thus, the notion or 'measure' of formality could remain relatively constant while the size of the firm was changed since this study was concerned with small firms and all the previous studies examined large economic organizations. Second, written documentation has been identified as a major dimension of the move toward formal planning in small firms (Buchele, 1967; Gilmore, 1971; Still, 1974; Robinson, 1980a). The categories used in this study and displayed in Table 1 consistently 'tap' this dimension.

More sophisticated measurement procedures have been suggested for measuring planning in policy research. For example, Wood and LaForge (1981) offer evidence of the viability of a corporate planning 'scale' using the Guttman scaling method. Unfortunately, such procedures

are again targeted toward large organizations. Furthermore, in this exploratory research, the emphasis was on examining differences between two or three 'categories' of small firms rather than exploring differences based upon a subtle, one- or two-point difference in a planning scale.

The second set of questions in the executive survey solicited, regardless of formality, the degree to which the bank's strategic decision-making incorporated six basic dimensions of strategic management commonly espoused in the literature. These dimensions were adapted from the conclusions of an extensive review of normative and empirical works dealing with the elements of strategy-making by Bourgeois (1980b).

The questionnaire process yielded 50 responses, or a 59 per cent response rate. Of the 50 responses to question set I (Table 1), 38 banks categorized their preceding five-year planning as category 1, 11 as category 2, and one as category 3. Based on these responses, the banks were divided into two groups: non-formal planners (category 1,  $N = 38$ ) and formal planners (categories 2 and 3,  $N = 12$ ). Since the questions were considered straightforward and easily understood based on input from the initial pilot group of small bank CEOs, no independent or secondary means were employed for questioning the validity of the questionnaire responses.

### Assessing bank performance

A random sample of 20 bank presidents from 85 federal- and state-chartered banks in South Carolina were asked to identify which performance goals their bank had pursued in the last three years. The four performance goals consistently mentioned included:

- |                      |                      |
|----------------------|----------------------|
| (1) Profit margin    | (3) Loan growth      |
| (2) Return on assets | (4) Return on equity |

Other 'goals' mentioned included community involvement, community respect, employee development and survival. In each case where these goals were mentioned, one or more of the four performance measures were seen as appropriate measures of the success of these 'other' goals. For example, loan growth was seen as a tangible measure (or result) of effective community involvement. This is consistent with earlier research by Friedlander and Pickle (1968). Examining the multidimensionality of organizational effectiveness in small firms, they found that measures of profitability and sales growth were significantly correlated with measures of customer, employee, and community satisfaction. Furthermore, 'goals' like community involvement could really be seen as strategies to achieve performance goals (e.g., loan growth) over a particular planning horizon.

Performance data on these four measures were obtained for three years (1977–1979) on each bank through the appropriate regulatory body. To avoid the methodological difficulties encountered by Wood and LaForge (1979:519–520) in averaging bank performance measures over multiple years, this study employed a percentile approach in setting up the performance data for subsequent analysis.

First, all South Carolina banks were divided into three groups based on total dollar deposits. Even though all banks in the study are considered 'small' by banking industry standards, there is a variation in size within the regional competitive area. To control for this relative size differential, the dollar deposit-based partitioning of the population was undertaken. The result was 23 banks with a 'low' level, 33 with a 'medium' level, and 29 with a 'high' level of dollar deposits. Table 2 provides a breakdown of the bank population across these three groups.

Second, within each group, all banks were ranked on each performance measure. The ranking was then converted into a specific percentile (relative to the ranking of the other banks within each partitioned group) for each performance measure during each year. This provided

Table 2. Partitioning of banks by relative size (dollar deposits)

	Relative amount of dollar deposits		
	Low <sup>a</sup>	Medium <sup>b</sup>	High <sup>c</sup>
Formal planners	4	5	3
Non-formal planners	10	12	16
Non-respondents	9	16	10
Total	23	33	29

<sup>a</sup> Less than \$10mm in total deposits.

<sup>b</sup> \$10mm to \$24.99mm in total deposits.

<sup>c</sup> \$25mm and above in total deposits.

consistency across financial measures and consistency, in the meaning of averages or changes in ranking, across all banks within the South Carolina banking industry.

### Representativeness and non-respondent bias

The issue of the representativeness of the sample and the potential for non-respondent bias was examined prior to addressing the research questions. First the data (Table 2) were examined on the relative size categories (dollar deposits) to determine if the sample was representative of the population and if the non-respondents were similar in size breakdown to the sample. In both instances, chi square goodness of fit tests were not significant ( $\chi^2 = 1.30$ , d.f. = 2; and  $\chi^2 = 0.73$ , d.f. = 2, respectively). Therefore, the sample was representative of the population and there was an absence of non-respondent bias on the relative size of the banks. Representativeness and non-respondent bias were again examined on the four performance measures (percentile rankings). On each measure, the mean percentile ranking of the sample was slightly above 50, the non-respondents slightly below 50, and the population, obviously, was 50 for each measure. Using correlated sample *t*-tests, no significant differences were found between the sample and the non-respondents or between the sample and the population. Again, the sample appears representative of the population and not significantly different from the non-respondents. Next, the sample was examined to ensure a representative breakdown between the number of formal and non-formal planners across the three relative size groupings as shown in Table 2. Using a chi square goodness of fit test, no significant differences were found ( $\chi^2 = 1.38$ , d.f. = 2).

## FINDINGS

### Research question 1

The first research question asked, 'Do formal planners significantly outperform non-formal planners on each of the four performance measures?' To examine this research question the following hypothesis was tested:

*Hypothesis 1: Banks engaging in formal planning will have a significantly higher mean performance ranking than non-formal planning banks from 1977 to 1979.*

This hypothesis was tested on each performance measure using a *t*-test instead of the multivariate statistic, Hotellings  $T^2$ , because of the relatively small number of formal planners.

Table 3. Formal planners versus non-formal planners. Mean performance percentile ranking: small banks statewide

	Profit margin	Return on assets	Loan growth	Return on equity
Formal planners	51.75	55.91	56.15	61.15
Non-formal planners	58.27	55.62	58.45	54.65

The results are shown in Table 3. No significant differences in performance ranking were found on any of the four performance measures. Therefore, hypothesis 1 was not supported: the performance of small banks engaging in formal planning is not significantly better than non-formal small bank planners.

These results contradict Wood and LaForge's (1979) finding that formal planners significantly outperformed non-formal planners in the banking industry. To be more certain that this contradiction holds within small banks, hypothesis 1 was retested using a different performance computation (for each performance measure): change in a bank's performance percentile ranking from 1977 to 1979. Although the two groups may not differ on mean performance ranking over the 1977–1979 period, one might argue, the formal planners might have improved their performance relative to non-formal planners over this time. This proposition would be logical given the results of the Wood and LaForge study.

Similar to the original test of hypothesis 1, a *t*-test was used to examine differences between formal and non-formal bank planners on each of the four measures (change in performance ranking) in lieu of the multivariate Hotelling's  $T^2$  procedure because of the small size of the formal planner group. Table 4 presents the results of this analysis. The modified hypothesis 1 was not supported. Formal planners did not experience a significantly higher improvement in performance ranking from 1977 to 1979 than non-formal planners on any of the four measures. Therefore, the contradiction with Wood and LaForge (1979) is reconfirmed. Formal strategic planning in small banks *did not lead* to significantly higher performance than non-formal planning.

Table 4. Formal planners versus non-formal planners. Change in performance percentile ranking: 1977 to 1979

	Profit margin	Return on assets	Loan growth	Return on equity
Formal planners	-5.09	-1.09	+18.36	-0.91
Non-formal planners	+1.13	-3.71	+8.61	-0.57

## Research question 2

The second research question asked, 'Why does this contradiction exist?' In other words, among small banks, why is the performance of non-formal planners equally as good as that of formal planners? One reason may be found in the unique characteristics of strategic decision-making within small firms. Buchele (1967), Robinson (1980b), Schollhammer and Kuriloff (1979), and Steiner (1967) have proposed that one important contingency in small firm planning is the need for less formality than that commonly associated with large firm strategic planning. Robinson (1980a, 1980b) and Schollhammer and Kuriloff (1979) argue, for example, that goals and objectives should be accorded secondary importance in small strategic planning,



whereas most literature on strategic planning (large firm based) considers goals and objectives of paramount importance as a formal first step in a planning process. Empirical studies by Robinson (1980a, 1982) and Robinson and Glueck (1980) support the ideas of process informality and secondary emphasis on objectives as key contingencies in effective small firm strategic planning. Further support is offered by Bourgeois (1980a) where he found that agreement on means, not ends (goals), is more critical to performance in small, single-product firms. Relative to the second research question in this study of planning in small banks, these studies suggest that non-formal planners may put emphasis on the important components of strategic decision-making equivalent to their formal planning counterparts, only they do it in a less formal manner.

To examine this proposition, a second set of questions was included in the questionnaire sent to the bank presidents (see Table 1). Included in this set of questions were six statements regarding six dimensions of strategic management commonly found in the policy literature (Bourgeois, 1980b). The executives responded by identifying the degree of emphasis placed upon each of the six components in the bank's decision-making process, regardless of the formality of that process.

To examine the second research question, the following hypothesis was tested for each of the six strategic decision-making dimensions:

*Hypothesis 2: The degree of emphasis on each dimension of strategic decision-making by formal planners will not be significantly different from that of non-formal planners.*

For each dimension, hypothesis 2 was tested using a *t*-test in lieu of the multivariate analogue, Hotelling's  $T^2$ , because of the relatively small size of the formal planning group. Table 5 presents the results of this analysis.

Hypothesis 2 was supported on five of the six dimensions of strategic decision-making. Although they differed on the formality of strategic planning, the formal planners and non-formal planners placed similar emphasis on (1) scanning the environment, (2) identifying distinct competencies, (3) aligning organizational structure, (4) deploying internal resources, and (5) monitoring/controlling implementation in the respective strategic planning processes. Hypothesis 2 was rejected on one strategic decision-making dimension: concern for formulating goals and objectives. Formal planners placed significantly greater emphasis ( $p < 0.03$ ) on this dimension than did non-formal planners. It is not overly surprising that the two groups differed according to this dimension since it was closely related to one basis ('written specification of objectives and goals') for classifying them (see Table 1). Two observations follow. First, this finding bolsters the validity of the initial classification procedure. Second, given the lack of significant differences in performance between formal and non-formal small firm planners, this finding offers credibility to the previous literature which suggests that

Table 5. Formal planners versus non-formal planners. Small bank firms: Mean emphasis on six dimensions of strategic decision-making

	Scan environment	Goal objs	Distinct competency	Authority relationships	Resource deployment	Monitor control
Formal planners	3.36	3.73 <sup>a</sup>	3.36	2.27	3.64	3.45
Non-formal planners	3.45	3.28 <sup>a</sup>	3.24	2.45	3.68	3.37

<sup>a</sup>  $p < 0.03$ .

## ANALYSIS AND DISCUSSION

The results of this study contradict the findings of Wood and LaForge (1979) regarding the value of formal strategic planning as a contributor to organizational performance. While their findings are generally consistent with previous research on the planning–performance relationship, this study suggests that the body of research is inappropriate for smaller business organizations. Focusing exclusively upon small banks, this study found that formal planners did not outperform non-formal planners over a three-year time period.

Three reasons are apparent for the contradictory findings. First, Wood and LaForge (1979) as well as previous policy research on the planning–performance relationship did not include small firms in their samples. Wood and LaForge's conclusions were based on survey responses from 41 of the 150 largest domestic banks in the United States (1979:518). Second, these previous studies did not systematically control for differential effects of market conditions, government factors and inter-industry differences as suggested by Kudla (1980) and Beard and Dess (1979). In this study, industry, market conditions, time and government influences were specifically controlled. Finally, this study found that non-formal and formal planners among small banks placed equal emphasis on five out of six important dimensions of strategic decision-making. While they may do so with less formality than the large-firm biases literature suggests, small firms appear to enhance their effectiveness through the *informal* application of basic, strategic decision-making practices. It appears obvious from this study that policy researchers would be wise to heed the proposition of several authors (Bourgeois, 1980b; Hofer, 1975; Lindsay and Rue, 1980; Robinson and Glueck, 1980; Robinson, 1980a, 1982; Schollhammer and Kuriloff, 1979) that firm size is a critical contingency variable in strategic management research and theory development.

Given the limited scope of the 'size' research to date, numerous dimensions reflected in the size variable may emerge as having equal or greater importance in the planning–performance relationship. For example, ownership pattern and power within the organization, complexity of the information processing requirements for decision-making purposes, and technological complexity of products or services intuitively influence the planning activity, its level of formality, and its relationship with performance. Future research should attempt to incorporate such dimensions in any operationalization of the 'size' variable. By so doing, this research could illuminate the role these key dimensions play in the differences in the planning–performance relationship attributable to the 'size' of the organization.

Yet while 'size' emerged in this study as a major reason for findings that contradict results in several previous studies, additional related issues suggest more refined research is needed to understand the 'size' contingency. For example, there were subtle differences between the measures of 'formality' and 'performance' in this study and those employed by Wood and LaForge (1979). While both studies' formality measures emanated from earlier work by Rue (1973), Rue and Fulmer (1973), and Thune and House (1970), this study employed a self-categorizing approach by bank CEOs based on three planning categories, whereas Wood and LaForge applied the Guttman Scaleogram-Analysis procedure to CEO responses on six planning-related questions in arriving at three planning categories (1979:518). And while both studies measured change in performance over time on similar variables (profitability and return on equity), this study employed a change in percentile ranking approach where Wood



and LaForge employed a percentage change approach based on average performance over time. While differences in *organizational size* appear to be the most obvious reason for the contradictory findings of these two studies, subtle differences in the measurement of formality and performance deserve further attention before they can be dismissed as sources of different results.

When the 'small' banks in this study were categorized by relative size (see Table 2), another interesting finding emerged: the percentage of formal planners did not vary by relative size of the bank. This is somewhat surprising. Even though all formal planners are 'small' banks by industry standards, there is considerable range in their sizes. From previous planning literature, one might expect larger banks within the sample to be more likely to utilize formal planning methods. The small number of formal planners (12) in this study could be one plausible explanation for this finding. Otherwise, it suggests a need for additional, fruitful research that would seek to determine at what point and for what reasons formal strategic planning begins to emerge in smaller organizations within specific industry groupings. Lindsay and Rue (1980: 402) arrived at much the same conclusions with regard to the formalization of small firm strategic planning.

Additional methodological issues that deserve future attention in small firm strategic planning research emerged in the process of conducting this research. Future attention should be directed to the need to relate the length of time a particular strategic planning system has been in place and the time required to reposition the performance generating capability of the firm. For example, can small firms significantly alter their performance in a one- to two-year time frame, or does it usually take five to ten years? This question is relevant to both the process and content (strategic decisions) of small firm strategic planning. Another issue of particular value regarding formality of strategic planning, whether it be in large or small companies, is the need to more carefully capture the *changes* being made by managers in their strategic planning system in order to better understand implicit cost-benefit trade-offs being made by executives with regard to their strategic planning systems over time.

The lone significant difference in this study between the strategic decision-making behaviour of formal and non-formal bank planners (emphasis on goals and objectives) is particularly interesting. While virtually identical in the degree to which they emphasized the other five key characteristics of strategic decision-making, formal planners placed significantly greater emphasis on specifying goals and objectives than did the non-formal planners. This result is logical since one would expect a formalized planning process to characteristically show a high concern for formalization of goals, targets and objectives. Indeed, this concern was incorporated into the procedure for classifying formal and non-formal planners in this study. Perhaps more importantly, this result confirms the research and arguments of Bourgeois (1980b), Robinson (1979, 1980a, 1982) and Schollhammer and Kuriloff (1979) that specification of goals and objectives should be accorded secondary priority in effective strategic planning within small firms. Far from being detrimental, de-emphasis of goal formulation may be an important aspect of effective small firm strategic planning, along with an 'informal' yet comprehensive process.

## IMPLICATIONS FOR RESEARCH AND PRACTICE

Further research is needed. This study extends the growing empirical evidence (Bourgeois, 1980b; Hofer, 1975; Lindsay and Rue, 1980; Robinson, 1980a, 1982) that firm size is a vital contingency in an evolving theory of strategic management. Contrary to the frequently

encountered (contingency) notion that strategic management is solely a large firm phenomenon, this study suggests that the small firm is an important arena for strategic management research.

Replication of this study in other industries would be an important contribution. Previous studies on the value of formal strategic planning in the electronics, grocery, chemical and other industries were limited solely to large firms. Further investigation into process and content dimensions unique to small firm strategic planning deserves attention. And more refined operationalizations of 'small' or 'size' need to be incorporated into future small firm research to better understand just exactly why size appears to be an important contingency in strategic management considerations.

A major implication for small firm executives concerned with the design of their firm's strategic planning system is that little benefit can be expected from employing a highly formal process. Small firms without a formal planning process performed as well as their formal planning counterparts.

Three specific observations can be made to apply these findings in a small firm strategic planning setting. First, effective informal planning systems in small firms mainly *de-emphasize the need for formal written documentation, reports and activities* as a means for deformalizing their strategic planning system. Second, in initiating the planning cycle, minimal emphasis is placed on specification of abstract notions like broad goals, company mission and long term objectives as a prerequisite to a meaningful planning process. Emphasis on resource evaluation, assessment of capabilities, and environmental analysis appear more tangible foci for inaugurating small firm strategic planning. Lastly, but perhaps most important, the success of 'informal' planners *does not* mean less planning is necessary. Of six dimensions common to strategic planning systems, informal planners placed an emphasis equal to their formal planning counterparts on every dimension (scanning environment, identifying distinctive competence, concern for authority relationships in the organization, deployment of financial and physical resources consistent with strategy, and monitor/control strategy implementation) except goal-setting; they just did so with less formal written procedures.

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