

## STRATEGIC PLANNING AND FINANCIAL PERFORMANCE: MORE EVIDENCE\*

NOEL CAPON

*Graduate School of Business, Columbia University*

JOHN U. FARLEY

*The Joseph H. Lauder Institute and The Wharton School, University of Pennsylvania*

JAMES M. HULBERT

*Graduate School of Business, Columbia University*

### ABSTRACT

A recently published meta-analysis of the impact of strategic planning on financial performance omitted a major study of corporate planning practice in *Fortune 500* manufacturing firms. This article briefly reviews that study in light of the results of the meta-analysis. Additional analysis examines performance and firm survival over a longer time period than in the original work. The overall conclusion is that a small but positive relationship between strategic planning and performance exists, and persists.

### INTRODUCTION

In an excellent meta-analytic review of the relationship between planning and performance published in this journal, Boyd (1991) concluded that the results were equivocal. He found that whereas early research suggested a positive relationship between planning and performance, later research was less reassuring, and that the overall effect was at best extremely weak. Boyd focused on a critique of the methodology employed in planning-performance studies, although a broader meta-analysis of performance studies also concluded that planning has a minimal effect on performance (Capon et al., 1991). However, Boyd's review did not include a major study of corporate planning in 113 *Fortune 500* manufacturing firms (Capon et al., 1987), in which most of Boyd's criticisms of planning-performance studies were addressed. Table I shows Boyd's methodological criticisms and how the Capon et al. study dealt with each of them. Adding the results of this omitted study, this note finds that well-established strategic planning has a continuing effect on return on capital and on firm survival.

*Address for reprints:* Noel Capon, 509 Uris Hall, Columbia University, New York, NY 10027, USA.

Table I. Methodological issues in studies of strategic planning raised by Boyd (1991) as dealt with by Capon et al. (1987)

<i>Design issue</i>	<i>Boyd criticisms</i>	<i>Capon, Farley and Hulbert study</i>
1. Small and non-representative sample sizes	Several studies employed very small sample sizes. Boyd points out samples of only 49, 21 and 14 firms.	Representative random 155 firm sample from <i>Fortune 500</i> located east of Mississippi; 113 firms agreed to participate
2. Data collection	Most studies collected data via mail questionnaires to CEOs; probably completed by others. Boyd believed methodology inappropriate given complexity of planning processes.	Data collected by full-time interviewers in respondent offices; each interview took one to two hours. Two questionnaires were employed. Questionnaire I, completed by the corporate planning officer (or the executive whose responsibilities were judged closest to that role), included sections on company goals, corporate strategy, the planning system, making resource allocation decisions, organization structure and organizational climate. Questionnaire II, completed by a knowledgeable assistant, embraced mainly descriptive items involving operating structures, organization of the planning effort, the corporate environment, and corporate operations and strategy
3. Quality of planning	Most studies classified firms either as planners versus non-planners, or used simple ordinal categories based on the degree of formalization of planning. Quality of, or commitment to, planning was not measured. Self reports of planning often used.	Over 500 different items employed to describe planning. Items formed the basis for qualitative classification schemes of planning practice; categories differed on quality of, and commitment to, planning. An additional 350 plus items measured environment, strategy, organization structure and organizational climate.
4. Cross-sectional data	Several studies correlated only planning and current performance, despite the fact that strategic decision-making might only have an impact after several years.	Return on capital (ROC), was measured contemporaneously, two years later, and as the five-year mean and standard deviation about trend. In this note we also include survival measurements taken several years later
5. Data reliability	Most studies used single items or did not report reliabilities on multiple items. Boyd argues for multiple indicators of both planning and performance.	The 500 planning items, and the 350 plus environment, strategy, organization structure and organizational climate items, were used to develop highly reliable scales
6. Moderating variables	While some studies attempt to control for moderating variables, Boyd cited significant limitations both as regards moderators used and analysis techniques. He was particularly concerned with industry effects	We used four moderating variables to test performance relationships: scale, degree of diversification, product line maturity and industry. No effects were found

## PRESENCE AND ABSENCE OF CORPORATE PLANNING

Closely resembling tests in many of these previous studies was a self-report question. All respondents were asked: 'Does your company develop a formal corporate plan (or plans) on a regular basis?' Seventy firms responded affirmatively; 43 responded negatively. There were no significant differences between the two groups for return on capital measures – effectively rejecting the hypothesis typically put forward by planning-performance researchers. It is interesting to note that several of the 70 firms that answered affirmatively to this question were not classified as corporate planners in the category scheme that we developed; even more were not classified as strategic planners. This finding confirms Boyd's suspicion of self-reported independent variables in planning studies.

## PLANNING CATEGORIES

The major approach of this study was the development of categories of planning practice through a deductive method. This categorization was performed rigorously using multiple raters whose classifications were highly reliable. Three criteria were used to categorize the 113 firms by planning practice. The first criterion distinguished between those firms that developed some set of longer-term plans (106) versus those that did not (7). The second criterion distinguished between those firms that developed corporate plans that were more than assemblages of lower-level plans (58) versus those that only developed plans at lower levels in the organization (48). A final set of criteria distinguished between plans that were largely strategic in nature (i.e. focused on long-run resource allocations) (61) versus those that were largely financial documents (45). The five resulting planning categories are more complex than those used in the studies reviewed by Boyd:

**Corporate Strategic Planners:** These 24 firms are the most sophisticated planners. Planning at both the corporate and division levels has substantial strategic content: division plans are integrated into a corporate planning perspective.

**Division Strategic Planners:** Lower level (usually divisional) plans of these 37 firms have substantial strategic content but are not integrated into a coherent corporate strategic plan.

**Corporate Financial Planners:** These 34 companies develop formal plans at the corporate level, but they contain little strategic content. The plans are largely financial documents; the process is basically one of projecting trends and preparing budgets.

**Division Financial Planners:** Plans of these 11 companies are financial documents with little strategic content. There is no content added at the corporate level.

Non-Planners: In these firms there is no evidence of any longer-term planning, strategic or financial. Some eschewed planning as policy; others simply had not started. There are only seven such firms in our sample.

#### HYPOTHESES ABOUT PERFORMANCE

The overall hypothesis regarding these categories is that the greater the degree of sophistication of the planning process, the better the performance. In our view, strategic planners should perform better than financial planners because of their focus on adaptation to the environment, and the formal thinking through of strategic issues and resource allocation priorities. This practice should lead to the better identification of opportunities and threats, and appropriate firm action. Similarly, corporate planners should outperform division planners since an integrated corporate perspective should offer advantage over individual subunit perspectives.

We also expect division strategic planners to outperform corporate financial planners because the adaptive environmental focus, albeit at a divisional level, should outweigh the benefits of corporate-wide financial integration. The very small number of non-planners is a statement about the perceived usefulness of planning among this population of firms and makes statistical testing difficult. However, overall we hypothesize that planners should outperform non-planners.

Thus, our hypothesis regarding order of financial performance is: corporate strategic planners > division strategic planners > corporate financial planners > division financial planners > non-planners.

#### MEASURES OF PERFORMANCE AND RESULTS

We originally measured financial performance in terms of a five-year mean return on capital, and standard deviation of that return about a five-year trend. (Smaller standard deviation should imply superior ability to manage risk.) In this note, we also include measures related to survival of the firm as an independent entity; these measures were not available in the original study.

Setting aside for a moment the small group of seven non-planning firms, the ordinal relationships (table II) for the mean and standard deviation about trend for those firm groups that do plan is as predicted: corporate strategic planners > division strategic planners > corporate financial planners > division financial planners. Furthermore, strategic planners were significantly more likely to survive over the long term.

As mentioned above, the small group of non-planners made analysis difficult, especially in light of the fact that removal of just one well-performing firm drops the mean group return almost three percentage points. Their very high standard deviation of return about trend may indicate a high level of risk that produced a low survival rate.

Table II. Performance results of the five planning categories

Planning category	Number of firms	Return on capital (%) 1977-1981		Survival (%) to 1991*
		Mean*	Standard deviation about trend*	
Corporate strategic	24	12.0	0.89	79
Division strategic	37	11.2	1.54	81
Corporate financial	33	10.5	1.93	62
Division financial	11	9.2	1.92	73
Non-planners†	7	13.2	2.03	43

†When the single high performing firm is removed, the mean is 10.4%.

\*Significant among groups at  $\alpha = 0.05$ , based on analysis of a finite population.

#### CONTROL FOR OTHER FACTORS

A further analysis included four sets of covariates that constitute alternative explanation of the results: scale, degree of diversification, product line maturity and industry, as measured by a 2-digit SIC code. Virtually identical results in terms of ordering of planning categories were found; the covariates were insignificant and had no systematic pattern of effects on performance over the planning categories.

Finally, several other financial performance measures were examined including means and standard deviations about trend for return on equity, cash flow as a percentage of sales and sales growth. Results were similar.

Other tests of planning definitions were investigated, including five planning categories developed by cluster analysis. The results were similar to, but weaker than, the results for the deductively developed planning category system discussed above.

#### DISCUSSION

We agree with Boyd's (1991) conclusion that later research on how strategic planning affects financial performance is not as reassuring as earlier research; we also agree that many studies of planning have similar methodological problems. To his set of studies, we have added conclusions from a much more comprehensive study (Capon et al., 1987) that is not subject to many of the deficiencies discussed by Boyd. In particular, we use more rigorous measures of strategic planning, test for (but do not find) industry effects, and perform separate analyses for different dimensions of planning. We find that a strategic direction stressing resource allocation at the corporate level to growing businesses in which the firm is well positioned improves performance of firms that plan strategically by more than 1 per cent return on capital. In addition, the passage of time also allows us to follow up on performance. Strategic planning at a point in time appears to double the longer term likelihood of survival as a corporate entity. Planning systems that focus

mainly on financial matters and budgets do not improve performance. We also found that a small group of non-planners perform as well as the strategic planners, although this equality tends to disappear over time and the likelihood of longer-term survival by non-planners is the lowest. We conclude that strategic planning really can improve performance, but that it is not a necessary condition.

#### NOTE

\* The authors are indebted to Scott Hoenig for his useful comments and for his help with the survival analysis.

#### REFERENCES

- BOYD, K. B. (1991). 'Strategic planning and financial performance: a meta-analytic review'. *Journal of Management Studies*, **28**, 353-74.
- CAPON, N., FARLEY, J. U. and HULBERT, J. (1987). *Corporate Strategic Planning*. New York: Columbia University Press.
- CAPON, N., FARLEY, J. U. and HOENIG, S. E. (1990). 'Determinants of corporate performance: a meta analysis'. *Management Science*, **36**, 1143-59.