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Linking the formal strategic planning process, planning flexibility, and innovativeness to firm performance

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ABSTRACT

This study explores the link between financial performance and the formal strategic planning process, planning flexibility, and innovativeness of 448 firms in a multi-industry sample. The results suggest that firms' formal strategic planning processes and planning flexibility are positively associated, and each is positively related to innovativeness. In addition, innovativeness fully mediates the relationships between firm performance and the formal strategic planning process and planning flexibility.

1. Introduction

Contemporary business leaders face remarkable challenges. Success is increasingly a function of a firm's ability to develop and to deploy unique and costly to imitate resources in an innovative way. Scholarly inquiry in strategy focuses on how firms can deliberately and proactively leverage their idiosyncratic combination of resources to create competitive advantages (Barney, 1991; Penrose, 1959). Scholars also question how formal strategic planning and planning flexibility may contribute to a firms' ability to innovate and profit (e.g., Titus, Covin, & Slevin, 2011; Wiltbank, Dew, Read, & Sarasvathy, 2006). Positioned at the nexus of these research streams, the current study examines the relationships among financial performance and formal strategic planning processes (i.e., the process of identifying and implementing the firm's strategic initiatives (Jarzabkowski & Balogun, 2009)), planning flexibility (i.e., the ability of a firm to deviate from its formal strategic plan in response to emerging opportunities or threats (Barringer & Bluedorn, 1999)), and innovativeness i.e., a firm's emphasis on innovation (e.g., Dibrell, Craig, & Hansen, 2011b).

We develop and test a set of hypotheses in which firm innovativeness fully mediates the path from formal strategic planning processes and planning flexibility to firm financial performance. Three research questions drive this study: (1) If firm success is predicated on its ability to build and to leverage valuable, idiosyncratic resources and capabilities, then what role may formal strategic planning processes and planning flexibility play in that effort?, (2) Can firms simultaneously develop formal strategic plans, yet integrate adaptive responses based on a changing environment and still successfully innovate?, and (3) How does the combination of the formal strategic planning process, planning flexibility, and innovativeness influence a firm's performance? Many studies examine the relationships between formal strategic planning and innovation (e.g., Miller & Cardinal, 1994; Salomo, Talke, & Strecker, 2008), between planning flexibility and formal strategic planning (e.g., Brews & Hunt, 1999; Grant, 2003; Rudd, Greenley, Beatson, & Lings, 2008), and between planning flexibility and innovation (e.g., Barringer & Bluedorn, 1999; Zhou & Wu, 2010). Other studies, however, note the need for a greater understanding of the possible mediators of the relationship between the formal strategic planning process and firm performance (Rudd et al., 2008).

This research offers multiple contributions. First, it informs the strategic planning literature by examining how (1) the formal strategic planning process functions in the presence of firm innovativeness, (2) planning flexibility relates to firm innovativeness, and (3) firms employ formal strategic planning processes and flexible planning systems concurrently. Consistent with Barringer and Bluedorn (1999), we use planning flexibility and flexible planning systems synonymously. These aforementioned extensions are significant because, though a formal strategic planning process has merits, an overly structured formal planning process can impede a firm's ability to respond to external conditions (Grant, 2003; Kukalis, 1989). Second, this study explores how innovativeness facilitates the generation of positive financial returns. Specifically, innovativeness should play a critical role in the relationships among formal strategic planning processes, planning flexibility, and firm financial performance. Third, our study contributes to resource based view (RBV) theory by examining how a non-novel

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process (i.e., formal strategic planning) can produce economic value and be a firm-level source of competitive advantage (Powell, 1992). Finally, the results contribute to recent conversations in the consideration of adaptive approaches in strategy formulation (Read, Dew, Sarasvathy, Song, & Wiltbank, 2009; Titus et al., 2011; Wiltbank et al., 2006).

2. Literature review and hypotheses development

2.1. Resource-based view

According to the resource-based view (Penrose, 1959), firms develop advantages by *capitalizing on* or *leveraging* their assets (Barney, 1986, 1991, 2001). In this study, we offer formal strategic planning processes, planning flexibility, and innovativeness as three factors that serve as the foundation for competitive advantage and performance (Barney, 1991).

2.2. The formal strategic planning process

Prior research strives to understand formal strategic planning processes and decision making in organizations (Delmar & Shane, 2003; Eisenhardt & Zbaracki, 1992; Mintzberg, 1994; Schwenk & Shrader, 1993). The relationship between formal strategic planning and financial performance has been both positive (e.g., Delmar & Shane, 2003) and negative (e.g., Honig & Karlsson, 2004), with most studies demonstrating a positive relationship (e.g., Miller & Cardinal, 1994). The firm's formal strategic planning process is concerned with defining, determining, and implementing the strategic initiatives of the firm (Jarzabkowski & Balogun, 2009).

More recently, authors have focused more on the uses of both *ends* and *means* to emphasize distinctive, though related, concepts of the formal strategic planning process (Brews & Hunt, 1999; Titus et al., 2011). Whereas *ends* pertain to what an organization desires to achieve (i.e., objectives), *means* reflect the process of how a firm intends to achieve these objectives (Brews & Hunt, 1999). Formal strategic planning process objectives (i.e., ends) involve developing objectives and establishing the degree to which firms formalize and document these objectives. *Means* conversations define the broad resource allocation commitments related to the strategies. The current study's arguments build on the perspective that strategic *ends* are increasingly difficult to predict, due to the rapidity of external change, and that being responsive to these changes is a requisite *means* that must be considered (Read et al., 2009; Titus et al., 2011; Wiltbank et al., 2006).

2.3. Planning flexibility

Although a formal strategic planning process is considered to be positively related to firm performance (Brews & Hunt, 1999; Schwenk & Shrader, 1993), evidence suggests that the effectiveness of strategic planning declines when environmental uncertainty increases as the perceived value of strategic planning decreases in kind. As a consequence, considerable debate exists over the efficacy of formal strategic planning compared with more adaptive styles of strategic planning (Ansoff, 1991; Gibbons & O'Connor, 2005; Mintzberg, 1991, 1994; Quinn, 1978). By its very nature, a formal strategic planning process creates a degree of inflexibility and rigidness, making efforts to adapt to changes in the external environment difficult, especially when managers become strictly tied to their strategic plans (Mintzberg, 1994). Increasingly, business leaders are voicing the need for their firms to alter their strategic plans to match changing external environments (Grant, 2003; Wiltbank et al., 2006). Thus, planning flexibility, as well as the ability to effectively conduct formal strategic planning, can be a powerful, though somewhat paradoxical, means to create competitive advantages. Armed with analysis and insights gained from a formal planning process, firms can make more effective decisions about the types of resources to develop or acquire. Matched with a willingness to deviate from formal strategic plans when opportunities present themselves, firms can more effectively leverage and deploy these valuable and difficult to imitate resources in pursuit of innovation.

Grant (2003) coins the term "planned emergence" to describe firms' ability to create a structured planning process while concurrently building decentralized decision making. The planned emergence strategic planning process integrates attributes of the design school approach (i.e., formal strategic planning) (Ansoff, 1991) and the process school approach (i.e., ad hoc, flexibility) (Mintzberg, 1994) to create effective strategies in turbulent environments. Environmental dynamism hinders firms' abilities to strategically plan their responses, let alone plan future strategies.

Extending Grant's (2003) work, Wiltbank et al. (2006) propose the inclusion of adaptive approaches to strategy. They argue that strategic planning with a strong emphasis on prediction of objectives constrains the firm in times of uncertainty. Conversely, an emphasis on control of its potential outcomes (e.g., affordable losses to limit the potential negative losses associated with launching a new product) helps the firm cope with the unpredictability (Wiltbank et al., 2006). Adaptive approaches to planning, therefore, can complement a firm's more formal strategic planning process.

Also, Kukalis (1989) and Barringer and Bluedorn (1999) introduce the concept of planning flexibility, which "refers to the capacity of a firm's strategic plan to change as environmental opportunities/threats emerge" (Barringer & Bluedorn, 1999, p. 424). Theorizing that performance is maximized when firms in complex environments adopt *flexible* planning systems, Kukalis' premise is that planning flexibility enables firms to pursue not-planned-for opportunities resulting from environmental change through quick adjustments of their strategic plans (Barringer & Bluedorn, 1999; Read et al., 2009; Titus et al., 2011).

Incorporating systemic planning flexibility allows the formal strategic planning process to maintain relevance in changing circumstances. Thus, when used in combination with the formal strategic planning process, planning flexibility can improve agility and help the firm leverage the potential of its key resources. This combination improves a firm's ability to overcome organizational inertia and break down institutional routines that block pursuit of explorative innovations (Zhou & Wu, 2010). Building on arguments that suggest that formal strategic planning is not the "one" best way to plan, we suggest:

H1. Formal strategic planning process and planning flexibility are positively associated.

2.4. Innovativeness

Reflecting an important means by which firms pursue new opportunities, innovativeness is a key to a firm's competitiveness (e.g., Covin & Slevin, 1989; Miller & Friesen, 1982). Innovativeness is defined as a firm's willingness to emphasize technological developments, new products, new services, and/or improved product lines in pursuit of competitive advantage (Lumpkin & Dess, 1996; Slevin & Covin, 1995). Innovativeness "is universally perceived as exploring something new that has not existed before" (Cho & Pucik, 2005, p. 556) and thus is a critical organizational competence providing advantages in any competitive market.

A critical aspect of any formal strategic planning process is a thorough scanning and analysis of the external environment. This involves the search and collection of data related to the external environment. This information can influence planning decisions by providing evidence of customer needs, exposing new technologies, or shedding light on future market or technological trends, which are important inputs into the innovation process (Dibrell, Craig, & Hansen, 2011a; Zahra, Neubaum, & El-Hagrassey, 2002). For this reason, a firm's formal strategic planning process should be positively associated with innovativeness (Salomo et al., 2008). Thus:

H2. The formal strategic planning process has a direct and positive effect on innovativeness.