Strategic Planning and Business Performance: A Study of SMEs in Malaysia

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There are many small and medium-sized manufacturing enterprises operating in Malaysia. Some of these enterprises are successful and some face problems or failures within the first five years. Many strategists call for formal strategic planning in order to improve business performances of organizations. As strategic planning involves a process by which firms derive a strategy to enable them to anticipate and respond to the dynamic business environment, such efforts inevitably improve the competitiveness of business firms and eventually their performances. The purpose of this study is to examine whether by practicing strategic planning, the business performances of these SMEs can be resilient and sustainable over the long term.

Data were collected via an e-mail questionnaire survey on 350 randomly selected small and medium manufacturers operating in the state of Perak. A total of 50 responses were received. Data analysis was conducted using a statistical analytical software (SPSS v. 17). The results confirmed that there is a positive relationship between strategic planning and their business performances ($r=0.591$, $p=0.01$). This indicates that manufacturing companies that have some form of strategic planning are more likely to perform better from the four perspectives of the balanced scorecard (BSC), namely, learning and innovation, financial, customer, and internal business processes perspectives. Multiple regression analysis results appear to indicate that the SMEs are particularly concerned over their financial performances and their customers’ satisfaction of their products.

Field: strategic management

1. Introduction

Many countries have accepted the notion that the small and medium enterprises (SMEs) are the building blocks of their respective economies. For Malaysia, the SMEs are a vital component and contribute significantly to the nation’s economy. Even though the sector is an important component, many these SMEs cannot sustain themselves over the long term and face problems and failures in their survivals within the first five years. Some authors have suggested that these failures arise because they do not practice any form of strategic planning (Chee, 1986). Strategic planning is a process which provides a direction for the improvement of business activities of organizations. It helps to formulate business strategy that when implemented tends to increase business performance in an organization.
Effective strategies are known to improve an organization’s performance (Poister, 2010). Thus, strategic planning is important to the development of a resilient SME sector (Anderson & Sohal, 1999).

The SMEs face many challenges in a globalized environment, for example, lack of financing, low productivity, lack of potential managerial abilities, access to technology, heavy regulatory burdens, etc. (Wang, 2003). Ting (2004) identified five key challenges: lack of access to finance, human resource constraints, limited or inability to adopt technology, lack of information on potential markets and customers, and global competition. In addition, he argues that there is a high risk that SMEs would be wiped out if they do not increase their competitiveness in the new, rapidly changing world of globalization. It has been documented that the barriers faced by SMEs in Malaysia tend to undermine their performance.

Strategic planning is extremely important for the success of an organization. Studies have also shown that the high failure rate among small firms, particularly among start-ups, can be attributed to the lack of formal business planning (Castragiovanni, 1996). According to Nobel (1999), the unsuccessful consumption of strategic planning is the major barrier to achieve expected or estimated performance.

Therefore this study attempts to explore the practice of strategic planning in SMEs and to investigate the impact of strategic planning on their business performances. It follows that the relationship between strategic planning and the business performance of the SMEs is examined.

2. Literature Review

The manufacturing industry is a significant contributor to Malaysia’s economy and the SMEs appear to be important to the manufacturing sector. According to SMIDEC (2002), the SMEs account for 93.8 percent of companies in the manufacturing sector, contribute 27.3 percent of total manufacturing output, own 27.6 percent of fixed assets, and employ 38.9 percent of the country’s workforce. In addition, the SMEs are providing the much-needed inter-firm linkages required to support large enterprises and ensure that they remain competitive (Tambunan, 2008). Therefore, the SMEs play a vital role in the Malaysian economy and remain the backbone of industrial development in the country (Saleh, Caputi & Harvie, 2006). Yet, there is a high risk that SMEs will be wiped out if they do not increase their competitiveness in the new, rapidly changing business environment (Ting, 2004). And, for SMEs to be competitive and successful, the practice of strategic planning should be adopted to effectively to allocate time and resources to the activities appropriately.

Many studies have shown that business failure is largely due to an organization’s failure to plan. Norman and Thomas (2003) argue that by lacking a clearly defined strategy, a business has no sustainable base for creating and maintaining a competitive edge in the marketplace. Some studies show that there is a positive relationship between strategic planning and business performance (Bracker, Keats & Pearson, 1986; Pearce et al., 1987:
Hopkins & Hopkins, 1997; Andersen, 2000). Still some authors show the relationship is negative (Fulmer & Rue, 1974; Kallman & Shapiro, 1978; Gable & Topol, 1987; McKiernan & Morris, 1994). Robinson and Pearce (1983) argue that formal strategic planning is a conceptual activity suited solely for larger firms and therefore has no effect on the financial performance of small firms.

Armstrong (1982) advises that formal strategic planning is an explicit process for identifying the firm’s long term objectives, procedures for generating and evaluating alternative strategies, and a system for monitoring the results of the plan implemented. He continues to mention that a systematic procedure is necessary to gain commitment of those affected by the strategies implemented.

According to Pearce and Robinson (2010), there are generally three modes of formal strategic planning; the entrepreneurial mode, the planning mode, and the adaptive mode. For the entrepreneurial mode, the companies are basically under the control of single owners, and they are smaller companies and produce a limited number of products or services. In such firms, strategic evaluation is informal, intuitive, and limited. Larger firms that make strategic evaluation part of a comprehensive, formal planning system are in the planning mode. Mintzberg (1993) identified the adaptive mode which is associated with medium sized firms. For firms that follow the adaptive mode, the identification and evaluation of alternative strategies are closely related to existing strategies.

Organizational theories predict that in uncertain external environment, there should be less bureaucratization and more flexible decision making (Burns & Stalker, 1961; Courtright, Fairhurst & Rogers, 1989). Thus, external instability leads to greater informality (Wilson, 1994). Kukalis (1991) observes that increased rates of external change tend to increase the flexibility of planning practices. However, Lindsay and Rue (1980) point out that organizations have always attempt to counter uncertainty with greater planning efforts.

Norman and Thomas (2003) argue that businesses tend to have more chance to succeed when there is strategic planning in the organization. They continue to reason that without a clearly defined strategy, a business has no sustainable basis for creating and maintaining a competitive edge in the market place. In other words, strategic planning can lead to increase in performance whereas performance can lead to business success. However, such statements require the support of empirical research.

The main reason why the relationship between strategic planning and business performance is still inconsistent is due to the use of different measures of business performance. Kaplan and Norton (1992) suggest the use of the balanced scorecard (BSC) to comprehensively determine the business performance of firms. BSC measures business performance across four different perspectives: the financial perspective, the customer perspective, the internal business process perspective, and the learning and growth perspective. With the use of four perspectives, the BSC captures both leading and lagging performance measures, thereby providing a more balanced view of business performance.
According to Kaplan and Norton (1992), the financial perspective is a financial performance measurement indicator as to whether the company’s strategy, implementation and execution are affecting the bottom line enhancement. Financial goals for big companies would be profitability, growth and shareholders’ value. But these are different from the financial goals of SMEs who do not have large volume of resources. For the SMEs, the financial goals are simply to continue to exist, to be successful and to prosper. Measurement of survival is measured in terms of cash flow, success by quarterly sales growth, operating income by division, prosperity by increased market share by segment, and return on equity (Kaplan & Norton, 1992).

As for the customer perspective, Kaplan and Norton (1992) advise that the customers’ concern tend to fall into four categories: time, quality, performance and service, and costs. Time refers to measuring time leaking when companies receive orders from customers to deliver the products and services to the customers. Quality refers to product defect level as perceived by the customers. Performance and services look at how the company’s products create values for the customers. Costs refer to the extent the customers perceived the selling prices of the products and services as value for money invested.

In terms of the internal business process perspective, metrics on this perspective allow management evaluate and judge how well business is operating and how well their products and services meet customer expectations. Although customer-based measures are important, they must translate these overall measures internally into the company in order to fulfill customer’s expectation. These critical internal operations need to be focused by the managers in order to satisfy customers’ needs. Core competencies should be identified and measured in order to ensure continued market leadership (Kaplan & Norton, 1992).

The learning and growth perspective examines how an organization learns and grows. Measures on this perspective include management emphasis on employee capabilities, information systems availability, motivation, and empowerment. Intense competition requires the company to make continued development to their existing products and processes and have the capacity to initiate new products. A company’s ability to innovate, improve, and learn is directly related to the company’s value to launch new products, create more value for customers, and improve operating efficiencies continually to increase revenue (Kaplan & Norton, 1992).

3. Research Models

The primary objective of this study is to identify the relationship between the degree strategic planning is practiced in SMEs and their business performances. This is followed by determining which perspectives are particularly important to their business performances. The research models are presented below:
4. Research Methodology

As the research objectives require the measurements of the degree or extent strategic planning is practiced in organizations and also that of business performance, the research approach has to be quantitative in nature. Thus, quantitative data were to be collected from targeted respondents. It followed that the data collection method was the structured survey method using a self-administered questionnaire.

A purposive questionnaire was designed to collect data on strategic planning and the four perspectives of business performance: the financial perspective, the customer perspective, the internal process perspective, and the learning and growth perspective. The questionnaire had three sections. Section A collects demographical information of the manufacturing companies. Section B collects data on strategic planning based on 5-point Likert scale. Section C collects data on the four perspectives of business performance, also based on 5-point Likert scale.

The study concerned the SMEs from the manufacturing sector. Thus, a list of manufacturing companies was obtained from the Federation of Malaysian Manufacturers (FMM). The SMEs are defined as:
Small enterprises – Sales turnover between RM250,000 to RM1,000,000 or employs between 5 to 50 full-time employees.

Medium enterprises - Sales turnover between RM1,000,000 to RM5,000,000 or employs between 50 to 150 full-time employees.

The list of SMEs was extracted from FMM list of manufacturing companies according to their definition. A total of 350 SMEs was found to be in the state of Perak and this list became the sampling frame. Subsequently, a sample of 50 target respondents was selected from the sampling frame using the simple random sampling method.

E-mails with the attached questionnaire were sent to the target respondents on 22 February 2012. By the end of the two week deadline, 34 responses were received. The responses from the remaining 16 respondents were collected by face-to-face structured interviewing.

5. Data Analysis and Findings

The questionnaires received were checked and edited for errors and omissions before being entered into a statistical analytical software, SPSS version 17 accordingly. The data analysis and findings were tabulated and presented in the following sections.

Characteristics of the respondents

Age of the firms
Up to 32% (16) of the SMEs surveyed were established within 4 to 6 years, 24% (12) within 7 to 9 years, and 30% (15) were established 10 years and above. Only 14% (8) were established for less than 3 years.

Type of industries
Up to 32% (16) were in food beverage manufacturing, 20% (10) in apparel manufacturing, 16% (8) in the steel industry, 12% (6) in the electrical industry, 6% (3) in construction materials manufacturing, and 14% (7) in other industries.

Number of full time employees
Up to 64% (32) of the SMEs surveyed employed 5 to 50 full time employees while 36% (18) employed 51 to 150 full time employees. This means that there were 64% small enterprises, and 36% medium enterprises.

Location
70% (35) were located industrial estates, 22% (11) were situated in shop lots, 6% (3) in housing areas, and 2% (1) located in other areas.
Descriptive Statistics

The means and standard deviations (SDs) for strategic planning practices are shown in Table 1.

<table>
<thead>
<tr>
<th>Strategic Planning Practices</th>
<th>Mean</th>
<th>SD</th>
</tr>
</thead>
<tbody>
<tr>
<td>Articulate vision</td>
<td>2.96</td>
<td>0.97</td>
</tr>
<tr>
<td>External and internal analysis</td>
<td>3.28</td>
<td>0.88</td>
</tr>
<tr>
<td>Use strategy to address issues</td>
<td>3.30</td>
<td>0.99</td>
</tr>
<tr>
<td>Commitment to implement strategy</td>
<td>3.34</td>
<td>0.98</td>
</tr>
<tr>
<td>Evaluate performance of strategy</td>
<td>3.28</td>
<td>1.07</td>
</tr>
<tr>
<td>Summated average of strategic planning</td>
<td>3.22</td>
<td>0.71</td>
</tr>
</tbody>
</table>

The results are interpreted based on measurement scales: 1 being Never; 2 being Rarely; 3 being Occasionally; 4 being Frequently; 5 being Very Frequently. Based on Table 1, the SMEs do practice some form of strategic planning (mean=3.22, SD=0.71). This indicates that the SMEs are trying to improve themselves by practicing some form of strategic planning. However, they practice them only occasionally. They tend to conduct external and internal analysis before they make decisions only on certain occasions (mean=3.28, SD=0.88) or confronted with certain issues, problems, or opportunities (mean=3.30, SD=0.99). However, when directed by the management, the employees are committed to implement the strategy (mean=3.34, SD=0.98). Occasionally, they do evaluate the performance and effectiveness of the strategy implemented (mean=3.28, SD=1.07).

The means and SDs of business performance are tabulated and presented in Table 2.

<table>
<thead>
<tr>
<th>Perspectives of Business Performance</th>
<th>Mean</th>
<th>SD</th>
</tr>
</thead>
<tbody>
<tr>
<td>Financial</td>
<td>3.08</td>
<td>0.55</td>
</tr>
<tr>
<td>Customers</td>
<td>3.30</td>
<td>0.77</td>
</tr>
<tr>
<td>Internal Business Process</td>
<td>3.08</td>
<td>0.80</td>
</tr>
<tr>
<td>Learning &amp; Growth</td>
<td>3.12</td>
<td>0.75</td>
</tr>
<tr>
<td>Business Performance</td>
<td>3.15</td>
<td>0.48</td>
</tr>
</tbody>
</table>

The results are interpreted based on the measurement scales: 1 being Strongly Disagree; 2 being Disagree; 3 being Neutral; 4 being Agree; 5 being Strongly Agree. Generally, the SMEs perform averagely as seen from the four perspectives of business performance (mean=3.15, SD=0.48). They perform quite well from the customer satisfaction perspective (mean=3.30, SD=0.77). They are also some efforts to instill learning and growth among the SMEs (mean=3.12, SD=0.75). However, they perform quite modestly from the financial perspective (mean=3.08, SD=0.55) as well as from the internal business process perspective (mean=3.08, SD=0.80).
The relationship between strategic planning and business performance

Table 3 shows the Pearson's correlation results for strategic planning and business performance.

| Table 3 Pearson’s Correlation: Strategic planning and Business performance |
|-----------------------------|-------------------|-----------------|
| Strategic Planning          | Pearson Correlation | Business Performance |
|                            | Sig. (2-tailed)    | 0.591**          |

** Correlation is significant at the 0.01 level.

The results confirm the significant relationship between strategic planning and business performance (r=0.591, p=0.00). The relationship is positive indicating that the more strategic planning is being practiced, the better would be the business performance of the SMEs. This finding found supports from many studies (Bracker & Pearson, 1986; Pearce et al., 1987; Hopkins & Hopkins, 1997; Anderson, 2000). With the business environments becoming uncertain, dynamic, and ever changing, and competition turning global, the SMEs are expected to be more professional in their management. They are advised to adopt strategic planning to prepare themselves properly for the new challenges ahead and sustain their competitiveness to achieve better business performance.

The relationships between strategic planning and the 4 perspectives

Table 4 shows the Pearson’s correlation results between strategic planning and the four perspectives of business performance.

| Table 4 Correlations: Strategic planning and 4 Perspectives of Performance |
|-----------------------------|-------------------|-------------------|-------------------|-------------------|
|                            | Financial | Customer | Internal Process | Learning & Growth |
| Strategic Planning          | Pearson Correlation | 0.479** | 0.490** | 0.336** | 0.291* |
|                            | Sig. (2-tailed) | 0.000 | 0.000 | 0.000 | 0.040 |

* Correlation is significant at the 0.05 level.
** Correlation is significant at the 0.01 level.

Table 4 shows the Pearson's correlation coefficients between strategic planning and the four perspectives and business performance. All the four perspectives of business performance are significantly related to strategic planning. The results indicate that the more strategic planning is being practiced, the more the four perspectives of business performance will improve. Of the four perspectives, the customer perspective will improve the most with more strategic planning (r=0.49, p=0.01). The financial performance will also
improve moderately with more resources committed to strategic planning by the top management \((r=0.479, p=0.01)\). As far as the internal business process is concerned, there is a slight positive correlation with strategic planning \((r=0.336, p=0.01)\). Lastly, the SMEs perceive the learning and growth perspective will improve the least with strategic planning \((r=0.291, p=0.04)\).

Kaplan and Norton (1992) state that the financial and customer perspectives are lagging measures because they are evaluated using past historical information such as sales growth, profitability, level of defects, costs of quality, etc. And the internal business process and learning and growth perspectives are leading measures because they are measured using estimated future information such as core competencies and new innovations, etc. The correlation results appear to indicate that emphasis on strategic planning by the management will bring better improvements to lagging measures (the financial and customer perspectives) than leading measures (the internal business process, and learning and growth perspectives). This is a significant finding for the SMEs. The two main concerns for SMEs are customer satisfaction and financial sustainability. They are in the know that customer satisfaction leads to sustainable sales turnover and profitability. Therefore, they have all the more reasons to adopt formal strategic planning in their organizations as the process gives strategic direction to accomplish the strategic goals and provide feedback to the managers for deviations from the goals established (Simmons, 2000).

**Multiple Regression Analysis (MRA)**

A MRA was conducted by regressing the four perspectives on the dependent variable, Business Performance. The objective is to identify the relative importance of the perspectives to business performance. Table 5 shows the beta results.

<table>
<thead>
<tr>
<th>Independent Variable</th>
<th>Beta</th>
<th>Rank</th>
</tr>
</thead>
<tbody>
<tr>
<td>Internal Business Process</td>
<td>0.421</td>
<td>1</td>
</tr>
<tr>
<td>Customer</td>
<td>0.404</td>
<td>2</td>
</tr>
<tr>
<td>Learning and Growth</td>
<td>0.393</td>
<td>3</td>
</tr>
<tr>
<td>Financial</td>
<td>0.287</td>
<td>4</td>
</tr>
</tbody>
</table>

Based on the regression results, the SMEs rated the internal business process perspective as the most important variable to business performance \((\text{beta}=0.421)\). This is followed by the customer perspective \((\text{beta}=0.404)\) and the learning and growth perspective \((\text{beta}=0.393)\). It is surprising that the financial perspective is of the least importance to business performance. This finding found support in Robinson and Pearce’s (1984) assertion that “formal strategic planning is a conceptual activity suited solely for larger firms and therefore has no effect on the financial performance of small firms”. Kaplan and Norton (1982) also advised that the SMEs are more interested in business survival rather than profitability, growth and shareholders’ value. Nevertheless, it is heartening to note that the SMEs place so much importance to the performance of the
leading measures (the internal business process, and the learning and growth perspectives) as these perspectives offer a way forward to enhance the competitiveness of the SMEs. Subsequently and surely, market growth and profitability will follow when the leading measures are in place.

6. Conclusion

The empirical study on the SMEs confirms that the degree strategic planning is being practiced has a positive moderate relationship with business performance. In other words, when more emphasis is placed on strategic analysis, implementation, and control, the better would be the business performance of the SMEs. The finding encourages the SMEs to adopt strategic planning in their management agenda in the hope that such management technique would improve the performance of the SMEs of the manufacturing sector.

Besides, although the SMEs tend to focus on improving their performance in the leading measures, strategic planning can help to improve business performance in terms of customer satisfaction and the financial objectives. These business performance perspectives are the immediate concerns the SMEs should prioritize in order to ensure survival and sustainability. Thereafter, the SMEs can seek improvements in competitiveness in order to achieve business success and profitability via good performance in the internal business process, and the learning and growth perspectives. So, it is clear that strategic planning and management is the change technique which can assist the SMEs to achieve business performance and success.

References


