Strategic Planning, Budget Monitoring and Growth Optimism: Evidence from Australian SMEs

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ABSTRACT

Purpose – The purposes of this paper is to assess the implications of concurrent strategic planning and financial management processes on anticipated future revenue growth.

Design/methodology/approach – We use a secondary dataset, gathered among Australian SMEs, by the Australian Bureau of Statistics. Our analysis adopts a regression approach including a mediated and a non-mediated path to explore the direct and indirect effects of strategic planning and budgetary planning and management on expected future revenues.

Findings - Our findings suggest that (a) firms that utilise strategic planning and robust budget planning and monitoring processes exhibit higher optimism about future sales growth and (b) firms that effectively configure these planning activities with market development tend to exhibit higher growth and more growth optimism.

Originality – we believe that this paper is one of the first to link managerial revenue growth expectations (optimism) to planning and monitoring activities. Our overall model, that anticipates positive benefits from the effective deployment of this configuration of planning, monitoring and optimism, is confirmed.

Keywords - Strategic Planning, Operational Planning, Growth Expectations, Optimism

INTRODUCTION

In general, private firms exist to create economic value and to appropriate some of this value for their owners (Tirole, 1986). Firms generally achieve these value creation and appropriation outcomes through the development and execution of plans and strategies – with these plans and strategies spanning the means of value creation (that is, the internal processes of the firm) and the means of making the firm's products and services available to the market profitably (namely, the market-facing and external processes of the firm).

To coordinate the often complex, dynamic, interdependent and disparate activities of production and value creation, firms generally use, to a greater or lesser degree, some forms of financial and strategic planning process (Bisbe and Otley, 2004; Chenhall, 2005; Henri, 2006). For smaller firms, or firms operating in simple contexts, these arrangements may be quite rudimentary, taking the nature of simple managerial heuristics or *rules of thumb*. In such contexts, budgetary and strategic planning is often characterised as emergent, informal and opportunistic (Anderson and Nelson, 2009; Kürschner and Günther, 2012).

For larger organisations, or firms in other and more complex contexts, the strategic planning process may be elaborate, highly formalised and continuous (Grant, 2003). Such processes are often highly rational in comparison to the informal and emergent forms employed in smaller firms, or in simpler competitive environments (Covin, Green and Slevin, 2006).

Budgetary Planning

The intensity of the use of budgetary managerial planning is a sign that an organization is seeking to understand its short term position in the market and is seeking internal and external feedback to identify how it can improve performance.

There was a time when organisational planning was essentially an expression of financial and accounting analysis (Cress & Pettijohn, 1985). However, as views of strategy have complexified, so has the view of how budgetary accounting systems can influence, and can be influenced by, deeper

understandings of the internal and external strategic environment of firms (Frezatti, Aguiar, Guerreiro & Gouvea, 2011).

The distinction between budgetary planning and strategic planning goes back to Anthony (1965). The use of budgets and feedback systems to compare actual financial outcomes with budgetary expectations has found its way into textbooks and SME education and training to the point where it is seen as an activity that is central to organisational managerial control (Otley, 1994). The research investigating the impact of budgeting on performance has been predominantly undertaken in large organizations (Chenhall, 2003). The findings are mixed, with its usefulness often highly contingent on factors such as environmental uncertainty and organisational structure.

Potentially, strategic and budgetary planning is most beneficial when firms are faced with fundamental uncertainty. Recent research by Dunk (2012) notes that effective budgetary planning and control at the earliest stages of a project's life cycle enhances project profitability and hence organisational performance. This is consistent with earlier work by Hart, Hultink, Tzokas & Commandeur (2003) that noted the importance of budgetary planning in the effective mitigation of the uncertainty associated with new product development.

Despite the considerable discussion of the weaknesses of budgets (see Libby and Lindsay, 2010), and moreso the downsides of slavish adherence to financial controls, there is no doubt that most organizations continue to use some form of budgetary control. While varied, a preponderance of evidence suggests that the valuing of budgets has been linked to organisational performance improvement (Libby and Lindsay, 2010).

There has been much discussion in the literature regarding the potential performance constraints that slavish attachments to budgetary control may create. An argument exists that SMEs might find budgetary adherence and control reduces innovation and creativity (e.g. Davila, Foster and Li, 2009). This tends to be counterbalanced by the potential benefits that are available for budgets and budgetary control in identifying new markets and opportunities (Davila, Foster and Oyon, 2009).

Strategic Planning

Strategic management is based on the notion that sustainable competitive advantage emerges from an optimal alignment of organisational resources and capabilities within environmental opportunities (Morrow, Sirmon, Hitt & Holcomb, 2007). With both the internal and external environments of firms in a constant state of dynamic emergence, achieving this optimal arrangement is often seen as much art as science (Bryson, Crosby and Bryson, 2009).

Strategic planning can be seen as a mode of organisational learning, bringing forth assessments of internal and external pressures with a view to making optimal and well informed strategic choices (Oakes, Townley & Cooper, 1998). Choices between and among emergent and informal approaches to planning versus more rigorous and formalised arrangements are often seen as contingent on the market context of firms. Such analyses point to the usefulness of adaptive strategic decision making in highly dynamic environments (Al-Shammari and Hussein, 2008).

Whichever form and mode of planning is pursued, two fundamental questions remain. How does the planning process add value, and how can this value creation process be optimised?

For such a fundamental issue in the strategic planning area, the extant research is surprisingly divergent and occasionally contradictory. In their major meta-analysis of the extant empirical literature, Kürschner and Günther (2012, 31) found in their assessment of the previous literature that explored the relationship between formalised strategic planning and organisational performance six studies that found a positive and significant correlation (at the 5% level of significance).

Research Framework



Figure 1: The Research Framework

Essentially, in this paper we are exploring the interplay between business and strategic planning (BSP) processes and anticipated increase in sales growth optimism (AIS), mediated and unmediated by effective budgetary planning and control (BPC) arrangements.

Strategic planning processes are aimed at creating and managing internal resource allocations and configurations in an optimum manner to seize opportunities available in the operational environment (De Waal, 2013). The objective of such arrangements is to create sustainable strategic niches that either increase revenues or profitability or both. As such, our first hypothesis (*H1*) suggests that *firms that actively utilise business and strategic planning (BSP) processes will anticipate increased sales (AIS) in future years.*

Business and strategic planning is essentially about assessing and making choices available to the firm. When done effectively, the optimum choice sets will emerge from a rational assessment of external opportunities (which are generally exogenous) and internal resources (which are often stubbornly hard to change, although are subject to resource investment decisions over time). As far as strategic and business planning entails the making of resource allocation and investment choices, we would anticipate the formation of these plans will antecede the development of formal budgetary plans, and the monitoring of these budgetary plans. Our second hypothesis (*H2*) suggests that *firms*

that develop business and strategic plans (BSP) are more likely to also develop and monitor budgetary plans (BPC).

Our third hypothesis (*H3*) suggests that *firms that develop and monitor budgetary plans (BPC) will likely anticipate sales growth (AIS)*. This hypothesis suggests that active budget development, and the monitoring of variance against these budgets against expectations, are hallmarks of a well-informed firm management that are generally better informed about both internal challenges and opportunities and also opportunities within the firm's marketplace.

Our fourth hypothesis (H4) suggests that the *development and monitoring of budgetary plans will mediate the relationship between business and strategic planning (BSC)* and *anticipated increases in sales (AIC)*.

METHODS

Data Employed: The Business Longitudinal Survey

This paper is based on an analysis of a sub-sample of data from the Business Longitudinal Survey (BLS) – a survey undertaken by the Australian Bureau of Statistics (ABS). The BLS has provided important insights into the activities and performance of Australian organisations, especially small to medium businesses. The BLS provides researchers with a four-year data panel (1994-95 to 1997-98 to accord with the Australian financial year). The data collected was remarkably comprehensive, gathering data on financial flows, employment, training activities and the development of managerial capabilities at the firm level. Importantly, all ABS data is gathered under the Census and Statistics Act 1905, coercively if necessary, effectively negating issues of non-response bias.

The Sample

This paper employs data from the latter three years of the BLS (from 1995-96 to 1997-98) for the purposes of statistical analysis. Although the entire sample of the BLS exceeds 9,700 firms, for the

purpose of this paper we carefully screened the data to ensure, as best we could, that the data we included in our analysis provided a sample of substantial firms with robust ongoing operations.

First, we chose firms that were operational in all four years of the survey, with sales in each year of at least AUD100,000. As a longitudinal database, there were also numerous firms that failed during the survey, or were lost to the survey for other reasons. We chose to focus only on firms that persisted in normal business operations for the duration of the survey.

The sample included many micro-firms and sole operators, and we determined that for very small firms many of the formal planning and monitoring processes of interest in this study would occur innately within the mind of the owner-manager. Our sales screen removed these micro-firms.

Through these screening processes, we achieved a final sub-sample of 2,406 firms. We note and acknowledge that one result of this screening was to skew the sample. We would describe these 'screened in' firms as atypical within the whole population of Australian SMEs. The firms could be characterised as successful in maintaining a viable business over the period examined. This skewed sample could be considered a problem were we seeking to provide a representative analysis of Australian manufacturing SMEs – which we were not. Empirically, a desirable outcome of the screening process was that we had a strong assurance that the data that we analysed for this paper was robust and an accurate representation of the organisational phenomenon in question.

Measures

The following measures were drawn from various data items taken from the BLS confidentialised unit record file (CURF).

Business and Strategic Planning (BSP)

We were interested in the use of formal business and strategic planning (*BSP*) within our sample. *BSP* is derived from the questions in the CURF asking 'did this organisation use a formal business or strategic plan'.

The principal data utilised to develop our intensity of use scores for this paper was collected dichotomously in the survey instrument. Such binary data is generally difficult to integrate into exploratory and confirmatory factor analysis due to its non-conformance with the requisite distributional patterns of normality. To address this shortcoming, we rescaled the data into an interval form using data from two years of responses (from years 2 and 3 of the survey, with a view to assessing an outcome in year 4). This approach had the benefit of integrating the notion of accumulative causality into our modelled data. The dataset has the benefit of being longitudinal and not simply cross sectional. The use of temporally consecutive data points to measure the cumulative effects of budgetary and strategic planning processes is a particular strength of the paper.

Budget Planning and Control (BPC)

We were interested in the use of formal budgetary planning and monitoring (which we name Budget Planning and Control – BPC) within small to medium enterprises aimed at improving organisational performance. *BPC* is derived from questions in the CURF relating to firms' use of 'budget forecasting' and 'regular income and expenditure reports'.

In a similar fashion to that discussed above, we rescaled these items into an interval form. For both BSP and BPC we used SPSS to undertake a Principal Component Analysis to extract a continuous factor score for use in the regression analysis.

Anticipated Increase in Sales (AIS)

Our dependent variable in the study is anticipated increase in sales (AIS). Adopting a growth, rather than profitability, measure for our study marks it apart from many studies that choose to look at some form of relative financial return. We chose to explore the impact of our independent variables on anticipated growth as there is an innate logic to the notion that firms integrate exploratory and exploitative techniques as a means of achieving a more substantial position within a competitive market context. Managerial optimism regarding the future of the organisation has a number of direct and indirect affects. Langabeer and Yao (2012) note that a predisposition to optimism among a sample of hospital CEOs has both a direct and positive effect on organisational performance, while also moderating the relationship between a rational assessment of environmental opportunities and threats and organisational performance. Further, Green, Medlin and Whitten (2003), in a sample of small manufacturers, found that employee and managerial optimism positively impacted organisational performance through the development of a culture of commitment and a predisposition to grow organisational resources and market presence.

Again, this marks our paper apart from those with more orthodox approaches to the measurement of organisational financial performance. We are comfortable focusing on optimism as the anticipation of growth predisposes a firm to resource allocations relating to forward looking strategic initiatives including research and development, manufacturing planning and the like. To consider the counterfactual instance – a firm without plans to develop and grow will tend to stagnate at best, or decline.

<<Insert Table 1 about here>>

Hypothesis Tests

In assessing *Hypotheses* 1 and 2, this study examines the possible direct and indirect effects on AIS from BSP and BPC. The test statistics of both hypothetical paths (BSP \rightarrow BPC and BPC \rightarrow AIS) are strongly significant, with positive directionality. The path coefficient of BSP \rightarrow BPC is 0.4046 (p < 0.001), indicating that Budgetary Planning and Control is directly and positively influenced by the variance in the use of Business and Strategic Planning. *Hypothesis 1* is hence supported by the sample.

<<Insert Table 2 about here>>



Figure 2: The proposed model

For *Hypothesis 2*, the mediating BPC factor correlates significantly, directly and positively with AIS (path coefficient = 1.8106 with p < 0.001).

Taken together, these hypotheses predict that a chain-link of activities exists in relation to (a) business and strategic planning, (b) budgetary planning and control and (c) anticipated increases in sales. This suggests that firms involved in formal strategic and business planning activities are more likely to undertake the development of formal budgets and to monitor those budgets. The chain is completed in that firms undertaking budgetary planning and control tasks are more optimistic about future sales growth than firms that do not.

For *Hypothesis 3*, we investigated the presence of a direct and unmediated relationship between BSP and AIC. The unmediated path between BSP and AIC is not statistically evident (p > 0.10). Hence, *Hypothesis 3* is not supported within our sample.

Taken together, there is evidence of a positive mediated configurational arrangement between formal business and strategic planning, budget planning and control and anticipated sales growth. The

strength of such indirect effects is 1.174 (p < 0.001). Since only the indirect effects of BSP that are mediated by BPC on firm performance are shown to be significant, *Hypothesis 4* gains support from the sample.

<<Insert table 3 about here>>

DISCUSSION AND CONCLUSIONS

Our analysis suggests that formal budgetary and strategic planning is an important part of any well run business. Our findings support the notion that an effective budgetary and strategic planning processes will increase the optimism held by firms' management in relation to future sales growth.

A key emphasis of our paper, and its main empirical contribution, is that we go some way in explaining how managers predict future changes in sales. In our sample, our unmediated model linking business and strategic planning to performance is not significant (p > 0.10), while our mediated model is highly significant in explaining the interplay between these formalised planning arrangements, budgetary planning and monitoring and growth optimism (p < 0.001).

As much as a dispassionate group of researchers should, we take heart in these findings. Appropriate planning and control systems are a counterpoint to organisational disarray and managerial capriciousness. As management scholars, it would be hoped that the presence of such systems would lead to improvements in the confidence managers have on future revenue changes – and this is the outcome we find.

Also, our research emphasises the importance of effective configuration. Strategic and business planning must be supportive of the generation and monitoring of resources and budgets by firms (Zott & Amit, 2008).

Limitations and Implications

Like any empirical study, and most especially empirical studies based on secondary data, this paper has some limitations. First, the sample reflects SMEs within the Australian manufacturing sector in the late 1990s. In many ways, there was nothing extraordinary in the Australian economy and the manufacturing sector at that time that would colour our analysis, but nonetheless this paper reflects a certain time and place.

Our measures are well suited to the questions examined here, but again we have had limited choice in terms of the measures adopted. Deeper and more complex measures relating to budgetary and strategic planning may have provided a more nuanced analysis of the issues at hand.

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| | Mean | SD | 1 | 2 | 3 | 4 | 5 | 6 | 7 |
|----------------------------------|-------|-------|-----------|----------|----------|------|----------|----------|------|
| (1) AIC Year 3 | 2.07 | 21.35 | | | | | | | |
| (2) BPC Year 1 and 2 | 1.83 | 1.22 | .072 **** | | | | | | |
| (3) BSP Year 1 and 2 | 1.06 | 1.16 | .054** | .549*** | | | | | |
| (4) Actual Sales Growth Year 1 | 1.10 | .85 | 011 | 0.034 * | .020 | | | | |
| (5) Actual Sales Growth Year 2 | 1.12 | 1.87 | .003 | .011 | .031 | 033 | | | |
| (6) Expected Sales Growth Year 1 | 7.44 | 34.19 | .036 † | .037 * | .034 † | .020 | .096 *** | | |
| (7) Expected Sales Growth Year 2 | 5.96 | 20.93 | .143 *** | .110 *** | .125 *** | .019 | .019 | .115 *** | |
| (8) R&D/Sales Year 2 | .0035 | .035 | .033 | .035 † | .047* | 008 | .002 | .067 ** | .031 |

Table 1: Means, Standard Deviations and Bivariate Correlations (Two Tailed)

† Correlation is significant at .1, * < .05, ** < .01, *** < .001

Table 2: Regression Analyses for BPC and AIC

| DV | | BPC | H2 | | AIC | H3 |
|------------------------------|---------|------------|-----|---------|------------|-----|
| Variables | Coef. | Std. Err. | | Coef. | Std. Err. | |
| Constant | 0.4673 | 0.0308 | *** | 2.7097 | 0.6084 | *** |
| BPC Year 1 and 2 | | | | 1.8106 | 0.3937 | *** |
| BSP Year 1 and 2 | 0.4046 | 0.0138 | *** | 0.4429 | 0.3042 | |
| Actual Sales Growth Year 1 | 0.0006 | 0.0005 | | 0.0079 | 0.0086 | |
| Actual Sales Growth Year 2 | 0.0022 | 0.0007 | *** | 0.1189 | 0.0141 | *** |
| Expected Sales Growth Year 1 | 0.0258 | 0.0182 | | -0.2328 | 0.3427 | |
| Expected Sales Growth Year 2 | -0.0039 | 0.0083 | | -0.1091 | 0.1561 | |
| R&D/Sales Year 2 | 0.1721 | 0.442 | | 19.5015 | 8.3143 | |
| | | | | | | |
| N | 2290 | | | 2290 | | |
| R^2 | | 0.2873 *** | | C | 0.0588 *** | |

*** Correlation is significant at < .001

| | Coefficient | SE | t Direct | р | LLCI | ULCI | |
|-----------------|-------------|-------|------------|--------|---------|--------|----|
| | | | Z Indirect | | | | |
| Total Effect | 1.1754 | .2603 | 4.5159 | 0.0000 | 0.6650 | 1.6859 | |
| Direct Effect | 0.4429 | .3042 | 1.4560 | 0.1455 | -0.1536 | 1.0394 | H1 |
| Indirect Effect | 0.7326 | .1613 | 4.5415 | 0.0000 | .5562 | .9647 | H4 |

Table 3: Significance tests for total, direct and indirect effects