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STRATEGY-MAKING PROCESS AND FIRM PERFORMANCE IN SMALL FIRMS

ABSTRACT

This paper argues that individual small firms, just like large firms, place differing emphasis on strategy-making and may employ different modes of strategy-making. It offers a typology of the different modes of strategy-making that seem most likely to exist in small firms, and hypothesises how this typology relates to performance. It then describes the results of an empirical study of the strategy-making processes of small firms. The structural equation analysis of the data from 477 small firms with less than 100 employees indicates among other results that the simplistic, adaptive, intrapreneurial and participative modes of strategy-making exist in these SMEs. Of these modes, the simplistic mode exhibits the strongest relationship with firm performance.

INTRODUCTION

Strategic management is an applied field of business and as such its survival and growth depend not only on its theoretical sophistication and the rigour of its methods, but also on its relevance to practitioners. Although studies show that firms that are sophisticated users of strategic management are more successful than firms that have not yet acquired strategy-making skills (Pekar and Abraham, 1995), practitioners often do not perceive strategy-making as relevant to improving their firm performance (Heracleous & DeVoge, 1998). Yet, Eden and Ackermann (1998) propose that the strategy-making process may be the most important factor that determines the ability of a firm to realise its strategic intent and that the strategy-making process that a firm uses may have a profound impact on firm performance (Hart & Banbury, 1994).

In the past forty years, strategic management scholars have investigated the strategy-making processes of firms and their impact on firm performance (e.g. Hart & Banbury, 1994; Miller & Friesen, 1977). The resulting literature tends to focus on building models that explain, predict and facilitate the positive influence of strategy-making processes on the performance of the firm. An important question that researchers of strategy-making processes should ask is how generalisable to small firms are those models that explain performance in large firms.

Few studies have investigated and developed models of strategy-making in small firms (e.g. Cooper, 1979; McCarthy & Leavy, 1998/99). Where researchers have studied strategy-making in small firms, the research tends to be prescriptive and focussed on discovering the degree to which formal strategy-making processes are employed in these firms (e.g. Robinson & Pearce, 1983). Marsden and Forbes (2003) explain the latter situations by suggesting that the scholars who investigate planning in small firms are different from those that study strategy-making in general. Scholars interested in strategy-making in general seek to develop analytical models and concepts which are applicable to all firms, often independent of contingent

factors such as size and industry. Scholars studying small firms are interested in the causes of performance variation, one of which may be strategy-making practices.

This paper aims to identify the strategy-making processes that small firms use, and explain which approaches are more likely to lead to success under different circumstances. To this extent it provides a snap-shot of the state of strategy-making in small firms. It does not pretend to offer an all inclusive coverage of the field, but rather is an exploratory investigation into a field of study that has been under-investigated in small firms.

A STRATEGY-MAKING TYPOLOGY FOR SMALL FIRMS

Strategic management is a relatively new field of study that has evolved in creative and unpredictable ways over the past forty years. Within strategic management a distinct body of knowledge, namely that of strategy-making process, can be found. The strategy-making process has been defined as an organisation-wide phenomenon that involves decision making by top managers and/or other organisation members (Lumpkin & Dess, 1995). Different firms make strategies in different ways, and do not only employ the rational process that is taught in most business schools. A set of approaches (or modes) to strategy-making process (e.g. Hart, 1991; Mintzberg, 1973) that is presented as complementary to each other, is called a typology of strategy-making processes. A bewildering array of such typologies of strategy-making processes has been developed over the past 40 years. This proliferation of typologies has produced several problems for researchers in this area. According to Hart (1991:99) the 'lack of methodological consistency and confusion over typologies that focus on similar phenomena from different points of view' are the most significant of these problems.

Nowhere is this problem as significant as in the research which investigates strategy-making in small firms. In fact, few of the models that were developed for large firms have been found to be applicable to small firms (O'Gorman & Doran, 1999). This situation is further exacerbated by the fact that strategy-making research in small firms is mostly undertaken in larger small and medium enterprises (SMEs) with up to 500 employees in North America and Europe (Analoui & Karami, 2002;

Miller & Toulouse, 1986; Ogunmokun, Shaw & FitzRoy, 1999), which do not offer many solutions to smaller firms. This section attempts to overcome this problem by exploring the existing typologies of strategy-making for modes that are likely to be relevant to small firms, typically those with fewer than 100 employees (Cameron & Massey, 1999). At the end of the section a typology of strategy-making processes for small firms is provided in the form of Hypothesis 1.

Strategy-making theory and teaching initially centred on a model of *rationality*. Rationality, as explained by the early authors (e.g. Andrews, 1971; Ansoff, 1965), implies that the decision maker(s) analyse the firm and its environment, consider all the possible alternatives or strategies, evaluate the consequences from the adoption of each alternative, and select the most appropriate strategy. These processes are commonly mistaken for the only kind of strategy-making process that exists (e.g. Gibson & Cassar, 2002). When authors discuss the absence or presence of strategy-making in a small firm without clarification, they are usually referring to either the compilation of the business plan for obtaining finance, or to a formal, rational strategy-making process. Even though rationality was, and to some extent still is, the dominant theoretical mode of strategy-making, some authors (e.g. Mintzberg, 1973; Quinn, 1978) question whether it is the only mode of strategy-making employed by firms. Although authors such as Hart (1991, 1992) find that the rational mode of strategy-making is very important to large firms this paper argues that the rational mode may not be relevant to small firms at all. Instead, other modes of strategy-making may be more applicable to small firms, as discussed next.

Mintzberg (1973) and Quinn (1978) suggest that strategy-making may also be made in a less rational, step-by-step approach. Mintzberg (1973) terms this mode of strategy-making *adaptive*, Quinn (1978) *logical incrementalism*, and Mintzberg and Waters (1985) *emergent strategy*. This mode implies that top-management provides the broad direction that the firm will follow, but that the detail of that strategy emerges over time through the actions of the employees of the firm. For example, Harris, Forbes and Fletcher (2000) find that strategy-making in small firms is mainly emergent, adaptive and reliant on personal relationships. Also, Chen and Hambrick (1995) explain that smaller firms are more responsive when attacked and implement their competitive reactions faster. This paper argues that the adaptive mode of

strategy-making indicates an active engagement of external stakeholders in the direction of the firm which is often employed by small firms because of their dependence on these stakeholders, which typically include customers and suppliers. This engagement may be less formal than when a rational strategy-making process is followed, but may nevertheless exhibit elements of strategic thinking, as suggested by Quinn (1980). Such strategic thinking is sometimes called the vision or an umbrella strategy (Mintzberg & Waters, 1985).

As well as supplying direction to firms employing adaptive strategy-making processes, vision also provides direction to firms that employ *command* strategy-making practices. Hart (1992) describes the command mode as a mode of strategy-making in which 'a strong individual leader or a few top managers exercise total control over the firm' (p. 335). In this mode employees are seen as followers who carry out the commands of the leader without question. The opposite of the command mode is the *intrapreneurial* mode of strategy-making. Also termed the 'generative' mode of strategy-making (Hart, 1992), this mode implies independent behaviour by innovative employees who are encouraged and sponsored by top-management to experiment and take risks. However, the independent existence of the command and intrapreneurial strategy-making modes are questioned by some authors (e.g. Dess, Lumpkin & Covin, 1997). The presence of top-managers who encourage and sponsor in the intrapreneurial mode implies some sort of induced (top-down) behaviour. But this paper argues that it is likely that strategy may be generated emergently by innovative employees in some small enterprises without strong direction from the owner or manager of the firm. Therefore it is likely that the intrapreneurial mode exists in such enterprises.

The intrapreneurial mode identifies one way in which employees can be involved in the strategy-making process of the firm. In this mode employees generate ideas, and therefore influence the strategic direction of the firm. But, it seems as if this strong trend towards the involvement of employees in strategy-making may actually be a joint attempt by managers and other employees (Hart, 1992; Parnell, Carraher & Holt, 2002; Wooldridge & Floyd, 1990). Dess, et al. (1997) and Khandwalla (1976/77) call this mode of strategy-making *participative* or democratic and indicates that decision-making involves employees on different levels

and across functions in the firm. This mode indicates that strategy-making occurs mainly from the bottom of the firm upwards, or in the case of organic firms, through teamwork. Participative strategy-making is not indicative of rationality, but rather of an informal, but inclusive, decision-making process. Participation is often conceptualised as being political in nature (Bourgeois & Brodwin, 1984; Shrivastava & Grant, 1985), but in very small firms it is unlikely to be the norm supposedly because of the strong influence of the firm owner (Mintzberg, 1973).

While a participative mode depends on a high level of involvement in strategy-making, often through political processes, the *symbolic* mode relies on a strong organisational culture, defined by the vision, basic philosophy and values of the firm (Hart, 1992). In a symbolic mode, the vision and culture provides employees with a sense of how things are done in this firm, and strategy therefore follows culture. Lumpkin and Dess (1995) combine the command and symbolic modes of strategy-making and call it *simplistic* strategy-making. Lumpkin and Dess describe the simplistic mode of strategy-making as characterised by 'single-mindedness, narrowly construed decision-making, and excessive attention to a specific internal strength or external opportunity' (1995:1403). SME researchers allude to the existence of this mode. For example, Frost (2003) finds in a study of 331 Australian SMEs with less than 100 employees that the use of strategic tools and a strategic plan was significant. But the range and depth of the tool usage are disappointing, especially when compared to previous studies in larger firms, such as Clark (1997). It is argued that this scaled down version of rationality may point to the simplistic mode which may be more relevant to small firms.

The rational, adaptive, participative, simplistic, command, symbolic, and intrapreneurial modes of strategy-making are found in most of the existing strategy-making typologies. However, this paper questions the existence of a rational mode of strategy-making in small firms. It further agrees with Lumpkin and Dess (1995) that the command and symbolic modes are in effect the same mode of strategy-making than simplistic strategy-making. This argument is in line with the earlier suggestions by Hart (1992) and Mintzberg (1973) who suggest that it is entirely possible that some modes can be used at the same time by a firm, and therefore represent another mode of strategy-making. For this reason, only four modes of

strategy-making, namely the adaptive, intrapreneurial, participative and simplistic modes will be used in this paper. Using Dess, Lumpkin and Covin's (1997) approach to hypothesising about the strategy-making processes used by firms, a synthesis of the above research suggests that:

H1 Small firms will employ all or some of the simplistic, adaptive, intrapreneurial and participative strategy-making processes

STRATEGY-MAKING PROCESSES AND FIRM PERFORMANCE

Although the literature identifies the existence of the aforementioned processes in small firms, it is of little consequence if these processes do not have the potential to improve firm performance. Several studies investigate the effect of strategy-making processes on firm performance.

This paper takes the stand that traditional rational processes will not be used significantly by small enterprises (Frost, 2003) and that the most formal process, instead of the rational process, that small firms normally employ is *simplistic* strategy-making. The general consensus seems to be that processes that are more rational in nature will be strongly associated with firm performance. For instance Miller and Toulouse (1986) find in a study of 97 small firms in Canada that successful small firms have more explicit strategies, longer planning horizons and more detailed decision analysis, that is, more rational processes. Van Gelderen, Frese and Thurik (2000) find in a study of Dutch small firms that formal processes will impact on performance and that performance will in turn lead to more formal strategy-making processes. In general it seems as if the support for a strong relationship between formal strategy-making and firm performance is quite conclusive. This paper argues that this conclusion can be extended to the relationship between simplistic strategy-making and firm performance because of the formal nature, albeit in a scaled down version, of the simplistic mode.

Other authors look at the relationship between *adaptive* strategy-making and firm performance. Barney (1991) suggests that adaptive strategy-making is a rare and inimitable process that will lead to competitive advantage. He is supported by

Hart (1991) who finds in a study of 916 firms of all sizes and industry sectors that the adaptive (transactive) mode of strategy-making is more highly associated with firm performance than the rational and generative (intrapreneurial) modes. But Van Gelderen, et al. (2000) find that not only does adaptive (reactive) strategy-making lead to poor performance, but poor performance leads to reactive strategies. The support for the relationship between adaptive strategy-making and firm performance is therefore mixed and may depend on the conceptualisation of adaptive strategy-making in a particular study.

Participative strategy-making also receives some attention in this regard. Parnell and Crandall (2001) raise the possibility that *participative* decision-making techniques may improve decision quality and therefore organisational effectiveness. Frese, van Gelderen and Ombach (2000) find that critical point (participative) strategy-making is the most highly related to firm success. This finding supports the study by Wooldridge and Floyd (1990) who find that participation in strategy-making is associated with improved firm performance.

Lastly, there has also been much debate about the performance outcomes of an *intrapreneurial* mode of strategy-making. Beaver and Jennings (2000) posit that the 'relationship between enterprise performance, management actions (or inaction) and the value and contribution of strategy is extremely tenuous and very difficult, if not impossible, to demonstrate conclusively' (p. 400). Much of what has been written about intrapreneurial strategy-making and its performance implication in both the popular press and academic journals assume that intrapreneurial strategy-making will lead to growth and profitability for the firm (Peters & Waterman, 1982, Covin & Slevin, 1991). But others such as Dess, et al. (1997) and Hart (1991) find empirically that it may impede performance. It can therefore be argued that:

H2 Firms that employ the simplistic or participative modes of strategy-making will outperform those that employ other modes of strategy-making

RESEARCH METHOD

An empirical study was conducted to test the hypotheses set out earlier. A questionnaire was designed to elicit the four modes of strategy-making and firm performance. Although a variety of contingency variables were also included in the questionnaire, this paper focuses only on the strategy-making and firm performance aspects of the study. In this section, a brief overview of the survey instrument and data-analysis is provided.

Data collection

A questionnaire that contains scales identified through a literature review was mailed to 2 000 small firms in New Zealand, chosen randomly from the Kompass database. A total of 477 usable questionnaires were returned, entered into an Excel datasheet and analysed with the use of SPSS 11.5 and AMOS 5. The firms that were selected from the database excluded farming operations, foreign owned firms and firms with more than 100 employees, following the norms established by Cameron and Massey (1999). The questionnaire was mailed to the owner-manager of each small firm, and a reminder was mailed one month later. 504 questionnaires were returned of which 477 were deemed usable.

Measurement instrument

Strategy-making mode was measured with the Hart (1991) scale as modified by Dess, et al. (1997). This scale was originally developed by Hart to test for strategy-making modes based on the two dimensions that he argued as 'central to [conceptualising] and understanding strategy-making processes: (1) top management 'intentionality', and (2) [organisational] actor "autonomy"' (1991, p. 104). Dess, et al. (1997) modified the scale and found that four modes resulted from their factor analysis. These modes are similar to the four modes identified earlier in this paper. Their scale consists of 25 items and is scored on a five point Likert scale, ranging from 1 'Strongly disagree' to 5 'Strongly agree'.

The dependent variable, firm performance, was measured by using the financial performance scale developed by Covin and Slevin (1989) and Gupta and Govindarajan (1984). Respondents had to indicate the 'importance' of ten financial

measures, namely sales level, sales growth rate, cash flow, return on shareholder equity, gross profit margin, net profit margin from operations, profit to sales ratio, return on investment, ability to fund business growth from profits, and overall firm performance, to the firm on a five point Likert scale. Thereafter they were asked to indicate their satisfaction with the firm's performance for the same ten performance measures. The 'satisfaction' scores were multiplied by the 'importance' scores and aggregated in order to compute a weighted average performance index for each firm. Weighing satisfaction with importance scores is the same method followed by Covin and Slevin (1989). The higher the aggregate score on this relative index, the better the perceived level of firm performance.

Data-analysis

The data were investigated to ensure that they satisfy the underlying assumptions for parametric testing. It was concluded that the assumptions for random sampling, normality, linearity and homoscedasticity were satisfied. The measurement instrument was also tested for reliability and validity. Further data analyses were conducted using Pearson's correlations and structural equation modelling (SEM).

First, a *measurement model* for the four modes of strategy-making in Hypothesis 1 was developed and analysed with AMOS 5. The four modes of strategy-making were the result of a process in which alternative models of modes of strategy-making were compared through SEM. The four modes model did not only describe the data best but were also the only model in which all the modes had satisfactory Cronbach alphas. Second, *causal models* based on Hypothesis 2 were tested. The measurement instrument presented earlier contained 45 items in total. The first 25 items of the strategy-making scale was used for the measurement and causal models as indicated in Figure 1. The 20 items from the performance scale was aggregated into an index as explained earlier and used in the causal model.

FINDINGS

In this section the findings are presented according to the two hypotheses formulated earlier.

Measurement model: Hypothesis 1

The measurement model was developed and analysed as a confirmatory factor analysis (CFA). To ensure internal reliability, the Cronbach alpha of each factor was also attained. AMOS uses the maximum-likelihood method. Each of the 25 items was allowed to load on its associated factor which was decided *a priori* (Byrne, 2001) through a thorough review of the literature.

The regression weights for errors were set at 1.0. Items were connected to factors as proposed in the theoretical model. None of the factors comprised less than three items (Hair, Anderson, Tatham & Black, 1998). Furthermore, the regression weight of the item that was expected to contribute most to each construct following the exploratory factor analysis (EFA) done to ensure reliability was also set at one, as was the regression weight of the factor that is expected to contribute most to the overall construct of strategy-making (for this factor, usually 'participation', no item had a regression weight of 1.0). The measurement model can be observed in Figure 1 if the performance variable is not considered. Table 1 reports the goodness-of-fit results for the measurement model.

Goodness-of-fit Statistics	Results	Ideal values
χ^2/DF	3.024	Below 5
P	0.000	Below 0.05
RMSEA	0.065	Below 0.08
CFI	0.856	Close to 0.90
PNFI	0.706	0.60 to 0.90
GFI	0.877	Close to 0.90

Table 1: AMOS goodness-of-fit results for the measurement model

As indicated in Table 1, the measurement model describes the data well and Hypothesis 1 can therefore be accepted. Therefore, New Zealand SMEs are likely to employ the simplistic, adaptive, intrapreneurial and participative modes of strategy-making.

Causal models – Hypothesis 2

Pearson's product moment correlation coefficient and SEM in AMOS were used to explore the relationships between the modes of strategy-making and firm performance. First, Pearson's product moment correlations were used to investigate whether linear relationships exist (Table 2). A significant positive relationship was

found between firm performance and the simplistic mode of strategy-making. The relationship of the adaptive and participative modes of strategy-making with firm performance showed a lower, yet also statistically significant, correlation. Although these correlations are weak ($r < 0.3$) they are nevertheless interesting. However, only a weak relationship was found between firm performance and the intrapreneurial mode of strategy-making at the five per cent significance level. The latter result is consistent with the findings of Dess, et al. (1997).

Modes of strategy-making	Pearson's correlation coefficient	Significance (p-value)
Simplistic SM	0.314	0.01
Adaptive SM	0.256	0.01
Entrepreneurial SM	0.106	0.05
Participative SM	0.255	0.01

Table 2: Pearson's correlations for modes of strategy-making and firm performance

Next, causal modelling in AMOS was employed to investigate this relationship further. The measurement model was used as the basis for developing the three causal models that investigate the impact of mode of strategy-making on firm performance. In the first model the various modes of strategy-making were linked to firm performance through the strategy-making construct (Model 1 – indirect: see Figure 1).

In the second model, the various modes of strategy-making were linked to firm performance directly (Model 2 – direct). This was done to ascertain the individual effects of the modes of strategy-making on firm performance as well as the direction of the strategy-making/firm performance relationship. In the third model, the arrow was also reversed to double check if performance is the dependent factor in Model 1 (Model 3 – indirect recurring). The results of the goodness-of-fit statistics for strategy-making – performance Models 1, 2 and 3 are found in Table 3.

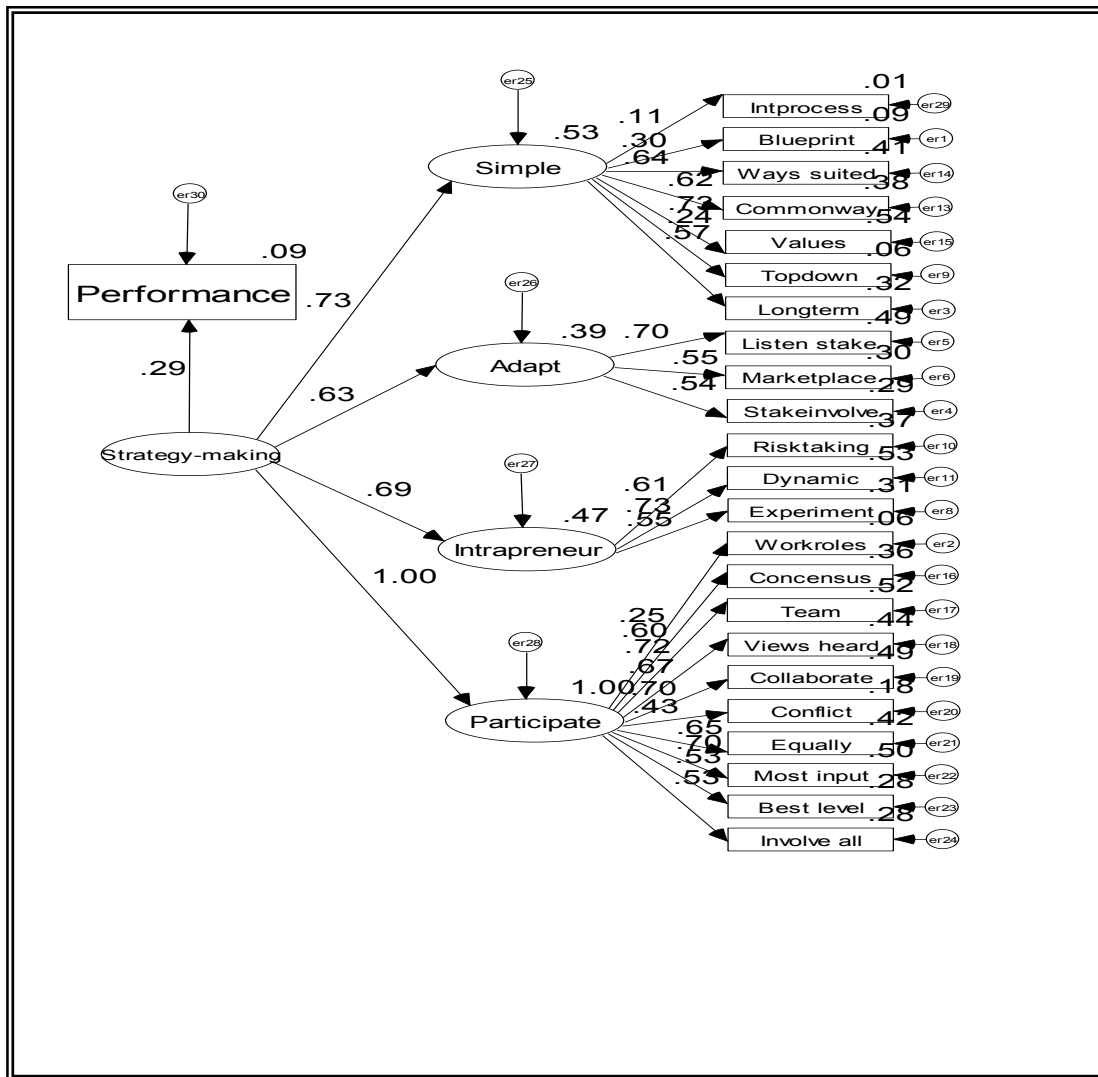


Figure 1: Strategy-making – performance (standardised weights shown)

Statistics	Model 1: (indirect)	Model 2: (direct)	Model 3: (indirect recurrent)	Ideal value
χ^2/DF	3.01	3.39	3.02	Below 5
P	0.000	0.000	0.000	Below 0.05
RMSEA	0.065	0.071	0.065	Below 0.08
CFI	0.836	0.807	0.835	Close to 0.90
PNFI	0.698	0.662	0.696	0.60 to 0.90
GFI	0.872	0.867	0.872	Close to 0.90

Table 3: A comparison of the goodness-of-fit statistics for the three Strategy-making-performance models

The χ^2 , RMSEA and GFI values indicate that Model 2 is worse than Models 1 and 3. But the difference between Model 1 and 3 is totally insignificant, suggesting that the link between performance and strategy-making is bi-directional. The lower

RMSEA values exhibited by Models 1 and 3 are indicative of the ability of a combination of modes to predict performance better than one mode at a time.

Items	Model 1	Model 2	Model 3	Measurement model	SW
Adaptive	0.391		0.412	0.381	0.197
Participative	0.995		0.949	0.995	0.002
Intrapreneurial	0.475		0.480	0.482	-0.052
Simplistic	0.526		0.543	0.509	0.350
Performance	0.085	0.165			
Strategy-making			0.093		

Table 4: Squared Multiple Correlations for structural models

When all the modes of strategy-making were considered together in Model 1, 8.5 per cent for the variance in the overall firm performance were explained by the combined modes of strategy-making (see squared multiple correlations (SMC) in Table 4). This is a reasonable multiple correlation considering that the modes of strategy-making only partially explain firm performance while the outcome thereof (the strategies) should have a more direct impact on firm performance. Note that the high SMCs of participative strategy-making in Models 1 and 3 are indicative of that mode's contribution to strategy-making and not to firm performance.

Although the goodness-of-fit statistics of Model 2 was not as good as for Models 1 and 3, it was good enough to be examined to see which mode of strategy-making contributed most to firm performance. The standardised weights (SWs) suggest that the simplistic mode of strategy-making contributes most to performance, followed by the adaptive mode of strategy-making. Participative strategy-making contributes little, while intrapreneurial strategy-making has a negative effect on firm performance. In total, 16.5 per cent of the overall variance in firm performance is accounted for in this manner. This result generally supports that of the correlations.

Collectively, these results suggest that simplistic strategy-making has the most significant relationship with firm performance ($r = 0.314$, $p < 0.01$) and also contributes most to firm performance in the structural model (SW is 0.35). Strong support for a similar relationship between participative strategy-making and firm performance was not found, although significant but weak relationships between adaptive strategy-making and firm performance, as well as participative strategy-

making and firm performance were found. Furthermore, the direction of the relationship between strategy-making and firm performance could not be established. These results provide therefore only partial support for Hypothesis 2.

DISCUSSION AND CONCLUSIONS

Four conclusions appear evident from the results presented in this paper. First, this study questions the validity of past studies which judged that small firms do not make strategy, when in effect they were investigating primarily whether rational strategy-making occur. An exploration of previous studies that investigate the tenuous link between strategy-making processes and firm performance in small firms shows that few studies entertain the idea that strategy-making processes do not have to be rational or even formal to contribute to firm performance. In reality, this paper suggests that pure rationality may not occur at all in small firms and that studies that investigate the use of strategy-making practices in small firms would be better off using a typology or taxonomy of strategy-making processes to explore it. In this regard, this paper provides an empirically derived taxonomy for the future investigation of strategy-making in small firms to researchers. This taxonomy consists of the adaptive, intrapreneurial, participative and simplistic modes of strategy-making.

Second, the most formal mode that emerges from this study is the simplistic mode. This mode indicates a very limited, simplified approach which is largely driven by the owner-manager of the firm and is based on the previous strategy of the firm. The simplistic mode exhibits little/no analysis of the environment or possible future strategies. This mode is strongly correlated with firm performance. This relationship is much stronger than that found by Lumpkin and Dess (1995) in large firms which further supports the previous suggestion that this mode may be particularly suitable to small firms.

Third, a strong theme that emerges from this study is one of involvement of internal and external stakeholders in the strategy-making process. For example, whereas the literature (e.g. Mintzberg, 1973) defines intrapreneurial strategy-making as a process driven by a strong leader, in small firms this mode is rather

characterised by emergent strategies, formed through involvement and experimentation by employees, which leads to innovative ideas. This result is interesting, because read together with the results of the next two modes indicates that small firms are heavily reliant on internal and external stakeholders and not as much on the owner-manager as theorised before by Mintzberg (1973).

The *adaptive* mode shows that adaptation in small firms is driven by the firm's responsiveness to its stakeholders. The firms that exhibit this mode therefore adapt to suggestions from, for example customers and suppliers, and these then influence the strategy of the firm. This take on adaptive strategy-making differs significantly from previous studies that define it as emergent strategy-making (Butler, Astley, Hickson, Mallory, & Wilson, 1979; Mintzberg, 1973), external and internal adaptiveness (Mintzberg, 1973), incrementalism (Quinn, 1980) and learning (Hart, 1992) and is more closely related to the interpretation of Miller and Friesen (1977) and Dess, et al. (1997).

The *participative* mode shows a very idyllic picture of a firm in which a large amount of cooperation, teamwork and values drive the strategy-making process. It should also be noted that the political aspects suggested by Mintzberg (1973) are absent from the strategy-making processes of small firms, most likely as a result of their non-threatening size, and lack of time, experience or need to engage in such activities. Rather than being driven by coercive politics, this mode is driven by values or culture. Although the modes representative of this involvement are not as strongly related to firm performance as simplicity, they are nevertheless related to it in varying degrees.

The last result that is of importance at this point is that SEM indicates a *reciprocal relationship* between strategy-making and firm performance. Although further analysis should be undertaken to explore this relationship, at this stage it suffices to state that it seems as if the use of strategy-making processes may have a positive effect on firm performance – something that strategic management scholars have argued for forty years (Khandwalla, 1976/77). However, it also seems as if firms that perform better are more likely to engage in strategy-making processes. This result is reasonable given that it was argued before that time and money may be

the reason why small firms do not engage in strategy-making. But if these issues are solved through high performance, and therefore increased resources, small firms may choose to engage in this activity which may then have a greater effect on firm performance. Conversely, it is also possible that a firm performs well through sheer luck (Khandwalla, 1976/77) and then uses the slack that results to invest in one or more of the modes of strategy-making, for example to become more venturesome (entrepreneurial), or to engage stakeholders more (adaptive).

A number of limitations have to be kept in mind when reading the results of this study. First, the strategy-making modes in the measurement model suggested in this paper are comprehensive, but certainly not exhaustive. Second, the data analysis merely shows that some strategy-making practices are more strongly related to performance. The data cannot be interpreted as indicating that firms that do not perform as well do not engage in strategy-making at all. Neither does it suggest that small firms cannot perform well without employing these strategy-making practices (Covin & Slevin, 1989). In effect less than ten per cent of the variation in firm performance can be explained by the use of the suggested strategy-making practices in the suitable context and/or content. Third, since data were collected from New Zealand SMEs, the generalisability of the results to other settings is questionable. Further research in other settings or countries will have to be undertaken to confirm the results. Last, the cross-sectional design may be another limitation (Bowen & Wiersema, 1999; Schwartz & Teach, 2000). A longitudinal study may provide some additional advantages.

This study offers a number of implications for business practice. First, if it is true that small firms naturally engage in strategy-making practices, researchers and practitioners may find it valuable to study the practices to develop tools that will naturally suit small firms so that they can be of more value. Academics and tertiary institutions will be well advised to develop strategic management courses specifically designed for small firms, which should contain specially developed techniques and tools that are less time-consuming and expensive to use and more suited to small firms. Second, this study find that SME owner-managers that are concerned with the development of the strategy-making processes in their firms can expect little benefit from employing highly rational processes, such as those taught in most business

schools. Instead, small firms should choose to concentrate on exploiting the advantages that stem from their small size so that they can benefit from aspects such as developing their capabilities to be strategically aware (Hannon & Atherton, 1996) and interacting with stakeholders with a view to considering their suggestions on the strategic direction of the firm. Additionally important are the ability to generate a positive organisational culture and employ this in the strategy-making process; the ability to communicate and work well as a team and the ability to adapt quickly to changes in the environment. If small firms engage in these practices firm performance is likely to improve. In the interim, this paper identifies four modes of strategy-making which represent a way of thinking about the range and complexity of techniques and issues that SMEs owner-managers may consider when they organise their firm's approach to strategy-making.

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