

The Contribution of Formal Planning Systems to Strategic Investment Decisions¹

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SUMMARY This paper aims to investigate linkages between formal planning systems (FPSs) and characteristics of the processes followed in making strategic investment decisions (SIDs).

The empirical testing was based on a sample of 70 SIDs drawn from 38 industrial enterprises operating in Greece. Primary data on FPSs and SIDs were provided by key participants in the decision-making process, using a combination of structured interviews and questionnaire completion.

Contrary to the argument raised by several academics that much decision making takes place outside FPSs, the findings of this paper support the view that at least for decisions of a clearly strategic nature this may not be valid. Results consistently show that strong associations exist between characteristics of SID processes and dimensions of FPSs. More specifically: The degree of *rationality-comprehensiveness* as well as degree of *financial reporting* in the process of making SIDs is positively associated with FPSs. Particularly strong is the association between the existence of a *set of formalized rules* guiding the process of strategic decision making and FPSs. Furthermore, the association between both *hierarchical decentralization* and *lateral communication* in advancing SIDs and FPSs appears to be fairly strong. Finally, results failed to support any statistical significant relationship between duration timing of SID processes and dimensions of FPSs.

1. Introduction

The literature on strategic planning is replete with studies arguing that formal planning systems (FPSs) are essential tools for managers, since they are designed with the aim to improve managerial decision making and contribute to more rational decision making (e.g. Kudla, 1976; Armstrong, 1982; Langley, 1988; Duncan, 1990). Mintzberg (1981) articulated this line attributing to planning

four tentative characteristics: planning as future thinking, as programming, as integrated decision making, and finally as a formalized procedure and articulated result. This argumentation, together with the conventional management wisdom that planning significantly contributes to strategic decision making, may lead us to support the existence of a close link between FPSs and strategic investment decision (SID) processes.

But the opposite line of argument also exists, understating the contribution of FPSs to strategic decision making. It has been convincingly argued that much of the actual decision making may take place outside FPSs (e.g. Hall, 1973; King, 1983; Sinha, 1990), since it is managers who make strategic decisions and not FPSs. Hall (1973) was among the first to contend that most of the formal planning models do not seem to significantly influence the actual strategy formulation processes. This mismatch, he argued, may be attributed,

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among others, to such factors as: ill-grounded views about the process of strategic planning, inadequate consideration of the role of a model in the planning process, disassociation of FPSs from the arenas in which actual decision making takes place, irrationality of managers, inadequate 'institutionalization' of FPSs, and finally an overarching emphasis on normative, theoretical frameworks, rather than on the actual processes of strategy formulation.

In the same vein, Gluck (1985), supported the view that formal planning may tend to be concerned more with the administration of the planning process rather than contributing to decisions that determine the success or failure of the firm. More recently, Sinha (1990) tested the assumption that CEO or top management may make decisions outside FPSs or without taking into account the input from FPSs. His empirical data generally supported the view that planning systems may be systematically selective, contributing more to decisions considered as important, risky, global in nature, or related to divestments, while ignoring others.

This apparent contradiction in the literature is far from being resolved and the question whether FPSs actually contribute to strategic decision making is in need of empirical verification. It seems that research in the area is more concerned with issues such as:

- (i) the association between planning and profitability (e.g. Ansoff *et al.*, 1970; Pearce *et al.*, 1987; Ramanujam *et al.*, 1986; Rhyne, 1986; Robinson and Pearce II, 1983; Kudla, 1980);
- (ii) the association between planning and the content of strategy (e.g. Lindsay and Rue, 1980; Boulton *et al.*, 1982; Javidan, 1984; Grinyer *et al.*, 1986); and
- (iii) integrative research examining such elements as corporate environment, planning sophistication, information systems, content of strategy and corporate performance (e.g. Rhyne, 1985; Robinson and Pearce, 1988).

Far less effort has been directed in examining the contribution of FPS to actual strategic decision-making processes. Indeed, despite the plethora of normative studies which take as granted the linkages between FPSs and strategic decision-making processes, the area is almost devoid of large-scale, empirical research providing specific quantitative results. With few exceptions (e.g. Sinha, 1990; Foster, 1986), empirical research has been scanty. Identifying relationships between dimensions of FPSs

and characteristics of the process of making SIDs would be an interesting and potentially fruitful line of research in this rather unexplored area.

The present paper aims to shed some light into the association between certain key dimensions of FPSs and a number of characteristics describing strategic decision processes of an investment nature (SIDs). By the term SID we define any decision implying a significant commitment of resources, having a profound impact on the firm as a whole and on its long-term performance and viability (Barwise *et al.*, 1986).

The paper is organized as follows: section 2 discusses the operationalization of dimensions of FPSs. Section 3 presents the dimensions adopted in characterising SID processes. Section 4 theoretically examines the association between FPSs and SID processes, while section 5 presents the methodological aspects of the research. Finally, sections 6 and 7 report on the empirical results and discuss their implications.

2. Selected Dimensions of FPSs

As noted by several authors (e.g. Chambers, 1984; Ramanujam *et al.*, 1986; Ramanujam and Venkatraman, 1987) FPSs should be seen as multidimensional, serving a number of objectives and acting as an integral framework within which decision making takes place. The present exploratory in nature study, however, will deliberately limit attention to only three dimensions and their interrelations with SID processes, rather than exploring all possible dimensions.

The *first* intends to measure the **degree of development of formal planning** within the company. It does so on five of the most popular domains of planning: production, sales, procurement, budget and long-range business plan. More specifically, it measures the existence of forward planning in each of these areas by means of five-point Likert-type scales (Table 1). The scales are tailor-made, taking into account the reality of the Greek business context and the possibility that a number of the FPSs studied might be rather rudimentary. Indeed, we expected to find a number of companies in our sample in which there is no formal planning effort, as well as cases where extensive planning is conducted covering almost every domain of business activity. The measurement scale in this particular dimension ranges from '1' for companies which do