

# Strategic Investment Decision Processes and Organizational Performance: An Empirical Examination<sup>1</sup>

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**The central question that this paper aims to answer is whether there is a relationship between organizational performance and the characteristics of strategic investment decision (SID) processes. To do so, it adopts an empirically derived nine-dimensional framework for classifying SID processes and employs a set of objective and perceptual measures of performance.**

**The empirical results stemming from the process-performance relationship, suggest that higher performance is strongly related to more rational decision-making processes (DMPs); more financial reporting activities; broader participation both in terms of departments and in terms of hierarchical levels. Furthermore, our data suggest that long-term performance appears to be more strongly related to SID processes than short-term performance and the 'structural' characteristics of the DMPs (i.e. rationality, financial reporting) are mainly related to long-term objective performance, while such 'behavioural' characteristics of the DMPs, as problem-solving dissension, reveal some interesting associations with short-term performance. In light of these findings, implications for theory and future research are advanced.**

## Introduction

Organizational performance is a complex and multi-dimensional phenomenon at the heart of strategic management theory and practice (Venkatraman and Ramanujam, 1986). Most researchers consider performance the ultimate test of new concepts and theories (Keats, 1988; Schendel and Hofer, 1979).

Much research investigates performance in relation to the content of strategy, planning and strategy formulation processes, structure, environment, leadership, and so on. Strategy content researchers usually link competitive and/or resource positioning to performance, while process

researchers seem somewhat less preoccupied with performance considerations. For example, with few exceptions (e.g. Bourgeois, 1980; Bourgeois and Eisenhardt, 1988; Dess, 1987; Eisenhardt, 1989; Fredrickson and Mitchell, 1984; Goll and Rasheed, 1997; Priem, Rasheed and Kotulic, 1995) empirical research has not examined the relationship between organizational performance and dimensions of strategic decision-making processes (Papadakis and Barwise, 1997; Rajagopalan, Rasheed and Datta, 1993).

In addition, the study of organizational performance and strategic decision-making seems to be problematic. As we discuss in greater depth in the theoretical framework, much of the research has yielded conflicting results. For example, Fredrickson (1984) suggests that comprehensive/rational processes are related to higher economic performance in a stable environment and to lower performance in an unstable environment. On the

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contrary, Eisenhardt (1989) and Miller and Friesen (1983) argue that effective SIDs in high velocity environments are characterized by more comprehensiveness and speed. It appears that the study of decision processes and performance may always be problematic since several organizational, external environmental and decision specific factors moderate the relationship between process characteristics and outcomes (Goll and Rasheed, 1997; Rajagopalan *et al.*, 1997). Furthermore, most of the existing studies focus on just one characteristic of the process of SDs: namely rationality/comprehensiveness. Other process characteristics (e.g. formalization, participation, politics, timing) have received much less empirical attention.

But the importance of this line of research has never been greater. Recently, it has been empirically supported (e.g. Hart and Banbury, 1994) that the process of strategic decision-making may hold the potential for building a competitive advantage. This reinforces the argument that particular attention should be devoted to not only the processes through which strategic decisions emerge and proceed, but also to their relationship to corporate performance (e.g. what are the trade-offs between rationality, formalization, participation, politics, timing and so on in the pursuit of superior performance). Indeed, performance considerations should be explicitly taken into account because if strategic decision-making processes (DMPs) are faulty, performance is likely to be impaired (Schendel, 1992).

This paper aims to fill that gap by examining the relationship between performance and a wide range of characteristics/aspects of strategic DMPs. It adopts an empirically derived classification of strategic DMP characteristics and employs objective (both long-term and short-term) and perceptual measures of performance. It is organized as follows. In the next section we review the literature and develop hypotheses. Section three describes our methods and section four gives our results. Section five discusses the results, and section six explores their implications, limitations and possible directions for future research.

## Theoretical framework

### *Performance and rationality*

The relationship between performance and comprehensiveness/rationality in strategic DMPs has

attracted much theoretical attention. Hambrick and Snow (1977) advanced a model of interaction between current and past performance and strategic DMPs, but concluded that the effects of performance on strategic decision-making (and vice-versa), were not well articulated and that the evidence was insufficient to support specific theories. Despite the fact that almost two decades have elapsed since then, little consensus has emerged as to the expected relationship between performance and strategic DMPs (e.g. Priem *et al.*, 1995; Rajagopalan *et al.*, 1993).

Some empirical support for a positive relationship has been provided by Smith *et al.* (1988). They found that, for both small and larger firms, comprehensive out-performed less comprehensive decision-making. In the same vein, Jones *et al.* (1992) reported consistently positive relationships between organizational effectiveness and comprehensiveness in decision-making. In addition, a series of publications on hospital integration strategies (e.g. Blair, Slaton and Savage 1990), found that successful strategic ventures were associated with comprehensive strategy formulation processes. These results suggest that performance is expected to be positively related to comprehensiveness/rationality.

However, as Fredrickson argues:

'Firms usually do not use slack generated by excellent performance to pay the costs of seeking optimal solutions; instead resources are absorbed as sub-optimal decisions are made. This phenomenon may help explain why managers in historically successful firms sometimes make a series of what appear to be inadequately considered, intuitive decisions that in combination have significant negative consequences.' (1985, p. 824)

Three decades ago, Cyert and March (1963) reached the same conclusion, that superior performance is expected to lower the intensity with which organizations will 'search' for and analyse information. In the same vein Bourgeois (1981) and March and Simon (1958), suggested that slack resources offer organizations the 'luxury' of 'satisficing', and suboptimal decision-making. The above arguments lead us to hypothesize that good performance may be *negatively* related to rational decision-making.

Of course, research has produced a range of explanations on this relationship. For example, it seems to follow logically that poor performance