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The Effect of Formal Strategic Management on Organizational Performance of Medium Sized Manufacturing Enterprises in Kenya: A Study of Selected Medium Sized Manufacturing Enterprises in Nairobi, Kenya

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Abstract:
Organizational performance assesses how firms are able to meet their stated objectives over time. It is known that the ultimate goal of any business organization is to be able to meet specific objectives such as customer satisfaction, profit maximization and cost effectiveness. A firm that is able to meet these objectives is perceived as being more successful than one that is not able to meet them. There are many ways of measuring performance, which include profitability ratios such as earnings per share, return on investment or return on equity. Many medium enterprises (MEs) have not adopted formal strategic management (FSM) and therefore cannot have competitive advantage in the industry.
This study examined the effect of formal strategic management on organizational performance of medium sized manufacturing enterprises in Nairobi, Kenya. The research was conducted through a survey of medium enterprises (MEs) in Nairobi, Kenya. Eighty MEs were selected using simple random sampling. Primary data was collected using a semi-structured questionnaire. The respondents who were members of management team filled open and close ended questions. The data was analyzed statistically using the SPSS and R packages through tabulation, proportions and logit analysis.
The results showed that organizations with formal strategic management (FSM) perform better than those without formal strategic management. MEs should therefore adopt formal strategic management to promote performance and counter competition.

Keywords*: Strategic management, formal strategic management, organizational performance, medium enterprises, adoption, competitive*

1. Introduction

The objective of the study is to assess relationship between adoption of formal strategic management and organizational performance in selected medium sized manufacturing enterprises in Nairobi, Kenya. Formal strategic management is that which is written or in official form. Strategic management is associated with the period from the mid-1970s onwards. Like strategic planning, it is based on the complexities of the total business environment. However, the approach is not to accept current conditions as being restricting. Rather, the approach is led by well-defined aims, well-developed means to achieve them, and by pursuing viable opportunities wherever they can be identified, which may be regardless of the nature of current operations. The approach relies upon a continuous supply of information about the environment and avoids the use of planning cycles in preference to being based upon a continuous process, Greenley (1989).

Strategic management system has been defined in different ways by different scholars. David (1986) defines strategic management system as the process of formulation, implementation and evaluation of actions that enable an organization to achieve its objectives. Wheelan and Hunger (1987) surmise that strategic management system is the set of managerial decisions and actions that determines the long run performance of a corporation. According to these authors the concept of strategic management includes strategy implementation, evaluation and control. The study of strategic management system therefore emphasizes the monitoring and evaluating of environmental opportunities and constraints in light of a corporation's strengths and weaknesses. Strategic management practice is concerned with matching the organization resources to the environment in which it operates.

Thompson and Strickland (2003) assert that strategic management refers to the managerial process of forming a strategic vision, setting objectives, crafting a strategy, implementing and executing the strategy and then overtime initiating whatever corrective adjustments in the vision, objectives, strategy and execution deemed appropriate. It includes strategy formulation, strategy implementation and evaluation and control.

Strategic management is concerned with complexity arising out of ambiguous and non-routine situations with organization-wide implications (Johnson and Scholes, 2002). It includes strategic analysis, choice and implementation. This is where the strategist seeks to understand the strategic position of the organization. Strategic choice has to do with the formulation of possible courses of action, their evaluation and the choice between them. Lastly, strategy implementation is concerned with both planning how the chosen strategy can be put into effect, and managing the changes experienced by the organization. Strategic management includes all activities that lead to the definition of the organization's objectives and to the development of programs, actions and strategies to accomplish these objectives. It provides basic direction and framework within which all organizational activities take place. Pearce and Robinson (1997) defined strategic management as the formulation, implementation, control and evaluation of business strategies to achieve further objectives.

Strategic management arises out of the need for organizations to exploit existing or emerging opportunities and deal with threats in the market. It is crucial that organizations seek to create a competitive advantage and wherever possible innovate to improve their competitive positions. This implies the readiness to change within the organizations and the ability to implement the proposed change (Thompson, 1994).

Strategic management practice may be more critical for medium businesses than for large ones. For example, medium business is likely to be seriously damaged by even minor market or competitive misreading. Large firms, on the other hand, can more readily absorb the costs of such mistakes (Fred *et al.,* 1999). The medium businesses are therefore significantly more vulnerable to the consequences of poor application of strategic management practice. Given the situation facing ME sector in Kenya today, strategic management practice would be useful in helping managers cultivate a culture of strategic thinking and management.

In Kenya, the studies established the existence of formal and informal strategic planning in large organizations. Environmental and organizational (contextual) factors were found to bring out variations in strategy practices. The contextual factors included ownership, complexity, company control, government and management orientation (Aosa, 1992, Sababu, 2001). However, the state of strategy of MEs in Kenya is not documented. Therefore, this study seeks to establish the effect of formal strategic management on organizational performance of MEs in Kenya.

Research findings in Kenya suggest that organizations using formal strategic management are more successful than those that do not use formal strategic management (Aosa 1992, Karemu 1993, Kang'oro 1998, Sababu 2001, Lewa, 2003).Thus, MEs can improve their performance and grow using formal strategic management. Through expansion and growth more employment will be created in these manufacturing enterprises.

Non-empirical literature conducted in Kenya (Kiggundu, 1989; Yabs, 2007) suggest that the effect of formal strategic management on organizational performance is not rigorously researched. Many hypotheses have been advanced to explain the failures of organizations in Kenya. This scenario was later advanced by Nguku (1996), who argued that lack of effective management in organizations was responsible for their demise. A similar observation was made by Nginyo (1997) and Sababu (2001). Finally, no studies in Kenya has empirically tested the relationship between formal strategic management and organizational performance in MEs.

2. Materials and Methods

The study was a descriptive survey which set out to collect data on the effect of formal strategic management on organizational performance of medium sized manufacturing enterprises in Kenya.

The research was carried out in industrial area of Nairobi where these manufacturing firms are situated. The study was descriptive aimed at determining how the environment in which these enterprises operate affects their performance and the relationship between adoption of formal strategic management and organizational performance.

The data collection exercise involved a self-administered structured questionnaire, as this was the most appropriate for collecting the information required for the study from medium manufacturing firms that had been identified through random sampling.

All the MEs in Kenya constituted the population. Evidence shows that manufacturing industry activities in Kenya are concentrated in major towns (KIRDI, 1997). The target population included all medium sized manufacturing enterprises in Nairobi from KIRDI directory listing which provided the sampling frame from which the study sample was selected. This is because two thirds of the medium sized firms are in Nairobi (KIRDI, 1997) forming the majority of the medium enterprises in Kenya. Out of 165 MEs, 112 (67 percent) are based in Nairobi and 33 percent are spread in all other parts of the Country.

The sampling technique used was simple random sampling which is one of the probability or representative sampling. In probability sampling each case had an equal chance of being selected from the population. A sample list was obtained from KIRDI directory from which the sample was drawn. Some eighty (80) MEs from the manufacturing sector in Nairobi were selected using simple random sampling.

Peter (1994) provided a useful table of determining the sample size. Saunders *et al*., (2000) provides a similar table. The sample size for the study is eighty (80) MEs because according to the table a population of about 100 should have a sample size of 80. Also, a sample size of eighty (80) MEs is above the recommended 10 percent (Saunders *et al.*, 2000).

The questionnaire method was used for data collection. The questions were picked from those of Aosa (1992) and Sababu (2001). However, these questions were modified to suit the objectives of the study. The questionnaire was on the strategic management process. It was divided into the following parts: - mission, objectives, developing the organizations strategy, implementation, evaluation, organizational performance and additional information.

The Likert scales used in the survey instrument were tested for reliability using the Cronbach's Apha method and found all to be highly reliable. This was evidenced by high values of the Cronbach's alpha coefficient,that is, above 0.9. Generally, according to George and Mallery (2003) the more Alpha tends to 1 for a Likert measurement scale, the higher its reliability.

The data was analyzed using Statistical Package for Social Sciences (SPSS) for windows version 6.1 and R computer package. The relationship between performance and formal strategic management were analyzed using binomial logit.

The most suitable method or test for rating the significant contributors to MEs performance and developing the conceptual working model on the cause-and-effect relationship was found to be the logit method. This is because the data was non-normal, that is, in proportions, and logit is used for analysis of non-normal data.

The response variable under investigation is binary (binomial). This is because there were only two responses in each case, either success or failure, that is, either adoption or non-adoption of formal strategic management. None of the responses had more than two categories. Therefore, the logistic regression model with the binary *logit* link function was the appropriate method of analysis.

The relationship between formal strategic management and performance.

$$\text{logit}(p_i) = \beta_0 + \beta_3 x_3 \qquad (7)$$

Where

p_i = P[Y=1] denotes financial viability to a great extent

q =1- p_i = P[Y=0] denotes financial viability to a small extent.

Where

$$Y = \begin{cases} 1, & \text{if to a great extent} \\ 0, & \text{if to a small extent} \end{cases}$$

and X_3 is the level of establishment of formal strategic management given by

$$X_3 = \begin{cases} 2, & \text{if formal strategic management is established in at least three areas} \\ 1, & \text{if formal strategic management is established in less than three areas} \end{cases}$$

The operationalized variables above were deemed to be the most important factors affecting adoption of strategic management and performance of medium enterprises in Kenya, but which have not so far been tested.

3. Results

The relationship between formal strategic management practice and performance was assessed using financial ratios. Financial viability is one of the indicators of organizational performance. The magnitudes of financial ratios for the respondents MEs are in Table 1.

Financial Ratios	To a Very Great Extent (1)	To a Great Extent (2)	To a Small Extent (3)	Not at All (4)	Mean Score
Ratio of current assets	23	47.5	29.5	0.0	2.1
Changes of net operating capital year 2002/03	14.8	45.9	34.4	4.9	2.3
Changes of net operating capital year 2003/04	16.1	40.3	33.9	3.2	2.3
Changes of net operating capital year 2004/05	14.5	37.1	32.3	6.5	2.3
Return on investment	6.5	45.2	40.3	4.8	2.4
Return on capital employed	9.7	50	32.3	3.2	2.3
Increased net profits	9.7	40.3	46.8	0.0	2.4
Gross profit margins	14.5	45.2	32.3	3.2	2.3

Table 1: The Perceived Extent to Which FSM Influences Financial Ratios of Mes (N=62)

As shown in Table 1 some (47.5%) of the respondents stated that the formal strategic management affects the ratio of current assets to current liabilities to a 'great extent'. Gross profit margins and return on capital employed were 45.2% and 50% respectively while return on investment, changes of net operating capital year 2004/05 and increased net profits were slightly below average. From the computed mean score strategic management influences financial ratios to a great extent. Thus, the study has revealed that the formal strategic management influences organizational performance (financial ratios) of an organization. Byras (1987) in his study concurs with above that organizations with formal strategic management practices significantly out performs others in terms of earnings per share, return on equity and return on capital employed.

The results of the analysis (Table 2) on the effect of formal strategic management on organizational performance indicate that *Change of net operating capital in year 2004/2005, return on investment* and *Return on capital employed* are the measures of organizational performance significantly associated with the establishment of formal strategic management.

Financial Ratios	R^2	□□□	Degrees of Freedom	p-value	Significance
Ratio of current assets to current liabilities	0.015	0.128	1	0.7205	Not significant
Change of net operating capital in year 2002/2003	0.025	0.8294	1	0.3625	Not significant
Change of net operating capital in year 2003/2004	0	0.3049	1	0.5808	Not significant
Change of net operating capital in year 2004/2005	0.025	4.7912	1	0.02861	Significant
Return on investment	0.082	4.051	1	0.044	Significant
Return on capital employed	0.027	3.8723	1	0.04909	Significant
Gross profit margin	0	1.0095	1	0.3150	Not significant

Table 2: Summary of Chi-Square Tests in 2×2 Contingency Table Relating Establishment of Formal Strategic Management and Key Measures of Organizational Performance

Table 3 shows the effects of formal strategic management on change of net operating capital in the year 2004/2005.

Formal Strategic Management	Parameter Estimate	Std Error	90% Confidence Interval	p-value	Relative Odds
Less than 3 stages	Reference				
At least 3 stages	1.47	0.61	1.47±1.00	0.016	4.35

Table 3: Effects of Formal Strategic Management on Change of Net Operating Capital in the Year 2004/2005

The chances of adoption of formal strategic management in at least three areas is 4.34 times more than those with less than three stages in change of net operating capital. The results of the analysis indicate that there is association between adoption of formal strategic management and the change of net operating capital in the year 2004/2005. From Table 4, it is apparent that organizations that have established formal strategic management in at least 3 stages were four times more likely to have a positive change in net operating in the year 2004/5 than those that had established strategic management in less than three stages. Table 4 shows the effect of formal strategic management on return on investment.

Formal Strategic Management	Parameter Estimate	Std Error	90% Confidence Interval	p-value	Relative Odds
Less than 3 stages	Reference				
At least 3 stages	1.13	0.57	1.29±0.94	0.048	3.10

Table 4: Effects of Formal Strategic Management on Return on Investment

The chances of adoption of formal strategic management in at least three stages is 3.10 times more than those with less than three stages on return on investment. Based on a Chi-square value of 3.02 on 1 degree of freedom (p-value=0.08), it can be concluded that there is association between adoption of formal strategic management and the Return on investment. Table 4 indicates that organizations that have established formal strategic management in at least 3 stages were 3 times more likely to have higher returns on investment than those that had established them in less than three stages.

Table 5 shows the effects of formal strategic management on return on capital employed.

Formal Strategic Management	Parameter Estimate	Std Error	90% Confidence Interval	p-value	Relative Odds
Less than 3 stages	Reference				
At least 3 stages	1.29	0.58	1.29±0.95	0.0275	3.63

Table 5: Effects of Formal Strategic Management on Return on Capital Employed

The chances of adoption of formal strategic management in at least three stages is 3.63 times more than those with less than three on return on capital employed. The results of the analysis (Table 5) also indicate that there is association between adoption of formal strategic management and Return on capital employed. It is also clear that organizations that have established strategic management in at least 3 stages were 3.6 times more likely to have higher returns on capital employed than those that had established them in less than three stages.

Thus, it was concluded that strategic management influence organizational performance (financial ratios) of an organization. Organizations that have adopted formal strategic management significantly outperform others in terms of change of net operating capital in the year 2004/2005, return on investment and return on capital employed. Byras (1987) study found that organizations with formal strategic management significantly outperform others in terms of earnings per share, return on equity and return on capital employed.

3.1. Impact of Formal Strategic Management on Organizational Performance

Using ANOVA, the results indicated that having written objectives [F=8.912 on 1, 50 df, p=0.004]; having developed strategies for operation [F=4.153 on 1,50 df, p=0.046]; and carrying out evaluation of performance [F=3.038 on 4,45 df, p=0.0267] significantly explain organizational performance. It was also noted that adoption of FSM in three or more stages significantly improved performance [F=6.93 on 1, 52 df, p=0.011]. Other measures of FSM did not significantly impact on the performance of the organization. Organizations that indicated that they have always motivate employees in the course of implementation of plans performed better than those that only motivated them occasionally [F=14.04 on 1, 52 df, p=0.001].

Of all the measures of FSM, employee motivation in implementation of strategic plans was noted as the most important factor that explains organizational performance. This measure explains 20% of the variation in performance. Carrying out performance evaluation, having written mission statement and having developed strategies for operation explain 14.3%, 13.5% and 5.8%, respectively, of the variation in performance. Adoption of FSM in three or more stages explained 10% of the variation in performance, Gichunge (2010).

4. Discussion

This study assessed the relationship between the adoption of formal strategic management and organizational performance. The study found that formal strategic management do play a positive role in determining organizational performance in Kenya as far as return in investment (60.7%), net operating capital (51.6%) and return on capital employed (59.7%) is concerned. Adoption of formal strategic management affect organization performance.

5. Conclusion

The study assessed the relationship between the adoption of formal strategic management and organizational performance. It was found that formal strategic management do play a positive role in determining organizational performance in Kenya as far as return in investment (60.7%), net operating capital (51.6%) and return on capital employed (59.7%) is concerned, Gichunge (2010).Strategies are yardsticks by which present and future performance of the firm is measured. Some companies have a competitive advantage in the environment because of adopting a strategic approach to performance. Therefore, the onus is for every ME, to continuously appraise the environment and identify issues/factors that can impact on the performance and act/manage them immediately.

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