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RELATIONSHIP BETWEEN STRATEGIC PLANNING PROCESS AND FINANCIAL PERFORMANCE OF PROFESSIONAL SERVICE SMES IN KENYA: MODERATING ROLE OF INNOVATION PRACTICES

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ABSTRACT: *This paper investigates the relationship between Strategic planning process and financial performance of professional service SMEs in Kenya. Specifically, the study had two specific objectives of the study: first, to analyze the effect of strategic planning process on the financial performance of professional service SMEs in Kenya and secondly, to test the moderating effect of innovation practices on the relationship between strategic planning process and financial performance of professional service SMEs in Kenya. The study targeted 384 SMEs as the sample size, with data collected from managers/owners through questionnaire. SMEs were randomly selected while respondents were selected through purposive sampling. The study findings indicated that innovation practices have a moderating effect on the relationship between strategic planning process and the financial performance of professional service SMEs in Kenya. From the findings, it can be concluded that SMEs with strategic planning practices and innovative practices are likely to have better performance than SMEs that have adopted strategic planning process only.*

KEYWORDS: Strategic Management, Strategy Formulation, Strategy Evaluation, Environmental Scanning, Strategy Implementation, Innovation Practices, Small Medium Enterprises

INTRODUCTION

SMEs play an important role in economies of many countries and Kenya is not exceptional. Mwarari and Ngugi (2013) ascertain that SMEs in Kenya are responsible for about 80% of employment and contribute about 40% to GDP. From these statistics, it is evident that SMEs are an integral part of the economy, critical in stimulating socio-economic development in Kenya. However, the environment in which SMEs operate in Kenya is very competitive, volatile and dynamic threatening their survival. Various studies exist that have documented the high rate of mortality in the SME sectors in Kenyaand Africa (Fatoki, 2012; Yeboah, 2015) due to the unstable and competitive environments. This current state of affairs demands that the SME management has to engage in strategic planning process to guarantee the survival of their businesses (Dansoh, 2005). It has been argued that more stable environments require less planning, whereas uneven and competitive environments require more planning capability and comprehensiveness. The need for strategic planning is even more pronounced in emerging economies like Kenya where the business environment is unstable, business cycles change and competition is tightening.

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There is no doubt that strategic planning process impacts positively on the performance of SMEs (Amurle, 2015). French (2009) defines strategic planning as a process of setting objectives, analyzing the situation, developing concepts to deal with the situation as well as achieving and implementing its objectives. Raczynski (2008) states that strategic planning is about looking at where an organization wants to go in the future and putting together the resources, assets and the personnel to get there. In addition to analyzing where the organization wishes to be in the future, strategic planning involves determining what outside forces may influence the vision. These include the actions of competitors, technical breakthroughs, and threats from changes in the world environment (Raczynski 2008). In practical sense, strategic planning is about competitive advantage. The objective of strategic planning is to enable a business to achieve a sustainable edge over its competitors.

SMEs have been challenged to adopt strategic planning process but also adopt innovative practices as a way of maintain their competiveness in the markets. Wheelen & Hunger (2011) suggest that SMEs pursuing both strategy planning process and innovation strategy may attain longterm entrepreneurial success. The introduction of innovative products, services, processes, or business models tailored to attractive niches is an additional opportunity for SMEs to stand out from competition. Empirical evidence suggests that it is important to build, maintain, and promote a culture of innovation among SMEs as a way of remaining competitive in the market (Ongwae, Mukulu, & Odhiambo, 2013; Polder, Leeuwen, Mohnen, & Raymond, 2010). Further empirical evidence also highlight the importance of strategic planning process on the performance of SMEs companies want to remain successful and create new products (De Wit, & Meyer, 2010; Oke, Burke and Myers, 2007). However, despite the attention towards the topic of innovation and strategic planning in SME literature, little previous research did not sufficiently analyzed relationship between innovation, strategic planning process and performance of SMEs.

In this light, this paper aims to contribute to the literature by providing a better understanding of the links between the layers of innovation and market performance. Equally, the study empirically tests the resource-based view (RBV) and is extended from Terziovski’s work [12]. In contrast to numerous previous studies that indicate market performance as a dimension of the firm’s performance, this study provides a clearer view upon the relationship between the constructs of innovation that drive market.

Statement of Problem

Strategic planning plays an important role on organizational performance in times when the contemporary business environment in which organizations operate is increasingly becoming uncertain and unpredictable, little is known of the use and application of strategic planning practices among small and medium enterprises, especially in Africa (Aldehayyat&Twaissi, 2011; Allison & Kaye, 2005). Empirical studies reveal mixed relationship between strategic planning process and performance. Studies by Auka and Langat (2016) ; Babafemi (2015) demonstrate that strategic planning process has a positive relationship with performance of SMEs. On the contrary, studies by Kutllovci and Shala (2013), Maroa and Muturi (2015) indicate absence of significant relationship between strategic planning process and performance of SMEs. Sandada, Pooe and Dhurup (2014) suggest that the mixed findings on the relationship between strategic planning process and performance of SMEs show that other factors mediate or moderate the process. Further, Nyamwanza (2016) asserts that innovation practices is a key factor to be considered between the relationship between strategic planning process and performance of SMEs. Although innovation practices have been acknowledged as

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having effects on the relationship between strategic planning practices and performance, there is little evidence of empirical research that demonstrates so. In this context, this study will enhance the knowledge of strategy planning-performance relationship in light of innovation practices among professional service SMEs in Kenya.

LITERATURE REVIEW

Environmental Scanning

Environmental scanning entails understanding the structure and causes of problems and issues to be addressed. This can be done by fully assessing the external and internal factors of the business. External Assessment is the activity of investigating the structure and dynamics of the environment surrounding the organization (De wit and Meyer, 2010). Both scanning of market environment and the broader environment can be considered to be part of assessing companies outside environment. In external environment, one should not only deeply understand the underlying structures of the industry under investigation but also fully identify and analyze the characteristics and strategies of each important actor such as customers, competitors, suppliers, distributors, unions, governments, and financiers (De wit and Meyer, 2010).

In conducting an environmental assessment, a business needs to review, evaluate and disseminate information from both the external and internal environments. For this reason, Babatunde&Adebisi (2012). Hudson-Smith and Smith (2007) suggest that to gather all the information about factors that affect the business, a business needs to assess both the internal and external environments. An internal scanning of business identifies its strengths and weaknesses while the external assessment establishes the opportunities and threats. Agbim, Oriarewo, and Zever (2014) mentioned that the business environment consists of three different environments, namely the micro-environment, market environment and the macro-environment.

Strategy Formulation

Strategy formulation consists of determining the organization's mission, goals, and objectives and selecting or crafting an appropriate strategy. Most organizations these days have mission statements. Usually, a mission statement is defined as being a formal expression of an organization's purpose. This may be distinguished from the strategic vision, which is a description of a desired future state, and strategic goals, which are specific outcomes that contribute to the achievement of the mission in the circumstances that prevail or are emerging (Joyce and Woods, 2002). The importance of the mission statement is that it leads to focus and persistence by the organization and these things are generally assumed to be important for organizational achievement. It may also be argued that mission statements and strategic visions are important for motivating and inspiring managers and employees within an organization.

Izadi (2012) defines a business objective as a target toward which a business directs its efforts. Gibcus and Kemp(2003), on the other hand, explains that objectives are outcomes expected from pursuing particular strategies. Businesses usually set up two main types of objectives, which are the short-term and long-term objectives. While a short-term objective indicates the outcomes to be achieved within a short-term, a long-term objective is the one that a business intends to achieve within long periods of time (Gică&Negrusa, 2011).

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According to Bogner and Thomas (1993), there are two competing models of strategy formulation. The objective model is based on economic concepts (supply and demand, competition factors, etc.). The model begins with a company objective, which will finally be affected by competition. The competition will have an impact on strategy formulation process. The industry structure (combined competitors) will directly impact the formulation process, which in turn will affect resource allocation decisions. This process will continue until an external factor (i.e., technological change) will disrupt it, at which time a new objective model will be formulated.

The second model is the cognitive model. It exposes a flaw in the objective model (i.e., the inability to capture the significance of the changes causing the objective formulation process to begin again). The cognitive model follows the sample principles as the first model. However, it also consists of a collective view of objective strategies, which are consolidated into one formulation process.

Strategy Implementation

Strategy implementation deals with establishing the annual objectives, policies, programs, staff motivation and resource allocation in order to facilitate the strategies. During this phase, the strategists will try to determine every employee and manager to work together in order to transform the strategies into coherent actions. The following decisions are taken within this phase (David, 2011): the creation of an organizational culture that will sustain the strategy; the creation of the marketing budget; the establishment of company budget; the development and use of the informational systems and the correlation of employees' salaries with the company's performance. Failed strategy implementation efforts cause enormous costs to the organization. Besides wasting a considerable amount of time and money, failed strategy implementation efforts cause lower employee morale, a diminished trust and faith in senior management (Wheelen and Hunger, 2011). Moreover, they result in making a yet more inflexible organization, because when an organization fails to change it will encounter more employee cynicism in its next attempt. Emphatically, the main issue here is how organizers should carry out strategy implementation effectively.

Strategy Evaluation

Strategy evaluation offers managers valuable information about the way in which the strategy proved its efficiency. Managers will compare the results with the goals established during the first phases of the process. This is a step absolutely necessary because the actual success of the current strategy is not a guarantee of the future success. The dynamics of the external environment will determine changes in the context in which companies act. Strategy evaluation includes the following activities: the analysis of the internal and external factors on which the strategy has been developed; the assessment of a company's performance and implementing corrective actions. The strategy evaluation and control is the last stage in the strategic management model. Therefore, based on the compared result with the desired performance, managers should make adjustments in the formulated strategy and/or the implementation. Evaluation and control enable the organization to determine the effectiveness and react to the new challenges. Although strategic evaluation and control cannot remove all irregularities and errors, yet through controlling the strategy, SMEs could escape from the big problems (Sandada, 2014).

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Innovation Practices

In addition to the competitive advantages of generic strategies mentioned in Porter (1985), Porter (2001) argues that innovation enables operational improvements, which enhance cost efficiency. Innovation is an organizational capability to adopt and apply new ideas, products, and processes. To achieve long-term success and competitiveness, innovation has been shown as one of the most crucial strategic positioning necessary for the firm. Being in a critical position for building organizational value, innovations enable firms to adapt their strategy to market alterations by developing new products, or altering the processes (Popescu, 2014).

A considerable number of types of innovation have been identified relative to product and process innovation (Oke et al., 2007). Many other authors have identified different types of innovation, stressing the importance of having a clear framework of the different types of innovation including the relationships between them (Verhees, &Meulenberg, 2004; Ongwae, Mukulu and Odhiambo, 2014). Product innovation means introducing the new products/services or bringing significant improvement in the existing products/services. For product innovation, the product must either be a new product or significantly improved with respect to its features, intended use, software, user-friendly or components and material.

Process innovation means improving the production and logistic methods significantly or bringing significant improvements in the supporting activities such as purchasing, accounting, maintenance and computing (Polder et al., 2010). Firms bring process innovation to produce innovative products and amendments are also brought in their processes to produce the new products. To decrease the production cost, firms go for bringing process innovation. The process innovation is reflected by the cost of the product.

Marketing innovation is defined as implementing new marketing method that involves significant changes in the packaging, design, placement and product promotion and pricing strategy. The objective of marketing innovation is to increase the sales and market share and opening new markets. The distinctive feature for the marketing innovation from the other types of innovation is the implementation of new marketing method that the firm has never been implemented before. The product design, that only changes the appearance of the product and does not change the features and functionality of the product, is also marketing innovation.

METHODOLOGY

The study adopted a cross-sectional descriptive study design. The study target population of the study were all the professional service SMEs in Nairobi. The study targeted one respondent from selected SMEs in Nairobi. A total of 384 SMEs were selected in the study. Random sampling was used to select participating SMEs with the Sampling size obtained from the Kenya National Chamber of commerce. Purposive sampling was used to select the participating managers in the study. A questionnaire was used as the data collection tool with tool self-administered. Primary data was collected from selected SMEs operating in Nairobi. The study's dependent variable was profits of SMEs collected through data collection forms. Secondary data was not used due to non-availability of data from SMEs. The study's independent variables were environmental scanning, strategy formulation, strategy implementation and strategy evaluation while moderating variable was innovation practices. Multiple regression was

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carried out to test the moderating effect of innovation. Diagnostics tests were conducted before regression analysis was done.

To establish whether innovation has a moderating effect on the relationship between strategy implementation and the financial performance SME professional service firms in Kenya, A moderated multiple regression model (MMR) showing the interactions innovation of the firm with the dependent and independent variables in this study. Moderated multiple regression model was carried out through process macro conditional analysis in SPSS. The relationship between strategic planning process and the financial performance of the professional service SME firm in this study was moderated by innovation. Innovation was measured through three levels of product innovation, process innovation, and market innovation.

Regression of First Model without Moderating Variable

Table1: Model Summary

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.4939[a]	.244	.176	.94766

a. Predictors: (Constant), Environmental Scanning, Strategy Formulation, Strategy Implementation, Strategy evaluation

b. Dependent Variable: Profits of SMEs

In table 3, the model summary shows the predictive ability of the study model. In the study, the R-value of 0.4939 has been established indicating that there is a small correlation between the predictor variables, all lumped together into one model. From the model, it can be concluded that 24.4% of the changes in the financial performance of professional service SMEs can be attributed to the adoption of the strategic planning process.

Table2: ANOVA

Model		Sum of Squares	Df	Mean Square	F	Sig.
1	Regression	14.499	5	2.900	6.22465	.000[a]
	Residual	136.505	293	.46589		
	Total	151.004	298			

a. Predictors: (Constant), Environmental Scanning, Strategy Formulation, Strategy Implementation, Strategy evaluation

b. Dependent Variable: Profits of SMEs

The output obtained from the SPSS analysis also gave an F-ratio of 6.2246 which is significantly greater than 1 thus showing that the model is appropriate in explaining their relationship between the predictor variables and outcome variables. This was also supported by p-values of zero that shows that the model is significant and therefore the null hypothesis that the model is not suitable for explaining the relationship between dependent and independent variables was rejected.

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Table3: Regression Coefficients

Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.
		B	Std. Error	Beta		
1	(Constant)	3.132	.706		4.434	.000
	Environmental Scanning	.135	.067	.177	2.017	.045
	Strategy Formulation	.053	.073	.727	2.869	.039
	Strategy Implementation	.072	.084	.953	3.598	.026
	Strategy Evaluation	.080	.146	.507	2.255	.046

a. Dependent Variable: Profits

From the table above, environmental scanning X1 with (β =0.135, p< 0.05) has the strongest relationship with the financial performance of professional service SMEs in Kenya, then followed by strategy evaluation X4 (β =0.08, p< 0.05), strategy implementation X3(β =0.72, p< 0.05) and finally strategy formulation X3 (β =0.053, p< 0.05) respectively. From the analysis, all four independent variables (strategic planning process) were statistically significant in predicting the financial performance of professional service SMEs in Kenya.

Moderating Effect of Innovation on the relationship between Strategic Planning Process and Financial Performance of Professional Service Firms

Table4: Model Summary

R	R Squared	F Statistics	P-value
0.634	0.40196	3.5952	0.0140

The results show the R^2 in the model with moderating variable was 0.40196 showing that R2 change in respect to the model without moderating variable was 0.1579, which means that the Moderated Model increased by 15.79%. The results indicate that the moderating model was statistically significant with the model had F = 3.5952 and p-value=.00140. This shows that the model is suitable for explaining the moderating influence of innovation on the relationship between strategic planning process and the financial performance of professional service SMEs.

Table5: Interaction Effect

Terms	Coefficients	T values	P-values	LLCI	ULCI
Constant	5.1678	10.1026	0.000	25.7200	38.1660
Innovation	0.4266	3.2261	0.023	0.3004	2.047
Strategic Planning Process	1.480	2.7582	0.045	0.2471	1.466
Interaction Effect	1.268	4.3847	0.016	0.026	2.185

Based on the moderation rule by Andrew Hayes, (2007), innovation has a moderating effect on the relationship between strategic planning process and the financial performance of

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professional service SMEs in Kenya. The rules state that the interaction term must be significant and if the interaction effect of the model values in both lower level confidence interval (LLCI) and upper-level confidence interval (ULCI) has no zero value between them, the moderating variable has a significant effect on the model. Thus the study rejects the null hypothesis and concludes that innovation has a moderating effect on the relationship between strategic planning process and the financial performance of professional service SMEs. These findings suggest that strategic planning process could influence firm performance through innovation activities in professional service SMEs in Kenya. The findings were in agreement with the findings of the study by Obeidat et al., (2016), linking innovation indirectly to strategic planning process-performance linkage.

Table 6: Conditional Effect of X on Y at Values of the Moderator

Innovation	Co-efficient	T values	P-values	LLCI	ULCI
Low level of Innovation	.4403	2.134	0.098	0.2656	1.9212
Moderates Level of Innovation	0.3119	3.7676	0.0423	0.2483	1.4706
High Level of Innovation	0.067	4.6796	0.0328	0.315	0.891

From the study findings in table 6, it emerged that only a medium level of innovation and a high level of innovation affects the relationship between the strategic planning process. This finding suggests that improvement of the strategic planning process effect on the performance of SMEs occurs best at firms with relatively higher levels of innovation. This study concurs with the results of Song et al., (2011) who concluded that firms with higher levels of innovation have better organizational performance occasioned by the corporate strategies. This result is emphasized in figure1 below, with results showing relatively low significance at a lower level of significance in comparison to the moderate level and high levels of innovation

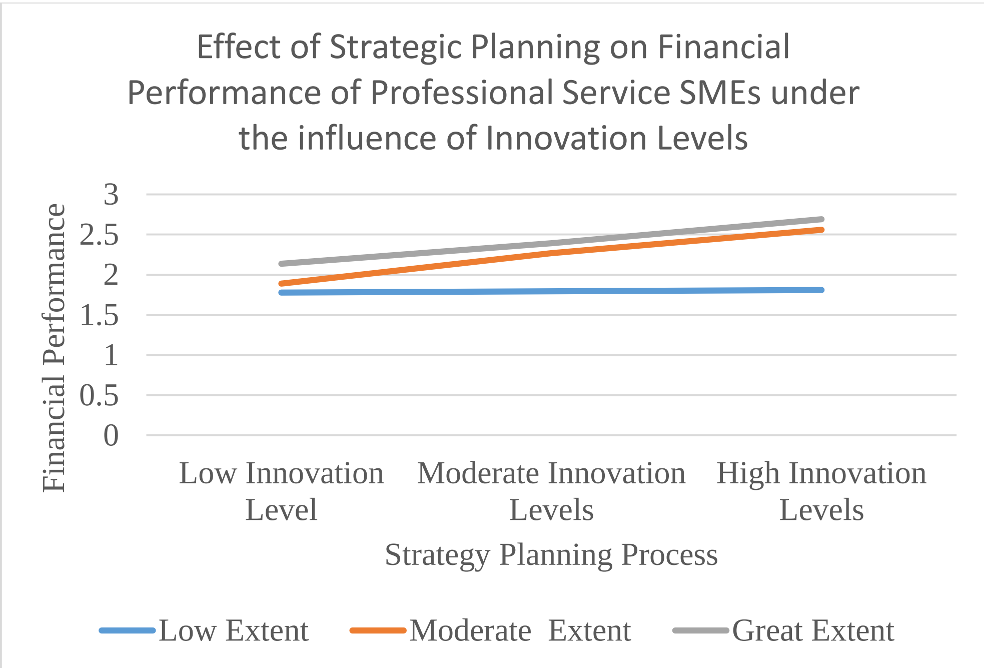

Figure 1: Effects of strategic planning on the financial performance of professional service SMEs under influence of innovation levels.

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Managerial Implications

The findings of the study point out some implications for managers in terms of the importance of innovation strategies, with regard to increasing the financial performance of SMEs that have adopted strategic planning process. Firstly, SMEs that have adopted strategic planning process should improve innovation as a way of enhancing financial performance, by building an innovative culture within the organizations. Marketing innovation is crucial for SME managers when it comes to creating new and unique products, and for attaining superior market performance. Secondly, SMEs, besides having adopted strategic planning process should carry out incremental innovation in their firms, as part of the pursuit of improving financial performance. These results help managers to achieve superior financial performance. Thirdly, SMEs managers should devote more resource to innovation in the same way as they devote resources to strategic planning process. The end result of this will be improved financial performance of SMEs.

CONCLUSION AND RECOMMENDATION

This article provides some insights on how innovation practices moderates the relationship between strategic planning process and the financial performance of professional service SMEs in Kenya. Through the findings of the study, it can be concluded that SMEs that have adopted strategic planning process are likely to experience better financial returns than SMEs that have not embraced innovation practices. Although innovation is a significant factor in the relationship between strategic planning practices and performance of SMEs, the study concludes that SMEs that keep innovating in their practices will have better performance. Also, it is important for SMEs not to rely on the strategic planning process as a way of improving performance, but to adopt innovation practices in their operations. The study recommends that SMEs in Kenya need to constantly innovate in line with the changes in the competitive environment require. Consequently, firms that delay in making this realignment may end up exhibiting poor results even with the development of corporate strategies.

Limitations of the Study

Despite the usefulness of the paper regarding the study area, the study is not without limitations. Firstly, this research is limited by the sampling frame that was used in the study may not have covered all the professional service SMEs. Another limitation the focus of the study in Nairobi county, where over 60% of SMEs in the country exists. This may limit the generalization of the findings to SMEs across the country.

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