A Review on the Relationship Between Strategic Management and Performance: The Role of Internal and External Contexts

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Abstract

Over the last few decades, strategic management practices have been widely applied in the public sector across the world. Though this approach and its component techniques are still in their infancy, most practitioners and academics have reached a consensus on the role of strategic management in enhancing organisational efficiency. Accordingly, there have been many studies examining the relationship between strategic management and performance in public organizations. However, as far as the public sector is concerned, there is still insufficient evidence to indicate that strategic management has a direct link with organizational performance, and it is still unclear whether there are any other determining factors that might affect this alignment.

This study aims to investigate the theoretical background to the relationship between strategic management and organizational performance. It also identifies how internal and external contextual factors have mediating and moderating effects on this relationship, and suggests that studies analysing the fit between strategic management practices and performance in public sector organizations should take the influence of contextual parameters into consideration.

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1. Introduction

The management of public organizations has become more and more difficult as a growing range of organizations begins to come under the remit of public service provision. Managers in the public sector have found it necessary to widen their knowledge-base and adopt diverse perspectives as boundaries between public organizations, private industry and third sector organizations have become much less obvious (Noble, 1999). To handle such increasing complexities within a public sector context, strategic management has grown into a topical issue over recent decades, as scholars and practitioners began to apply business management techniques into public sector environments. These techniques have been brought into play mainly to enhance capacities and standards within organisations, but also to help them offer better services to the public by embracing methodologies used by the business sector (Joyce, 1999). In other words, public sector strategic management aims to improve public organisations’ performance in order to help them attain targets.

Strategic management is traditionally linked to the methodology and attitude of private businesses. In the private sector, business strategies are often considered “as ways of defeating rivals in competitive markets” (Andrews et. al., 2012). However, over recent decades, attention has been increasingly paid to public organization strategies. It is quite difficult to measure effectiveness and efficiency in the public sector as its focus is mainly on common weal. Public service policies restrict strategic management understanding and practices, because they do not just come under the influence of economic parameters but also of various factors such as social and political changes (Balci et.al., 2013). As far as the public sector is concerned, strategy is very different, and can be more appropriately conceptualized as a means for organizations to develop their performance and offer better services for the general interest.

It is widely believed that strategic management contributes the organizational performance through optimal use of resources, diminishing ambiguity and motivating the staff. (Ozgur, 2004). Public management scholars have begun to associate the relationship between strategic management and performance, and have identified within it different dimensions and variables which would benefit from a wider investigation by combining organizational capacities with external determinants and
with limitations on performance (Boyne & Walker, 2010). However, it is still a matter of debate as to whether strategic management tools and associated approaches are readily adaptable to public service environments. Some public management scholars and practitioners question the idea of using management tools in a public context, and consider that the public sector should design its own management tools and approaches as the two domains are very different (Hood, 1991; Pollitt, 2006). Others concentrate on the problems and contradictions strategic management might face when applied to the public sector. One criticism is that the approach may work against creativity and innovation (Joyce, 1999). For instance, a five-year strategic plans can restrict staff into thinking pragmatically in the short term, and may prevent them from making quick decisions. As such, strategic management can be considered as a limitation to short term performance. However, Joyce (1999) argues that strategic management emerged as a multi-purpose option which would allow public service management to ensure that their organizations survive in the short and medium term while they are building for a long term future.

Poister and Streib (1999) consider that ‘effective public administration’ in an era of results-oriented management requires that public agencies improve a capacity for strategic management, a central management process that integrates all primary functions and activities and directs them at a single goal of advancing strategic organizational agendas. However, some experts argue that strategic discretion is restricted in the public sector when compared to the private sector. The monopolistic nature of public organizations means that political and legal pressures and regularity constraints can constrain the relevance of the techniques (Joyce, 1999). Nevertheless, the strategic management techniques, gathered under headings like budgeting by results and objective setting, have been applied widely since the 1970s. In the 1990s, public sector management (especially in the guise of Next Step initiatives in the UK and Reinventing Government in the USA) came to allow the public sector to adopt strategic targeting in the longer term (Johnson & Scholes, 2001). As such, government unification—especially over recent years, has ensured that strategic management has become an essential practice despite the constraints of applicability as far as the public sector is concerned.
However, developments in the public field are documented by only minimal literature in both empirical and theoretical terms. Articles by James and Hatten (1994), Conant et al. (1990), and Woodside et al. (1999) can be cited from the corporate viewpoint, and for the public sector Meier and O’Toole (2007) in the USA and Andrews et al. (2009) in the UK have produced some empirical studies over the last decade which have sought to reduce this imbalance by taking a look at the links between organizational strategy formulation and implementation as far as public sector performance is concerned.

In these studies, strategy is broadly considered to represent a choice of direction for collective effort in order to focus efforts towards goals, promoting consistency in managerial approaches over time and across different sections of the organization. The assumption is that a clear and coherent strategy will win out over the absence of and real content and methodology, as well as Inkpen and Choudhury (1995) considers that the absence of a strategy does not equate with a lack of core capabilities. However, although identifiable strategies may be considered necessary for good performance, they will not suffice alone (Andrews et al., 2012). The content of strategy and the process of strategising may be obvious yet may have no real bearing on the organization’s objectives. As such it will be useless, so there must be other elements leading towards different perspectives other than a clear strategy, process and content.

Joyce (1999) claims that strategising will result in an over-concentration on performance, so strategy as a means of directing and shaping behaviour is relevant only when an organization ensures the implementation of such strategy in real terms. Internal and external stakeholders may act as causal mechanisms linking performance with strategy. Johnson and Scholes (2001) asserts that one of the biggest problems as far as implementation is concerned is persuading personnel that strategies are worthwhile. Only those who have a personal stake in organizational performance, such as middle managers, will be able to help direct strategic selection and implementation. So at an internal level, strategy is used to plan and maintain positive attitudes. Operational goals will then be considered along with performance targets, and will be applied on the basis of strategy, informing ideas, actions, performance and change.
The performance environment for management strategies should be considered. Macmillan and Tampoe (2000) states that “strategic management should start from a good understanding of the unique context.” This means that strategic management and performance evaluation can change, depending upon countries or organizations examined. To explore this further, the next section will investigate such distinctions in the context.

2. The Effects of Internal and External Contexts

Strategy matters, in that performance is not completely determined by technical and institutional factors or by structural and organizational characteristics. Many private sector studies have shown that some scope for alteration is built into strategies adopted by organizations in order to influence their achievement. The impact of strategy can either run parallel to organizational and environmental variables as a separate performance contributor, or it can moderate internal and external variables by weakening or strengthening their effects. Either way, even after organizational and environmental constraints are accounted for, enough space is left for strategy content and process to make their mark on organizational effectiveness. The moderate or low levels of statistical correlation in performance studies that include only environmental and organizational variables can help to provide indirect support for this supposition.

Performance differences cannot just be linked to strategic differences if all organisations have the same process and content (Andrews et.al., 2012). The same strategy may produce different effects in different environments or when combined with different characteristics, but performance variations might result from these latter variables rather than strategic management for its own sake. To examine such differences concerning the importance of context, there are theories and approaches that can be addressed.

The first is the rational approach. Rational approaches to strategic management include formal rules that will defer to centralized control. Using this model, the implementation and formulation processes should be considered as separate from the actual activity (Macmillan & Tampoe, 2000). Unity in strategic implementation may encourage a more successful collaboration. Additionally, the separation of formulation
from implementation can offer clearer insights into both performance and target-setting.

One of the main arguments for Rational Theory is that it takes all potential alternatives into account and offers a better knowledge of the situation (Simon, 1997). However, one element of the bounded rationality approach (which claims that the human mind has limited qualifications, resources and competence, and therefore strives to satisfy instead of optimizing) is that task environments produce environmental factors which shape peoples’ decision making mechanisms (Jones, 2003). To make a rational decision, all uncertainties and non-absolutes should be eliminated. In other words, our knowledge of ex-ante outcomes and of the subjects to be implemented should be rounded, “not ill-structured” (Jones, 1999). Otherwise, if there are still some faults in the ideal conditions that surround the decision making process, individuals’ mental and emotional feelings should be taken into account (Jones, 1999). Let’s take example of the metaphor of Simon’s scissors. This states that the rational decisions of individuals are configured by the environment and people’s cognitive abilities. If the two factors that affect decision making are considered as the blades of a pair of scissors, the task environment and our mental abilities should be in accord with each other in order to come to the right decision. If they are not, we will steer away from the right decision (Bendor, 2012). Accordingly, based on Simon’s philosophy of bounded rationality, the task environment will be a feature of Bounded Rational Theory affected by individual cognitive constraints, and will therefore influence the mentality of individuals as well. As such, it can be claimed that external environmental factors in which the organization finds itself can affect the ability and efficiency of its staff.

These different considerations have been taken into account to improve bounded rationality by bringing in a second approach, which is incrementalism. The opposite to rational approaches, the process of logical incrementalism refers to a flexible and decentralized approach to strategic management. This is considered much better suited to the ambiguous and uncertain nature of public organizations, in which changes to both external and internal determinants can be accommodated by various environmental conditions. As this approach is provisional and decentralized, it can be changed with relative ease without formal consent (Hughes, 1998). There is considerable discussion as to which approach—rational or incremental—represents the best way forward for
enhancing performance in the public sector. Hart and Banbury (1994), and Bailey et. al. (2000) specifically deal with these relationships in the private sector, while Andrews et. al. (2005) discuss the topic in the public context. It is considered that incremental strategic management will take internal and external conditions into account more than rational strategic management styles, when dealing with the relationship of these conditions to organizational performance. In other words, internal and external contexts can accommodate and moderate the relationship between the two vital processes.

The concept of institutional theory includes the argument that public sector organizations will try to increase their legitimacy by considering social prescriptions emanating from an institutional context. However, this isomorphism in institutional settings is presented from a different perspective when considering the public sector. Since the 1970s, customization within the business sector and its relevance to the public sector has ushered in a duplicate process within centrally regulated government organizations. Further legitimacy is derived from interest groups in the tertiary sector who have brought in such mechanisms as voice, public meetings, campaigns and letters (Hughes, 1998). Similarly, some management approaches such as citizen-oriented or performance management style can enhance accountability in public organizations by activating those who receive services (Ateş & Çetin, 2004). Public sector organization strategies in both historical and public settings can be affected by social factors, implying that this type of institutional isomorphism has entered the public sector via strategic management techniques. To put it more straightforwardly, strategic management plays the role of mediator between social prescriptions which influence strategy and organizational effectiveness.

In addition, contingency theory claims that there is no best approach. Cures and prescriptions depend on particular environments in which techniques, human resources and internal and external relations can be examined in each individual case (Andrews et.al., 2012). Contingency theory is therefore considered as an overall approach in terms of coverage and necessary inclusion in all potential situations. The implementation of strategies should relate to individual situations—which can mean different countries and organizations—and under these conditions a correlation can be found between strategy and its effect on performance in particular situations (Donaldson, 2001). If no correlation is found, then the connections between these variables will be insufficient or
possibly invalid. “The Best Value Initiatives programme” in UK local government organizations has faced criticism mostly on the grounds that it proposes specific prescriptions for every organization, when strategic organizational implementations might actually fit best into the environment in which each organization exists (McLaughlin et.al., 2002). It is claimed that the recognition of this link has produced a significant effect on organizational performance.

The Miles and Snow framework (1978) can be broken down into four different strategy types: prospector, defender, analyser and reactor. A prospector strategy looks towards effecting innovation by taking risks. Analyser strategies combine these two approaches, protecting existing environmental conditions while seeking new ones. Defender strategies will work in environments that are stable and well-defined in conditions in which opinions are in accord. Reactor strategies are bold in cautious surroundings and cautious in adventurous settings, helping to strategise appropriately in changing environments—unless any force comes into play from external sources such as financial or stakeholder pressures.

Miles and Snow’s framework can be considered when analysing internal factors. Firstly, they assert that different organizations may adopt different strategies based on internal and inherent characteristics. Such organizations can affect their performance directly, and prospect organizations can set innovative targets which implement strategies through risk-taking, which will be expected to produce higher organizational performance outcomes.

Public management scholars recently conducted empirical studies on related issues based on the Miles and Snow framework. Although research was initially performed in the public sector, all improvements to the topic brought in by business academics have been considered. For instance Andrews et.al. (2009) tested the Miles and Snow framework when analysing the performance of 47 Welsh local government organizations. The study looked at environmental influences by applying contingency theory, and was designed longitudinally in order to get more confident outcomes as well as Meier et al.’s (2007) study on 3,041 Texas-district schools—a case which drew less attention to contingency effects. In terms of strategic modelling, public management studies discovered similar results which showed that prospector organizations show a
far better performance than reactor organizations, which are unfavourable in terms of efficiency. Both studies discovered that defender organisations produced statistically diverse results in different contexts, thereby indicating that different strategic benefits may be contingent upon national context.

Lastly, research design may also impact on relationships between strategic, performance and contextual elements. Conant et al.'s empirical study (1990) explains that large-scale studies analysing relationships between types will produce results which show that defender, prospect and analyzer organizations’ performances will produce a higher performance than reactor organizations. In Conant’s study, 83 health service organizations were examined, with 14 defender, 36 prospectors, 29 analyzer and 4 reactor approaches identified; the smallest strategic approach group, the reactor type, showed a weaker relationship between organizational performance and strategic choice. However, Woodside et al. (1999) claimed that if reactor organizations had been greater in number, the connection between strategic types and organizational performance would have been enhanced. In other words, sample size should be considered attentively. Another important study by Zahra and Shortell (1990) presents possible solutions to the limitations of the Miles and Snow model, and a literature review can address the questions raised by Woodside et al. (1999). Zahra and Shortell (1990) claimed that strategic choices on the part of organizations will likely be contingent upon specific environmental situations and internal features. They also asserts that the model should be considered in a wider context by looking at internal and external elements instead of addressing relationships between performance and strategy just by asking for staff opinions which may misdirect the study. The aim of the study should be to discover the reality of the organization's situation, rather than relying on staff responses which can be subjective or even deliberately biased. Working out changes within strategic types necessitates longitudinal research over a more extended period by testing data on multiple studies more deeply over time. Overall, research design and other factors which might affect the study should be considered in order to get more reliable results.
3. Critical Evaluation of Contextual Determining Factors

Strategic management aims to enhance effective performance outcomes and influence potential public sector organizational performance, which can be addressed in the light of all these frameworks and theories, all of which affect approaches to strategic management in turn. These can be classified as external and internal determinants regarding organizational performance (Andrews et. al., 2012).

Rational strategic management is constructed upon a body of rules in a top-down structural hierarchy. Central government strategies, as an external influencer, may therefore potentially affect organizational performance in financial terms. For example, Meier et. al.’s (2007) study of Texas School Districts reveals that organizations need central support in order to maximise their performance. Despite the traditional prominence of the rational approach to strategising, there is an important body of work that considers the value of an approach at the other end of the spectrum—the incremental approach. This enhances the role of organizations’ members, viewing them as active participants in the development and implementation stages, something encouraged by the incremental approach. Although staff participation, as an internal factor, it is considered to improve organizational performance, the separation of formulation and implementation stages may can the failure of the overall strategy.

Institutional approaches also argue that organizational performance may be constrained by external forces that happen to affect it. While these external forces lead out from society and strive to make all organizational strategies similar, they also have a knock-on effect on organizational performance, and this relates directly to strategic management. Strategies considered legitime by powerful groups in the institutional environment will probably lead to more financial and political support for an organisation, eventually bringing improvements in service performance. In the same way, contingency theory suggests a direct relationship between specific technical and institutional environments and organizational outcomes. More generally, contingency theory does not accord with the one-size-fits-all approach in public service management (Andrews, et. al. 2012). While institutionalism emphasises the small scale of the groups within society, contingency theory deals with problems at state or country
level in order to explain more general causes as well as looking at external contingencies.

Moreover, when looking at strategic management literature and performance, Miles and Snow’s framework (1978) can be seen as the most commonly applied approach. One reason for its popularity could be that it is easily adaptable to many different kinds of organizations as a comprehensive model. However, there are also disagreements about the variables the framework should be examining. Woodside et al’s study (1999) built the framework further by identifying problems of association between two variables. This study asserts that the Miles and Snow framework does not reflect organizational relationships between strategy and performance; instead it focuses on how organizations and their staff work out what it is they need to do. Although this understanding is quite different than the common concept underlying the framework, it does still account for the effects of internal and external factors.

When considering existing literature on public and business sector studies, theoretical and empirical foundations of strategy knowledge, specifically in the public sector, are very scarce. The public sector may be affected by global problems such as the 2007 economic crisis, or by public sector problems such as political and legal constraints. The number of dependent variables, particularly as far as organizational performance in certain empirical studies is concerned, should therefore be increased in order to obtain more reliable results and refine concepts and methods (Zahra & Shortell, 1990; Boyne & Walker, 2010). Future studies which directly examine the public sector will therefore need to focus on theory, data and empirical evidence from a much greater variety of sources, by considering different countries and different organizations that work under a wider variety of conditions.

4. Conclusion

This essay was focused on topical organizational performance and strategic management issues in public management literature, looking at them in conjunction with other determinants which might affect this relationship. In the first part, strategic management and its relationship with organizational performance within public sector literature was identified. The second part showed that theories from public
administration—and particularly from strategic management literature—can be identified and introduced to help analyse the area under investigation. The classification of such approaches and theories by the external and internal components of organizational performance also offers an opportunity to reveal more evidence in order to obtain more accurate results.

There are five different theories and approaches which relate to the topic discussed above; central government intervention may be required when the rational theory approach to strategic management is implemented, because of the nature of the theory. In the same way, incrementalist approaches may encourage personnel participation, which may in turn affect the relationship between strategic practices and organizational performance. Institutional theory places more emphasis on how responses from society and the powerful groups within it can influence this relationship and may augment mediator variables.

In terms of more comprehensive theory and framework, contingency theory places the importance for the technical environmental effects on the relationship by showing that contextual determinants may work as moderated effects. Lastly, the Miles and Snow framework presents four types of strategic stances as further moderating effect in the strategic management and performance relationship, but as internal elements as opposed to exterior factors discussed by contingency theory.

Despite the problems of strategic management in the public sector, it appears that the topic will occupy a place in public management literature over the forthcoming years. Finally, it could be suggested that our understanding of the topic might be developed by undertaking more empirical studies on the basis of coherent theories and better research design.
Bibliography:


