

# The moderating

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# THE MODERATING EFFECT OF CONTINGENCY VARIABLE ON THE RELATIONSHIP BETWEEN FORMAL STRATEGIC PLANNING AND COMPANY PERFORMANCE

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## Abstract

This research examines the moderating effect of some contingency variables, which consisted of environment, structure, size of organization, and culture of organization, in organizational context, on the relationship between the level of formal strategic planning and company performance. The investigation was done to small and medium enterprises (SMEs), and data were gathered through interviews and questionnaires collected from 64 (sixty-four) SME exporters of regional featured products. Five hypotheses were tested in this research using Partial Least Square analysis technique. The analysis result showed that one hypothesis was supported by facts while the others were not. The four unsupported hypotheses were about the moderating effect of variable. The generalization of research result could be extended by using the setting of industries that are more varied and adding more number of samples.

**Keywords:** Moderating effect, formal strategic planning, contingency variables, organizational context, company performance

## 1. Introduction

In the last three decades, formal strategic planning (here in after referred to as FSP) has attracted the researcher's interest. As a matter of fact, there have been a lot of researches that investigated the relationship between FSP and performance, but most of the research results were insignificant. Researches on the relationship between FSP and performance of organization showed unconvincing evidence. Some findings empirically proved that FSP could improve performance while some others showed there was no effect of FSP on performance. An early study on the relationship between FSP and performance conducted by Thune and House (1970) indicated that the economic performance of a group with formal strategic planning is better than a company without planner. It was supported by Herold (1972) who proved that FSP has a positive effect on financial performance. Meanwhile, Capon et al. (1984) stated that the higher the sophistication of strategic planning process, the better the company performance. In addition, Sinha (1989) as well as Ramanujam and Venkatraman (1987) claimed that as a planning action the strategic planning process will give real values to the company.

Several other studies concluded contradictory results, however, showing that there is no clear systematic relationship between FSP and company performance (for example, Shrader et al., 1984). Some researchers stated that FSP may be useless due to the introduction of exaggerated rigidity and bureaucracy (Bresser and Bishop, 1983). Furthermore, Fulmer and Rue (1974) as well as Whitehead and Gup (1985) provided contradictory empirical evidence because in a company with planner the economic performance is in fact worse than the company that has no planner. Most of the studies on causality of FSP towards performance used advanced countries as the research settings, for example Canada, USA, England, Australia, Japan, as well as other countries in Europe (Koufopoulos et. al., 2005). Haines (1988) and Glaister et al (2008) stated that in fact there is an opportunity for researchers to investigate the conceptual framework of FSP causality towards performance using developing countries as research settings. The main reason for this was because, in general, developing countries experience a transition process and changing era that also cause changes in the need for formal strategic planning.

This research was designed using a developing country and SMEs as the research setting. It is expected that this investigation into the moderating effect of contingency variables will be able to explain the controversy over the empirical evidence of the relationship between FSP and performance. It is also hoped that this study will discover the appropriate model of relationship between FSP and performance as well as the moderating effect of contingency variable .

This study was aimed to broaden knowledge, to examine moderating effect some contingency variables in the context of organization, such as environment, structure, size of company and culture of organization towards company performance based on the formal strategic planning conducted by the company.

## **2. Literature Review and Hypothesis**

### **2.1. Formal Strategic Planning**

The goal of FSP implementation is to describe the managerial process of organization. FSP can be defined as a process to determine the mission, goals, strategies, and policies that regulate the acquisition and allocation of resources to achieve the organization's objectives (Pearce et. al., 1987). FSP tends to be used as a messenger saying that the process of company's strategic planning involves a systematic procedure that explicitly reflects the involvement and commitment of main stakeholders in the planning design.

Hopkins and Hopkins (1997) explained that the process of strategic planning consists of three main components: (1) Formulation (including development of mission, identification

of main objectives, assessment of internal and external environment, and evaluation and selection of strategic alternatives); (2) Implementation; and (3) Evaluation. Strategic planning can be considered based on the contents or the points of view of the process (Glaister et. al., 2008). The contents are related to various elements of strategic planning that vary from company to company, or popularly known as typology of strategy. Meanwhile, the process is related to the mechanism to develop and distribute the strategic planning.

## **2.2. Relationship between Formal Strategic Planning and Performance**

Explicitly, the practice of strategic planning does not only emphasize the need for opportunity and threat identification but also urge the design of appropriately firm action plan. Overall, the researcher hypothesized that the performance of a company with planning will be better than without planning. Although some literatures mentioned that the relationship between strategic planning and performance is positive, Boyd (1991), in his research, had not revealed the existence of clear relationship between both variables. The relationship was empirically tested for the first time by Thune and House (1970) who then found that the economic performance of formal planner group is better compared to the non-planner company.

Several researchers reported that the practice of strategic planning is lack of benefits, for example Fulmer and Rue (1974); on the other hand, Whitehead and Gup (1985) gave contradictive empirical evidence because in a company that has a planner the economic performance is worse than the company with no planner.

## **2.3. Contextual Variables of Organization**

Early studies on FSP and performance showed less significant results and had been criticized for not considering the factor of organizational context. These researches assumed as if FSP is a group of isolated activities. Therefore, researchers claimed it as a limitation and suggested that contextual variables should be studied. Amstrong strengthened the benefit of formal planning but found a serious problem, which should be considered by future researchers, concerning how to design the planning and when to plan as one essential matter to study. Pearce et al., (1987) also concluded that a miss-link company is proven to be unable to achieve better performance due to the inconsistency between strategic planning and the existing environment (overlapping). Some empirical evidence is inconsistent because it does not consider the factor of organizational context. According to Glaister et al., (2008) how far a company is involved in the strategic planning process will reflect whether the strategic planning is formal or informal, and it all depends on the context of organization. Based on the aforementioned phenomena, this research would be directed to test the moderating role of

some contextual variables in an organization as contingency variables towards the relationship between the level of strategic planning formality and company performance.

#### **2.4. Environmental Turbulence**

The external environment of a company is considered as an important factor that can affect the relationship between planning and performance (Pearce et al., 1987; Priem et. al., 1995; Andersen, 2004; Glaister et. al., 2008). Environment is usually defined as the strengths or power outside the control of the company management (Shrader et al, 1984). According to some researchers (Boyd et. al., 1993; DrazinandVen de Ven, 1985) certain aspects of strategic planning and performance are influenced by external environment. In this case, strategic planning may be more important in a turbulent environment than in a quiet one (Armstrong, 1982; Miller and Friesen, 1983, Miller and Cardinal, 1994). The characteristics of a turbulent business environment according to ChristopherandHolweg (2011) are the more global competition, the more demanding customers, and the more uncertain market. Consequently, the relationship between planning and performance may become stronger in a turbulent environment and weaker in a quiet environment. However, there is an argument that contradicts this view: strategic planning will be likely to give positive effect on company performance in a less turbulent environment because the future condition is easier to anticipate (Mintzberg, 1973).

#### **2.5. Organization Structure**

Structure of organization is crucial to supporting the ability to manage information, and it has significant influence on the context and characteristic of human interaction (Miller, 1987). Previous researchers have studied the relationship between strategy and structure as well as the relationship between structure and environmental uncertainty (Khandwalla, 1977; CovinandSlevin, 1989 in Gibbons and O'Connor, 2005). The types of organization structure include mechanistic structure versus organic structure (Burns and Stalker, 1961).

The research done by Owaand O'Connor (2005) found that a company with organic structure tends to adopt the process of strategy formation in a step-by-step or sudden manner, while a company with mechanistic structure tends to adopt formal and comprehensive strategy formation. Furthermore, the characteristics of external environment can be divided into stable and uncertain/unstable that will affect the organization structure adopted by the company. A turbulent, dynamic environment will be effective for an organic structure, but a relatively stable environment is more suitable for a mechanistic structure.

Environmental instability can influence a company structure in which the manager can develop a more flexible mechanism to overcome the uncertainty. Miller and Droge

(1986) explained that uncertainty is related to changes, customers' taste, behaviors in competition, technology of supply resources, and others. The contingency theory was proposed by Lawrence and Lorsch (1967). Pugh et. al., (1969), Perrow (1970), and Child (1972) in Glaister et al., (2008) stated that the increasing uncertainty will create irregular, more complex tasks.

## **2.6. Company Size**

Strategic planning is often considered as a management tool that is more useful for a relatively large company; however, it is also suitable and used by small and medium companies, which started to be studied (Matthews and Scott, 1995). Pearce et. al., (1987) identified that the weakness in research methodology is affected by the company size and may be related to the relationship between planning and performance. This explicitly encourages the need for a research on the effect of company size. Size as a controlling variable has been a matter for debate (Swan and Allred, 2003; Lau et. al., 2007) or as a significant contingency variable that needs to be considered when designing an effective strategic planning system (Glaister et al., 2008). According to Swan and Allred (2003), company size reflects the economic potential or non-economic scale of the company that can trigger bias when a researcher is going to assess the performance; therefore, researchers often use company size as a controlling variable. Hopkins and Hopkins (1997) found a directly negative relationship between bank size and intensity of company's strategic planning that will eventually have a negative effect on the bank's financial performance.

## **2.7. Organization Culture**

At first, studies on culture functioned as an independent variable that has a dominant influence on performance (Kotter and Heskett, 1992). Referring to the concept of McKensey's framework, it was mentioned that share value means the accumulation of organization's values as an outcome of interaction between strategies and structure, system, style, staff, as well as skills (Priyono, 2004). The development of researches on culture is broadening, and some researchers described the characteristics of culture according to the organization climate. For example, Pearce and Bean (1998) classified the typology of culture that can encourage the performance of managers into Apollo and Athena culture types. Meanwhile, in his research, Zwaan (2006) divided culture into more varied types, which are Zeus, Apollo, Athena and Dionysus.

Borantaset. al., (1990) in Priyono (2004) confirmed that, as a continuum, culture is only divided into two types, Apollo and Athena, which have extremely opposite characteristics. The characteristics of Apollo culture are for example: task planning system is



more formal and centralistic with fixed and hierarchical plans, and it uses a rigid bureaucracy and commando system (Pearse and Bean, 1998; Zang, 2009). The recommendation of research by Glaister et al. (2008) was that future researchers need to consider the probability of culture as a contingency variable in testing the effect of FSP on performance because the benefit of FSP will be stronger when an organization has a culture that tends to use decentralization pattern and give freedom to managers to innovate according to their own tasks and responsibilities.

## 2.8. Research Model and Hypothesis

The research model was established on two main foundations: first, the empirical researches on the relationship between strategic planning and company performance have not come to conclusions; second, some weaknesses in research methodology encourage the need for harmony between strategic formulation and several contingency variables, such as organizational context as a moderation variable. In this study, the factors of organizational context to be considered in establishing the moderating effect on the relationship between strategic planning and company performance were environmental turbulence, organization structure, organization size, and organization culture. From the aforementioned explanation, the conceptual framework of this research can be illustrated as in Figure 1.

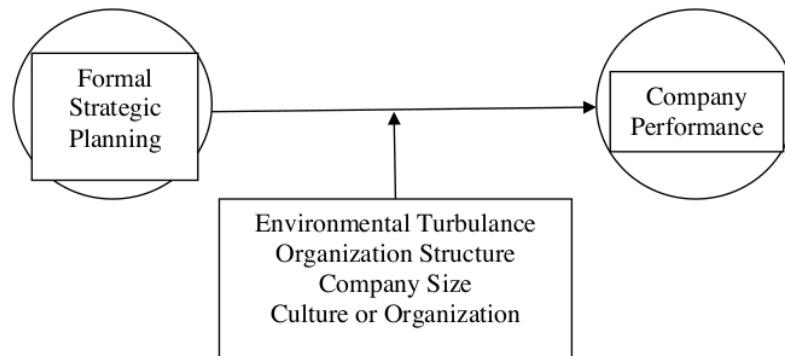


Figure 1: Research Model

Based on the literature review and research model, the proposed hypotheses to test in this research were:

- H1: The more flexible the formal strategic planning, the higher the company performance

H2: A more turbulent business environment can strengthen the relationship between formal strategic planning and company performance.

H3: A more “organic” structure of organization can strengthen the relationship between formal strategic planning and company performance compared to the “mechanistic” structure of organization.

H4: A larger company will have more ability to strengthen the relationship between formal strategic planning and company performance compared to a small-scale company.

H5: An “Athena” culture of organization tends to be able to strengthen the relationship between formal strategic planning and company performance compared to an “Apollo” organization culture.

### **3. Research Methods**

#### **3.1. Data Collection Techniques**

The data collection techniques in this research used mixed methods in developing instrument assessment to reach a high level of content validity. Data were gathered through in-depth interviews with several small-medium enterprises and studies on company report documents, such as annual report, environmental report, and other. Then, for the process of confirmation and hypothesis testing, data were collected by distributing questionnaires.

#### **3.2. Operational Definitions of Variables**

In this research, the six variables consisted of one dependent variable, which is company performance, and one independent variable, that is formal strategic planning, as well as four moderating variables comprising environmental turbulence, organization structure, organization size, and organization culture.

#### **Company Performance**

Greenley and Foxall (1997) explained that, in general, objective assessment towards performance is difficult to predict, particularly about how far this performance is influenced by strategic planning. Therefore, to assess the company performance, a subjective assessment of performance is applied by asking the executives to perceive the achievement of company performance compared to the average industry in the last three years. The achievement indicators of company performance are: profit growth, sales growth, and market growth.



**Formal Strategic Planning**

Formal strategic planning is defined as an explicit statement and written documentation about the basic design of strategic planning process. To measure the construct of formal strategic planning, this study used eight (8) question items that have been developed by Gleitser et al., (2008). All the indicators of formal strategic planning construct focused on the process of strategic planning, in which the measurement was conducted by measuring the constructs to find out whether the characteristic of strategic planning tends to be implemented formally or flexibly. The eight indicators include the procedure or mechanism of planning design, time for scheduling discussion, evaluation of planning implementation, process of planning result presentation, involvement of corresponding parties in decision-making process, communication process for strategic planning design, evaluation of progress, and the need for responsibility for the designed plan to be conducted strictly or limitedly.

**Environmental Turbulence**

Environmental turbulence was measured from two essential dimensions, which are the dimension of market uncertainty and changes as well as the dimension of technological changes. The development of the first dimension refers to the measurement developed by Gleitser et al. (2008) that includes three indicators: predictability of market demand, life cycle of products, and change in customers' need. The measurement of technological changes refers to the indicators developed by Miller and Droge (1996) using one indicator, which is the influence of technological changes on the production capacity.

**Organization Structure**

The construct of organization structure was measured by referring to the measurement developed by Burns and Stalker (1961) that include pattern of authority distribution in task completion, hierarchical relationship, flexibility of tasking pattern, and problem in employee mobility.

**Organization Size**

The size of company in this research used one of the indicators commonly applied in Indonesia, which is number of employees.

**Organization Culture**

There were three measurements of organization culture in this study, which are the value of working that prioritizes loyalty or creativity, the system of employee control that is based on task control system and procedure, or career orientation.

### 3.3. Data Analysis Model

The model of analysis in this study was the Structural Equation Modeling (SEM) with Partial Least Square (PLS) approach. This approach was chosen due to the limitation of samples. There were two steps of analysis using PLS in SEM: measurement model and structural model. Measurement model was applied to test whether each indicator could be used for measuring the construct/latent variable. In PLS, the measurement model was observed through the value of outer loading. Meanwhile, the structural model used inner weight.

## 4. Results and Discussion

### 4.1. Results

#### Outer loadings (Measurement Model)

The indicator of this study was a multi-dimension indicator, so the validity of each latent variable or construct would be tested by observing the loading factor from the relationship between each observed variable and latent variable.

An item is declared valid if its value of outer loading (measurement model) is higher than or equal to 0.5. In addition, a statistical test using t-test was required for obtaining outer loadings. The validity criteria using the value of probability (P) required that the model was determined valid if the value of  $p \leq 0.05$ . The complete test result is presented in Table 1.

**Table 1**  
**Validity Test for Measurement Model**

Variable	Outer Loading	P	Note
Strategic Planning (PS)			
PS1	0.749	0.000	Valid
PS2	0.639	0.006	Valid
PS3	0.127	0.331	Not Valid
PS4	0.448	0.055	NotValid
PS5	0.297	0.134	NotValid
PS6	0.733	0.000	Valid
PS7	0.290	0.170	NotValid
PS8	0.022	0.471	NotValid
Company Performance (KP)			
KP1	0.636	0.000	Valid
KP2	0.737	0.000	Valid
KP3	0.751	0.000	Valid
KP4	0.679	0.000	Valid
KP5	0.755	0.000	Valid
KP6	0.790	0.000	Valid

It can be seen from Table 1 that not all of the indicators used for measuring the formal strategic planning variable was valid. From eight indicators, only three were valid: PS1, PS2, and PS6. Meanwhile, in the indicators for measuring the company performance variable, all the indicators were valid. The test on measurement model was conducted for all the indicators of each latent variable. This result was then included in the structural model but only the valid indicators were involved.

#### **Inner Weights (Structural Model)**

After the measurement model for all the indicators of each latent variable, a structural model (inner weight) was implemented to analyze the relationship between constructs without including the invalid indicators. The relationship between constructs is considered significant if the value of probability ( $p \leq 0.05$ ). The test result according to the hypotheses is illustrated in Table 2.

Table 2: Structural Model

Relationship Path	Original Sample Estimation	Probability Value	Note
H1: Strategic planning on company performance	0.413	0.000	Significant
H2: Moderation of business environment on the relationship between strategic planning and company performance	-0.002	0.398	Insignificant
H3: Moderation of company structure on the relationship between strategic planning and company performance	-0.054	0.321	Insignificant
H4: Moderation of Company size on the relationship between strategic planning and company performance	-0.099	0.117	Insignificant
H5: Moderation of company culture on the relationship between strategic planning and company performance	-0.061	0.191	Insignificant

The result in Table 2 indicates that only one hypothesis was significant and accepted or supported by the facts in this study; that was the effect of formal strategic planning on company performance, while using the significance level of probability ( $p \leq 0.05$ ) the other four hypotheses were insignificant.

#### **4.2 Discussion**

The variable testing result of strategic planning on company performance using PLS analysis tool is presented in Table 2.

From the result of hypotheses testing (Table2), it can be seen that Hypothesis 1 was acceptable or supported by the facts of the study. It means that the hypothesis on export-oriented furniture and craft companies in Yogyakarta supported previous studies (as in Boyd, 1991). This research also proved that the more formal the strategic planning of the furniture and craft company, the lower the company performance; this is in line with the research finding conducted by Fulmer and Rue (1974) as well asGup (1985).

The second hypothesis was **not supported by facts**. The path coefficient showing the interaction between strategic planning and business environment on company performance, which was also an effect of moderation from business environment towards the influence of strategic planning on company performance, was negative; however, the coefficient figure was relatively small. It means there is a tendency that the **more turbulent the environment, the more flexible strategic planning** is required to establish better performance. This result supported the opinion of Mintzberg (1973) who stated that formal strategic planning is more suitable for a more stable environment because it is easier to anticipate. However, this result did not support Amstrong (1982), **Miller and Cardinal (1994)** who explained **that formal strategic planning may be more applicable in a turbulent environment**.

The third hypothesis was **not supported by facts**. The effect of organization structure moderation on the influence of strategic planning on company performance was negative with a relatively small coefficient (-0.054). This negative effect means that the more organic the company structure, the smaller the influence of strategic planning on company performance. On the other hand, the more mechanistic the organization structure is, the more significant the influence of strategic planning on company performance. It means there is a tendency that the more flexible the strategic planning, the more mechanistic organization structure is required to achieve better performance. This is in line with the research of Owaand O'Connor (2005) who found that mechanistic structure of organization tends to adopt formal, comprehensive strategic planning process.

The fourth hypothesis was **not supported by facts**. The effect of company size moderation on the influence of strategic planning on company performance was negative with relatively small value. It means the larger the company size, the smaller the influence of strategic planning on company performance. It indicates a tendency that the larger the company size, the more formal strategic planning **is** needed to improve company performance. It corresponds to the opinion of Millerdan **Cardinal (1994)** that **a larger, more complex** company requires **more control and integration** of strategic planning in order to achieve better performance than smaller companies.

The fifth hypothesis was not supported by facts. The effect of organization culture moderation on the influence of strategic planning on company performance was negative. It means the more Athena culture is adopted by an organization, the smaller the influence of strategic planning on company performance, and the more Apollo culture is implemented, which means more support is provided by the company for creativity, development of two-way communication, and competition for success, the more significant the influence of strategic planning on company performance. It means there is a tendency that the more flexible the strategic planning, the more the organization will adapt Apollo culture to achieve better performance. This tendency can also mean that in order to develop flexibility in planning, the loyalty of employees is essential.

### **5. Conclusions, Limitations, and Further Research**

The result of hypotheses testing showed that only one hypothesis was significantly supported by the research facts; that is the first hypothesis, which stated that the more flexible the strategic planning, the better the company performance. The hypotheses that tested the effect of moderation from business environment, organization structure, organization size, and organization culture on the influence of strategic planning on company performance was insignificant. The testing of moderation effect from business environment, structure, size, and culture of organization resulted in a range of error probability from 10% to 40%.

In relation to the moderation tendency, it can be seen that it tends to be negative. A negative direction indicates that a more turbulent environment will decrease the flexibility of planning's effect on performance. To support the success of flexible strategic planning in improving performance, a more mechanistic structure is required. In addition, a more flexible strategic planning will tend to be implemented in smaller organizations, supported by a culture that adopts Apollo type and loyalty of employees. This research result neither fully supported nor rejected previous studies.

This research needs follow-up that deeply studies the characteristics of sample companies and recent related researches in order to analyze the cause of controversy over the findings compared to previous studies.

To strengthen the findings, more samples are required by adding the number of samples or varying the types. The limited number of obtained samples may affect the choice of analysis model and results. More varieties of samples in other industry classifications (other than furniture and craft) will provide better generalization.

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