Executives wildly overestimate financial benefits of strategy planning

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Credit: 123rf.com/Rice University

New research shows executives are likely to overestimate the financial benefits of strategy planning—as conducted by an overwhelming majority of large companies—by a factor of five.

Executives at 88% of large companies engage in strategy planning, according to the research featured in a chapter of "Focus: How to Plan Strategy and Improve Execution to Achieve Growth," a new book co-authored by Vikas Mittal, professor of marketing at the Rice's Jones Graduate School of Business, and Shrihari Sridhar, professor of marketing at Texas A&M University's Mays Business School. The objectives of the practice are setting goals, assigning resources, defining major initiatives, and creating and adjusting budgets, all with the hope of improving financial performance.

In three separate surveys, 136 executives were asked to provide their estimate of the correlation between strategy planning and financial performance. The average across the three studies ranged from 0.60 to 0.74. The objective correlation between strategy planning and financial performance is 0.12, so executives overestimate the financial benefits of strategy planning by at least a factor of five.

"There are many reasons why executives may overestimate the financial benefit of strategy planning," Mittal said. "Rather than rigorously assess its success, executives are bound to think that strategy planning improves firm financial performance. It's a classic case of confirmation bias among executives.

"It's like stock-pickers who believe they can beat the market index when, in fact, it is very difficult to do," he continued. "Retrospectively, the stock-picker may only look at and remember stock picks that beat the market while ignoring failures, a case of confirmation bias. Over time, the stock portfolio of such a stock-picker will lag the market. In a similar vein, executives who overestimate the benefit of their current strategy process will likely diminish their firm's financial performance."

To determine the objective correlation, the authors examined 717 correlations between strategy planning and financial outcomes from 58

published studies reflecting the conclusion of 58,456 data points. Among the correlations, 75% (534) were statistically zero and 4% (29) were statistically negative. Only 21% (154) were statistically positive. The average correlation of strategy planning and objective financial performance was 0.12.

"This is similar to a pharmaceutical company finding 717 correlations in clinical trials testing the efficacy of a drug and 75% showing the medication does not improve patient health, 4% showing the drug diminishes patient health, and 21% showing the drug improves patient health," the authors wrote. "Under the circumstances, it would be difficult to imagine doctors prescribing the medication or patients wanting to take it. With similar evidence for the effectiveness of traditional strategy planning, why would companies want to undertake it?"

"Strategy planning in most companies seems to be stuck in the dark ages, reliant on executives' hunches, gut feel and intuition," Mittal said. "Almost every other endeavor in companies now relies on analytics based on sophisticated statistical analysis, machine learning algorithms and randomized experiments to establish true causality. It will benefit companies to move strategy planning in that same direction."

Mittal cautioned, however, that "each company needs to assess the efficacy of its strategy planning independently" when applying the findings.

Provided by Rice University

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