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A CLOSER LOOK AT BUSINESS PLANNING: EARLY STAGE OUTCOME EFFECTS OF HOW IT IS PREPARED AND USED

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Abstract

The widespread use of business planning in combination with the mixed theoretical and empirical support for its effect suggest research is needed that takes a deeper into the quality of plans and how they are used. In this study we longitudinally examine use vs. non-use; degree of formalizations; revision of plans, and moderation of planning effects by product novelty, among nascent firms. We relate these to attainment of profitability after 12 months. We find that business planning is negatively related to profitability, but that revising plans is positively related to profitability. Both these effects are stronger under conditions of high product novelty.

Introduction

Business planning continues to play a central role, and frequently serves as a central capstone role in entrepreneurship education and counseling. Plans are frequently the primary evaluated output of an entrepreneurial course at both the graduate and undergraduate level, and are a required input into counseling and funding decisions (Burke, Fraser, & Greene, 2009; Honig, 2004). They are promoted in global competitions, and have become the standard calling card for those seeing to start new firms and attract capital and other resources. Business planning is so pervasive that an extensive market exists for the production and improvement of business plans, business plan software, books, and advice (e.g. Blackwell, 1998; MasterPlans the business plan experts, 2010). For less than \$400, a hopeful entrepreneur may receive a complete 25 page business plan, complete with 20 pages of custom generated text, spreadsheets, and 3D graphics (BusinessPlans.com, 2010).

One theorized cause of the aforementioned activity is that business plans provide legitimacy (Honig & Karlsson, 2004; Oakes, Townley, & Cooper, 1998; Shane & Delmar, 2001), an important element necessary to overcome liabilities of newness and smallness (Aldrich & Fiol, 1994; Stinchcombe, 1965). An important question must therefore be raised as to whether a budding entrepreneur is better advised to simply purchase her business plan legitimacy for \$399, or alternatively, to spend the many weeks and months necessary to complete a polished reputable formal business plan. Answering this question is the primary focus of our paper.

Theoretical Background and Hypotheses

Despite the ubiquity of plans and planning, empirical research on the benefits of planning is limited, and results obtained so far are mixed (Burke, et al., 2009; Castrogiovanni, 1996). Advocates and adherents argue that plans are useful and important for one or more of the following four reasons: 1) they provide an action plan determining the steps and actions necessary to launch a business (Armstrong, 1982; Brinckmann, Grichnik, & Kapsa, 2010); 2) they provide a tool for convincing investors and banks regarding the viability of the project a project (e.g. legitimacy, see Karlsson & Honig (2009); Oakes, Townley & Cooper, 1998; Shane & Delmar, 2001); 3) they provide a useful research tool for selecting, evaluating, and fine tuning new business activities in order to avoid potential hazards and mistakes, as well as a method of establishing goals that lead to actions (Delmar & Shane, 2003; Locke & Latham, 1980), and 4) and they serve as a tool for communicating strategic intent, and for assisting with employee direction, motivation, and efficiency (Delmar & Shane, 2003; Timmons, 1999).

From another theoretical standpoint, planning should lead to intentions, followed by behaviors. The theory of planned behavior holds that perceived behavioral control, combined with behavioral intentions, leads to behavioral

achievement (Ajzen, 1991). Entrepreneurial intention is an important step in the process that eventually leads to new business creation (Bagozzi, Baumgartner, & Yi, 1989; Bird, 1988; Kolvereid, 1996; Krueger, Reilly, & Carsrud, 2000). People's goal-directed motivations are acknowledged as important elements in the formation of entrepreneurial intentions (Krueger & Brazeal, 1994; Krueger & Carsrud, 1993). An individual's anticipation to achieve particular goals motivates their career choices (Kuratko, Hornsby, & Naffziger, 1997). Because aspiring entrepreneurs are self-motivated, goal theory suggests that as they take the initiative to plan and build an enterprise, they must successfully implement a range of personal goals (Kuratko, et al., 1997). Thus, according to this theoretical perspective, individuals whose plans advocate action and provide expectations of self efficacy (Bandura, 1977; 1982) would be more likely to develop active business activities. However, other psychological theories imply planning can lead to 'foolish consistency' or escalation of commitment (Cialdini, 1988; McCarthy, Schoorman, & Cooper, 1993)

While much theoretical and empirical work seeks to explain and evaluate the positive effects of business planning, critics frequently employ an alternative perspective invoking new institutional theory (DiMaggio & Powell, 1983; Meyer & B., 1997; Oliver, 1991; Powell & DiMaggio, 1991). From this perspective, business plans are written primarily to signal legitimacy to potential investors, but are otherwise rarely used for the aforementioned organizational goals (Honig & Karlsson, 2004; Karlsson & Honig, 2009; Oakes, et al., 1998). Entrepreneurs may loosely couple their planning activities from their operational environment, completing plans in order to satisfy the demands of external actors and develop legitimacy, while avoiding the actual use of plans as an internal or research oriented tool (Karlsson & Honig, 2009). As a result, while plans may yield other benefits to the entrepreneur, the time taken with the activity may actually divert the entrepreneur from their primary organizing tasks. Stated as a hypothesis we have:

H1: Business planning is negatively related to new venture creation performance

Along the same lines, different types of planning formality require significantly more resources than other, more informal planning. If planning serves primarily a ceremonial function, limited commitment (as evidenced by loose coupling) will result in less formal planning, requiring less time and effort. Stated as a hypothesis:

H2: Given planning, a more formalized form of planning is more negatively related to new venture performance than is more informal planning.

Finally, there exists considerable debate regarding the effects of environmental uncertainty on the importance and utility of planning activities. Entrepreneurs frequently enter into new and uncertain environments, as they spot opportunities overlooked by other firms. Some scholars portend that planning is an effective way of dealing with environmental uncertainty, providing both persistence and self-confidence (Liao & Gartner, 2006) Others maintain that the unpredictable nature of dynamic environments virtually prohibit the efficient use of planning routines (Bourgeois & Eisenhardt, 1988; Mintzberg, 1994) Scholarship also points out that entrepreneurs frequently maintain highly flexible approaches to their activities (Sarasvathy, 2001; , 2008). Further complicating the relationship between persistence and planning, one recent review of research on nascent entrepreneurship found relatively consistent support for a positive relationship between planning and persistence, but no clear association between planning and outcomes, such as getting to an operational stage; attaining first sales, or becoming profitable (Davidsson & Gordon, 2009b). However, once a business has emerged, a greater opportunity exists to plan known elements of the future business activities. One important conditional constraint to this activity is that in uncertain environments, if planning is to be successful, it will require frequent modification of the business plan in order to account for environmental changes. Stated as a hypotheses:

H3: Given planning, revision of the plan is positively related to new venture performance.

Not all ventures face the same sort of environmental or relative uncertainty, thus planning should be more or less viable according to the predictability of the firm's activities. The literature on environmental uncertainty categorizes uncertainty into various groups, such as financial, the firm's mission, it's market development and characteristics, the product type, growth goals, and attractiveness toward a merger (Jauch, Osborne and Glueck, 1980). All things being equal, we anticipate the planning is more effective when the environment is more predictable, and of less value when the environment is more unstable and less predictable (Sarasvathy, 2001). High degrees of product novelty should thus have a negative impact on the effectiveness of planning, as newer products face more

uncertain, less predictable, environments. Thus:

H4: Business planning is relatively more detrimental (or less beneficial) for ventures offering a higher degree of product novelty.

Finally, once a firm with a new product has emerged, many of the previously unknown and unforeseeable events and relationships have been resolved, enhancing the opportunity of effective planning based on revision. Thus:

H5: Revising the business plan is relatively more beneficial for ventures offering a higher degree of product novelty.

In sum, there is widespread use of business planning and business planning education, with the mixed theoretical and empirical support for its effects. Competing theoretical perspectives strongly suggest that research is needed to carefully adjudicate the importance of business planning, how it is used, promoted, and taught. In this study we longitudinally examine the use and non-use of business plans, their degree of formalizations; and the importance and impact of business plan revision among nascent firms including controls for those with more product novelty. We relate these to outcome measures after 12 months using a new unique data set collected from a randomly selected population of nascent entrepreneurs in Australia.

Method:

Sample and Data

The data used for testing our hypotheses are from the Comprehensive Australian Study of Entrepreneurial Emergence (CAUSEE). Partly harmonized with the PSED II study in the US (see Reynolds & Curtin, 2008) and www.psed.isr.umich.edu/psed/home) CAUSEE is a longitudinal panel study of nascent and young firms. After two rounds of pre-testing, the main data collection for CAUSEE commenced in July, 2007. Adult members of 30,105 Australian households, selected through random digit dialling, were screened for status as 'nascent entrepreneurs' (NE) using techniques that have been carefully refined through prior projects (Reynolds, 2009). A total of 1,010 individuals (3.4%) tentatively qualified as NEs, meaning they were at the time of the interview actively involved in a business start-up in which they were going to be an owner; where concrete steps towards firm formation had been undertaken within the past 12 months, but where the business did not as yet have regular sales that covered all costs. Tentatively qualified NEs were directed to a comprehensive telephone interview (40-60 minutes) about the emerging venture, either directly or by later appointment. This first wave interview (W1) was completed by 625 cases (61.9% of those eligible). As close as possible to 12 months after the first interview, these respondents were re-contacted for a comprehensive follow-up interview (also 40-60 minutes) including information on outcomes as well as capturing many other aspects of the ventures' development. This second wave (W2) generated information on outcomes and other requisite follow-up information for 493 cases (78.9% of eligible cases and 48.8% of those initially identified as tentative NEs). These 493 cases comprise the sample used for our analyses. Other CAUSEE samples (the random sample of young [but operational] firms and the judgment over samples of 'high potential' nascent and young firms, are not used in this paper. Although one respondent per case is used it is acknowledged that about 50 percent of the sample represents partnerships or team based ventures. As CAUSEE is conceived of as a venture level study with the sampled respondent as the spokesperson, the respondents are asked to provide information about the contributions of all team members. See (Davidsson & Steffens, forthcoming; Davidsson, Steffens, & Gordon, forthcoming) for further details on CAUSEE and its sample.

Operationalization: Dependent Variables

It has been recognized that for a variety of reasons the performance of young and small firms is hard to measure and interpret, and that arguably these challenges are even greater when the study concerns emerging entities (Brush & Vanderwerf, 1992; Cooper, 1993; Davidsson, 2008). For example, in the specific context of business planning among nascent firms it has been demonstrated that reported positive results of planning on 'performance' actually apply only to outcome indicators reflecting 'persistence' rather than success. We argue that the best available indicator of success is *W2 Profitability*, which therefore is our choice as performance indicator. This is

dichotomous variable where '1' reflects affirmative answers to "Has this business, [business name], received any sales revenue, income, or fees for more than six of the past twelve months?" and to the immediately following question "Has your monthly revenue been more than monthly expenses for more than six of the past twelve months?" at the 12 month follow-up interview. This applies to 121 cases (24.5 percent). Cases failing to affirm either question were coded '0'.

Operationalization: Independent Variables

Business planning is assessed with the following four, dichotomous variables:

For testing H1 we use *W1 Business Plan of Any Kind*, where '1' means an affirmative answer to "A business plan usually outlines the markets to be served, the products or services to be provided, the resources required — including money — and the expected growth and profit for the new business. Have you already begun preparation of a business plan for this new business, will you prepare one in the future, or is a business plan not relevant for this new business?". A 'yes' to this questions applies to 320 cases (64.9%). All other cases were coded '0'.

For testing H2 we use *W1 Formal Written Business Plan*. For a score of '1' this dichotomous variable requires the response 'Formally prepared' to the first-wave follow-on (to the above) question "What is the current form of your business plan — is it unwritten or in your head, informally written, or formally prepared?" (125 cases; 25.3%).

W1-W2 Plan Upgrade also concerns the degree of formalization of the plan and is used as an additional test of H2. It is scored '1' if a W1 non-planner has a business plan of any form at W2; if a W1 unwritten plan has become a W2 written plan, or a W1 informally written plan has become a formally prepared business plan (84 cases; 17%). All other cases were coded '0'.

For testing H3 we use *W1-W2 Plan Revision*. This concerns the contents of the plan and is scored '1' if a plan of any form existed at W1 and at W2 an affirmative answer was given to "Has the business plan been revised in the last 12 months?" (179; 30.2%). All other cases were coded '0'.

Operationalization: Moderator variable

Product novelty was assessed in the first wave interview as a four-point variable computed from a sequence of questions and where '0' means the venture offers an imitative product whereas the highest score (3) reflects a product that is 'new to the world' (as assessed by the respondent). Intermediate levels correspond to a substantial improvement to what is currently offered by others in the market served or to something assessed as 'entirely new' in that specific market (cf. Dahlqvist, 2005, 2007; Ettl & Elsenbach, 2006). We treat this variable as continuous in the analysis. Mean-centering was performed before computing the product terms (with *W1 Business Plan of Any Kind* and *W1-W2 Plan Revision*) and including it and the product terms in the analysis.

Operationalization: Control variables

We use a carefully selected set of control variables in order to reduce the problem of heterogeneity in the types of venture the respondents try to start as well as in their initial state and the total time needed for their establishment.. The selection of control variables was influenced by comprehensive preparatory work reported in (Davidsson, et al., 2009) and are aimed primarily at helping make correct distinctions between what drives the *time* it takes to reach a certain outcome and the more relevant question (for our hypothesis test) of what drives the *quality* of the outcome itself. We control for the following: *W1 Stage of Development*. This is the number of 'Gestation Activities' (Gartner, Carter, & Reynolds, 2004) that were already completed at W1 (apart from business planning activities). Rationale: regardless of planning, those who have completed more activities are closer to achieving certain types of outcomes. We use two controls for *W1-W2 Action & Effort*, the first being number of gestation activities completed between the first and the second interview and the second the logarithm of the number of hours invested in the venture (by all team members) in that time span. Rationale: *ceteris paribus* (and thus regardless of planning) those that devote more time should achieve certain outcomes at an earlier point in time. Four dummies control for *Venture Type*, namely

Retailing industry (incl. wholesale); being a *Hitech* venture (respondent-assessed); a focus on selling *Products* rather than (solely) services, and *Brick-and-Mortar* reflecting absence of plans to have any online sales. Rationale: preliminary analyses suggested these variables are related to outcomes mainly by shortening or extending the time needed to reach certain outcomes and mainly in the direction of more sophisticated ventures requiring more time (Davidsson, et al., 2009). Finally, we control for *Venture Ambition* with a dummy indicating preference for maximum growth over a small, ‘manageable’ size, and a continuous variable indicating the percentage of sales aspired for outside of the local market. Rationale: prior research as well as preliminary analyses suggest that higher ambition ventures may have gestation processes of longer duration and (especially when ambition is correlated with human capital) also be more likely to terminate at a given (low) level of performance (Davidsson & Gordon, 2009a; Davidsson, et al., 2009; Gimeno, Folta, Cooper, & Woo, 1997).

Table 1 summarizes the variables used in our analyses.

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Insert Table 1 About Here!

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Analysis Technique

We use the multiple logistic regression routine in PASW 18.0 (formerly SPSS) to test our hypotheses. The control variables are entered first, followed by the IVs in the second step and the moderator variables in the third step. We will display each step in our reporting of results.

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Insert Table 2 About Here!

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Results and Implications

Table 2 provides the results of our analyses of our models (see Table 1 and the Method section text for an explanation of relevant variable names). Model 1 shows the results of a logistic regression consisting of the control variables regressed on the effects of a business reaching profitability. Almost all of the control variables demonstrate statistical significance, suggesting that they are important controls in assessing profitability. The number of gestation activities (W1-W2 Action & Effort) and the total hours invested in the firm by all team members between the first and second wave (W1-W2 Action & effort 2) are both positive and statistically significant. Further, retailing firms are more likely to attain profitability, as are firms that don’t base sales on the internet (bricks and mortar). In addition, firms that seek high growth, as well as those in Hi-technology or which are product based are less likely to be profitable at this stage.

Model 2 maintains the same relationship as the controls in Model 1, but also includes the business plan variables. It provides a statistical improvement over Model 1 in the log-odds prediction of the dependent variable (Nagelkerke R2 improving from .36 to .38). Having any kind of business plan is statistically strong and a negative predictor of profitability. Thus, H1, which asserted this relationship, is supported. H2 offered that more formalized planning would be more negatively related to performance than more informal planning. While the coefficient formal business plan is negative, it is not significant. The same is true for *W1-W2 Plan Upgrading*. Thus, we cannot definitively support H2, although the data show weak (and non-significant) relationships in the expected direction for both indicators of business plan formalization. H3 proposed that revising plans would be positively related to new venture performance. As can be seen in Table 2, the variable for revision (*W1-W2 plan Revision*) is fairly strong and statistically significant, thus supporting the hypothesis. Next, we report the moderation of the business plan existence by product novelty, which we hypothesized to be detrimental. As can be seen from the product novelty times business plan variable, the coefficient in Model 3 is both significant and strong in the negative direction. Thus, H4 is supported. Finally, we turn to how product novelty moderates the relationship between business plan revision and achieving profitability. H5 stated that a business plan revision would be more beneficial to those with high

product novelty. As Model 3 shows, the variable product novelty by plan revision is both strong and statistically significant in the expected, positive direction. Thus, H5 is supported.

In sum, our results clearly indicate a negative influence of initial planning on becoming operational, as well as a negative influence on initial planning for firms with more novel products. While we were unable to show clear relationships between formal and informal planning, we were able to establish a positive relationship between the subsequent revision of plans and profitability for both the entire population, as well as when using the moderating variable for those with more novel products. Thus, planning at an early stage appears to be disadvantageous, while revised planning at a later stage appears to provide assistance to profitability.

This research has important implications for those engaged in teaching and training entrepreneurs. For those encouraging nascent entrepreneurs who have yet to develop their business model or launch their business (e.g. the numerous undergraduate and MBA entrepreneurship students), encouraging the systematic development of a business plan may be a disservice (Honig, 2004). Our findings strongly suggest that early stage businesses that plan experience negative consequences. On the other hand, for those engaged in coaching or incubating already existing plans, we provide some evidence that planning can provide assistance, and even result in greater profitability. Our interpretation is that planning is most successful only when a venture is suitably molded, ongoing, and determined. Early nascent entrepreneurs should be encouraged to act and investigate, rather than to plan.

Some caveats are required. Comparing firms for profitability at an early stage is not proof that a venture will become highly successful, however, it is a good performance indicator that is likely to track organizations as they mature. Therefore, our results do not prove that planning is overall likely to have a negative influence on all venture outcomes – only that it appears to be negatively related to profitability during the earliest stages. However, this research has important implications for both theory and practice in showing that naïve belief in general, positive effects of planning is unwarranted. It suggests we need to develop a much better understanding of what use of business planning is beneficial for what type of ventures and entrepreneurs at what stages of development. A preliminary suggestion from our research is that using the plan as an action plan in early stages is questionable, whereas using it as an internal document leading toward organizational identity and cohesion may have positive effects.

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Table 1: Legend for Table 1

<i>Controls</i>	
W1 Stage of Development	No. of gestation activities completed at first interview (less BP activities)
W1-W2 Action & Effort 1	No. of gestation activities completed between first and second interviews (less BP activities)
W1-W2 Action & Effort 2	Log of total No. of hours invested by all team members between first and second interviews
Venture Type: Retailing	Industry = retail or Wholesale
Venture Type: Hitech	Self assessed dummy “Do you consider this business to be high tech?”
Venture Type: Product based	Dummy – (intends to) sell(s) mainly products or mix of products and services (rather than predominantly services)
Venture type: Brick_and_Mortar	Dummy (Intended) online share of sales = 0%
Venture Ambition 1	Dummy based on preference for statement “We want this business to be as large as possible” over “we want a size we can manage ourselves or with a few key employees?”
Venture Ambition 2	(intended) % sales in non-local markets
<i>Business Planning Variables</i>	
W1 Business Plan of Any Kind	Dummy based on “have you prepared a business plan, will you do so in the future, or is this not relevant to this business?”
W1 Formal Written Business Plan	Dummy based on “What is the current form of your business plan -- is it unwritten or in your head, informally written, or formally prepared?”
W1-W2 Plan Revision	Dummy based on “Has the business plan been revised during the last 12 months?”
W1-W2 Plan Upgrading	Dummy based on the current form of business plan being ‘higher’ than in W1
<i>Moderation</i>	
Product Novelty	Computed from set of questions. 0 = imitative; 3 = new to the world. Mean centered (for use as moderator)
Product Novelty * W1 Business Plan of Any Kind	Product term of variables described above
Product Novelty * W1-W2 Plan Revision	Product term of variables described above
<i>Dependent Variable</i>	
W2 Profitability	Dummy based on ‘yes’ to questions indicating the venture has had sales for more than six of the past twelve months?” and that revenue covered all expenses for more than six of the past twelve months?”

Table 2. Main Analysis: Regression results for effects of business planning on reaching profitability

	Model 1	Model 2	Model 3
<i>Controls</i>			
W1 Stage of Development	.092 ***	.104 ***	.115 ***
W1-W2 Action & Effort 1	.066 #	.069 #	.081 *
W1-W2 Action & Effort 2	.972 ***	.931 ***	.968 ***
Venture Type: Retailing	1.061 **	1.113 **	1.085 **
Venture Type: Hitech	-.602 *	-.619 *	-.668 *
Venture Type: Product based	-1.113 ***	-1.072 ***	-1.038 **
Venture type: Brick_and_Mortar	.784 **	.819 **	.822 **
Venture Ambition 1	-.918 **	-.991 **	-.943 **
Venture Ambition 2	-.006 n.s.	-.006 n.s.	-.007 #
<i>Business Planning Variables</i>			
W1 Business Plan of Any Kind		-.863 **	-1.276 ***
W1 Formal Written Business Plan		-.150 n.s.	-.233 n.s.
W1-W2 Plan Revision		.691 *	1.031 **
W1-W2 Plan Upgrading		-.238 n.s.	-.268 n.s.
<i>Moderation</i>			
Product Novelty			.204 n.s.
Product Novelty * W1 Business Plan of Any Kind			-1.412 ***
Product Novelty * W1-W2 Plan Revision			1.209 **
Constant	-5.467 ***	-5.207 ***	-5.453 ***
N	493	493	493
Nagelkerke R ²	.36	.38	.41

P = #p<.10 * p<.05 **p<.01 ***p<.001

