

**THE VALUE OF BUSINESS PLANS FOR NEW VENTURES: COMPANY AND
ENTREPRENEUR OUTCOMES**

Richard C. Becherer
University of Tennessee at Chattanooga
richard-becherer@utc.edu

Marilyn M. Helms
Dalton State College
mhelms@daltonstate.edu

ABSTRACT

Writing business plans is often the first step for entrepreneurs in developing new venture ideas. Trade press publications support their value and include templates or even software for crafting the business plan. However, the academic literature supporting the value of a business plan is limited, particularly on how the plan directly affects entrepreneurs and their standard of living. This study polls a national cross section of owner/operators of small to mid-sized business start-ups in operation less than ten years to determine the value of the business plan for the business, its success and longevity, and even its value, separately, for the founding entrepreneur. Results indicate a relationship between the use of a business plan in start up and the age of the business, its financial success, strong company success, and the achievement of financial return goals. Findings support the link between a business plan and the achievement of an "excellent" overall organization.

Keywords: business plan, start-up, company success, growth, and excellence.

INTRODUCTION

Business plans are often the starting point for would-be entrepreneurs as they outline their business ideas and develop a plan to seek financing. The business plan is a formal document which describes a good opportunity and outlines a strategic approach to pursue the opportunity. Along with cost

estimates and profitability projections, the business plan is used to guide strategy and to provide information for potential partners and other investors. The value of a business plan is often assumed and seldom questioned. Because strategic planning is known to be important to businesses and to new ventures in particular, the business plan

is often intuitively linked with improved performance. Unfortunately, this relationship has seldom been tested in the academic literature. There are few studies on the value of a business plan to the business itself or to the entrepreneur personally.

Importance of a Business Plan

Hormozi, Sutton, McMinn, and Lucio (2002) outline the essential elements of a business plan and agree that regardless of the size or stage of development, companies use a business plan to improve their internal operations as well as to describe or market the business to outside investors. Parks, Olson, and Boker (1991) agree few have questioned the value of business plans, particularly for small business start-ups, and they find there has been increased advocacy for business plans in entrepreneurship and small business management offerings at colleges and universities. In fact, an Internet search of college entrepreneurship course descriptions quickly reveals preparing a business plan is the major course deliverable. Popular press books and software programs abound to help the nascent entrepreneur formulate their idea into a business plan.

Purpose of a Business Plan

Struebing (1997) reported on a four-year study conducted by the American Institute of Small Business which found the chances of success by companies undertaking major expansion or by those starting a new business increased

by 50% or more if they first prepared a business plan. The chances of obtaining a bank loan increased by an even greater percentage when the applicant had prepared a business plan.

Other studies of the value of a business plan have focused primarily on the business plan's use as a vehicle for securing funding. Singhvi (2000) studied 24 small businesses and their business plans and found more than 70% used the plan primarily for financing. The business plans covered periods ranging from three to ten years. Interestingly, the study found most small businesses did not update their plans, leading one to assume the plan was used only for early stage financing. Kirsch, Goldfarb and Gera (2009), in their study of 722 funding requests submitted to American venture capital (VC) firms, found the presence of business plans weakly associated with VC funding decisions and inferred the VCs learned much of the information about a start-up from other sources independent of the business plan itself.

Bowers (2009) reporting on the Goldfarb, Kirsch, and Gera (2009) study notes that venture capitalists who screen hundreds or even thousands of solicitations for new business funding do not even consider the content of the business plan. Venture capitalists reveal that most of the information in the business plan, particularly in the financial forecast, is not relevant for their decisions. Market validation or evidence of potential customers for the

service or product, however, is relevant. Generally the findings of these studies agree the business plan is not pointless and enables entrepreneurs to think through the logistics, pitfalls and possibilities and to clarify goals, particularly in the context of a competitive landscape.

While the business plan is assumed to be the first step for validating a new product or service idea, Bartlett (2002) reported only 40% of the *Inc. 500's* company founders had formal written business plans prior to launching their companies. It should be noted that these percentages were based on firms still in existence. If it were possible to collect this information on all new ventures during the same time period, the percentage of ventures with business plans would be even less. Allred and Addams (2006) studied successful companies included on the *Inc. 500's* list to determine whether these companies used a business plan once financing had been obtained. They concluded CEOs and top management of small companies should prepare an effective business plan, revise it to fit the environment, and refer to it often to assist their company in achieving even greater success in their operations.

Some researchers question if the business plan is even necessary since the plan includes numerous assumptions about the future, which is uncertain and continually evolving. The act of starting a business itself results in a change in

the environment and initiates actions by competitors, hence the environment is changed and the value of a business plan is compromised. Karlsson and Honig (2009) agrees the preparation and use of business plans are supported by various universities, governmental assistance agencies, management consultants, and a wide array of literature, but are often not considered as useful tools to be used or updated. Karlsson and Honig (2009) studied six companies over five years and found initial conformity to business plans was followed universally by a gradual loose coupling with the plans over time. Most entrepreneurs who wrote business plans also never updated them and rarely referred to them. Upton, Teal, and Felan (2001), however, studied fast-growing family firms and found the majority did prepare and use formal written business plans.

Business Plans and Firm Performance

Other studies have hypothesized and explored a link between the preparation and use of a business plan and resulting firm profitability. In their study of the 1987 *Inc. 500* firms, Parks, Olson, and Boker (1991) hypothesized that business plan preparation should improve profitability for the respondents, but they found just the opposite. The average profitability was substantially higher for firms without prepared business plans. The explanation of these findings may relate to the composition of the 1987 *Inc. 500*. Their business

start-up success was higher than average and attributed not to a sound business plan but to a proprietary advantage, timing, meeting a well defined customer need, or a revolutionary idea or technology. Parks, Olson and Boker (1991) also noted that fifty percent of the successful businesses had no formal written plan. Heriot, Campbell, and Finney (2004) agree there is a presumption that a business plan will lead to positive firm performance and this therefore assumes preparing the business plan is a good idea. While they agree there are many ways to operationalize positive performance, their findings were mixed at best.

Business Planning Versus Business Plans

Researchers have supported a positive relationship between planning and firm performance and these strategic models typically support the preparation of a formal, written business plan (see for example Rue & Ibrahim, 1998; Perry, 2001; Fletcher & Harris, 2002; Sahlman, 1997). Yet no clear relationship between the preparation of a business plan and corresponding firm performance or any other positive outcomes has resulted. While Perry (2001) found positive relationships between business plans and performance, others have found the exact opposite (see, for example, Hand, Sineath, & Howle, 1987). Perry (2001) concluded that in general, very little formal planning is performed in US small businesses. Hannon and Atherton (1998) believe a closer inspection of the

research suggests the benefits of a business plan are for actual planning within business rather than as a document for acquiring resources.

Business Plans and Positive Outcomes

In support of the business plan leading to a new business, using historical cases, Liao and Gartner (2008) found nascent entrepreneurs who completed a business plan were six times more likely to start a business than individuals who did not complete a business plan. Fiet and Patel (2006) tested a theoretically-based approach for evaluating and predicting business plan performance. Their results accounted for 74% of the variance above the expected ROI to investors based on the original business plan estimates. Similarly, Koh, Kim, and Lee (2008) studied the relationship between business plans and corporate performance in small and mid-sized enterprises (SMEs) in Korea and found good performance was found in firms with an excellent plan and excellent implementation.

Delmar and Shane (2003) studied new ventures in Sweden and found planning in general as well as the business plan itself to be important prerequisites to action in new ventures. The plans helped founders make decisions, balance resource supply and demand, turn goals into operational steps, accelerate new product development and venture organizational activities, and reduce the likelihood of disbanding the venture. In a follow-up study, Shane and Delmar

(2004) again studied Swedish entrepreneurs and found those completing business plans before talking to customers and beginning promotional and marketing activities had a lower risk of failure, thus pointing to the benefit of business plans.

Challenging the hypothesis of a link between a business plan and performance, Perry (2001) studied the relationship between written business plans and small business failure in the US. He found while few firms engaged in formal planning, surviving firms do more planning than failed firms did prior to their bankruptcy.

Business Plans and the Entrepreneur's Outcomes

Even though there has been research investigating the relationship between business plans and firm outcomes, there is a dearth of research on how using a business plan to start a new venture can directly impact the actual entrepreneurs. While business plans may increase the probability of success of the new venture and its profitability, does preparing a business plan directly impact the start-up entrepreneur's personal income or wealth? This research question should be included in any comprehensive assessment of the value of business plans in start-up ventures.

HYPOTHESES

Based upon the literature review, there appears to be limited empirical evidence business plans play an important role in

leading to positive outcomes for the start-up venture or for the entrepreneur. The results are generally supportive of the importance of a business plan, although most studies do not directly link the use or importance of a business plan in a start-up to specific situations or specific performance outcomes. It is important to initiate exploratory research focusing on the link between using business plans for start-ups and an industry or company-specific characteristics. Similarly, are there linkages between using a business plan and both specific firm outcomes and/or personal entrepreneur outcomes?

The business plan plays different roles in firms based on their type and competitor conditions. It is likely there will be a relationship between when a firm was started, the scope of their business operations and industry, and whether they used a business plan to start their venture. Hence the first hypothesis is:

H₁: There is a relationship between the nature of the start-up firm and its competitive environment and the use of a business plan in the start-up.

Regarding firm outcomes there are a number of ways to measure the success of the firm. One measure is how large a business becomes both in sales revenue and the number of employees. Hence, the second hypothesis is:

H₂: There is a relationship between the use of a business plan in start-ups and how large a firm becomes.

At start-up, most entrepreneurs have a vision of the firm they aspire to own and the success to be realized. Generally, most entrepreneurial firms are created to generate financial success, but often the entrepreneur secures equal or even more satisfaction from initiating a firm that creates a loyal customer following or a strong company with a solid employee base. Therefore to assess success outcomes, three different hypotheses are required:

H₃: There is a relationship between the use of a business plan in start-up and financial success.

H₄: There is a relationship between the use of a business plan in start-up and customer satisfaction success.

H₅: There is a relationship between the use of a business plan in start-up and strong company success.

Start-up firms have specific and diverse goals. Often these goals focus on the financial returns the firm achieves or the growth the firm realizes. Thus, the next two hypotheses relate to goal achievement outcomes.

H₆: There is a relationship between the use of a business plan in start-up and satisfactory achievement of financial return goals.

H₇: There is a relationship between the use of a business plan in start-up and satisfactory achievement of growth goals.

The long run viability of a firm is based upon how well it creates management practices and systems that develop into an “excellent” overall organization with an ability to achieve sustained performance. Proponents of business plans would suggest their use as a first step in building a firm that would be considered an “excellent” organization. Therefore, it is likely that there is a relationship between using a business plan as part of a start-up and creating a business that excels over the long term.

H₈: There is a relationship between the use of a business plan in start-up and the achievement of an “excellent” overall organization.

While entrepreneurial businesses may benefit from the use of a business plan in start-up, it is important to link the use of a business plan to benefits for the entrepreneur. Certainly being an owner of a successful business is a positive indirect outcome for the entrepreneur. But does the use of a business plan in start-up related to direct personal benefits for the entrepreneur? And so, the final hypothesis:

H₉: There is a relationship between the use of a business plan in start-up and improved standard of living for the entrepreneur once the business is established.

METHODOLOGY

The Sample

Using a national mailing list, a stratified random sample was created of 1,800 owner/ operators of small to medium sized businesses. The sample included equal numbers of manufacturing businesses, wholesale/distributors, retail businesses and service businesses. The sample mailing included a cover letter explaining the nature of the study and its anonymity, the questionnaire, and a postage-paid return envelope. Three weeks later a second complete mailing was sent to the entire sample encouraging completion of the survey if they had not already done so.

Completed questionnaires were received from 191 respondents for a response rate of 10.61%, which is typical for mail surveys. The first twenty percent (38 total) of the 191 responses were compared with the last twenty percent (38 total) on all key variables and no significant differences in response patterns were identified. This would indicate that non-response bias was not a problem (see Armstrong & Overton, 1977).

Measures

Since the focus of this research is the role and importance of the business plan in the new venture process, only businesses established during the past ten years were included (62 respondents). There were two primary reasons why the research focused on these respondents. First, it is likely that

beyond ten years, it would be difficult for respondents to provide valid and reliable information about their business plan process. Second, the direct impact of the business plan on business outcomes and business success will likely diminish over time. Beyond ten years, many additional factors play a role in creating favorable or unfavorable business outcomes.

Each respondent was asked to provide demographic and classification information regarding themselves and their business. These variables included the "age of the business", the "scope of their current operation", and their "industry type". Regarding their business planning process, each respondent was asked to indicate whether they "used a business plan to launch their business".

To evaluate the role of business plans in launching and sustaining a successful business, several "outcome" variables, representing various facets of a successful business, were measured. Since the size a business achieves is often a surrogate for success, respondents were asked both their firm's "last year total sales" and their "number of full-time employees". From the perspective of the owner/operator, success of the business is also a function of how the venture personally affects them. To evaluate this dimension, respondent owner/operators were asked how they would describe their standard of living today compared with their

standard of living at the time they started their business. Using a five-point Likert-type scale, respondents rated their standard of living from “much worse” (1), through “about the same” (3), to “much improved” (5).

Positive outcomes for small to medium sized businesses can be evaluated from a number of perspectives on various dimensions. To capture these multiple viewpoints, again using a five-point Likert-type scale, respondents were asked to indicate their level of agreement with nine statements representing aspects of business success. Items included: “successful in creating a positive reputation”, “successful in growing sales”, and “successful in positioning the company for long term prosperity”. Using factor analysis, three underlying success dimensions -- “financial success”, “customer satisfaction success” and “strong company success” emerged from the nine variables. Financial Success is measured with five items (alpha reliability = .86), Customer Satisfaction Success is measured with two items (alpha reliability = .87), and Strong Company Success is also measured with two items (alpha reliability = .54).

Additional outcome measures were based upon self reports of how well the company achieved goals. Owner/operators were asked to rate how satisfied they were with their company’s achievement of seven specific goals (e.g., Market Share Growth). These seven items were also factor analyzed and two

underlying dimensions emerged as measures. The first goal-related dimension, “satisfactory returns” consisted of four items (alpha reliability = .90). The second, “satisfactory growth,” comprised three items (alpha reliability = .68).

The final measure was a standardized outcome measure, an adaptation of the EXCELL scale (“Excellence”) based upon the work of Peters and Waterman (1982). The original sixteen attributes that characterized excellent companies who achieved a sustainable business were adapted and operationalized by Sharma, Netemeyer and Mahajan (1990) who created an EXCELL scale in only eight dimensions. Similarly our study used the condensed adaptation to accommodate the constraints of the questionnaire and to encourage a higher response rate. The outcome/success “excellence” measure had an alpha reliability of .71.

FINDINGS

To investigate the role of the environment a firm faces relative to the use of business plans, three variables were utilized: Age of the Business, Scope of the Business, and Industry Type. Table 1 presents a cross tabulation for businesses by age, scope and industry type relative to whether they utilized a business plan for start-up. As indicated, there is a significant chi-square relationship between age of the business and use of a business plan ($p \leq .08$).

Table 1 - Description of the Sample and Comparison of Business Plan Start-Ups with Non Business Plan Start-Ups

	With Business Plan		Without Business Plan		Total	
	Number	Percentage	Number	Percentage	Number	Percentage
Age of the Business*						
1-3 years old	9	75.0	3	25.0	12	20.3
4-7 years old	19	59.4	13	40.6	32	54.2
8-10 years old	5	33.3	10	66.7	15	25.4
Total	33	55.9	26	44.1	59	100.0
Scope of the Business						
Local	12	44.4	15	55.6	27	43.5
Statewide	1	100.0	0	0.0	1	1.6
Regional	12	66.7	6	33.3	18	29.0
National	6	85.7	1	14.3	7	11.3
International	5	55.6	4	44.4	9	14.5
Total	36	58.1	26	41.9	62	100.0
Industry						
Manufacturing	3	60.0	2	40.0	5	8.2
Service	20	57.1	15	42.9	35	57.4
Wholesale/Distributor	4	100.0	0	0.0	4	6.6
Retail	6	54.5	5	45.5	11	18.0
Other	2	33.3	4	66.7	6	9.8
Total	35	57.4	26	42.6	61	100.0

*Chi-Square significant at $p \leq .08$

The other competitive environment variables related to business plan utilization for start-up, Scope of the Business and Industry Type, were not significant based upon the chi-square analysis. Hence, based on the analysis in Table 1, there is only partial support for H_1 . This suggests the use of a start-up business planning process is not based upon the particular competitive environment a new venture is preparing to enter. Use of a business plan appears to transcend the competitive environment a firm faces relative to both

the scope of the business and the industry within which they compete.

Hypothesis H_2 relates to the relationship between the current size of the business and whether the business used a formal business plan for start-up. Two measures of size were investigated, Sales Revenue and Number of Employees. Table 2 reports the sales revenue for firms who utilized a business plan for start-up, and those who did not. There was no significant difference in sales of the two groups. Similarly, as is indicated

in Table 2, there was no significant difference in the size of firms who used a business plan for start-up and those who did not. Thus the presence of business

plans at start-up is not associated with eventually either larger or smaller firms and H₂ is not supported.

Table 2 - Comparison of Business Outcomes With Business Plan Start-Up and Without Business Plan Start-Up

	Business Plan	Non-Business Plan	F	Significance
Sales	\$3,649,614	\$524,217	1.42	NS
Number of Employees	9.91	8.08	0.09	NS
Financial Success	4.24	3.92	3.04	0.08
Customer Satisfaction Success	4.74	4.67	0.27	NS
Strong Company Success	3.71	3.13	5.29	0.03
Satisfactory Returns	3.56	3.13	3.32	0.07
Satisfactory Growth	3.48	3.21	1.49	NS
"Excellence" Measure	4.37	4.2	3.24	0.08
Standard of Living	3.85	3.5	2.74	0.10

The relationship between use of a business plan and firm success was investigated on three dimensions of success: Financial Success, Customer Satisfaction Success, and Strong

Company Success. The results for this analysis are also presented in Table 2. There is a significant difference between start-ups who used a business plan and firms with no business plan on Financial

Success ($p \leq .08$) and Strong Company Success ($p \leq .03$). There is no significant difference between business plan start-ups and companies without business plans relative to Customer Satisfaction Success. Thus, H_3 and H_5 are supported, but there is no support for H_4 . Perhaps business plans are designed to consider macro-level issues such as the strength of the idea, the financial feasibility, and long-run viability. Often customer satisfaction success is a micro-level issue resulting from the day-to-day operation and management of an organization. The strategy and tactics used to attract customer satisfaction success may be beyond the scope of the initial business plan but instead due more to the style of the management, feedback during operations, tactics employed, attention to detail and continuous improvement.

Regarding the achievement of goals as an outcome, analysis results regarding Satisfactory Financial Returns and Satisfactory Growth are also reported in Table 2. As is indicated, firms with business plans have returns which are higher and significantly different than firms without a start-up business plan ($p \leq .07$). Regarding satisfactory growth, however, there is no significant difference. Therefore there is support for H_6 but not for H_7 .

The Excellence measure was utilized to investigate the relationship between using business plans at start-up and the creation of a strong, sustainable business. As is indicated in Table 2, the

Excellence score for firms that used a business plan at start-up were higher than for firms that did not use a business plan. This difference was also significant ($p \leq .08$). Thus, H_8 is supported. The fact that excellence is linked to the use of a business plan is encouraging from a planning perspective and supports much of the assertions in the literature.

Excellence, however, may only consider a limited set of decision areas relative to the operation of the firm. The business plan process may not be able to anticipate and focus on all the factors that define a business as "excellent." Future longitudinal case studies may be able to track changes in the subcomponents of the excellence variable which are more closely related to the initial business planning process.

The final hypotheses, H_9 , examined the relationship between using a business plan at start-up and an improved standard of living for the entrepreneur. Table 2 shows that when start-ups use a business plan, the future standard of living for the entrepreneur is higher. This difference is also statistically significant ($p \leq .10$). For this reason, H_9 is supported.

DISCUSSION AND IMPLICATIONS

Results of the study offer interesting findings for both academicians and practitioners and suggest several areas for future research. The data in this study indicates that business plans have been utilized more in recent years and that older firms were less likely to use a

plan at business start-up. This finding may be confirmation that the textbooks, courses and websites that commonly recommend business plans for start-up ventures are having an impact on actual practice. Apparently, the decision to write a business plan at start-up is not related to the type of industry or the scope of the proposed business operations for the new venture.

The study also adds to the literature supporting the link between writing a business plan and the venture achieving financial success, building a strong company, and achieving financial return goals. This validates the current pedagogical methodology of teaching business plan preparation in collegiate entrepreneurship and small business classes, as there is value in the exercise itself and the finished product is an important resource for the start-up entrepreneur.

It is interesting to note that business plans were not associated with achieving greater company size, achievement of growth goals, or more customer satisfaction success. This may indicate that the primary benefit from a business plan for creating new ventures is creating a financially solid and sustainable organization, but not necessarily one that becomes exceptionally large, achieves high growth or above average customer loyalty. These outcomes are not associated with business plan preparation. Similarly differing organizations are likely to have different

goals for their business and for their business plan. An effective business plan supports the goals of the organization, and perhaps firms with varying strategic goals should be identified in the data collection process to better assess the organization's "definition" of positive outcomes, whether it be a lifestyle business to support a sole entrepreneur, a larger scale family business, or the highest performing multinational corporation.

The business plan process was also associated with achievement of higher EXCELL scores. The focus of this measure is employee development oriented and corporate culture oriented, which provides further evidence that the business plan is an initial step toward building a strong sustainable organization with a dedicated employee base and an employee centered corporate culture.

An important finding of this research is the positive link between writing a business plan at start-up and creating a business which ultimately provides a higher standard of living for the entrepreneur. While we often discuss the value of the business plan for the business, it is important to personalize outcomes to the business owner, as the entrepreneur has to put the time and effort into the preparation of the business plan. This provides further encouragement for the entrepreneur to invest the necessary time to craft a business plan when launching a new venture.

These findings support the link between a business plan and the achievement of positive outcomes for both the business ventures and the entrepreneurs, thus validating the worth of business plan preparation to entrepreneurs and others acting as consultants to small businesses including the Small Business Administration (SBA), the Small Business Development Council (SBDC), the Service Corps of Retired Executives (SCORE), and a host of other incubators for new venture creation. For communities considering additional investments in assistance for new ventures, this study offers confirmatory evidence of the value of business plan preparation assistance. For entrepreneurs who do not really need a business plan to obtain external funding, the findings in this research point out that the firm still benefits from preparing a business plan to focus the company and its strategies, markets, and products or services. In short, the study validates the need for the business plan document, and as a corollary, cautions against skipping the preparation of the business plan.

AREAS FOR FUTURE RESEARCH

While this is exploratory research, the findings point to interesting relationships between the business plan and resulting business and personal outcomes. Further research should utilize additional methodologies including in-depth interviews to identify unique aspects of business plans which

have particularly strong linkages to positive organization or entrepreneur success, and raise new variables for investigation.

Interestingly, there was no support for the link between a business plan and the firm's competitive environment, how large the firm becomes over the decade of study, meeting growth goals, or the customer satisfaction with the venture's products or services. In suggesting areas for future research, exploring why these factors are not relevant is a key area for study. Additional research should also compare companies of various sizes and ages and on other key demographic characteristics to determine if responses change over time. These relationships and linkages should also be studied with international entrepreneurs.

Future research should consider the "quality" of the business plan and how this quality relates to outcomes for the organization or entrepreneur. More research needs to specifically define what is meant by a business plan (i.e., scope, depth, length) as well as the actual characteristics of a business plan that constitute "quality." Future research should attempt to define the key criteria to evaluate a business plan and develop measures to objectively assess and compare quality on a number of key issues. We would anticipate that the relationships identified in this study linking positive outcomes of the business plan for the business and the entrepreneur would even be stronger

when business plans are deemed to be of higher quality.

Most start-up businesses would like to attain customer satisfaction success as part of their long-run goals. Further research should investigate the aspects of the business planning process that could be employed to ensure the business would be operated in a way that customer satisfaction success would be a priority and an outcome. This may be an aspect of the marketing planning section of the business plans that needs further development. Similarly, further investigation on the role of the "excellence" measure as an outcome of start-up firms is needed. It may be that excellence better relates to more mature firms, and the 10-year study window used in this research may not allow enough time for excellence to be fully developed. However, it may be difficult to fully evaluate this relationship as firms that eventually achieve true excellence may not be able to recall the origins of the business plan or the actual business planning process. In more mature firms, often the entrepreneur has harvested the business and current organizational leaders were not part of the initial start up and the actual business development process. Original plans may not be available.

Further exploration of the relationship between preparing a business plan and other variables related to the standard of living of the entrepreneur should be examined separate from an improvement in the standard of living.

Outcomes such as self-actualization for the entrepreneur may also be relevant. Additional research with a larger sample size is also needed to confirm the results of this study, particularly the relationship between the use of a business plan in start up and the age of the business, its financial success, is strong company success, and the achievement of financial return goals.

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Richard C. Becherer holds the Clarence E. Harris Chair of Excellence in Business and Entrepreneurship at the University of Tennessee at Chattanooga. He has had extensive experience both as an academic and as an entrepreneur. He co-founded one of the first for-profit Health Maintenance Organizations in the United States which became a public company. He has been published in numerous journals, including *Entrepreneurship Theory and Practice*, *Journal of Small Business Management*, *Journal of Marketing*, and *Decision Sciences*. He holds a doctorate degree from the University of Kentucky and was a Fulbright Scholar in the Czech Republic in 2008.

Marilyn M. Helms holds the Sesquicentennial Chair and is a Professor of Management at Dalton State College in Dalton, GA. She teaches strategic management, entrepreneurship and quality management systems classes. She is the author of numerous research studies published in journals including *the Journal of Business and Entrepreneurship*, *the International Journal of Entrepreneurship and Innovation*, *the Journal of Small Business Strategy*, and *the Journal of Developmental Entrepreneurship* and writes a monthly business column for the *Dalton (GA) Daily Citizen* newspaper. She holds a doctorate degree from the University of Memphis (Tennessee) and was a Fulbright scholar at the University of Coimbra, Portugal in 2000.

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