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Don't Mistake Business Plans For Planning (It May Be Dangerous to Your Financial Health)

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ABSTRACT

Most academic research concerning business plans suggests that business plans improve the performance of new firms, and virtually all textbooks related to small business advise entrepreneurs to prepare plans before starting a business. A survey of the chief executive officers (CEO) in the INC. 500 (America's 500 fastest growing, privately held small firms) suggests otherwise—fewer than twenty percent of the respondents indicated that they had prepared complete business plans before start-up. Furthermore, firms which prepared business plans were less profitable when entering the rapid growth phase than those which did not. This article explores benefits and limitations of business plan preparation.

INTRODUCTION

Several years ago at a regional SBIDA meeting a friend asked me if Northwest River Supplies had a written plan. No, we hadn't. The friend reminded me of two firms: one had not grown appreciably in the last 15 years, and the other (Taco Time) was wildly successful. Taco Time had a business plan and the other didn't! His implication, "it's not too late—even for a sinner like you—if you at least create a five year written plan." Somehow we never created that plan. Is Northwest River Supplies forever doomed to mediocrity for want of a plan?

— Bill Parks

Few people have contested the value of business plans for small business start-ups. In fact, over the last 10 years increased advocacy for business plans has paralleled increased offerings of entrepreneurship and small business management courses in the academic community. Virtually every small business textbook lauds the business plan as the map for the future.

The purpose of this article is to explore the benefits and limitations of preparing a complete business plan and to argue that a business plan is not a substitute for planning. Survey results will be presented showing the use of business plans by rapidly growing firms. These results cast doubt on the finality with which many authors advocate the preparation of formal business plans. Why are business plans important?

Successful Small Business Management by Megginson et al. is a typical small business text:

> The business plan could be the most important document you ever put together: it may be your "road map to riches." When you are up to your neck in the details of starting the business, the plan keeps you on target, keeps your creativity on track and concentrates your power on reaching your goal. . . . It provides a detailed blueprint for the activities needed to finance the business, develop the product, market it, and otherwise manage the new business (4, p. 155).

Business plans are blueprints and projections of what we imagine the prospective firm will find in the market and what effort and resources will be necessary to create and sustain that firm.

The failure rate of new business has caused small business researchers, counselors, and consultants to search for a divining rod to identify prospective failures. The many failures associated with starting poorly conceived businesses, virtually doomed from the start, cause not only economic loss, but many personal tragedies as well. Yet even business experts have great difficulty forecasting which prospective businesses will succeed and which will fail.

Though the common recommendation, "have a positive attitude," is critical for surmounting the bad times, it can generate euphoria and leaves little room for cautionary advice. However, a prospective business needs a realistic appraisal of its prospects before starting up. Business plans can fill that need. Without negative connotations, the business plan functions as a filter to ward off failure by reducing the number of poorly conceived new businesses. But discouraging bad business is not the same as increasing the level of success for good business. Aside from raising money, a business plan's most appropriate use is to expose faulty reasoning and unrealistic assumptions.

SURVEY RESULTS

Just how common is the use of business plans among rapidly growing firms—the ones most likely to need a plan for external financing? Questionnaires were sent to 442 firms from "The 1987 INC. 500: America's Fastest-growing Private Companies" published by Inc. in December 1987. These companies were the fastest growing firms based on percentage of sales increases between the years 1982 and 1986. Hence, 1982 was the latest year that firms could have started and still be included in the survey. Naturally the majority of these firms started earlier.

One hundred twenty usable replies were received to a question regarding the preparation of a formal business plan. Business plan preparation was measured by asking if a formal business plan had been developed prior to start-up. A business plan was defined as a written document summarizing start-up information about a venture idea including an industry analysis, a marketing plan, financial needs, key personnel, etc. The listed possible answers were: 1) no formal plan was developed, 2) a partial plan was created, and 3) a complete plan was developed.

Results showed that fewer companies in the INC. 500 used business plans than small business experts would have assumed. In fact, 50 percent of the businesses had no formal plan. This result is consistent with an earlier study which found 50.7 percent had not prepared a business plan (8). In the present study 32.5 percent generated a partial plan, and only 17.5 percent completed a formal plan. Thus, 82.5 percent of these highly successful firms responding to the questionnaire did not create complete plans.

Another part of this study focused on examining the relationship between business plan preparation and profit performance. The hypothesis was that business plan preparation (i.e., formal strategic planning) should improve profitability. This position seemed reasonable even though some research disputes this reasoning (2,7). For the firms in the current study, 1982 profit rates (profits as a percent of sales) were obtained from financial statistics in the December 1987 issue of Inc.. Although 1986 profit rates were also available in the Inc. issue, 1982 information was employed because there would likely be a more direct (contemporaneous) relationship between a business plan developed prior to start-up and performance in 1982 than 1986. In other words, less time would have lapsed between business plan preparation and resulting performance. In Table 1 firms were classified by their profit rate and whether they had a complete, a partial, or no written business plan before start-up. Observe that the percentage of firms with losses was lower for firms without plans than for those with complete plans. Furthermore, on the profitability side, of those firms that were profitable, average profitability was substantially greater for firms without plans than for firms with complete plans.

Table 1. Firms Classified By Business Plan Preparation And 1982 Profits As A Percent Of Sales

	16%+	11-15%	6-10%	1-5%	Break-Even	Loss	Row Total
No Plan	6	4	13	19	3	15	60
/%	10%	7%	22%	32%	5%	25%	101%
Partial Plan	2	6	5	11	4	11	39
/%	5%	15%	13%	28%	10%	28%	99%
Complete Plan	0	0	1	6	3	11	21
/%	0%	0%	5%	29%	14%	52%	100%
Column Total	8	10	19	36	10	37	120

Notes: 1) Firms were from 1 to 10 years old in 1982. To maintain the integrity of the original purpose of the study, data was only collected from firms founded after 1972.

2) Percentages were calculated based on each row total and may not add to 100% due to rounding.

The next step in the analysis was to explore why firms in Table 1 with complete plans had a higher percentage of losses than firms having no written business plans. (Firms with partial plans were excluded from the analysis because the survey question did not distinguish between a plan that was only a rudimentary sketch and one that was substantially complete.) Initially it was thought that the year in which the firms were founded might account for this unexpected result. Perhaps a good number of the 21 firms with complete plans were founded in more recent years and, hence, their younger age was the reason such a high percentage (52 percent) were unprofitable. In like manner, perhaps many of the 60 firms with no business plan were older and that their age related experience was the reason such a low percentage (25 percent) were unprofitable.

To evaluate this reasoning, firms were separated into two classes: those founded in 1981 or 1982 and those founded before 1981 (i.e., 1973 - 1980). Table 2 contains the contingency table results for each of the two time periods. Note that 51 of the 120 firms started in 1981 or 1982, and of these firms 7 had complete plans and 25 had no plans. Further, 69 firms were started before 1981 and 14 had complete plans and 35 had no plans. As is evident, the results did not support the proposed reasoning. When comparing firms with complete plans to those having no written plans, the percentage of firms with losses was higher for firms with complete plans in both periods (86 percent versus 36 percent in the 1981 - 1982 period, and 36 percent versus 17 percent in the 1973 -1980 period). As expected, firms in business for a longer period were less likely overall to have losses. However, their age did not explain the differences in loss percentages between firms with and without business plans in Table 1.

Table 2. The Effect Of Firm Age On The Plan—Profitability Relationship

Founding Year 1981 - 1982

	16%+	11-15%	6-10%	1-5%	Break-Even	Loss	Row Total
No Plan	1	2	7	5	1	9	25
/%	4%	8%	28%	20%	4%	36%	100%
Partial Plan	1	4	3	4	2	5	19
/%	5%	21%	16%	21%	11%	26%	100%
Complete Plan	0	0	0	0	1	6	7
/%	0%	0%	0%	0%	14%	86%	100%
Column Total	2	6	10	9	4	20	51

Founding Year 1973 - 1980

	16%+	11-15%	6-10%	1-5%	Break-Even	Loss	Row Total
No Plan	5	2	6	14	2	6	35
/%	14%	6%	17%	40%	6%	17%	100%
Partial Plan	1	2	2	7	2	6	20
/%	5%	10%	10%	35%	10%	30%	100%
Complete Plan	0	0	1	6	2	5	14
/%	0%	0%	7%	43%	14%	36%	100%
Column Total	6	4	9	27	6	17	69

The founding CEO's prior management experience was another factor that could have affected the business plan and performance relationship. One might expect (hypothesize) that CEOs with prior management experience would plan more effectively than CEOs without prior management experience. Their management experience and familiarity with business plans would combine to produce profitable results. To test this proposition, results from another survey question were utilized. Each INC. 500 CEO was asked whether or not the firm's founding CEO had management experience prior to starting the firm. The contingency table results for these two groups are contained in Table 3. This table shows that of the 120 firms of which 35 were started by CEOs without prior management experience, 4 had complete plans and 24 had no plans. Also, 85 firms were started by CEOs with prior management experience and 17 of these firms had complete plans and 36 had no plans. The results did not support the hypothesis that management experience would combine with business plan familiarity to produce profitable results. In particular, different patterns were not observed for the two groups. That is, when comparing firms with complete plans to those having no written plans, the percentage of unprofitable firms was higher for firms with complete plans for both groups (75 percent versus 33 percent for CEOs without prior management experience, and 47 percent versus 19 percent for CEOs with prior management experience). Therefore, founding CEO prior management experience was also not helpful in explaining the Table 1 results.

Table 3. The Effect Of Management Experience On The Plan—Profitability Relationship

Management Experience: No

	16%+	11-15%	6-10%	1-5%	Break-Even	Loss	Row Total
No Plan	3	2	5	6	0	8	24
/%	13%	8%	21%	25%	0%	33%	100%
Partial Plan	1	1	2	2	1	0	7
/%	14%	14%	29%	29%	14%	0%	100%
Complete Plan	0	0	0	1	0	3	4
/%	0%	0%	0%	25%	0%	75%	100%
Column Total	4	3	7	9	1	11	35

Management Experience: Yes

	16%+	11-15%	6-10%	1-5%	Break-Even	Loss	Row Total
No Plan	3	2	8	13	3	7	36
/%	8%	6%	22%	36%	8%	19%	99%
Partial Plan	1	5	3	9	3	11	32
/%	3%	16%	9%	28%	9%	35%	100%
Complete Plan	0	0	1	5	3	8	17
/%	0%	0%	6%	29%	18%	47%	100%
Column Total	4	7	12	27	9	26	85

Another reasonable hypothesis was that a firm's technology (product versus service orientation) might affect the business plan - performance relationship. Product-oriented firms often require more preparation to start than service-oriented firms. It could then be argued that the unprofitable firms which had complete plans were more likely to be product-oriented and the complexity of their technology was the cause of their unprofitability. The survey question that was employed to examine this hypothesis asked CEOs if their firms were primarily product- or service-oriented. Table 4 contains the contingency table results for these two groups. Again, the results did not support the proposed reasoning. When comparing firms with complete plans to those with no written plans the relationship was the same—the percentage of firms with losses was higher for firms having complete plans in both groups.

Table 4. The Effect Of Firm Type On The Plan—Profitability Relationship

Product Firms

	16%+	11-15%	6-10%	1-5%	Break-Even	Loss	Row Total
No Plan	2	2	7	1	0	3	15
/%	13%	13%	47%	7%	0%	20%	100%
Partial Plan	0	1	1	3	2	7	14
/%	0%	7%	7%	21%	14%	50%	99%
Complete Plan	0	0	0	3	2	3	8
/%	0%	0%	0%	38%	25%	38%	101%
Column Total	2	3	8	7	4	13	37

Service Firms

	16%+	11-15%	6-10%	1-5%	Break-Even	Loss	Row Total
No Plan	4	2	5	18	2	12	43
/%	9%	5%	12%	42%	5%	28%	101%
Partial Plan	2	5	4	8	2	4	25
/%	8%	20%	16%	32%	8%	16%	100%
Complete Plan	0	0	1	3	1	8	13
/%	0%	0%	8%	23%	8%	62%	101%
Column Total	6	7	10	29	5	24	81

A final factor which might help explain Table 1 is the size of the firm (number of employees) at start-up. The surveyed firms were separated into two classes: very small firms with three or fewer employees at start-up and larger firms with four or more employees at start-up. The hypothesis was that very small ventures would not need a complete (written) plan in order to become profitable because in these businesses important information usually can be analyzed and communicated with little resort to paper. In larger businesses, however, formalized plans would be needed to partially structure or control the planning-profitability relationship.

The contingency table results for these two groups are contained in Table 5. Observe that when comparing firms with complete plans to those with no written plans a different pattern or relationship existed between the two groups. The percentage of firms with losses was lower for firms with complete plans among the very small firms (17 percent versus 25 percent) and higher among the larger firms (67 percent versus 25 percent). This different pattern, however, was opposite the results that were expected to occur given the hypothesis. That is, it was believed that the preparation of a formal business plan would be more effective in reducing losses among the larger firms than the very small ones; hence, although these results are worthy of further interpretation, the hypothe-sis was not supported.

Table 5. The Effect Of Firm Size On The Plan—Profitability Relationship

Three Or Fewer Employees At Start-Up

	16%+	11-15%	6-10%	1-5%	Break-Even	Loss	Row Total
No Plan	4	3	10	9	1	9	36
/%	11%	8%	28%	25%	3%	25%	100%
Partial Plan	2	3	3	4	3	5	20
/%	10%	15%	15%	20%	15%	25%	100%
Complete Plan	0	0	1	2	2	1	6
/%	0%	0%	17%	33%	33%	17%	100%
Column Total	6	6	14	15	6	15	62

Four Or More Employees At Start-Up

	16%+	11-15%	6-10%	1-5%	Break-Even	Loss	Row Total
No Plan	2	1	3	10	2	6	24
/%	8%	4%	13%	42%	8%	25%	100%
Partial Plan	0	3	2	7	1	6	19
/%	0%	16%	11%	37%	5%	32%	101%
Complete Plan	0	0	0	4	1	10	15
/%	0%	0%	0%	27%	7%	67%	101%
Column Total	2	4	5	21	4	22	58

DISCUSSION

Although the profitability of the firms in this study was examined for only one year (1982), the results are still striking. Perhaps it has been assumed that firms with business plans would naturally succeed and those without plans would fail. Of course, many firms have succeeded without business plans: "After all, everybody gets lucky now and then" (9, p. 290). But when 82.5 percent of the successful small firms didn't develop a complete plan, perhaps it is time to re-examine the assumptions. One could even conclude that when an overwhelming majority of rapidly growing small businesses reject advice to produce a business plan, such advice could be irrelevant to their success. This overwhelming rejection is even more striking because of the pressure from venture capitalists and banks to create a business plan.

Regarding the business plan-profitability relationship in Table 1, it was not expected that firms with complete plans would have a higher percentage of losses than firms with no business plans. Further, given the variables examined in this study, only firm size produced patterns that might help explain this relationship. Although the firm size results were also not anticipated, they deserve discussion.

Firms frequently need to adapt or change during their early years because of market uncertainties. That is, it is difficult in a business plan prepared before start-up to predict perfectly what will occur after start-up. Planning is a continuous activity that does not end with the completion of a business plan, and CEOs need to have proper attitudes concerning changes in a firm. Perhaps many CEOs of the larger firms with business plans in Table 5 did not make the necessary adjustments after start-up; whereas CEOs of the very small firms with business plans did adjust. A negative side of a formal business plan is that it can lead to rigidity in a business unless the CEO is constantly anticipating and adjusting.

No matter how carefully investigated, most plans are obsolete before they can be implemented. Both Napoleon—"He who knows from the first whither he is going surely will not go far" (3, p. 226)—and George S. Patton Jr.—"...successful generals make plans to fit circumstances, but do not try to create circumstances to fit plans" (5, p. 235)—captured the essential notion of effective strategy. Unfortunately, implementing strategy contained in business plans is liable to make the circumstances fit the plans.

Of course, business-plan proponents would suggest the simple solution of revising the business plan. But those who have endured the stress and tension of a business start-up know that the requisite energy and time are unlikely to become available. Instead, the plan is more likely to remain the guide even when events have outstripped its reality. Perhaps the word "plan" rather than the substance of its meaning has misled us. What is the relationship of plans to planning?

If planning is viewed as learning, then the value of a business plan may end with its completion. In other words, learning occurs when the plan is being prepared and perhaps it should be destroyed shortly after completion. Proactive business plans are environmentally based, but the environment changes, and if plans are not revised, businesses become isolated from their environment. It is doubtful that a business plan is the right vehicle with which to practice planning as learning. Business plans tend to be revised only in times of crisis, resulting in a reactive instead of proactive business. "The challenge, therefore, is to recognize and react to environmental change before the pain of a crisis" (1, p. 71). If someone takes as valid this argument for learning as the essence of long term survival and success, then it is possible to see the potential danger implied in a business plan.

Tom Peters is one advocate of the need for change in our perception of planning:

> The long-range strategic plan, of voluminous length, is less useful than before. But a strategic "mind-set," which focuses on skill/capability-building (e.g., adding value to the work force via training to prepare it to

respond more flexibly and more quality-conscious), is more important than ever.

> Sound strategic direction has never been more important . . . .Yet strategic planning, as we conventionally conceive of it, has become irrelevant, or worse damaging. What is a good strategic plan? There is none. But there is a good strategic planning process. . . . Flexibility is the necessary watchword (6, pp. 394, 510).

Consider further the remarks Robinson and Pearce make concerning their recent research. They studied small banks and measured "formality" of planning by the degree to which sophisticated written documents emanated from strategic planning. They stated:

> A major implication for small firm executives concerned with the design of their firm's strategic planning system is that little benefit can be expected from employing a highly formal process. Small firms without a formal planning process performed as well as their formal planning counterparts.
>
> ...effective informal planning systems in small firms mainly de-emphasize the need for formal written documentation, reports and activities as a means for deformalizing their strategic planning system....but perhaps most important, the success of 'informal' planners does not mean less planning is necessary. Of six dimensions common to strategic planning systems, informal planners placed an emphasis equal to their formal planning counterparts on every dimension (scanning environment, identifying distinctive compe-tence, concern for authority relationships in the organization, deployment of financial and physical resources consistent with strategy, and monitor/control strategy implementation) except goal-setting; they just did so with less formal written procedures (7, p. 206).

CONCLUSION

The literature suggests that business plans are appropriate for two main purposes: to raise capital for a proposed or new venture and to examine the feasibility (and profit potential) of a new venture before making substantial time and capital commitments. An appropriate secondary purpose may be to use a business plan as a partial guide to organizing a firm's resources.

The results of this study showed that, of the INC 500 firms surveyed, fewer companies used business plans than would have been expected based on the majority of the small business literature. In fact, 50 percent of the successful businesses had no formal written plan, 32.5 percent generated a partial plan, and only 17.5 percent completed a formal plan. Another part of the study focused on examining the relationship between business plan preparation and profitability. Although the profitability of the firms in this study was examined for only one year, the results were still striking: the percentage of firms with financial losses was lower for firms without plans than for those with complete plans. Several variables were examined to try to explain this study outcome. Only the firm size variable produced patterns that might suggest reasons for the unexpected results.

Additional research in the area is definitely needed. A limitation of the current study was that entrepreneurs who developed business plans were not asked why plans were developed or the degree to which the plans were used. The assumption throughout the study was that developed plans influenced profitability.

Future research could also investigate the rigidity issue. It could well be that start-up business plans written by some entrepreneurs are implemented (followed) with little, if any changes, even though the environment has changed or is different than originally perceived. And this may be particularly true for larger versus very small new ventures. A negative side of the formal business plan is that it can lead to rigidity in a business unless the CEO is constantly anticipating and adjusting (planning). Business plans should complement planning, they are not a substitute for it.

We believe it is important for researchers to identify the characteristics that relate plans to profitability so that practitioners and counselors can be more effective in reducing start-up losses. Perhaps, when entrepreneurs stubbornly refuse advice to create a formal business plan, they know something their advisors don't.

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