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## Do Formal Business Plans Really Matter? – An Exploratory Study of Small Business Owners in Australia

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### Abstract

*This exploratory study examines the findings of a survey of small business owners in Australia, their use of formal business planning and its relationship to business performance. While the use of formal business plans is widely considered to be a positive for small business management, previous research has been equivocal on the relationship between use of such plans and profitability. This study used a statistical analysis to examine the relationship between use of formal business plans and business performance and character. The findings suggest that possession of a formal business plan was significantly associated with higher gross revenues and growth in sales. A discriminant analysis found twelve variables that differentiated firms with formal plans from those without. These provide insight into the nature of formal planning within small firms. However, the issue remains as to whether the plan is responsible for the growth or the growth responsible for the plan.*

### Introduction

The role of formal planning within small to medium enterprises (SMEs) is a somewhat contentious issue. By its nature formal business planning requires organization, analysis, discipline and a willingness to make a commitment (at least to paper) of a particular course of action in a given direction. All these elements are commonly found within the average small business owner-manager, with the possible exception of the commitment to writing

down the plan. Despite formal business plans being viewed by most banks and enterprise development agencies as vital to success, it is more common to find small business owners without a formal plan than with one (Unni, 1984). A survey of 500 small businesses in the United States during the mid-1990s found that fewer than 42 per cent possessed a formal business plan (*Managing Office Technology*, 1994). It has been argued that small business owner-managers do not plan because they lack the knowledge, confidence or skills to do so (Posner, 1985).

Academic interest in formal planning within the small business has been motivated by evidence from larger firms that formal planning is associated with successful performance (Ansoff, 1965). While the lack of formal planning within small firms is recognised, the importance of strategic awareness and personal commitment from the owner-manager is viewed as having the potential to serve as a counterweight (Gibb and Scott, 1985). Advocacy of formal planning is strong among business management academics who tend to emphasise the importance of written mission statements and clearly articulated vision (Holt, 1999). Unfortunately the research evidence for a clear link between formal business planning and enhanced financial or market performance has been equivocal (Kargar, 1996). This paper examines the past research evidence relating to the benefits of formal planning within SMEs and offers the findings of a survey of Australian small businesses that suggests formal plans may be associated

with superior performance. The study defines 'formal planning' as involving the possession within the firm of a formal written business plan. This distinguishes it from 'informal planning' where owner-managers can plan intuitively but not commit their ideas to paper.

### **Literature Review**

Formal business planning within SMEs is frequently associated with a process whereby the owner-manager(s) of the firm systematically attempt to examine their business environment and establish a framework and direction for future activities. Several elements frequently encompass such a process. The first of these is the preparation of a mission statement, examination of the current situation facing the business and forecasts for future growth. The establishment of objectives and strategies to meet them follows this. These elements must then be documented for internal and external stakeholders and a monitoring-evaluation process established (Linder and Vick, 1984). Also of importance is the owner-manager's own personal objectives and the ability to learn from any past successes or mistakes (Howard and Emery, 1985). Finding the best 'fit' between mission, opportunities and firm capabilities is frequently a major challenge for small business owner-managers (Bryan, 1998). External consultants such as Accountants or Business Advisors can assist effective business planning within SMEs, but it is the owner-manager who must take ultimate responsibility for the plan and its implementation (Bracker and Pearson, 1985).

Small business owner-managers have been found to have a less sophisticated approach to formal business planning than their counterparts in larger firms. This is generally related to a lower level of systematic data gathering or statistical analysis. However, owner-managers are

strategically aware and realize the consequences of their decision (Rice, 1983). Castrogiovanni (1996) has suggested that a lack of formal business planning among SMEs, particularly start-ups, may contribute to higher failure rates. However, the evidence for causation is weak.

The benefit of formal planning to small business performance has been debated within the academic literature throughout the past twenty years. Some have argued that formal strategic planning is more appropriate within larger firms and of limited benefit to the financial performance of small business (Robinson and Pearce, 1984). The empirical evidence to support the case for formal planning having a benefit to SMEs has been both inconsistent and contradictory (Pearce, Freeman and Robinson, 1987). Schwenk and Schrader's (1993) examination of 14 research studies relating to formal strategic planning and performance in small business was unable to offer conclusive support to the benefits of such planning to SMEs, however it did reject the notion that it was appropriate only to large firms.

Empirical studies of SME performance and the relationship with formal planning suggest that such plans may make a difference although the precise nature of the link between the two is poorly defined. A study of 51 small firms by Robinson, Pearce, Vozikis and Mescon (1984) found formal planning to be beneficial to business performance regardless of the growth stage in which the business found itself. Start-up firms tended to be more profitable if the owners engaged in formal planning. Firms engaged in growth stages were likely to benefit from higher sales growth if they conducted formal planning.

A further study by Olson and Bokor (1995) of 442 small start-up firms supported the case for formal planning enhancing business performance although this was

found to be context dependent. Characteristics of the owner-managers – prior management experience or previous work history – were found to be significant. Sexton and Van Auken (1985) undertook a longitudinal study of 357 small firms in Texas over a four-year period. They found formal planning was conducted by only a relatively small number of firms and concluded that adoption of systematic planning might not take place unless a strategic-planning orientation was adopted. Failure rates among firms with high-levels of formalized planning were significantly lower than among firms that had little or no formal planning.

Ackelsberg and Arlow (1985) examined 135 small firms in the United States within different industries. Their findings supported a relationship between formal planning and enhanced sales and profitability, although the influence of economic environmental factors was noted, as was the importance of analysis within the planning process. Orphen (1985) who used a daily diary study to track the planning activities of 58 senior managers from small companies identified similar findings. He found a greater level of formal planning behaviour among higher performing firms who also displayed more depth of analysis and longer-term forecasting.

Berman, Gordon and Sussman (1997) investigated the relationship between small business performance and the level of sophistication within the planning process. They classified the level of planning into four categories – crisis management, planning through the budget, long-range planning and strategic planning – each becoming increasingly more sophisticated. Drawing on a sample of 161 small businesses they concluded that enhanced financial performance was associated with formal planning. Further the level of

sophisticated planning among small businesses was low.

Matthews and Scott (1995), in a study of 130 small firms, examined the degree of sophistication of planning within the company and its relationship to business performance. They compared growth oriented 'entrepreneurial' firms with small businesses within the context of environmental uncertainty. Their findings suggest that 'entrepreneurial' firms were more likely to engage in sophisticated strategic and operational planning than other small businesses. However, both types of firm experienced a decline in the sophistication of their planning as the level of environmental uncertainty increased. This suggests that 'crisis management' becomes more common when owner-managers are faced with external environmental challenges.

Lyles, Baird, Orris and Kuratko (1993) examined 188 small firms and compared performance against the level of sophistication in the planning undertaken. Their findings indicated a significant difference between formal and non-formal planners with higher growth rates found among formal planners, even though the relationship between planning and financial performance was weak. Their findings supported previous research by Robinson and Pearce (1983) who also found no significant relationship between financial performance and planning within the small business, but a significant enhancement in growth rates among formal planners'. It raises the question, initially mooted by Bracker and Pearson (1986), as to whether it is the plan or the process of planning that is important in determining small business performance.

Rue and Ibrahim (1998) who examined the performance of 253 small businesses further highlighted that planning is a key issue in small business success. Their findings show that greater sophistication in

planning behaviour is associated with growth in sales. Further, they indicate a moderately significant relationship between planning and perceived performance relative to the industry but no significant relationship was found with respect to financial performance.

O'Gorman and Doran (1999) conducted a survey of 115 small businesses examining the nature of the planning task with respect to the value of mission statements. They identified those firms that had a written mission statement and those who did not, and compared this with company performance. Their results suggested no positive correlation between the possession of a formal mission statement and business performance.

Mazzarol and Ramaseshan (1998) who surveyed 113 small Australian firms have also examined the benefits of formal marketing plans to small business performance. A significant association was found between small firm performance and formalization in the marketing process. A further study by Ennis (1998) of small technology firms in Ireland also examined marketing planning in SMEs. Adopting a case study methodology the research indicated that planning processes within small firms are more pragmatic and less likely to cleanly fit the prescriptive models recommended by academic management principles.

These studies suggest that a relationship between small business performance and formal business planning does exist but that it may be difficult to clearly identify the linkage between the two. Contextual issues such as the background of the owner-manager, the industry to which the firm belongs or external environmental factors might all impact on the relationship. Formal planning also appears more strongly associated with growth – particularly sales growth – than profitability or return on investment.

## **Methodology**

This study is part of a long-term examination of the factors influencing growth in small businesses. It draws upon the findings of a small-scale qualitative study undertaken by Hall (1992) of high-growth SMEs in the United Kingdom. This study identified six key dimensions common to these high growth firms - 1) focus/direction, 2) customerising, 3) partnering, 4) personality, 5) quality and 6) systems. The first of these relates to the vision and mission of the firm, and the second to marketing and customer servicing issues translating broadly into the concept of 'customer delight' (exceeding expectations). The issue of partnering involves developing working relationships with customers, suppliers, employees and other stakeholders (eg. banks, accountants and industry associations). 'Personality' relates to organisational culture, but focuses more on the owner-manager's personality with which the small business culture is closely aligned. The 'quality' dimension concerns formal quality assurance process and 'systems' involves the development within the firm of systems (eg. financial control, information databases) to make the growth process work.

In order to examine the nature of these dimensions in a quantitative manner a questionnaire was prepared. This was based on Hall's (1992) initial framework, but included several performance measures relating to future growth intentions, levels of expenditure on training and marketing, and financial performance indicators in the form of gross income and profit figures for a four-year period. The six dimensions were measured within the questionnaire via 180 items with 5-point Likert rating scales designed to capture owner-manager responses. The questionnaire was piloted with a course of owner-managers undertaking a management development program.

## **Sampling**

An initial sampling frame of 500 small firms throughout Australia was identified and all were approached via letter seeking their willingness to participate in the research. This group was selected from among firms that had won small business awards as well as firms randomly selected from business databases. A total of 88 owner-managers agreed to participate and a questionnaire with covering letter was posted. A final useable sample of 55 survey forms was returned, providing a response rate of 62.5 per cent.

The final sample - while small - was drawn from a cross section of industry sectors of which manufacturing (24.5%) and retailing (23%) made up the largest. Just under half (48%) of the sample had fewer than 10 employees with only 10 per cent reporting more than 50 employees. The majority of respondents had been owner-managers within their firms for at least 6 to 10 years. Eight per cent had been operating their business for over 20 years, twenty-five per cent for over 10 years and thirty-three per cent for less than 5 years.

Respondent owner-managers were on average aged between 20 and 40 years with 47 per cent under 40 years. Levels of formal education among the respondents were low with only 10 per cent having proceeded beyond senior high school. Only 12 per cent of firms reported being engaged in exporting. A comparison of these demographics with the true population as measured by the five-year census suggests that while small the sample was representative of small businesses within Australia (ABS, 1998).

## **Analysis and Results**

During an earlier study the findings of this survey were examined using a principal component analysis that confirmed the validity of the initial six dimensions

identified by Hall (1992). This identified 39 factors within the six main dimensions. These were subsequently developed into derived 'factor variables' for later analysis. Also undertaken in this earlier study was a discriminant analysis that identified the importance to growth in sales of elements from the 'Systems', 'Quality', 'Custom-erising' and 'Partnering' dimensions (Mazzarol, 1999).

To examine the nature of formal business planning and small firm characteristics in this current study a discriminant analysis was undertaken. This type of analysis is useful for predicting group membership and used where a dependent variable is categorical and the independent variables interval or ratio data (Holbert and Speece, 1993). The dependent variable for this analysis was a question item asking whether or not the respondents possess a formal business plan? Approximately half the group (51%) indicated that they possessed a formal business plan. It was therefore possible to create a dichotomous dependent variable on the basis of this item for use in the subsequent analysis.

A stepwise discriminant analysis was used to examine the proposition that the characteristics of small firms with formal business plans would be significantly different from those without them. Sixty-five independent variables were used in the analysis. These included both ratio and interval data covering the six dimensions of business performance mentioned above. They also included variables relating to profit, annual turnover, expenditure on training and marketing, number of employees, owners age, owner's education, length of time in business, number of managers with formal training and future intentions some of which were categorical variables. Prior to analysis some of the variables were subject to a mean substitution process. Although this process can impact adversely on the true variance of the data, the risk of this compromising the data was considered low. Further, due

to the small size of the sample exclusion of whole cases was undesirable. As a result 53 out of the 55 cases were used in the final analysis with some of the independent variables missing values replaced with the series mean.

F statistics were computed from the relevant Mahalanobis distance measures to determine whether or not the two groups were significantly different to each other. Initial solutions found only for size with larger firms being more likely to have a formal plan than smaller ones. It was therefore necessary to control for this variable. A solution was produced after seventeen-steps with both groups found to be significantly different at least at the 0.05 per cent level.

A single discriminant function differentiating the two groups was found with an Eigenvalue greater than 1. Twelve variables were found to be significant within the model. Table 1 shows the results of this analysis. As shown there were eight positive and four negative variables in the final model. These were drawn from the initial 65 independent variables and indicate different aspects of the nature of formal versus informal planners. Those variables with a positive coefficient indicate that this characteristic is likely to be increasingly stronger among firms with formal business plans than among firms without. The variables with negative coefficients are by contrast likely to be characteristics increasingly less strong among formal planners.

**Table 1: Results of Discriminant Analysis**

<u>Variables in final model</u>	<u>Coefficients</u>	<u>Wilks' Lamda</u>	<u>Min D<sup>2</sup></u>	<u>Signif</u>
1. Number of managers with formal qualifications	3.417	0.468	4.15	0.0005
2. 'Core Skills' (possession of skills within firm)	4.487	0.049	71.19	0.0000
3. 'Customer Delight' (ability to delight customer)	5.811	0.378	6.01	0.0003
4. 'Structure = Strategy' (firm to market synergy)	-2.320	0.016	217.50	0.0000
5. Level of 'Customer Loyalty' (repeat business)	-1.171	0.012	306.42	0.0000
6. 'Supplier Focused' (work closely with suppliers)	5.171	0.576	2.692	0.0008
7. Use support network (use experts & family)	4.417	0.188	15.837	0.0000
8. 'Values Planning' (owner's values in planning)	-2.552	0.310	8.156	0.0002
9. 'Value Added' (adding value to product/service)	4.094	0.124	25.742	0.0000
10. 'Action Culture' (firm takes action if needed)	-2.813	0.087	38.551	0.0000
11. Size of firm's annual turnover	1.833	0.027	133.019	0.0000
12. Firms' engagement in exporting	5.201	0.242	11.443	0.0001

The goodness of fit statistics for this model is shown in Table 2. It can be seen that the model correctly classified 75.5 per cent of cases. This suggests that the model fits the data quite well and may be used for further analysis.

**Table 2: Goodness of Fit for the Model**

<u>Group membership</u>	<u>cases</u>	<u>Group 1</u>	<u>Group 2</u>
Has a formal written business plan	27	21 (77.8%)	6 (22.2%)
Has no formal written business plan	26 (53)	7 (26.9%)	19 (73.1%)
Percentage correctly classified:	75.5%		

Before discussing the findings, a brief description of the twelve variables in the model is appropriate in order to understand the significance of the results:

- 1. Number of managers with formal qualifications** - this ratio variable measured the level of managerial education existing within the firm. Firm's with formal business plans were found to have a higher number of managers with formal education (mean = 2.72) as compared with the firms without formal plans (mean = 0.76). A *t*-test (2-tailed) of the differences between these means found it significant at the 0.05 level.
- 2. Core skills possession** – this item was a factor variable derived from the initial principal component analysis undertaken in the earlier study. It is drawn from the 'Focus/Direction' dimension initially identified in Hall's (1992) work, and is measured by six items relating to the owner-manager's ability to measure their possession of 'core' or critical skills, abilities and

resources needed to maintain the business over the long term.

- 3. Level of Customer Delight** - this factor variable came from the 'Customerising' dimension. Six items relating to the ability of the business to meet and exceed customer expectations measure it. A firm with high levels of customer delight should be able to repeatedly exceed their customers' expectations resulting in repeat business and positive word of mouth referral.
- 4. Structure = Strategy** – this factor variable came from the 'Partnering' dimension and is measured by three items relating to the link between business organisation (how it is structured) and the strategy it is adopting (product or market focus). Firms with high levels of 'structure = strategy' will have organisational structures that are aligned with the needs of their strategic positioning within their markets. The roles undertaken by employees and their function within the business will have been designed to maximise the company's ability to exploit its markets.
- 5. Customer Loyalty** – this factor variable is also drawn from the 'Partnering' dimension. It is measured by three items that deal with the level of repeat business enjoyed by the firm. High levels of customer loyalty will result in the firm obtaining most of its business from repeat, loyal customers.
- 6. Supplier Focus** – is a factor variable also drawn from the 'Partnering' dimension. It is comprised of three items measuring the level of attention given to working closely with suppliers. Firms with high levels of supplier focus will seek to develop mutually beneficial relationships with



their suppliers and may even configure their organisation to assist their suppliers to achieve mutual objectives.

7. **Use of a support network** - this factor variable is drawn from the 'Partnering' dimension. It is measured by two items relating to the level of use the owner-manager makes of their support network particularly in the area of family and expert advisers.
8. **Values planning** - this factor variable is drawn from the 'Personality' dimension. Two items relating to the role the owner's personal values play in business planning measure it. Firms with high levels of values planning are likely to have their owner-manager's personal values strongly influence the business plans they develop.
9. **Value Added** - this factor variable is drawn from the 'Quality' dimension. Four items relating to the firm's ability to add value to its product or service measure it. Firms with high levels of 'value added' will be seeking to improve or develop their products or services and may invest more in research and development.
10. **Action Culture** - this factor variable was drawn from the 'Systems' dimension. Measured by three items it relates to how the firm's culture is focused on taking action when the need to do so arises. Firms with high levels of 'action culture' will tend to operate independently of their owner-managers in reacting to the changes they perceive within the external environment.
11. **Annual turnover** - this variable measured the annual average turnover for the firm over a four-year period using a ratio scale. Among the 54 firms in the sample average gross sales revenues over the four-year period measured by the survey ranged from

\$31,500 to \$27.8 million. Average growth over four years in sales turnover among the sample was \$1.03 million with a range from -\$1.2 million to \$4.7 million. A series of *t*-tests (2-tailed) were used to identify any significant differences between the two groups in terms of these sales revenue figures. These found a statistically significant difference between the firms with a formal plan and those without on these financial measures. Table 3 shows the results.

12. **Engagement in export activity** - this categorical variable was a question in the survey that simply asked whether or not the firm was engaged in export activity or planned to do so in the next three years. Chi-square (Pearson) tests of the relationship between export activity and possession of a formal business plan were not significant at the 0.05 level. Most exporting firms lacked plans and the number of firms with plans who engaged in exporting was equal to those who did not.

As shown in Table 3, the firms with a formal plan were experiencing significantly higher levels of sales and sales growth than those who had no formal plans. However, as can also be seen, the differences in profits over the same period were not found to be significant at least at the 0.05 level.

### **Business Planning and Other Firm Characteristics**

Following this discriminant analysis further examination was made of the relationship between possession of a formal business plan and individual variables relating to financial performance and other demographic characteristics of the businesses in the sample. This was undertaken as a means of identifying the influences of any industry or size characteristics. Chi-square tests found no

significant relationship between firm possession of formal business plans and such variables as industry, length of time in business, age of owner-manager or level of education of owner. A significant relationship (at the 0.05 level) was found between possession of plans and number of

employees. Possession of a formal business plan increased substantially with firm size. Firms with less than 5 employees were significantly less likely to have a written plan than firms with 10 or more employees.

**Table 3: Formal Planning and Financial Performance**

<u>Financial Performance indicators</u>	<u>Have a Plan</u> (mean)	<u>Have no Plan</u> (mean)	<u>t-score</u>	<u>significance</u>
Average gross sales revenues over 4-year period	\$3.7m	\$872,000	2.442	0.022
Average growth in sales revenues over 4 years	\$1.6m	\$514,000	2.474	0.020
Average annual profit over 4-year period	\$120,941	\$59,867	0.850	0.405

**Discussion of the Findings**

These findings support earlier research indicating the importance of firm size to formal planning within the business. The larger the firm becomes the more likely it will undertake formal business planning processes. While significant relationships were found between firm size (e.g. employees, turnover) and planning, the study offers no clear evidence of a causal relationship between small business profitability and the possession of formal business plans. The discriminant analysis suggests that firms with formal plans may be classified by some of the characteristics measured by the twelve variables identified in the model. In interpreting these findings two perspectives can be adopted. The first is that formal planning has an impact on the firm resulting in some of the characteristics described in the discriminant model. This argument is a ‘practice follows planning’ view. The

second perspective is that the firm characteristics come first leading eventually to formal planning. This is a ‘practice precedes planning’ view.

The question as to which of these views is correct cannot be answered by the findings of this research. However the possible direction of the debate can be examined with reflection on the twelve characteristics found in the discriminant analysis model.

It is worth noting that of these twelve variables four had negative coefficients and the remainder were positive suggesting weakening or strengthening tendencies in these characteristics among formal planners.

In the first positive case the number of management personnel with formal management qualifications increases substantially with the size of the firm.

Increasing firm size in terms of numbers of customers, employees and operations will eventually compel the owner-manager to recruit professional managers to assist them to run the business. Further, as most management education places high emphasis on formal planning it should come as little surprise to find significant associations between the number of professionally educated managers within a firm and the existence of a business plan. This would support the practice precedes planning model as the business may take on management teams and commences formal planning processes leading to formal documented plans.

The positive nature of 'core skills' within the model is somewhat more difficult to explain. This variable suggests that the owner-manager has considered whether their business has all the necessary skills, resources and assets needed to ensure ongoing operations. It is likely that a formal planning process would require the owner-manager to consider this issue. Most business plans address the concept of SWOT analysis (strengths, weaknesses, opportunities and threats) that encourages the firm to consider what core skills it has, what it needs and what capabilities these core skills offer the firm.

'Customer Delight' was also found to have a positive coefficient. This dimension is a measure of the level of perceived ability within the firm to meet and exceed customer expectations on product or service delivery. Why it should be a characteristic of formal planners is unclear. The model suggests that this dimension may work in conjunction with the others to describe the overall nature of the formal planning firms. Its presence in the model is possibly explained in relation to the other items. An examination of the relationship between the items was undertaken using a Pearson correlation test. 'Customer Delight' was significantly correlated (at the 0.05 level) with the variables 'core skills',

'customer loyalty', 'value added' and 'action culture'.

'Structure = Strategy' and 'Customer Loyalty' were both found to have negative coefficients. The first of these variables relates to the alignment achieved between the firm's organisational structure and its market. It is correlated closely with 'customer focus', which is a measure of the firm's market orientation. The second is a measure of the firm's ability to generate repeat business. This item is significantly correlated with 'customer delight'. One possible explanation for the presence of the first item in the model is that firms that engage in formal planning might begin to formalise the organisation's structure. This may thereby make it less flexible than might be the case were the owner-manager able to intuitively adjust his/her organisational structure to the needs of the market. The negative nature of 'Customer Loyalty' may suggest that as the firm adopts formal planning processes it may see itself with less need to rely upon repeat business from loyal customers, opting instead for a more systematic monitoring of 'Customer Delight'.

The next two items 'Supplier Focus' and 'Use of Support Networks' are closely correlated (as measured at the 0.05 level using Pearson's correlation coefficient). The relationship between levels of supplier focus, use of support networks and formal planning might be explained in terms of the influence that such networks are likely to have on small business owners. Suppliers, for example, may be larger firms – particularly in the case of retailers and manufacturers – who will require their customers to demonstrate 'good business practice'. Support networks, comprising accountants, bank managers and business development advisors, are also likely to encourage formal planning as 'good business practice'. As firm size increases so does the demand for external financing and assistance from expert advisors. Bank

managers, accountants and small business development agencies are all likely to either encourage or even insist upon formal written business plans.

The negative coefficient of '**Values planning**' is also of interest. This is a measure of the role the owner-manager's personal values play in business planning. This is not concerned simply with formal written plans but the general process of planning. Owner-managers with good 'intuitive planning' skills could be expected to engage in more 'values planning' than their counterparts who undertake formal planning practice. A feature of formal planning practice is its ability to reduce the influence of individual owner-managers by instituting objective measures aimed at controlling for such personality factors. Modern management practice is concerned with introducing universal systems capable of application to all businesses. These practices do not encourage the kind of individual influences within the planning process that are engendered by the variable 'values planning'.

By comparison the item '**Value Added**' had a positive coefficient. This suggests that a characteristic of formal planners may be a tendency to also seek value adding in products and services. Perhaps not surprisingly this variable is significantly correlated (at the 0.05 level) with 'core skills', 'customer delight', 'customer loyalty', and '**Action culture**'. This last variable had a negative coefficient within the model, but was itself correlated with the items mentioned as well as 'structure = strategy'. A tentative interpretation of these findings may be that formal planning encourages value adding, or alternatively that attempts to improve products and services encourage formal planning. New product development processes can involve complex and expensive activities for which support from professional managers, advisors or financial suppliers is

required. This is likely to lead to the creation of formal business planning.

The last two items – **annual turnover** and **exporting** – are somewhat easier to explain within the model. As shown in Table 3 the larger the firm's annual sales the more likely it had a formal business plan. Increasing size of turnover is usually associated with increased employment levels, scale of operations and complexity of customer and supplier relationships. All these elements are likely to combine to encourage a process of formal planning within the firm. Further, as scale and scope increase the hiring of professionally educated managers or use of expert advisors is likely to grow. It has already been noted that this exposure to professional management practice is likely to encourage formal planning as 'good business practice'. The relationship with exporting is less clear although the process of export frequently leads both to increasing sales revenue and the need to seek expert or professional advice.

These findings provide evidence for both the 'practice follows planning' and 'practice precedes planning' perspectives. In the first instance the growth of a small firm is likely to bring the owner-manager into contact with the formal planning advocates. However, once an owner-manager embraces this network and their ideas he/she may be inclined to adopt a formal planning orientation. Many small business owners do not prepare formal business plans until they are encouraged to do so by external influences. The provision of formal management education to small business owner-managers is also likely to lead to the adoption of formal plans due to the strong emphasis that management educators place upon them.

Unfortunately this emphasis on formal planning ignores the lack of evidence of a strong casual link between formal plans and performance. Successful small

business owner-managers do not require formal-written plans to achieve success. If they possess a clear sense of direction, maintain close relations with their customers and monitor their business performance via use of key data they can achieve successful performance and early growth. Whether a business can grow beyond a certain size lacking a formal business plan is problematic; however a case might be put that in small firms the lack of a formal business plan is not by itself critical. A distinction should also be made between formal plans and the process of planning. Many small business owners do not commit their ideas to paper, but they nevertheless engage in planning. This 'intuitive planning' is pragmatic and often highly flexible in the face of opportunity or threats.

### **Conclusion and Implications for Management and Research**

The results of this study suggest that possession of formal business plans is difficult to relate to small business characteristics with the exception of size. It is unlikely that the possession of a written business plan will – by itself – cause harm, but it is also unlikely to be essential to success, at least in the very small firm. Formal business plans can be useful in assisting the owner-manager to 'communicate' with or 'sell' their ideas to external professional networks (e.g. accountants, bankers) and may also assist in enhancing relationships with suppliers. Overall the process of planning rather than the plan itself is likely to be more important to small business performance. Expert networks and management education can assist firms to develop formal planning processes although the existence of a written business plan should not be viewed as an indicator of success. As noted in the literature, contextual issues need to be examined.

This research is highly exploratory and does not attempt to be prescriptive in its findings. Sample size and a lack of additional information to fully explain the nature of the discriminant model limit the study. Future research should explore the nature of the planning process within the small business perhaps making use of a case-study methodology to examine these findings in greater depth. It does suggest that the relationship between adoption of formal business plans and small business performance is highly complex and requires consideration of more than financial performance measures alone. Particular attention should be given to the interplay of forces – some related to the business and some to the owner-manager – that predict or create formal business planning. Finally, the causal relationship between formal planning and small business performance continues to remain obscure. Future research may wish to concentrate on the nature of 'intuitive' versus 'formal' planning within small firms, controlling for such variables as size and industry. It is likely that successful performance can be achieved through informal planning where the owner-manager is a competent 'intuitive' planner.

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