

**C.C.S.B.E. 19th Annual Conference
2002, Halifax, N.S.**

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BUSINESS PLANNING IN EARLY STAGE SMALL ENTERPRISES: RESULTS FROM A LONGITUDINAL STUDY¹

This article reports on the results of an empirical study into the nature and role of business planning within the new venture. In order to explore the benefits of business planning and compare the experiences of surviving versus failed businesses, the authors analyzed 327 micro-enterprises launched during the 1997-1999 period. As postulated, there was no direct association between early stage planning and survival/failure during the company's first three years. While the learning and efficiency benefits of the business plan were quite high, these benefits were not directly associated with survival/failure.

The impact of the business plan in terms of helping the entrepreneur both to learn more about managing his/her business and organize the business more efficiently was significantly higher when i) the plan incorporated a market research component or ii) had been prepared with the intent of being used to guide decision-making.

Introduction

This paper explores the business planning/new venture relationship within the context of a three-year research project designed to respond to the need for longitudinal studies of small enterprises (Chandler and Hanks, 1994; Krueger et al., 2000; Lussier, 1996). Using a sample of 327 start-up businesses located in Northeastern Ontario, the current study examines the linkage between pre-start planning and survival and evaluates the role of the business plan in helping the startup entrepreneur learn more about managing his/her business and organize the business more efficiently. We also evaluate the impact of the motivation for the plan, comparing situations where the business planning effort is driven by the need to produce a document for a prospective lender to those where this motivation is attributable to the entrepreneur's desire to compile a guide for the future direction of the enterprise.

¹Acknowledgements: The researchers are indebted to FedNor (Industry Canada's Federal economic development agency for Northern Ontario) for its research funding support, and to Julie Henri for her administrative assistance.

Business Planning in the Small Firm

The entrepreneur is often described as a high-energy individualist, with a penchant for action and a 'seize the opportunity' mindset. This popular profile contrasts with the commitment to research and analysis required to prepare the typical business plan. These small business operators rarely see the value in conducting a detailed review of their industry or competitors, particularly when market conditions are fluid and their proprietary advantage promises to be short-lived (Bhide, 1994). However, the undue haste with which many new ventures are initiated (ostensibly in the interests of pre-empting competitive reaction) often necessitates moving ahead without adequate resources or a well-conceived blueprint for decision-making. Moreover, intuition can mislead small firm managers, for instance, on the question of how to best deal with competitive pressures and environmental conditions (Covin and Covin, 1990).

The business plan can serve as a valuable guide for future business decisions, providing the framework for a wide range of critical activities, including the identification and costing of alternative promotional strategies, and the assessment of mechanisms for controlling product or service quality. However, once the enterprise is in operating mode, the uninterrupted time required for these activities becomes a very scarce commodity.

Nonetheless, it can be difficult to delineate the role of the business plan. For instance, besides discussing the importance of planning processes, Sandberg and Hofer (1987) highlighted the development of managerial skills and the characteristics of the entrepreneur as key determinants of business success. In addition, while some studies have found business planning to be a factor in small business success (Bracker et al., 1988, Hillidge, 1990; Schwenk and Shrader, 1993), other research has indicated that formal planning is not necessarily effective for small businesses (Lumpkin et al., 1998; Leontiades and Tezel 1980). Lussier (1996) identified 12 studies of small businesses in which planning was found to have been associated with success (defined as above average profits), compared to only three studies in which the business plan did not emerge as a relevant factor. In a larger review of 60 previous studies (Shrader et al., 1984), a definitive connection between planning and performance could not be found.

Furthermore, the effect of the business plan on performance may be moderated by industry conditions (Shrader et al., 1984), the stage of development of the enterprise (Schwenk and Shrader, 1993; Frese et al., 2000) and/or the plan's degree of sophistication (Rue and Ibrahim, 1998; Frese et al., 2000).

Other researchers have expressed the view that business planning does not have a direct effect on business outcomes, but rather enables the business to develop in a way that enhances its prospects for success (Castrogiovanni, 1996; Ramanujam and Venkatraman, 1987). In undertaking to develop a formal plan, the entrepreneur is engaging in a structured learning process that leads to a better understanding of the product, market, and operational requirements of the proposed business. From a cognitive perspective, individuals are using the business planning process to select information from the environment and construct a cognitive map that later acts as a guide for decisions and behaviours. Over time, this cognitive map is adjusted as new sources of information and experience are accessed, so that beyond the pre-startup phase, there is an iterative learning process, which helps the owner-manager adjust the business according to changing circumstances.

In addition, in developing the ability to articulate fully the business concept, the entrepreneur is able to persuade the financial lender of the worthiness of the proposed enterprise (Castrogiovanni, 1996).

Measuring Small Business Performance

Given the absence of clear benchmarks for evaluating performance levels, the measurement of small firm performance is a complex area (Dollinger, 1984; Keats & Bracker,

1988). These uncertainties are particularly acute when evaluating new ventures, insofar as their small initial base of sales and assets tends to produce erratic growth rates in the early years. A variety of financial measures have been utilized to gauge small business success: sales volume (Boyle & Desai, 1991; Chandler & Hanks, 1994; Rue and Ibrahim, 1998), profit levels (Birley and Westhead, 1990; Shrader et al., 1989), number of employees (Birley and Westhead, 1990; Shrader et al., 1989), and increases in market share (Sexton, 1986). Nonetheless, the dearth of publicly available financial data and the inability and/or unwillingness of small business owners to share financial data represent significant impediments to the gathering of reliable data.

It should also be recognized that the issue of small business performance may be considered from two different perspectives: survival and success. Obviously, a venture fails when it ceases to exist as an economic entity; thus, survival is an absolute measure of venture performance that depends on the ability of the enterprise to continue to operate as a self-sustaining economic entity (Barney, 1986). Success, by contrast, is a relative measure of business performance manifested in the ability of the venture to create value in an economically efficient manner (Coyne, 1986). However, as already noted, use of the latter approach introduces various measurement complexities; in addition, successful firms must first *survive* their startup phase - a daunting task, given the high attrition rates experienced by new ventures.

Accordingly, with the focus of this study being early stage performance, survival and failure is employed as the measurement base. We have categorized the sample businesses into survivors (i.e. three years after startup) and failures (anytime during this three year time frame).

Research Propositions

The paper's first proposition is based on the premise that "Business survival, profitability, or other performance outcomes do not result directly from pre-startup planning" (Castrogiovanni, 1996, p. 803).

P1: Early-stage business planning is not directly linked to new venture survival

The next two propositions draw on Castrogiovanni's beliefs that the learning and efficiency aspects of the business plan are each associated with a higher probability of survival. Learning occurs through the business planning process insofar as the founder is obliged to conduct an in-depth investigation of competitors, customer segments, requisite resources, labour requirements, health and safety regulations, and sundry other issues that together will define the business. At the same time the business plan can be expected to produce a set of operating procedures, such as invoicing systems, price lists and performance review protocols. (It is also expected that these learning and efficiency benefits will be positively associated).

P2a: There is a positive association between the 'learning' aspects of the business plan and new venture survival.

P2b: There is a positive association between the 'efficiency' aspects of the business plan and new venture survival.

As we turn to an assessment of i) the impact of business plan complexity and ii) motivational forces, the remaining propositions will not differentiate between surviving and failed businesses. The rationale for P3a and P3b is that evidence of market research can help differentiate between simplistic and more advanced plans.

P3a: *The learning benefits of the business planning process will be higher in instances where the business plan includes a market research component.*

P3b: *The efficiency benefits of the business planning process will be higher in instances where the business plan includes a market research component.*

According to the principles of adult learning, the learning/planning process will be effective when the entrepreneur is highly motivated and sees the relevance of the tasks (DeSimone and Harris, 1998, p. 77). It is reasonable to expect that a business plan prepared for the sole purpose of obtaining outside financing will be associated with high motivation (wants the funds), but low relevance (not useful in developing the business concept). In this case, we would predict a low level of learning. Alternatively, if the business plan is perceived as an aid in decision-making, both the motivation and the relevance should be high, resulting in a high level of learning. Hence the final propositions:

P4a: *The learning benefits of the business planning process will be lower in instances where the business plan is assembled primarily to satisfy requirements for financing.*

P4b: *The efficiency benefits of the business planning process will be lower in instances where the business plan is assembled primarily to satisfy requirements for financing.*

Methodology

Data Collection

As described below, this research effort called for the tracking three separate cohorts of small businesses - 1997, 1998, and 1999 startups –during their first three years of operation.

The project began with a pilot study of 31 local firms; this process facilitated the revision or elimination of any items which the respondents had difficulty interpreting. Subsequently, in late 1997, a mailing list of 358 business start-ups was compiled with the help of 14 government agencies based throughout Northeastern Ontario. The initial contact with potential participants (business owners) was by telephone - if a successful contact could not be made after three attempts, the business was deleted from the list. Following confirmation that the business was registered in 1997, a 70-item questionnaire was faxed to the company (note that only a section of the questionnaire is reported in this article).

After deleting those background questions applicable to only the start-up year, the survey was administered one year later and again two years later. Thus, data on the first cohort was gathered for three consecutive years. A similar three-year process was followed for cohorts 2 and 3 (i.e. ventures that were registered in 1998 and 1999, respectively).

This longitudinal research design facilitates an intensive examination of business planning within the emerging small business. The use of multiple cohorts allows for the separation of age, period and cohort effects, while multiple panels (repeated measures for each cohort) significantly increases the statistical efficiency (due to less sampling error) in comparing changes from period to period (Simon 1977). In addition, a longitudinal study will yield a reliable (Everett and Watson, 1998), categorical performance indicator (i.e. survival or failure).

Survey Instrument

The questionnaire consisted of separate sections devoted to: *background information* (e.g. owner's age group, gender, education level, and previous business ownership), *finances*, utilization of the *small business support network* (both professional and government), *pre-start activities*, and *management practice*. Many of these questions utilised a '0 to 100' scale and were designed for repeated, regular measurements.

Using a list of different types of pre-start activities, the respondents indicated whether or not they had i) prepared a business plan or ii) conducted market research. The 'management' section of the questionnaire contained a series of follow-up items dealing with business planning:

- "Why did you put the business plan together?" [a) Prerequisite for financing; b) As a guide for the future direction of the business; c) Other reasons]
- "Who put the plan together?" [Myself and/or partners OR Outsiders]

The respondents were also asked to respond to the following two items using a 0-100 scale (0="completely disagree"; 100 = "completely agree")

- "The business plan helped me learn more about managing the business, developing targets, etc."
- "The business plan helped me to organize the business more efficiently"

Sample Size and Attrition

Table 1 traces the composition of the sample over the course of the study. Of the 358 business start-ups in the 1997 mailing list (Cohort 1), 108 completed the questionnaire in year 1. By the following year, there were 71 participants and in the third year only 38 firms continued to participate. By comparison, of the 409 businesses that comprised the mailing list for the second cohort, 111 initially completed the questionnaire; 74 of these enterprises continued to participate for a second year and 45 for a third year. This decline in participation levels occurred despite ongoing follow-up by the research team; some businesses no longer perceived involvement in the study as a priority and cited 'survey exhaustion,' while others lost interest as their degree of contact with the respective government agency declined. In total, as outlined in Table 1, there were 114 companies that both survived their first three years of operation and continued to participate, while another 66 were identified as business failures.

Table 1

Longitudinal Study Data Collection

Number of Respondents by Year of Operation				Failed Businesses
	Start-up year	Second Year	Third Year ('Survivors')	
Year of Start-up				
1997 (1 st cohort)	107	71	38	27
1998 (2 nd cohort)	111	74	45	21
1999 (3 rd cohort)	109	66	31	18
Totals	327	211	114	66

The retention level of 65 percent between the first and second years (211/327) is similar to the 60 percent rate reported by Gatewood, et al. (1995) and compares very favourably to the 33 percent retention reported by McCarthy, et al. (1990). For the third year of the study, the participation rate was 35 percent (114/327).

Results

Twenty percent of the owner-managers in this sample had previously owned a business and even though start-up funding is generally at very modest levels, 45 percent reported that they financed their business *entirely* from their own funds. Many of the businesses operate as self-employment ventures, and only a small minority conduct any business outside of the local region. The data presented in Table 2 indicates that the sample is dominated by micro-enterprises.

Table 2

Profile of Sample (Positive Response Rates)*

	1997 Cohort (n=107)	1998 Cohort (n=110)	1999 Cohort (n=110)
Category			
Sole Proprietorship	83%	81%	75%
Home-Based Business	66%	63%	59%
One-person Business	68%	65%	66%
Start-up Capital < \$10,000	57%	51%	52%
Business market confined to Northern Ontario	92%	91%	77%
	All Cohorts Combined		
Business Plan?	77% (252/327)		
Business Plan and Market Research?	52% (171/327)		

* Data is from start-up year

As detailed in Table 2, 252 of the study's 327 participants had prepared a business plan during the pre-startup period. Furthermore, most of those with business plans had also carried out some market research as part of their pre-launch activities. It is also important to point out that only 16 respondents had their plan prepared externally, suggesting that for this sample, the classic 'hands-on' entrepreneurial style may extend to the business planning process.

Interestingly, there were only five instances of a business plan being initiated in either the second or third year of operation. This finding contrasts with previous research, which suggests that the tendency to engage in business planning becomes more evident as the venture moves from the start-up to the operating stage (Shuman and Seeger, 1986).

In comparing the survivor group, (114 firms that were still in operation in their third year), to the failed firms (66 ventures that were confirmed as having failed during this period), a chi-square analysis revealed no significant difference ($p = .980$) in terms of the incidence of business plans. Thus, as postulated (P1), there is no connection between business planning and performance.

The analysis revealed no association between the type of business plan ('simple' versus 'sophisticated' as indicated by the presence or absence of market research) and survival or failure (chi-square = 1.051, $df = 1$, $p = .305$). Similarly, it was also determined that those firms with *no business plan* were no more likely to have failed (or survived) than were firms with a simple

business plan (chi-square = .422, df = 1, p=.516) or a more sophisticated plan (chi-square = .047, df = 1, p=.829).

During the startup year, there was a high level of agreement with both the learning (mean=70, s.d.=22.6, n=214) and efficiency (mean=71.1, s.d.=23.8, n:=216) aspects of the business plan; also, consistent with Castrogiovanni's (1996) model (which depicted a positive relationship between the learning gained by the entrepreneur from the planning process and the efficiency levels obtained through this same process), there was a very high level of correlation between these two scales (p=.000). In addition, when results for these two items were tabulated for the second year of operation, the means continued to be robust: 71.0 for the 'learning' scale (n=133) and 72.7 for the 'efficiency' scale (n=134). However, t-test comparisons of surviving and failed companies' mean scores on these items did not reveal any significant differences ("The plan helped me learn more about managing the business" [p=.566]; "The plan helped me to organize the business more efficiently" [p=.246]). Accordingly, neither P2a nor P2b are upheld.

The association between the complexity of the business plan and its learning benefits, as articulated in P3a, was significant (p<.05). In addition, as outlined in Table 3, the owner-managers of the firms that had conducted market research as part of the business plan also scored much higher on the 'efficiency' dimension of the plan (p<.01).

Table 3

Business Plan Benefits: Comparison of Types of Business Plans

Variable	Nature of Business Plan	Mean response (s.d.)	t-Statistic	p
<i>The plan helped me learn more about managing the business (P3a)</i>	No Market Research (n=58)	64.3 (24.0)	-2.320	.021
	Market Research Component (n=147)	72.3 (21.6)		
<i>The plan helped me organize the business more efficiently (P3b)</i>	No Market Research (n=60)	63.7 (24.8)	-2.895	.004
	Market Research Component (n=146)	74.2 (23.0)		

Table 4 depicts the results of an analysis of variance (ANOVA) between the reasons for preparing the business plan and the mean score for the aforementioned learning scale, across the three cohorts. The learning aspect of the business plan was significantly lower for the group that had prepared it only to meet financing requirements: a Scheffe multiple comparison analysis revealed that this group, i.e 'group 1,' scored significantly lower than both group 2, which had developed the plan as a decision-making guide (p<.05), and group 3 (p<.001). In the second year of operation, the differences between the means for group 1 (61.7) and group 3 (78.0) were significant (p<.05).

Table 4

ANOVA Results: Relationship between Reasons for the Business Plan and “Learning” Benefits

	First Year of Operation (F=10.067; p<.001)			Second Year of Operation (F= 5.040; p<.01)		
	N	Mean (0-100 scale)	Standard deviation	N	Mean (0-100 scale)	Standard deviation
	205			133		
Prerequisite for Financing (group 1)	35	57.3	24.7	22	61.7	22.5
Guide for future direction (group 2)	91	68.7	24.1	60	68.5	25.4
Both Reasons (group 3)	79	76.9	17.4	51	78.0	16.0

These results are consistent with P4a and suggest that those entrepreneurs whose main impetus for preparing a business plan is to secure outside financing fail to capitalize fully on the inherent opportunity to learn more about managing the operation. While some ‘forced learning’ may occur as the owner-manager assembles the plan, the benefits derived from the process appear to be of a residual nature when compared to the degree of learning benefit that takes place when the plan is intended (at least partially) to guide the operation.

With respect to the business plan’s utility in helping the entrepreneur operate the business more efficiently, this effect is lowest in cases where the plan was prepared to satisfy conditions of financing. As demonstrated in Table 5, the differences between groups 1 and 3 are significant at the .01 level ($p=.005$), however this difference was not evident in the second year of existence. Thus, P4b is moderately supported by the analysis.

Table 5

ANOVA Results: Relationship between Reasons for the Business Plan and “Efficiency” Benefits

	First Year of Operation (F= 5.598; p<.01)			Second Year of Operation (F= 1.810; p=.168)		
	N	Mean (0-100 scale)	Standard deviation	N	Mean (0-100 scale)	Standard deviation
	205			134		
Prerequisite for Financing (group 1)	35	61.3	25.5	22	66.5	22.8
Guide for future direction (group 2)	92	70.5	25.6	61	71.3	23.9
Both Reasons (group 3)	78	77.2	21.5	51	77.1	22.3

Discussion

The identification of the linkages, both direct and indirect, between business planning and enterprise performance represents one of the more challenging dimensions of small business research. Castrogiovanni's (1996) premise that it is the planning **process**, not the formal plan, that is relevant to success or failure represents a primary theme of this paper. This position is only partially reaffirmed, as P1 is supported by the data, but not P2.

The degree of learning that occurs through the business plan appears to be high across this sample. This "discipline of learning" (McGrath and MacMillan, 1995, p. 54) has particular value in the new venture where many, if not all, of the entrepreneur's assumptions are untested and the planning process obliges him/her to articulate the weaknesses and uncertainties associated with the business concept.

These findings also indicate that a structured learning process (preparing and using the business plan) helps owner-managers create a more efficient business, and that more learning takes place when the business plan includes market research. The more sophisticated business plan enhances learning. Though the business plan clearly facilitates learning, other means that create and maintain disciplined enquiry by the entrepreneur could be equally beneficial. For example, regular discussions with an experienced mentor, banker, venture capitalist or public accountant may suffice if available in a timely manner.

It is not surprising that in cases where the business plan has been produced to satisfy conditions of financing, the plan's role in helping the founder to better organize the venture or learn more about the dynamics of the business is diminished. But it is noteworthy that the highest levels of business efficiency and learning were attained by those owner-managers who prepared their business plan for both financing and decision-making. These dual motivations appear to be additive and inject greater relevance into the planning process - conditions which are favorable to adult learning. The lower efficiency benefits that were observed in the second year of operations may simply reflect the establishment of effective business routines and systems during the startup year.

Insofar as the survey instrument did not provide for effective discrimination between different types of pre-start plans (other than the presence or absence of market research), the testing of the planning benefits/survival relationship may have been confounded by the presence of a number of 'back-of-the-envelope' business plans in the sample.

Clearly, small enterprise business plans are not homogeneous. At the low end of the business plan complexity continuum, are the 2-3 pages of descriptive information required by certain government agencies, while at the high end are detailed documents containing market research and industry data, rigorous financial analysis and cash flow projections, an assessment of individual competitors, and an organizational plan. These more formal planning efforts have been linked to a more thorough decision process within the organization (Lyles et al., 1993). Different types of business plans may also have varying effects on new venture performance: for instance, plans that are largely oriented towards detailed financial projections have been found to be associated with business performance (Lumpkin et al., 1998). Thus, in order to fully capture how the plan impacts management behaviour and ultimately, business performance, a more robust approach to differentiating between types of business plans is needed.

Conclusion

The aim of this study was to accumulate further evidence on the nature and role of business planning in the early stage small business. While business planning in the venture's pre-startup period serves as an important learning tool, it has no significant association with survival

or failure in the early stages. The impact of the business plan in terms of helping the entrepreneur both to learn more about managing his/her business and organize the business more efficiently was significantly higher when i) the plan encompassed market research or ii) had been prepared with the intent of being used to guide decision-making.

The results of this study should be examined within the context of the limitations of the research design. All the participants are located in the same geographic region; even though this allows for effective control over industry and market variations, the particular business environment within which these enterprises operate may be markedly different from other parts of Canada and North America, thus limiting the generalizability of the findings. Secondly, as noted already, more work needs to be done on the nature of the business plan and its impact; for instance, the planning process, whether short term or long term, may be reactive, opportunistic, or focused on the perceived critical element (Frese et al., 2000). The typologies advanced by previous researchers (Bracker and Pearson, 1986; Frese et al., 2000; Rue and Ibrahim, 1998) may provide useful frameworks for extending this study to encompass the level of sophistication of the business plan.

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