“If you fail to plan, you are planning to fail”¹
Can business plans reduce the high failure rate of SMEs?

Part one²

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One school of thought believes that a business plan is ‘the GPS’ of a business, and that it helps map out a company’s journey from where it is today to where the owners want it to go – identifying milestones, obstacles, and desired routes along the way” [Simoneaux and Stroud, 2011]. Another school of thought, reflected in the work of Sahlman [1997], cautions against over reliance on a business plan, stating that the problem with most business plans is that “most waste too much ink on numbers and devote too little to the information that really matters to intelligent investors”. So, business plan or no business plan? Is there a performance difference between SMEs that prepare business plans and those that do not? What impact can business plans have on the little talked about issue of high failure rate of SMEs?

This article examines these and other issues related to SME performance and survival.

¹Quote attributed to Benjamin Franklin
²This two-part article is excerpted from and adapted from a “Business Plans or Business Planning? A study of the Business Planning Practices of Small Businesses in North America,” a dissertation submitted in part-fulfillment of the requirements for the degree of Master of Business Administration of the University of Warwick.
The growing number of development agencies that provide support for small and medium enterprises (SMEs) in Africa – as part of their private sector development strategy – is a tacit recognition of the critical role that SMEs play in the economies of most nations [see Table 1]. Between 2006 and 2013, for example, the African Development Bank (AfDB) approved 70 operations specifically supporting SME development, with a total value of approved SME assistance of approximately US$1.9 billion, accounting for about 3.7 percent of all its project approvals during the period [AfDB, 2015]. It is not surprising that SMEs are often described as the backbone of the economy [Dahlberg, 2011] and an engine of sustainable and inclusive economic growth [IDEV, 2014; Kurokawa et al, 2008].

**Box 1: SMEs play a critical role in most economies**

- The International Finance Corporation (IFC) states that there are 125 million micro and medium enterprises in the 132 economies it operates in.

- Agbor & Quartey [2010] report that SMEs in Ghana provide about 85% of manufacturing employment, contribute about 70% to Ghana’s GDP, and account for about 92% of businesses in Ghana. They estimate that about 91% of formal business entities in South Africa are SMEs, which contribute between 52 to 57% to GDP and about 61% to employment.

- In the U.S.A, small businesses generate about 50 percent of the gross domestic product [Office of Advocacy, U.S. Small Business Administration, 2010], and are considered a major force in the U.S. economy. Indeed, most of the major players in the business world in the United States are or were once small business owner and they have had a profound impact on the business world and on the world economy in general: some of these well-known entrepreneurs include Bill Gates [Microsoft], Sam Walton [Wal-Mart], Steve Jobs [Apple Computer], Michael Dell [Dell, Inc.], Steve Case [AOL], Pierre Omidyar [eBay], and Larry Page and Sergey Brin [Google] [Office of Advocacy, 2010]. It is generally believed that five entrepreneurs built and transformed the U.S. into what it is today – John D. Rockefeller, Cornelius Vanderbilt, Andrew Carnegie, Henry Ford and J.P. Morgan [Elumelu, 2015].

- According to the OECD, more than 95% of enterprises in the OECD area are SMEs, and they account for almost 60% of private sector employment, make a large contribution to innovation, and support regional development and social cohesion [Dahlberg, 2011].

- According to the European Commission, micro-firms [those with less than 10 employees] are the most common form of enterprise and account for between 78% of firms in Japan and 96% of all firms in Denmark, India, Netherlands, Spain and Sweden. An OECD study found that SMEs accounted for over half of all employees in all 27 OECD countries.
Key private sector operators in Africa also advocate more support for private sector development, with a special focus on the entrepreneurs behind SMEs. Tony O. Elumelu, a successful private sector operator in Africa, has called for entrepreneur-led development as a new model of development for Africa (Elumelu, 2015), underscoring that African businesses usually come down to individuals – and that behind most companies are an entrepreneur. Speaking at Georgetown University in Washington D.C. in May 2015, and at a White House event on global entrepreneurship hosted by US President Barack Obama, Mr. Elumelu highlighted the importance of global entrepreneurship as a development model: “humanitarian assistance and economic opportunity are two sides of the same development coin...” He further emphasized that “it is the economic opportunity side of the development coin that... will have more catalytic impact in driving development on the African continent.”

Small businesses contribute to national economies by creating jobs and providing people with opportunities to achieve success; they complement the activities of big firms by providing them with goods and services; and they also encourage innovation (U.S. Small Business Administration, 2010). This is no doubt the intent behind the growing support for SMEs in Africa. However, this is not yet the situation in Africa. Indeed, although Africa’s private sector generates 70% of the continent’s output, 70% of its investment, and 90% of its employment; it is still largely composed of informal micro – and small enterprises, with limited capacity (AfDB, 2013). As well, although SMEs do play an important role in Africa’s economies (in terms of GDP and employment), cross-country and micro-level research has not yet established a clear causal link between SMEs and economic development (Kurokawa et al, 2008). The evidence shows that both small and big firms contribute to growth; however, smaller firms may face larger and different constraints (Kurokawa et al, 2008). [See Box 1]. Just as they adopt different approaches to foster SME development, donors use different approaches to eliminate constraints – with varying degrees of success. Efforts comprise both firm-specific interventions and upstream support for the enabling environment, defined by policies, laws and regulations affecting private sector development (Kurokawa et al, 2008). What seems certain is that, based on experience from other parts of the world with long experience in SME activity, donors and governments need to pay greater attention to such issues as the survival and sustainability of SMEs. This is important given the increasing public resources being allocated to SME development.

“In the U.S., where about half of all U.S. adult workers are either self-employed or work for a small business only, about half of all new businesses survive five years or more and about one-third survive 10 years or more.”
The survival and sustainability of SMES is a problem even in countries with a long tradition of SME activity. For example, in the United States of America, where about half of all U.S. adult workers are either self-employed or work for a small business, only about half of all new businesses survive five years or more and about one-third survive 10 years or more, according to the U.S. Small Business Administration (SBA), which has been helping small businesses since 1953. This high failure rate is most likely due to inadequate business planning for, according to Zimmerer et al (2008), “for decades, research has proven that companies that engage in business planning outperform those that do not”. They further state that any entrepreneur who is in business or is about to launch a business needs a well-conceived and factually based business plan to increase the likelihood of success; they note, however, that studies unfortunately show that many entrepreneurs never take the time to develop plans for their businesses. This should sound a note of caution for donors funding SME activities in Africa.

Thus, the efforts of governments and donors notwithstanding, the nature of the constraints facing SMEs in Africa suggests a need to also strengthen the business planning skills of the continent's operators – both informal and formal.

Indeed, from a business standpoint, most of the constraints facing SMEs in Africa can be mitigated through rigorous business planning, since a business plan requires one to look outward and perform an environmental scan, analyzing the

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**Box 2: Constraints facing SMES in Africa**

Independent evaluations [AfDB, World Bank, Kurokawa et al, 2008, Norad] of donor support for private sector development find that constraints facing SMEs include high costs and poor access to financing, low access to electricity, corruption, tax burden, inadequate level of skills, lack of transportation, poor skills and knowledge on the operations of SMEs (such as lack of market knowledge).

Abgor & Quartey mention constraints such as lack of access to appropriate technology; limited access to international markets, the existence of laws, regulations and rules that impede the development of the sector; weak institutional capacity, lack of management skills and training, and most importantly finance.

Celine Kauffmann (2005) writes that “SMEs are weak in Africa because of small local markets, undeveloped regional integration and very difficult business conditions, which include cumbersome official procedures, poor infrastructure, dubious legal systems, inadequate financial systems and unattractive tax regimes.” Some of the binding constraints stem from market and government failures.
industry, the competition, identifying potential opportunities and threats” [Simoneaux and Stroud, 2011]. Business planning also involves gathering and analyzing information, evaluating tasks, identifying risks and strategy, projecting financial developments and documenting these in a written plan (Castrogiovanni, 1996; Sexton and Bowman-Upton, 1991, cited in Delmar and Shane 2003). The flip-side of this is the risk that in some circumstances, where the business environment is characterized by much uncertainty and instability and weak institutions [as is often the case in Africa], business planning in uncertain circumstances may be counterproductive and misleading and may discourage entrepreneurs from pursuing opportunities that seem too risky [Mintzberg [1991, 1990]. Is robust business planning the missing link in the new venture exploitation chain in Africa? This article9 suggests that the performance of SMEs in Africa can be vastly improved by strengthening the business planning capability of the entrepreneurs behind SMES.

The article examines the use of business plans by SMEs in an economy with a strong tradition of SMES to highlight what the burgeoning SME sector in Africa can learn to improve survival and sustainability – and thus contribution to economic development.

The article is presented in two parts:

• Part I introduces the theoretical aspects of business planning and venture creation through a literature review of foregoing work on the topic: One school of thought believes that a business plan is ‘the GPS” of a business, and that it helps map out a company’s journey from where it is today to where the owners want it to go – identifying milestones, obstacles, and desired routes along the way” [Simoneaux and Stroud, 2011]. Another school of thought is reflected in the work of Sahlman [1997] who cautions against over reliance on a business plan, stating that the problem with most business plans is that “most waste too much ink on numbers and devote too little to the information that really matters to intelligent investors”. He argues that business plans are not a guarantee of success and too much attention is sometimes paid to them – he ranks them no higher than 2 – on a scale from 1 to 10 – as a predictor of a new venture’s success... and sometimes, in fact, the more elaborately crafted the document, the more likely the venture is to fail”. So, business plan or no business plan?

• Part II of the paper looks at what small business owners actually do. Does the theory match the practice? Is there a difference in performance between SMEs that engage in business planning and those that do not? It describes the findings and conclusions of a study designed to investigate the link between business planning and performance and identify good business planning practices that can be useful if prioritized by small business owners in Africa.

9This two-part article is excerpted from and adapted from a “Business Plans or Business Planning? A study of the Business Planning Practices of Small Businesses in North America,” a dissertation submitted in part-fulfillment of the requirements for the degree of Master of Business Administration of the University of Warwick.
Literature review: Business plan or no business plan?

Business planning can be defined as the efforts undertaken by firm founders to “gather information about a business opportunity and to specify how that information will be used to create a new organization to exploit the opportunity” (Castrogiovanni, 1996, cited in Delmar and Shane 2003). One would thus think that the purported benefits of business plans would make them a welcome prescription for prospective entrepreneurs. But this is not the case. At best, the literature on the need for business plans is conflicting, with viable arguments being made for and against them.

The case for business plans

In a statistical analysis of business survival in New England, Lussier and Corman (1996) find that among fifteen potential predictors of success or failure, business plans are a predictor of success for businesses with less than ten employees. This confirms the position of business plan proponents such as Volkman et al. (2010), who describe business plans as the core document of successful enterprise formation. Bewayo (2010) considers business plans essential for entrepreneurial success and a requirement for business start-up financing. Similarly, Faltin, Ripsas and Zimmer (1998) see business plans as an important basis for potential investors’ assessment of the economic viability and prospects of a proposed venture. Empirical research by Rea (1989) lends further credence to this view. In a review of questionnaire responses from members of a US-based venture capitalist association, Rea finds that a solid business plan can increase the likelihood of successful seed capital negotiations for start-ups.

In other words, business plans serve to attract acquisition of capital from investors and lenders, thus constituting the “business card” of the new enterprise and its management team” [Volkmann et al., 2010]. Business plans also serve to predict future changes in the existing market, and to convince potential investors about the feasibility of a new idea and probable benefits of participation [Legge and Hindle, 2004].

Academia seems to also be in favor of business plans, as a course on business plans is a core part of most entrepreneurship academic programs [Bewayo, 2010]. Honig et al [2012], citing Menzies [2009] note from informal observations of the content of common entrepreneurship textbooks and from more systematic examinations of course descriptions and syllabi for a wide range of entrepreneurship courses that most of the courses advocate the development of a business plan. Brinckmann et al [2015] also reach the same conclusion from their review of several authors on the subject, concluding that business planning has received great attention from entrepreneurship and strategy scholars as a central activity to make sense of business environments and identify an appropriate course of action.

The SBA, whose mandate is to help Americans start, build, and grow small businesses, proposes 10 easy steps to help people plan, prepare and manage their business. The first step in its “10 Steps to Starting a Business is to “Write a Business Plan”, which will help the business owner map out how they will start and run the business successfully. Does the finding that many entrepreneurs never take the
time to develop plans for their businesses (Zimmerer, 2008) explain the high failure rates among small companies? According to Zimmerer et al. (2008), research has proven that companies that engage in business planning outperform those that do not. This is because a business plan forces someone with a business idea to critically examine the idea and identify its strengths and weaknesses (Simoneaux and Stroud, 2011).

“a business plan is the GPS of a business, that is, a well-documented business plan helps map out a company’s journey from where it is today to where the owners want it to go – identifying milestones, obstacles, and desired routes along the way” (Simoneaux and Stroud, 2011).

Simoneaux and Stroud (2011) further underscore that a good business plan helps deal with changes effectively and can often mean the difference between long-term success and failure. They conclude that “If You Fail to Plan, You Plan to Fail” and make a compelling case for a business plan as ‘the GPS’ of a business, that is, a well-documented business plan helps map out a company’s journey from where it is today to where the owners want it to go – identifying milestones, obstacles, and desired routes along the way” (Simoneaux and Stroud, 2011). Volkmann et al. (2010) echo the idea of the business plan as a GPS, referring to it as an important navigation instrument for management. One may therefore conclude that “a business plan is an important step in the creation of a new venture. It is the end result of business planning, which forces entrepreneurs to analyze all aspects of their venture and to prepare an effective strategy to deal with the uncertainties that may arise” (Kuratko & Hornsby, 2009). Instituting business plans as a requirement for SMEs in Africa could help them better identify and plan for how to most effectively address the constraints described above, thus increasing the chances of their survival and sustainability.

The case against business plans

It seems, however, that despite the almost universal agreement that planning is essential for business success, most entrepreneurs do not prepare business plans (Bewayo, 2010) and Volkmann, C.K., K.O. Tokarski, and M. Grünhagen (2010). This viewpoint is supported by Perry (2002), whose study, the Relationship between Written Business Plans and the Failure of Small Businesses in the U.S., investigates the influence of planning on U.S. small business failures and provides insights into the impact of business plans on the success or failure of new ventures. The study concludes that very little formal planning goes on in U.S. small businesses. This is also the finding of a Wells Fargo/Gallup Small Business Study (Barringer & Ireland, 2012), which reports that only 31 percent of 600 business owners started their firms with business plans. Simoneaux and Stroud (2011) also report on the questioning of business plans, citing firm owners who argue “they’ve operated for years
successfully without a business plan”. Indeed, it would seem that the necessity of a business plan is often questioned, in particular, by founding members of a company: “We have all the important details of our planned business project in our heads” or “Once it has been completed, the plan is anyhow very quickly outdated” are typical reasons for not setting out the business plan in writing [cf. Delmar/Shane (2004a)].

Many researchers seem to advocate direct action to pursue business ideas (Bhide, 2000; Carter et al., 1996) and criticize business planning because they argue that it interferes with firm founders’ efforts to “undertake more valuable actions to develop their fledgling enterprises” (Delmar and Shane, 2003). For example, Mintzberg (1991, 1990), argues that [business] planning in uncertain circumstances is counterproductive and misleading and may discourage entrepreneurs from pursuing opportunities that seem too risky – mostly because they seem difficult to test. He cautions against over-optimism about the ability to forecast certain markets owing to a culture of belief in the reliability/value of planning in business. Other researchers have put forth that in practice, the linkage between planning and success or failure has been difficult to establish and even more difficult to quantify (Perry, 2002). Indeed, empirical investigations of established firms have generally been unable to find a strong link between business planning and performance (Lumpkin et al). Some researchers suggest that business plans have no predictability for the success of entrepreneurial ventures, such as Lange, Mollov, Pearlmutter, Singh and Bygrave (2007). This team finds that among a sample of 116 ventures started by Babson College alumni, performance was the same whether the founders had written formal business plans or not, leading the researchers to suggest that written business plans are necessary only when founders are seeking to attract seed capital – in line with the conclusions reached by Faltin et al. (1998) and Rea (1989).

While it is difficult to generalize Lange et al.’s results past their sample of Babson College alumni, other studies also present empirical evidence that is ambivalent towards business plans. Kirsch, Goldfarb and Gera (2009) analyzed over 1000 funding requests made to an American venture capital firm, of which some 700 contain planning documents, and found that these documents were weakly linked with venture capital decisions. This, on the other hand, goes against the results of Faltin et al. (1998) and Rea (1989), illustrating the lack of consensus in the literature. Along the same lines as Kirsch et al., is Bewayo’s 2010 article on the usefulness of business plans. Although Bewayo presents their merits, he also holds that while business plans are thought to lead to entrepreneurial success, “the correlation
between start-up business plans and business survival has been found to be weak; and that although business plans are considered to be a requirement for business start-up financing, financial institutions, seem to have “more objective criteria of determining credit worthiness than relying on written business plans.” He concludes that: “Leading voices on entrepreneurship education such as D. Gumpert, G. Gendron and A. Bhide have called for a de-emphasis on business plans, asking academics and business advisors to “burn” or “forget” the business plan.” This is in line with empirical research such as that of Honig and Samuelsson [2004], which finds, in a longitudinal 40 month-long study of over 600 fledgling Swedish entrepreneurs, that there is no relation between business plans and firm performance.

According to Sahlman [1997], the problem with most business plans is that “most waste too much ink on numbers and devote too little to the information that really matters to intelligent investors”. He argues that business plans are not a guarantee of success and too much attention is sometimes paid to them – he ranks them no higher than 2 – on a scale from 1 to 10 – as a predictor of a new venture’s success… and sometimes, in fact, the more elaborately crafted the document, the more likely the venture is to fail”. He attributes this failure to too much emphasis being placed on crafting a winning business plan rather than on ensuring that there is an appropriate ‘fit’ among the four dynamic components (the people; the opportunity; the external context; and, the deal) of any venture creation and management process [Salman, 2008]. Sahlman’s four dynamic components are supported by research covering different regions. Dimov [2010] joins Sahlman in noting that the opportunity and the industry experience of the people involved in a venture are more significant predictors of success than any form of planning. Dimov finds that among a sample of 830 nascent entrepreneurs in the United States, business planning in the early stages of a venture only affects success indirectly. Research by Yusuf and Saffu [2005] upholds Sahlman’s thesis by finding empirical support for the importance of external context. Their study of SMEs in Ghana reveals that while times of economic hardship do not encourage entrepreneurs to plan more seriously, planning – but not necessarily formal planning – does affect firm performance positively.

The importance of business planning helps reduce the likelihood of a venture disbanding and accelerates product development and venture organizing activity by helping firm founders to make decisions, balance resource supply and demand, and turn abstract goals into concrete operational steps.
Dwight D. Eisenhower: “In preparing for battle I have always found that plans are useless, but planning is indispensable.”

Conclusion: Business planning is the key... not business plans

It would seem that for decades, research has proven that companies that engage in business planning outperform those that do not and that “the real value in preparing a business plan is not so much in the plan itself as it is in the process the entrepreneur goes through to create the plan [Zimmerer et al., 2008, p 156]. This is because “although the finished product is useful, the process of building a plan requires an entrepreneur to subject her or his idea to an objective, critical evaluation. What the entrepreneur learns about the company, its target market, its financial requirements, and other factors can be essential to making the venture a success.” [Zimmerer et al., 2008, p 156]. Perry’s study [2002] finds that non-failed firms do more planning than similar failed firms did prior to failure. According to Perry, there is almost universal agreement that planning is essential for business success. This idea is corroborated by Delmar and Shane [2003], who contend that business planning is an important precursor to action in new ventures. They hold that business planning helps reduce the likelihood of venture disbanding and accelerates product development and venture organizing activity by helping firm founders to make decisions, balance resource supply and demand, and turn abstract goals into concrete operational steps. In a subsequent paper, Delmar and Shane [2004] also find that by engaging in planning activities, entrepreneurs decrease the likelihood of seeing their ventures disband, and increase the product development process. That planning is more important than a business plan is aptly captured by a quote by Dwight D. Eisenhower: “In preparing for battle I have always found that plans are useless, but planning is indispensable.” (Cited in Zimmerer et al, (2008); and Volkmann et al, 2010); however, the problem may stem from the fact that “planning can be overdone, incorrectly done, and ineffective [Mintzberg, 1994].

Part II of this article starts on page 74: “If You Fail to Plan, You are Planning to Fail”: Can business plans reduce the high failure rate of SMEs?

Part II: Where theory Meets practice.