

BUSP 01

Theoretical Reflections
Planning process in start up companies

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New ventures are an important part of a healthy economy with most of the net new jobs created by their start-up. They play a crucial role in driving economic growth. Economies with a higher proportion of new ventures normally have higher growth rate than others. The Global Entrepreneurship Monitor illustrates that almost half of the differences in economic growth of developed nations can be explained by the level of entrepreneurial activity within these countries. Entrepreneurial efforts are a fundamental driving force for the prosperity of modern societies.

Problem area

However, the scope of venture failures is substantial, with the majority of the ventures failing prior to their third year. During the first three years, the venture activity is most vulnerable to failure and this period is regarded as “valley of death”. These mistakes can be of various forms and reasons. Some of them are: no formal or clear structures; ineffective financial & managerial control systems; unresolved differences of opinion; unreal expectations; lack of relevant sectorial experience and others.

A way to effectively overcome these problems is to avoid strategic mistakes. The most successful companies are those that have developed aggressive venture strategies and have made ventures critical components of their strategic and operating success. New venture success often depends on how the founding team collectively understands its world, estimates effects of possible actions, makes decisions, and allocates appropriate resources [1].

The empirical evidence reveals that, regardless of the indications that planning can be useful when starting new ventures, many entrepreneurs continue to start them without any effort at formal planning. Our problem area lies in the question if there is actual, relevant and applicable entrepreneurship theory about planning process in the new ventures. The question is whether practical implications of this theory can be exploited by new venture managers in order to improve planning process.

Purpose

In order to improve new venture performance strategy formation it is important to realize how planning is being conducted in start up companies. With an example, of the Vanatage Oresund project and theory reflection we are going to examine the process of start up planning and whether theory reflects and addresses issues of practical planning process. The purpose is also to identify weak points of the theory and which matters should be researched more so new venture managers can benefit from them.

Theory review

Most of the previous research has been focusing on the relationship between planning and firm performance but in large organizations as a rule. Planning in large organizations differ from the planning in small young organizations due to difference in size, operational and management structure, external relationship with market and stakeholders. Research on planning in small companies has also been conducted but no clear outcome of the relationship between planning and firm performance. Some studies found a positive relationship (Perry, 2001), while other studies have found a negative relationship (Hand, Sineath, & Howie, 1987) [7]. Thus, the impact of formal planning on performance is unclear.

Start-ups

We will be referring to the start-ups in this paper. A start-up is a new business with limited operational history and few established practice. Early in their lifecycle, start-up companies are vulnerable and prone to failure. They are fundamentally different from established firms and require decisions and solutions to problems that are unique to them [12].

Business strategy

In management theory strategy is defined in a number of ways by various authors. One of the earlier authors, Chandler (1962) defines strategy as “the determination of the basic long-term goals and objectives of an enterprise, and the adoption of courses of action and the allocation of resources necessary for carrying out these goals” [8].

Micheal Porter (1996) defines strategy as “the creation of unique and valuable position, involving a different set of activities” and distinguishes it from operational effectiveness, which is described as “performing similar activities better than rivals perform them”[11].

Mintzberg (1978) has developed an alternative strategy definition and its application in practice. Mintzberg questioned prior general understanding based on which strategy is

defined as "that of a deliberate conscious set of guidelines that determines decisions into the future". He argues that Chandler's definition of strategy is incomplete since it only focuses on formal process of planning. Mintzberg rejects this definition of strategy as a plan because it is incomplete. Instead he proposes to perceive strategy as a "pattern in a stream of decisions". He believes that his definition of strategy reveals the dynamics of strategy formation. He states that "the strategy maker may formulate a strategy through a conscious process before he makes specific decisions, or a strategy may form gradually, perhaps unintentionally, as he makes his decisions one by one".

Mintzberg concludes his discussion by pointing out that, "In general, the contemporary prescriptions and normative techniques of analysis and planning-and the debate that accompanies them-seem unable to address the complex reality of strategy formation" [7].

Deliberate and emergent strategies

Differentiating between deliberate and emergent strategies is one of the most important aspects when discussing planning in the new venture creation.

As Mintzberg (1978) explains, some strategies may be created in a deliberate manner; other strategies emerge without formal planning. He defines deliberate strategies as those that get realized after being planned. When intended strategies do not get realized they are called unrealized strategies. When realized strategies were never intended, these may be called emergent strategies. Mintzberg suggests that emergent strategies may be realized in spite of the fact that "no strategy was intended at the outset or perhaps because. . . . Those that were got displaced along the way. ..." [7, 9].

Strategy formation in start-ups

In start-ups strategy is formed based on various factors such as the size, staff, industry and financial capital of the company. H. Mintzberg (1973) outlines 4 major characteristics of strategy making in entrepreneurial companies:

- 1) In the entrepreneurial mode, strategy-making is dominated by the active search for new opportunities, thus the entrepreneurial organization focuses on opportunities and problems are secondary;

- 2) In the entrepreneurial organization, power is centralized in the hands of one individual, the chief executive;
- 3) Strategy-making in the entrepreneurial mode is characterized by dramatic leaps forward in the face of uncertainty;
- 4) Growth is the dominant goal of the entrepreneurial organization [13].

In their research of S. Lim et al (2007) study the manufacturing strategy development in start-ups, the challenges encountered by them and the strategic decisions that a start-up company make in their early growth stage.

They indicate a number of challenges that start-ups face. These challenges are mainly in the areas of product development, marketing, finance, human resources and management³³ creation based on H. Mintzberg's concept of deliberate versus emergent strategy. They conducted their research through two case studies: one with detailed planning (The Pampered Chef) and the other with no deliberate planning (Google Inc).

Although, the strategic plannings in those start-ups were entirely opposite, both firms performed very well within few years and grew very rapidly. The researchers implied that future research could be carried out on the study of start-up failures due to poor planning or poor concept, role of intended planning on new firm's success and significance of number of start-ups with intended planning [7].

Planning and performance

Skrt and Antoncic (2004) studied the relationship between strategic planning and small firm growth in terms of empirical analyses that include various strategic planning elements. Authors claim that strategic thinking is important for small firms in the time of global competition, technological change and increased dynamics in markets. Even if many entrepreneurs do not formulate business plans, the strategic planning and systematic decision-making can be considered a key determinant of survival and success of small firms. They advise that entrepreneurs need to be aware that strategic planning practices, processes and techniques can be beneficial for growth of the firm. In order to

enable their firms to grow, entrepreneurs may like to consider exactly formulating vision and strategy, incorporating the elements of internationalization and networking in the firm vision, focusing on growth, profit, and market, among strategic analysis techniques paying special attention to analysis of market and competition, and exactly formulating generic business strategies. All these strategic planning efforts need to be reinforced by practices that follow the key growth and market orientations, and have company-wide support [4].

Business Plan

Business plan development is one of the most important areas in the new venture planning process. Most of the new ventures create business plan when According to Hisrich et al (2008) business plans are often criticised as being “dreams of glory”, however it is probably the single most important document to the entrepreneur at the start up stage [5]. The business plan may be read by employees, investors, bankers, venture capitalists, suppliers, customers, advisors and consultants. Very often business plans serve as a legitimacy function. For instance when applying for the bank loan or looking for venture capital. There are different perspectives on the business plan role and usefulness in the new venture planning.

Karlsson, T and B. Honig (2009) studied business plan creation and implementation in new venture companies. The research is based on 6 new ventures based in business incubator in Sweden. The research is carried out through interviews, observations, and archival data. Interviews were conducted with actors important to the new ventures, like incubator managers, external capital providers. The originality of the study is that it focuses on not only rare successful companies but on companies that share common risks and challenges on the market.

The results of the study show that writing a business plan was most extensive during startup stages of the venture. It slowed with time and none of the firms studied updated or revised their business plans in the future. The entrepreneurs rarely referred to them or utilized them. They also didn't implement their business plans in their actual business.

According to the research, one of the main motivations for business planning was gaining legitimacy in the eyes of external actors and attracting external resources for funding new ventures, making the companies appear structured, well planned, and established. However, an interesting conclusion authors make is that venture capitalists and banks were not that much interested in business plans as they are usually expected. Instead, the institutional pressure of requiring or stimulating business plan creation was noticed from incubator managers, business schools, and governmental organizations. The study also suggests that formal business planning might actually have a negative performance consequence for a firm, as observed by entrepreneurs at Beta, who wrote their business plan primarily to gain external capital. Authors argue that business plans enhance financial performance as there are significant gaps between the plans and the actual operations of their businesses, and researches found that these gaps increased over time.

Method

Autoethnography will be the main method for analysis in this paper. We think it is appropriate method for the analysis since it combines ethnography, biography, and self-analysis. Autoethnography is a qualitative research method that utilizes data about self and its context to gain an understanding of the connectivity between self and others within the same context. This research method is distinctive from others in three ways: it is qualitative, self-focused, and context-conscious. As a research method, autoethnography takes a systematic approach to data collection, analysis, and interpretation about self and social phenomena involving self. Autoethnographic data provide the researcher a window through which the external world is understood [3].

Data

The data is primarily observational data that I have recorded through out the Master Program in Entrepreneurship including learning journals, guest lectures from practitioners, advice from support agencies, conducted market analysis for the project.

Analysis

Planning is an important aspect of running a start up. However, my impression was that there is not enough of research and theoretical framework for planning in start ups. There are various studies about strategy and planning in established mature organizations. But since the nature of new venture and mature organization is completely different, I believe that approach to planning should be different as well.

Mintzeberg and Waters (1985) briefly covered the topic of the entrepreneurial planning. They have questioned if entrepreneurial strategy is deliberate. The conclusion was that entrepreneurial intentions are more difficult to identify and that they are less specific. However, the main reflection from this study is that Mintzberg and Waters treat entrepreneur as an individual dominating the start-up firm only with his vision. Though around almost 3 decades have passed since they conducted their study and obviously the perception of entrepreneur is not that simplistic in current research field as it recognizes its complexity.

It is important to realize that planning in start ups should be considered as a dynamic process from the initial stage. When company launches its operations it automatically starts to interact with dynamic system, starts to be influenced by external and internal factors, which are unexpected very often. That is why when planning, these factors should accounted and planning should not be regarded as static process. Partially, I found support for my personal perception in Mintzberg's theory. I believe that start ups should open to implement emergent strategy and combine it with initial deliberate planning.

Even well-established companies cease to carry out deliberate strategies due to turbulence and dynamic character of today's environment. They have planning but allow it some flexibility to act in response to external environment challenges. For start up, following deliberate strategy is even more challenging as the company constantly evolves and interacts with the market which is "emergent", not "deliberate". My experience of working with Vantage Oresund project throughout the year proved that planning some specific goals is very challenging and often will work against you. I've realized that it is

better to have some general goals outlined but allow flexibility as well. Flexibility is advantageous for start up and outlined business only limits it.

Another important aspect of new venture planning I have researched is business plan creation and its usefulness. Having reviewed the literature I have found research conclusions both on business plans being useful as well as not very important. However, the major assumption was that business plans are necessary for successful start of new company. My personal reflection on the theory about business plans is in line what literature has to offer. Having dealt with business plans writing and communicating with other students who were writing it, I can tell that there are different opinions on usefulness of the business plans, just like in the literature. Also, from my personal experience throughout the year I can tell that business plan was a useful tool for me to get my ideas and thoughts in clear and structured way. Once it happened, it led to generation of some new ideas following the general structure.

Many students who were looking for external funding for their projects wrote business plans with an aim of gaining legitimacy. Legitimacy is a separate aspect of the business plan and I think that it is an efficient source of legitimacy for new start ups. When a business is only starting and has no previous track of record of its activity, it's extremely hard to attract external funding for its future operations. Also, providers of the capital often require a plan, an outset of the future organization together with financial projections. I would say entrepreneurs have no other choice than to come up with some sort of planning to gain legitimacy in the eyes of investors and to attract capital. Same can be noticed with business incubators. For example, in order to get a free office space in the Venture Lab or become part of the Ideon incubator, it would require an entrepreneur to come up with a business plan. But when we talk about venture capitalists, banks and new venture business planning, the standard business plans that are being taught in entrepreneurship textbooks might not be of great interest for them. From my own experience I know that often they would rather have a short, informative outline of business, its key aspects, and realistic financial projections (where possible to project). Often they would rather look at the personality or team that runs a business. Karlsson and

Honig's study also has some conclusions that investors and banks were not that much interested in formal business plan. According to the study banks had its own procedure for evaluation and investor required one page strategic summary of the business. I think that one of the reasons for this is that investors do not have much time to read extensive and descriptive parts of business plan, while it can be outlined in shorter summary of key aspects of business. As for financial planning section, I think it is almost not relevant due to lack of possibility to project realistically or close to it. New business does not have past performance and thus it is impossible to analyze average growth rate of revenues, costs, and invested capital. Thus, it is not possible to analyze historical ROIC (return on invested capital) or IRR (internal rate of return). In order to value company properly, one needs to forecast its future free cash flows (using Discounted Cash Flow method). However, future free cash flows can not be forecasted realistically or close to it without analyzing past growth of free cash flows. Financial forecasting without available historical analyzing is a rather of speculation than a scientific based approach. I would like to see more research and studies conducted on financial planning for new start ups. I think it is highly understudied. Textbook on entrepreneurship for ex. by Hisrich et al, does not address problems of new venture financial planning and pretty much describes how to build financial statements.

Conclusions

Planning is an important part of the start up company operations even though managers often focus on vital day to day operations losing strategic focus. We think theoretical field needs to focus more on planning in start ups in particular as there is not enough research compared to mature companies' strategic decision making. That is the gap between theory and practice that I have discovered for myself.

It is important to realize that planning in start ups should be perceived and carried out as a dynamic process that is flexible and able to adjust when needed. This is due to the fact that start up companies operate in the dynamic and turbulent. In the same time planning should not only be emergent since it would be too blurry. We think a start up company should have general strategy and objectives including vision, mission and values. Also "room" for emergent planning should be left on top of deliberate. We believe that such combination is the most efficient and it worked for me in the past.

Business plans is one of the most important aspects of the planning process in start ups. Generally, we didn't find substantial gaps between theory on business plan and its practical use. The only thing we think lacks in business plan theory is financial planning with practical implications for entrepreneurs.

Most of the theory states that business plans are not used after carrying out its legitimacy gaining function. From my experience I think that it is really so. But in my case by writing a business plan I came up with new ideas and learnt new things in the process of writing.

Planning in start up organizations is often intuitive and spontaneous process since young companies change so fast. Still, we believe that planning is beneficial for young companies provided they take advantage of emergent planning more than deliberate in the initial stages of development. It is important that theoretical field recognizes the need to address this topic and delivers some practical implications for entrepreneurs.

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