CHAPTER TWO - Strategic Business Planning

2.1 Theory of Business: A General Outlook

Business plan formulation process cannot exist in isolation or as a stand alone piece meal business strategy. It is a central element in a larger scope of business planning process (Robertson, 1998). In analyzing a viable business planning strategy, Professor Peter F. Drucker (1992) advances four specifications of a valid theory of business, viz

- Assumptions about environment, mission and core-competencies must fit reality.
- Assumptions in all the above stated three areas have to fit one another.
- The theory of business must be known and understood throughout the organization, and
- The theory of business has to be tested constantly.

From the four specifications introduced by the said management guru, we must be aware that the first two specifications above are actually tell us to converge and treat the two as an entity. An entity which is interrelated and becoming the crux of the theory of the business. The last two specifications are in fact the reinforcement elements endorsing the said theory of business. Once a company is able to determine factors in its environment, mission and core-competencies, the company is believed to have known its own ability to conduct business activities effectively. Another aspect of the above scenario is that, the evaluation of the company's environment, mission and core-competencies must be dynamic and not to be left idle. This is due to the fact that, over time business environment is ever changing and sometime the company's mission and core-competencies are unable to keep up with the changes. In order for any firm to fulfill the
first assumption of the valid theory of business, the top management of the firms must be aware and keep abreast of changes, they must have the ability to conduct efficient environmental scanning. This environmental scanning must involves analysis of internal and external factors to the firms that might affect the entire business setting. Internal environmental scanning simply explains the process of analyzing the firm's strength, weaknesses, opportunities and threats. It also involves determination of the firm's resources and value chain analysis. Whereas the external environmental scanning deals with the observations about the macro events (activities that are unmanageable by the firm) that might affect the firm's performance, such as bilateral trade agreements, government policies and requirements. Here, the existence of knowledgeable top management team are essential in providing and determining the firm's appropriate internal and external environment variables. Once these two sets of variables are identified, the top management team must then be able to align these identified variables to fit in the firm's mission and core-competencies. In carrying out environmental scanning, top management team must have the necessary ability to filter, analyze and derive managerial decision based on limited information available.

A maxim of "information is power" is indeed an essential element in the Peter Drucker's the theory of business. This simply explains that, with limited information and constraints of knowledge offered to the top management team, the firm's environment, mission and core-competencies are put at risk if the information given is not carefully examined and scrutinized. The firm's business direction is solely based on environmental scanning, and fine tuning it to fit the reality of the situation surrounding the firm. This will lead the firm to have a better awareness toward macro elements of business and external factors such as industrial, sectorial activities and manage to ponder and gauge the political and economic scenario (Yeoh, 1998).
In deriving the appropriate assumptions about specific mission of the organization, top management must have the ability to gauge current political and business scenario with the firm’s intended mission in mind. The mission must be complementary and compatible with the overall local business setting. With the current prevailing "cut throat" business setting, substantial sized firms in our country have better opportunity to be having better business planning.

Thus, in summation of the above ideas, I would deduce that a good understanding of a valid Theory of Business is essential for budding entrepreneurs in their process of creating new business ventures. This is true to the fact that, understanding of the valid theory of business is very much needed to formulate a strategic business planning in the initial stage of new venture creation (Ronstadt, 1984).

2.2 Strategic Business Planning: A subset of the Theory of Business.

The celebrated management guru, Professor Henry Mintzberg (1994) developed several perceptions of formal definitions of Planning, such as, planing is future thinking, planning is controlling the future, planning is decision-making and planning is integrated decision-making. However he summed up all the definitions by injecting the concept of strategic management through the understanding that “planning is a formalized procedures to produce an articulated results, in the form of an integrated system of decision”.

Through his definition, “planning” emphasizes on formalization, the systemization of the phenomenon to which planning is meant to apply. He further stated that formalization in the definition would seem to mean 3 important things, namely 1) to decompose 2) to articulate and 3) to rationalize the process by which decisions are made and integrated in
organization.

His definition seem to be in agreement with other scholars such as Steiner, he argued that," plan can and should be to the fullest possible extent objective, factual, logical and realistic in establishing objectives and devising means to obtain them" (1969). Bryson referred strategic planning as a discipline effort, in fact a simple set of concepts, procedures and tests (1988). Stoner, Freeman and Gilbert stated that planning is a process of establishing goals and a suitable course of action for achieving those goals (1995).

Numerous studies have outlined the benefits of planning to organizations and reasoning behind the importance of planning to the business performance. Conclusively, I tabulate some of the benefits highlighted in previous studies, namely

- **Organizations must plan to coordinate their activities.** Micheal Porter (1980) claimed in his book, *Competitive Strategy,*" significant benefits to gain through an explicit process of formulating strategy, to insure that at least the policies (if not the actions) of functional departments are coordinated and directed at some common set of goals".

- **Organizations must plan to ensure that the future is taken into account.** This is important to look into and understand the future implications of present decision. What planning does specifically in this regard is to introduce a discipline for long term thinking in the firm ( Hax and Majluf 1971). Another study tabulated that planning is actually taking future into consideration by engaging the following procedures; 1) preparing for the inevitable, 2) preempting the undesirable and 3) controlling the controllable.( Starr, 1971 ).

- **Organizations must plan to be "rational".** Wildavisky (1973) captured the importance of planning by saying that planning is not really
defended for what it does but more for what it symbolizes. Planning, identified with reasons, is conceived to be the way in which intelligence is applied to organizational problems. Organizations with planning are presumably better that other organizations because they result in policy proposals that are systematic, efficient, coordinated, consistent and rational. He further stated that the virtue of planning is that it embodies universal norms of rational choice.

- **Organization must plan to control.** John Kenneth (1967) says, "control through planning is minimizing the uncontrollable externalities in formalizes strategy making process. Planning is also meant to control the future of the organization, and therefore the environment outside the organization".

From the series of the above perceptions, it is clearly noted that strategic business planning evolves greatly either in internal or external environmental scanning. Businesses need internal environmental scanning in order for them to derive their core-competencies. On the other hand, businesses require external scanning for them to determine their business threats and opportunities. These aspects of business scanning are actually a part of the said "theory of business"

### 2.2.1 Its Concepts and Principles

As previously mentioned in the preceding chapter, planning is no doubt inevitable to any business existence. The definition given by Henry Mintzberg has actually sparked off several ideas on the benefit of strategic planning to the business performance. In this context, I will try to relate a concept of formal business planning as an enabling tool in strategic business planning.

Theoretically, a strategic business planning process involve environmental scanning (both external and internal), strategy
formulation (strategic or long range planning), strategic implementation, and evaluation and control (Wheelan & Hunger, 1998). The above concept of strategic planning process can be easily explained as below:

Figure 1: The Framework of Strategic Business Planning.

The above figure simply explains that strategic business planning must incorporate four main phases. These phases are interrelated to each other. Environmental scanning as the first phase is actually trying to blend with Drucker’s valid assumptions of the theory of business. Environmental scanning must be done carefully to determine the business’s environment, mission and core-competencies. Once this first phase is established, the strategy formulation process follows to fit all the assumptions (assumptions about the firm’s environmental, mission and core competencies) to reality. At this phase, the firm must be able to distinguish between the attainable goals and direction of the firm via viable strategy formulation phase. The derivation of viable strategy formulation phase will eventually develop a single separate process to materialize that identified formulated strategy. This process is called strategy implementation phase. This phase entails complete tasks and requirements needed to materialize the firm’s first and second phase. To ensure the continuation of the firm’s valid theory of business, evaluation and control phase is deemed of importance for the firm’s survival. At this phase, the firm’s is bound to have mechanisms that check and adjust the firm’s relevance of existence.
2.2.2 Strategic Management Model

If we were to analyze closely, the above model of 4 main phases in the strategic business planning is a matter of fact an endorsement to the theory of business propounded by Peter F. Ducker. All the 4 phases are in fact embedded in all the assumptions that make up the said theory of business. The evolution in business management discipline leads us to a new dimension in business planning, which is called "Strategic Management Model". This model is in fact identical to the strategic business planning model as discussed previously. Nonetheless, this strategic management model is actually the improvement of business planning and emphasizes on the importance of linkages between the 4 major phases. Thomas L. Wheelan and J David Hunger in their book entitled, "Strategic Management and Business Policy (1998)" has developed a comprehensive strategic management model based on the said 4 main phases with its linkages.

Figure 2: The Overall Concept and Principle of Strategic Business Planning.
Up to this point, the chapter has brought us to a discussion of the theory of business, and it's relevance towards the concepts and principles of strategic business planning. Lately, this business-planning concept has gone further to the evolution of strategic management model( Wheelan & Hunger, 1998). The model, as shown in Figure 2 is reflecting the overall concept of formal business planning. All the factors mentioned in the strategic management model must be taken into consideration in the business plan formulation process.

2.3 Business Plan

In attempting to search for the ideal concept of business plan, the writer has come across various perceptions and definitions about the formal business plan. This section presents a compendium of definitions on a formal business plan.

Robert Ronstadt (1996) in his book, "Entrepreneurship" quoted that a business plan is a report written by you about your venture at a particular point in time. Your business plan should describe your venture, what it is, who will be active in it, why you believe it will be successful and how you intend to implement your plans. It should be concise, readable, well-written document. It should be evaluative, not promotional in substance and tone. It also should be dated because you will want to revise or re-write it in different time during the evolution of your venture

W. Moorman & James W. Halloran in their book, "Contemporary Entrepreneurship" stated that business plan, is a written description of all steps necessary to ensure success in owning and operating a business (1996:25)
Richard M. Hodgett and Donald F. Kuratko in their book, "Effective Small Business Management" outlined the business plan as a road map for the would be entrepreneur and prepared to deal with uncertainties. It should incorporate where am I going, how will I get there, what opportunities and what problems and how will I deal with them (1995:159)

Thomas W. Schneider in his article "A business plan" which appeared in Strategic Management Journal (Nov/Dec 1998:31) propounded that, the business plan serves as " road-map" for the organization. Like a well-drawn map, business plan enables the owner to set objectives, identify milestones for measuring success, assess progress towards the goals, and the change course if necessary. A business plan requires the owner to assess the feasibility of the venture, identify support and equipment needs, analyze the market and reining the competition. The plan also provides structure for organization, identifies the principle and management for the company and project profitability.

He further stated that the business plan also identifies potential hazards in operating the business, including the impact of environmental and economic factors (such as government regulations, changing markets, competition, pricing, financial uncertainty, change in customer base, new technology etc.)

Jeffrey A. Timmons in his book, " New Venture Creation: Entrepreneurship in the 1990s' , cherished the idea that a business plan is one type of planning document which results from the presence of planning. It is a written document that 1) summarizes a business opportunities, 2) defines and articulates how the management team expects to seize and execute the opportunity identified. He also made a caution statement that creating business plan is more a process than simply a product. Business plan is
analogous to a pilot's cross-country flight plan, in that it defines the most desired, most timely, and least-hazardous route to a given destination. (1990:329).

It is well noted that, the above definitions are in fact toiling at the same issue, that is, a formal business plan is a written business planning needed to assure the smooth sailing of a venture, taking into consideration all the necessary steps and procedures needed to perform the venture. Here we can see that, the entire concept of a formal business plan is actually in agreement with the Strategic Management Model as previously mentioned in the preceding chapter. This similarity augurs from the fact that both the Strategic Management Model and the concept of a formal "Business Plan" are wide angled perception of business management tool. This assertion tries to explain that, a formal business plan is actually a subset of the strategic management model, where both of them incorporates similar "thinking approach" in dealing with business management. The 'thinking approach" refers to the sequential and rational steps needed to address business managerial issues. These steps are depicted in figure 2 on page 10. Nonetheless, one must remember that, sequential process as explained in the figure is not rigid. The sequential steps involved in the strategic business model changes over the environment and circumstances of the local business setting.

2.4 Fundamental Elements in a Business Plan

From the preceding section, we have noted that several issues were raised in the business plan's definition. The issues were primarily ranging from what factors constitute a good business plan, to the ideal understanding of comprehensive strategic business plan. In this section, the writer will try to derive the fundamental elements that make up comprehensive and effective business plan.
In spite of the many definitions and perceptions on formal business plan appearing in many academic journals as well as text books, fundamental elements in a formal business plan depends largely on the purpose(s) and reason(s) behind the preparation of the business plan itself. Many local entrepreneurs who had been approached by the writer revealed that the sole purpose of a formal business plan is to seek for financial assistance only. More often than not, the business plan is prepared by an external consultant with a pre-determined objective just to show favorable financial projections. However, these local entrepreneurs fail to realize that, the formal business plan is very important to the company in three primary areas. First, it teaches us about the business opportunity with calculated risk. Second, the business plan gives us enormous insight onto the experience and sophistication of the business of which leading to enhance the ability of opportunity recognition for entrepreneurs. Finally, it helps to create and reveal entrepreneurial development potential. The process of a formal business planning also enables the entrepreneurs to begin to identify the needs of the emerging business, human resources as well as financial needs.

Another aspects of informal information gathered from the writer’s series of discussions with our local entrepreneurs show that, in our local business context, the company is induced to prepare a formal business plan if there exist substantial borrowed capital for the company to run the business, and academic background of the company’s top management team. This observation is parallel to David Pierce’s opinions. David Pierce, a president in Pierce Investment Corp, in his article entitled,” A Venture Capitalist and Business Planner Look at Business Plan”, suggested the idea that companies with high loan gearing are critical with their business plan. The business plan is the door opener, if the plan is favorably perceived the company will have better credit evaluation. In the process of creating a
"door opener" sort of business plan, the plan must be able to answer the fundamental elements needed by the venture capitalists as well as the entrepreneur himself, namely

- What is unique about the company, projects, products or services?
- What does the company do?
- How does or will the company attain profitability?
- What benefit or will be derived from a capital infusion?
- Is the management capable of implementing the business plan?
- Do the financial projections make sense?
- Is there an exit strategy for the entrepreneur?

If the business plan satisfactorily answers these questions, the plan is said to have served its purpose.

William E. King in his article, "12 steps to a successful business plan" appeared in Journal of rural telecommunication, Nov/Dec 1998, justified that a good business plan should be concise, compelling document that describes a concept, assesses the industry and market in which the business will operate, outlines operational plans, quantifies the necessary resources, clearly identifies the benefits to those who provide the resources to get the business running.

Thomas W. Schneider, a fund manager, in his article "A Business Plan" concluded that elements of a comprehensive business plan usually divided into several sections, with no official format. However most plans consist of an introductory page, executive summary, description of the venture, back ground on key participants, market analysis, marketing plan, production plan (if needed), organization and management plan and financial analysis.

Notwithstanding the above, The Association of American's Small Businesses has come up with fundamental elements in a formal business
plan. The Association is of the opinion that, the essence of a formal business plan can be divided into four distinct sections, namely:-

- The description of the business
- The marketing plan
- The financial management plan, and
- The management plan

In macro perception, the above fundamental elements have in fact been deliberated in the preceding sections. Hence, it is appropriate to adopt the four domains as the most important elements that a business plan should be have in a formal business planning process.

2.5 Business planning and business performance: An overview of Malaysian Small and Medium sized Entrepreneurs(SME).

Academic examinations of business performance in Malaysia are impeded by one main factor, ie culture. Culturally, Malaysia businesses regardless of their sizes are extremely secretive about their state of business affair. This is reflected by low response rate received for this study (please refer to chapter four). In analyzing the current situation of business planning and business performance among the Malaysian SME, one must be able to define the characteristics, which distinguish Malaysian SME from their large-scale counterparts. As what being reported from World Bank Report, June 1982," Malaysian Development Issues and Prospects of Small Entreprises", many of SMEs characteristics such as their organizations, production, marketing orientation and location are universal in nature. They are common to SMEs in almost all developing countries. SMEs in Malaysia are typically organized as family or sole proprietorship business, and involving low-levels of capitalization.
A prolific rise in the number of large-scale public enterprises in the 70s straddling almost all the sectors in the economy together with the rapid growth of large scale-export oriented foreign investments dominated enterprises. The phenomenon has actually eclipsed the importance of SMEs (David Artko, 1990). Other factors contributing to the relative decline of SMEs in Malaysia are manifolds, and the main factors include:

- High rate of business failure
- A general lack of entrepreneurial culture and managerial skills
- A policy environment, which has tended basically to be more effective in promoting larger scale enterprises compared to SMEs.

However, recently Ernst & Young International has carried out a definitive survey to address the issues of leading practices of fast growing SMEs in Malaysia. The survey touches on the relevance of proper business planning practices among the SMEs in managing business for better performance. A hot topic in the firm's survey is whether successful entrepreneurs formally plan for fast growth business performance. It has been noted in the survey that the planning spectrum may range from informal (only in the entrepreneur's mind) to formal (written documents). The study suggested that, when an entrepreneur places a high degree of emphasis of flexibility in decision making, there would be a tendency to ignore the formal process of allocating management time to the planning effort. The study has selected 116 top SMEs performers in the last quarter of 1997. The result shows that as many as 55 % of fast growth entrepreneurs tend to ignore the formal written plan.

Although the survey done by the firm did not determine the content of business plans, given the performance of the respondents, some level of formal planning is apparently appropriate. Developing formal written
business plans however is the exception, not the rule in fast growth firms in Malaysia. From the survey, of the firms that base their planning on formal written documents, the majority (63%) do so on a yearly basis, 10% do so for a two-year time frame, and 27% do so for three years or more. The survey has concluded that, the result of the survey is consistent with the pattern that has emerged in terms of strong family involvement in management and the long-term objective of ownership and control.

The survey indicates that amongst the 45% that work with formal written business plans, the majorities are large firms who also tend to take the long-term view of planning for three years. The survey revealed that majority of Malaysian SMEs do not use a formal planning process to manage the firm. The firm proceeded the survey in finding out how those who did use a written plan actually put it to use. According to Ernst and Young, planning becomes effective when it is specific enough to measure planned against actual results, and even more so when this information is tied to top management compensation. From the survey, 84% of the CEOs responded that their plans are specific enough to tie planned to actual performance. 75% of the plans are specific enough so that management compensation is adjusted when actual performance deviates from the plan. In summation, the Ernst and Young’s survey of leading planning practices amongst the top Malaysian SMEs performers recommended the following factors to enhance business performance via business planning, namely;

- An informal planning process that places emphasis on flexibility and change.
- Establish functional planning and control systems that tie planned to actual performance and adjust management compensation accordingly.
• Share with employees the periodic planned versus actual performance data that is directly linked to the business plan.

• Link job performance standards that have been set by management to the business plan.

2.6 The relationship between Formal Business Plan and Performance.

Countless studies have sought to discover the impact of formal business planning on firm performance. There are evidence that strategic planning can positively influence a firm's survival and performance (e.g. Brackers, Keats & Pearson, 1988; Capon, Farley & Huber, 1994; Hills, 1984; Robinson & Pearce, 1984), some studies have reported non-significant or negative relationships (e.g. Robinson & Pearce, 1984); Rue & Fulmer, 1973). Given inconclusive, sometimes contradictory findings, several scholars have undertaken extensive critical reviews of the literature in an effort to gain insights of what formal planning can do for a firm's performance. Armstrong (1982) reviewed twelve planning and performance studies and concluded that formal planning benefited firms. Sharader, Talyor and Dalton (1984) review over 60 studies and concluded there was no systematic relationship between formal planning and performance. Pearce, Freeeman and Robinson (1987) reviewed 18 studies and concluded that the planning-performance link was tenuous. Meta-analyses conducted by Boyd (1991) and Schwenk and Shrader (1993) concluded that planning positively, but modestly, correlated with several measures of firm performance. Arguments have set forth by these scholar that individual studies appeared to underestimate the true relationship between planning and performance and were plagued with theoretical, measurement and methodological difficulties that overwhelmed the relationship between formal planning and a firm's performance.
2.7 The Writer's Presumption: Revisited

As previously mentioned in the beginning of chapter one, this study lies on the presumption that formal business planning and firm's performance is positively interlinked. Nonetheless, there exist contradictory perceptions in this relationship and previous empirical studies done by prominent scholars were unable to come to a valid agreement. There exist a variety of conclusions and results. Some of the results suggested that formal business planning positively related to a firm's performance during the initial inception of the business. Few of the results suggested that formal business planning is suitable for larger business organizations only. This phenomenon was the result of researchers failing to distinguish the size and the firm's stage of development. Schwenk & Shrader (1993) argued that firm size and stage of development are critical factors in understanding the link between planning and performance.

It is well understood that, a formal business plan is a part of business strategy, a driving force that enhances business direction. As what being opinionated by Adam Brandenburger and Barry J. Nalebuff, both are professors from Havard Business School and Yale School of Management, in their article entitled, "The right game: Use Game Theory to Shape Strategy", they liken business as a high stakes games, the essence of business success lies in making sure you are playing the right game. But how do we know if it is the right game? This question boils down to the fundamental reason of what constitutes the purpose of a formal business plan. This question strikes the very core of a formal business plan to strategize business policy and corporate strategy.

However, what is apparent in the Malaysian local context is that the term "playing the right game theory" in business is more often than not, refers to be playing the "right connection game theory" with businesspersons and
political figures. The Malaysian business sector is too much intertwined and polarized with political-business relationships. This lead to the notion that "playing the right game" in business is superfluous. Regardless of how well thought out your formal business plan seem to be, it would be difficult for entrepreneurs without the "right connection" to have better or equal business opportunities. This is due to the fact that, these small scale business operators who are without better connected business-political relationships are left with limited opportunities and are exposed to biased business practices, even though they are equipped with excellent technical-know-how capacity with comprehensive formal business plan.

Notwithstanding to the said "right connection game theory", the "game theory" suggests that, the player (businessman) must be well versed in his/her scope of works, business tactics that may add value to the products or services offered by the player. These factors can be achieved by formulating a comprehensive formal business plan.

From the above, it is therefore relevant to note that, the process of formulating a formal business plan is actually embarking into the "game theory" of business, searching the right ingredient for business success.

Nonetheless, what more important to this study is to determine the true perception of our local small and medium sized organizations toward the concept of business planning. As explained in the preceding chapter, the general perception of the real cause of preparing a formal business plan for our local businessmen has nothing to do with enhancing the business performance. But it is merely treated as a tool to get favorable financial assistance from venture capitalists, financial institutions, investors and the like. Apart from that very reason, it is well perceived in the market that, companies with knowledgeable and better-educated top management team are the only business entities that embark on full-fledge formal
business planning.

Therefore, this study will focus on the relationship between formal planning and firm performance in small and medium scale industries. The writer tries to justify the relationship between the two elements from the perception of local small and medium scale. The forthcoming chapters will highlight the process of gauging small and medium scale entrepreneur's perceptions’ in formal business plan formulation process and the link between formal business planning and firm performance.