

# Do Start-Ups Really Need Formal

*Studies Find Often Time Wasted Gathering Data With No Link to Success*

**B**usiness schools and consultants have long preached that writing a formal business plan greatly improves a start-up's odds of success. But a growing number of academics are questioning whether that's really the case.

Budding entrepreneurs can spend months, sometimes years, polishing elaborate 50- to 100-page business plans that include financial projections, market research, and intricate details on day-to-day planning and organization. But skeptics say there's little concrete evidence that extensive planning is highly correlated to success.

A more practical approach, they say, for entrepreneurs who aren't seeking external start-up financing from venture capitalists or angel investors, is to write a "back-of-the-envelope" plan with basic financial projections, such as cash flow, and fine-tune the business model after launching the business.

**'Just Do It'**

"What we really don't want to do is literally spend a year or more essentially writing a business plan without knowing we have actual customers," says William Bygrave, an entrepreneurship professor at Babson College in Wellesley, Mass., who says he generally advocates "just do it." Entrepreneurs must be nimble, and will be more apt to stick with a flawed concept they spent months drafting, he adds.

The doubts fly in the face of a huge, lucrative business-planning industry, chock full of authors writing step-by-step guides and consultants selling business-planning services. A recent search for "business plan" on Amazon.com turned up more than 19,000 book titles. Business schools also have reason to push planning: It's much easier to teach than intuition. Many colleges and universities have ramped up their entrepreneurship programs in recent years and introduced business-planning courses. Many top business schools including the University of Pennsylvania Wharton School and Harvard now host student business-plan competitions for cash prizes.

Vinay Gupta of Ann Arbor, Mich., spent six months attending conferences, meeting with consultants and writing a 60-page business plan before launching an outsourcing consulting firm for midsize businesses in 2004. But after starting the business it became clear far fewer midsize firms sought outsourcing help than his research suggested. He scrapped his origi-

nal idea and developed outsourcing-management software geared toward companies with annual revenue of more than \$1 million. While the planning helped him learn about the industry, it didn't point out the fundamental flaw of his original idea.

"We were handed one or two prospects in the planning stage, but it was a lot harder going after a broader base of customers after we launched," Mr. Gupta says.

The critics of formal planning contend that it runs counter to what's at the heart of the entrepreneurial spirit: the ability to learn and adapt through experience. And there's a growing body of research supporting the notion that formal planning may not make much difference.

**Planning Debate**

**The News:** Some academics doubt the conventional wisdom that formal written business plans do much to help start-ups succeed.

**The Background:** Some recent studies suggest there's little correlation between having a business plan and profitability. Advocates of business plans counter that the plans give entrepreneurs focus and prevent costly mistakes.

**The Bottom Line:** There are questions whether entrepreneurs may be spending months fine-tuning 50-page business plans, when they might be better off just sketching out basic financial projections and launching the business.

A study recently released by Babson College analyzed 116 businesses started by alumni who graduated between 1985 and 2003. Comparing success measures such as annual revenue, employee numbers and net income, the study found no statistical difference in success between those businesses started with formal written plans and those without them. The study concludes that "unless you need to raise external start-up capital from institutional sources or business angels, you do not need to write a formal business plan."

Amar Bhidé, a Columbia University entrepreneurship professor, found that 41% of Inc. magazine's 1989 list of the 500 fastest-growing private firms didn't have business plans and 26% had only rudimentary plans. A follow-up by the magazine in 2002 found the numbers without a plan have remained pretty much the same. Many business concepts are "transitional in nature," meaning there are competitive advantages to starting the business quickly and by the time you write

a full business plan "the opportunity will be gone."

**Knowing Customer Base**

Benson Honig, a professor at Wilfrid Laurier University in Ontario, Canada, says his research of 396 nascent entrepreneurs in Sweden from the late 1990s also found no correlation between business planning and profitability. Instead, his study found the biggest predictor of success to be knowing customers in advance. Mr. Honig says he teaches "contingency planning" to his students—or thinking about a business as constantly progressing, changing and making decisions based on the market climate—instead of traditional business planning.

Business-planning advocates counter that plans, while not always perfect, can help nascent entrepreneurs nail down important aspects of their concept, and sometimes prevent costly mistakes.

Bill Evans, a counselor for Score, a group of retired business executives who counsel entrepreneurs, says one client wanted to start a business designing custom scrapbooks. But it wasn't until she started formally planning that it became clear she would only make \$3 an hour for her labor.

**Untold Failures**

Scott Shane, a professor at Case Western Reserve University, says most studies that discount business-planning are flawed because they don't correct for business failure rates, only accounting for businesses that survived. If they did, they would find that a far greater number of businesses that failed never had a formal business plan. Mr. Shane's research, which relies on the same sample from Sweden as Mr. Honig's study, controls for failure rates and shows that businesses with formal plans are more likely to survive. He says most business ideas don't have to be rushed to market and that it typically takes a long time for businesses to get started anyway. "I'm not sure that saying, 'Oh, people shouldn't write business plans' would accelerate a lot more people into the start-up process," he says. "They seem to be held back by a lot of other things."

The most compelling reason to write a formal business plan, even critics agree, is when seeking venture capital or angel investors. But only roughly 55,000 of about four million start-ups each year get that money. And even then, the merits of having a lengthy business plan may be overblown.

Matt Coffin, founder and chief executive of LowerMyBills.com, a Web site sold to Experian Corp. in 2005 for \$330 million, says he used a 10-page PowerPoint presentation that he spent four to six months gathering research for in-

# Business Plans?

stead of a formal business plan when pitching his idea to investors in 1999. He succeeded in raising \$4 million in venture capital by convincing them that the market for people needing a one-stop place on the Internet to refinance was ballooning.

Tim Petersen, managing director of Arboretum Ventures, a health-care venture-capital firm in Ann Arbor, Mich. says he generally prefers getting five to 10-page summaries of business ideas or PowerPoint presentations over lengthy business plans.

"I'll have to confess, it's not always crucial to have the 60-page business plan," he says. While most entrepreneurs seeking should have their ideas well-formulated, "some people will get a little caught up in the perfection of their plan," he says.

Even some believers of business planning say formal planning foes have some valid points. Tom Kinnear, executive director of the entrepreneurial studies institute at the University of Michigan says writing a business plan shouldn't take more than three or four weeks.

"There's no question that some people are obsessed with writing plans that are too wrought with detail," Mr. Kinnear says. "Early on, all you really need is a compass."

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