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IS INFORMAL PLANNING THE KEY TO THE SUCCESS OF THE *INC.* 500?

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ABSTRACT

A review of the research on planning indicated that formal planning might be unnecessary for small, fast-growing companies. Many small, flourishing companies are operating with no written business plan. This study surveyed INC. 500 CEOs to investigate their view on the importance of informal and formal planning practices. The CEOs were asked about the time spent on formal and informal planning for the fundamental business functions (marketing, finance, human resource, operations management, supply chain management, information technology, legal issues, social responsibility, and management). The findings indicated that INC. 500 CEOs spend more time on informal planning than formal planning. When involved in informal planning, CEOs spend significantly more time on management, marketing, operations and finance than the other business functions. When involved in formal planning. CEOs spend significantly more time on the same four business functions as informal planning (though the order is slightly different). The study concludes that both informal and formal planning are vital and necessary for small business success. Knowing when and what to do in both areas of planning is essential.

INTRODUCTION

Many good business schools at universities across the country have business plan competitions where students create elaborate 50-page documents. The contest winners, judged by professors and practitioners, often receive sizable cash prizes. The winners, in many cases, are not required to apply the winnings toward their plan for any existing or future business. If the goal of these contests is to teach students how to write effective business plans, then the contest may be of value. If the goal is to teach students entrepreneurship, trigger new business start-up, or increase existing business success, then these contests may be ineffective. That is, several studies indicate that formal, written business plans have little influence on the success of small, fast-growing companies.

Some researchers contend that in today's extremely dynamic business environment, for many companies, the formal business plan becomes obsolete before it is ever printed. Others maintain that business plans are generated primarily to meet an investor's requirements, but are seldom used in day-to-day management of the company. Further, some researchers have discovered that numerous, successful companies have no business plan whatsoever. For example, Bhide's (1994), *Harvard Business Review*, investigation of *INC.* magazine's list of the 500 fastest-growing companies in the U.S. found: (1) 41 percent of these successful entrepreneurs had no business plan, (2) 26 percent had only a rudimentary (back-of-an-envelope) plan, and (3) 5 percent constructed financial analysis only when required by investors.

If fast-growing companies can succeed without formal, written business plans, then what methods, tactics, or procedures are they implementing? Kiedel's (2005) study may provide part of the answer. He indicates that strategic insight often originates in informal settings. Keidel explains that the conception of Southwest Airlines came over lunch when Rollin King drew, on a cocktail napkin, a triangle connecting Dallas, Houston, and San Antonio and suggested to Herb Kelleher that they could offer fares so low people would fly instead of drive. Similarly, Jack Welch, Keidel indicates, outlined the vision for GE to his wife over dinner. Welch drew three intersecting circles (manufacturing, technology, and services). Welch explained that any businesses that fell outside the circle were to be fixed, sold, or closed. Much of GE's phenomenal success was based on that informal, back-of the-napkin drawing. A formal (50 page), detailed, written plan wasn't necessary.

The purpose of this study is to survey the CEOs of successful, fast-growing, small U.S. companies--the *INC.* 500-- to investigate the allocation time spent on both formal and informal planning practices. We hope to offer new insights, identify changes that may have occurred since Bhide's (1994) study, and provide valuable managerial implications.

LITERATURE REVIEW

A host of researchers have examined formal planning and informal planning. Previous studies cited in the following literature review have used the terms "formal" and "informal" planning, but specific definitions were not included. Based on our research and discussions with managers this study defines "formal planning" as an activity associated with a method that is scheduled, orderly, written, recorded and disseminated. It often involves a prescribed meeting with at least one other company employee in attendance. "Informal planning" is not associated with fixed rules and schedules. It is flexible and may be conducted anywhere, anytime-- inside or outside the organization. The informal plan may be disseminated via verbal or written communication.

Formal Planning

A substantial stream of research has investigated the impact of planning on the success of the firm. Fulmer and Rue (1974) noted, for example, that Henri Fayol wrote about the value of the ten-year plan in 1916. Since then, the importance of planning has grown in popularity, been widely discussed, and generally accepted. Fulmer and Rue suggested, however, that many firms are engaged in planning not because they wish to, but because they feel they must—due to its popularity. Is formal planning based merely in tradition and corporate culture, or is it a vital component of long-term business success? The answer is complicated with research results both for and against formal planning.

Some researchers point toward planning as fundamental to business success. Thune and House (1970) found, for example, that planning does pay. These researchers examined six industries and found that formal planners significantly out-performed informal planners. Latham and Saari's (1979) study uncovered substantial research indicating that setting goals often leads to increased performance. Herter (1995) concluded that every business, regardless of size, needs an effective, comprehensive business plan because the process of developing the plan forces the entrepreneur to think about the harsh reality of the business world rather than the more common dream world. Schneider (1998) agreed, concluding that the business plan was the difference between success and failure.

Hormozi, Sutton, and McMinn (2002) asserted that a business plan is an effective tool used by businesses to organize their goals and objectives into a coherent format. According to these authors, no matter the size or stage of development, companies use business plans to improve internal operations and to market the business to potential outside investors. Hormozi et al. emphasize that a business plan should be written by (1) new business owners, (2) new business owners seeking outside financing for start-up, (3) existing business owners seeking outside financing for expansion, and (4) business owners who want to increase the success of their businesses.

Some researchers take a middle of the road approach. Armstrong (1982), for example, reviewed published empirical evidence on planning processes and situations where planning is most useful. Armstrong noted that researchers have obtained conflicting findings regarding profit improvement and growth from formal planning processes.
Few conclusions could be drawn about *how* to plan and *when* to plan. Ibrahim, Angelidis, and Parsa (2004) examined the planning practices of small firms in the U.S. and found that the planning practices of smaller businesses might be more sophisticated than generally perceived. Almost 81 percent of the 663 responding firms reported that they prepare some type of written long-range plan. Sixty-nine percent of these firms prepare plans covering at least the next three years. However, Ibrahim et al. concluded that further research is needed to evaluate whether performance of small firms is different between planners and non-planners.

Other researchers have concluded that formal business planning is *not* a vital component of business success. Bhide's (1994) study, for example, argued that many small companies do not bother with well-formulated plans because they work in rapidly changing industries and niches. Trying to adapt quickly to changing market conditions, these business owners rely on their flexibility for success and do not take the time to write detailed business plans.

Sanberg, Robinson, and Pearce (2001) reported that at least one-half of small businesses they studied did not have a business plan. Their research indicated that most small business owners contended that a business plan is important primarily for establishing a line of credit, obtaining loans, or attracting investors. Once funding was received, business owners indicated that the formal business plan has minimal value. From a different perspective, but with similar conclusions, Perry (2001) investigated the influence of planning on U.S. small business failures. A failure was defined as ending in bankruptcy. Failed firms and non-failed firms were analyzed from the Dun & Bradstreet credit-reporting database. Perry concluded that very little formal planning goes on in U.S. small businesses.

Orser, Hogarth-Scott, and Riding (2000), surveyed 1,004 small and medium-sized businesses and found that the presence of a business plan was highly correlated with performance (revenue increases). However, much like Bhide's research, only one-third of the firms surveyed indicated that they were involved in an ongoing, formal planning process.

Our review of the literature identifies considerable disagreement about the value of formal, written planning on the success of the firm. There is, however, less disparity amongst researchers about the number of firms that create formal plans. Many businesses had no formal, written plan or process. If there is no formal, written plan or process, then what are successful business owners doing in regards to planning practices?

Informal Planning

Informal planning is being utilized successfully and needs further study, according to various researchers. Robinson and Pearson (1983), for example, emphasizing the need for more research on the *informal (or non-formal)* planning practices utilized in small companies, analyzed the responses of 50 small bank presidents in South Carolina. No significant differences in performance ranking were found on any of the four performance measures between formal and non-formal business planners over a three-year period. Specifically, Robinson and Pearson found that formal planners and non-formal planners placed similar emphasis on five of six planning dimensions—the *non-formal planners* just did so with less formality.

A major implication from their study focused on the minimal benefit that can be expected for a small firm from using a highly formal planning process. Instead of emphasizing broad goals like long-term objectives, informal planners emphasized assessment of capabilities and resource evaluation, etc. They concluded that small firms appear to enhance their effectiveness through *informal* practices. Success for *informal planners* does not mean less planning is necessary—just fewer formal written plans.

Although many past research studies have focused on the relationship of company performance and formal planning (evidenced by a formal business plan or other formal planning documents) some research findings indicated the *planning process* itself--formal or informal-- is essential. For example, Bracker, Keats, and Pearson (1988) surveyed 217 owner/managers of small businesses in the electronics industry. While their findings substantiated the importance of the entrepreneur's role in business plan usage, they asserted that the process, not the plan, was a key component of performance.

Likewise, this line of research was evident in a study by Lyles, Baird, Orris, and Kuratko (1993). They studied the formality of the planning process by assessing the degree of planning manual usage, emphasis on developing written plans, and existence of specific schedules for formulating plans. Using this construct, they compared responses from 188 small business firms in a midwestern state, categorizing respondents as either formal planners or non-formal planners. Their study indicated that there was no significant difference in terms of return on equity and return on assets between the two types of planners. Due to the limitations of their study, they recommended further research on the relationship of the planning process and performance of small firms.

Shrader, Chacko, Herrmann, and Mulford (2004) argued that planning is best examined in the context of both its formal and informal aspects. Results from a survey of 150 manufacturing firms' top managers added support to the argument that both formal and informal planning pays. In a less-formal study, Keidel (2005) found evidence that senior-level managers often utilize less-formal planning practices and generate important plans in the process. Keidel offered several vivid examples of informal planning on a napkin by CEOs for Southwest Airlines and General Electric, etc. Keidel recommended that every organization needs some measure of big-picture thinking in informal settings. If giant companies like these utilize informal methods, small companies may also benefit.

Informal planning was one aspect of a larger study on planning by French, Kelly, and Harrison (2004). They investigated the relationship between firm performance and four types of "planners." Using a sample of small, regional professional service firms, they compared non-planners, informal planners, formal planners, and sophisticated planners. Although no significant relationship between the performance measures and factors was identified, a significant relationship between net profit and *informal* planning emerged. The authors strongly suggested that more research is needed regarding informal planning.

Given the implications of these research studies coupled with the persistent call for more research into informal planning practices, this study examines the extent of formal and informal planning being utilized in small successful companies. Specifically, the research questions this study intends to examine are: (1) What is the fundamental purpose of formal and informal planning? (2) How often do small, successful companies engage in formal and informal planning practices? And (3) what is the most effective formal and informal planning activity INC 500 CEOs use?

METHOD

The researchers in this study mailed surveys to *INC.* 500 CEOs. The *INC.* 500 represent *INC.* magazine's annual ranking of the 500 fastest-growing companies in the U.S. To be eligible for the listing, a company must be an independent, privately-held corporation, proprietorship, or partnership; have had sales of at least $200,000; and have had a five-year sales history that included an increase in sales over the previous year's sales.

Four hundred and sixty- nine surveys were sent to *INC.* 500 CEOs (31 CEOs' addresses were unobtainable). Forty-two surveys were returned to sender for incorrect address or no longer at address. Hence, 427 of the *INC.* 500 CEOs were potential respondents. Of those 427 CEOs, 100 completed and returned the survey, generating a 23.4 percent response rate.

The *INC.* 500 CEOs responded to a one-page questionnaire that asked about the amount of time spent on formal planning for the fundamental business functions (i.e., marketing, finance, human resource, operations management, supply chain management, information technology, legal issues, social responsibility, and management). A Likert-type scale was used, anchored by "1" representing no time spent and "7" representing significant time spent. Similarly, the surveys asked the CEOs about the amount of time spent on informal planning for the fundamental nine business functions listed above. Survey questions were anchored with "time spent" as opposed to "importance" because the researchers felt time spent increased validity. For example, if a respondent were asked how important is family, career, and health, the respondent might give all three factors a "7" (very important). However, if you assess time spent in those three areas, the results will likely be more accurate.

CEOs were also asked an open-ended question: "What is the most effective *formal* planning activity you are involved in?" and "What is the most effective *informal* planning activity you are involved in?" Additionally, the CEOs were asked some categorical questions: (1) "Do you have a formal, written plan?" (2) "How often do you participate in formal planning?" and (3) " How often do you participate in informal planning?"

FINDINGS

Some of the key questions were:

1.Do the CEOs spend different amounts of time on formal versus informal planning activities (considering all the different functions simultaneously)?
2. Do the CEOs spend different amounts of time on each business function regardless of formal versus informal planning?
3. Are the patterns of time spent by the CEOs on different business functions significantly different across formal versus informal planning?

a. If yes, then what seems to be the pattern in formal planning? What seems to be the pattern for informal planning?

Because each respondent answered all 18 questions (time spent on 9 business functions for each of the two planning modes), the survey data represent a fully-crossed, 2-factor repeated measures design. The factors are: Planning (2 levels – formal versus informal) and Function (9 levels – Management, Finance, ... Supply Chain). These data were analyzed with MANOVA repeated-measures design.

The main effect of the factor "planning" is statistically significant at the multivariate level (Wilk's Lambda = 0.887, F(1,99) = 12.62, p-value = 0.001) suggesting that the CEOs spend different amounts of time on formal versus informal planning activities (considering all different functions simultaneously). The pattern of the means (shown in Table 1 and 2) indicate that CEOs spend significantly more time on informal planning activities than formal planning activities.

The main effect of the factor "function" is statistically significant at the multivariate level (Wilk's Lambda = 0.226, F(8,92) = 39.48, p-value = 0.001) suggesting that the CEOs spend different amounts of time on each business function regardless of the type of planning as shown in Tables 1 and 2. The pattern of the means indicate that regardless of the formal versus informal planning, CEOs tend to spend the most time on Management, Marketing, Operations and Finance followed by Human Resources and Information Technology. The CEOs tend to spend minimum time on Legal, Social Responsibility and Supply Chain functions.

However, both of the significant main effects reported above need to be qualified due to the presence of a statistically significant planning-by-function interaction effect (Wilk's Lambda = 0.693, F(8,92) = 5.1, p-value = 0.001). This interaction effect (shown in Figure 1) indicates that the pattern of time spent by CEOs on the different business functions vary based on whether he/she is engaged in formal versus informal planning process. Follow-up tests indicate that CEOs spend significantly more time on Management, Marketing, Operations, Human Resources and Social Responsibility functions while engaged in formal planning process than informal planning process. However, CEOs spend about the same time on Finance, Information Technology, Legal and Supply Chain functions while engaged in formal or informal planning process.

Additionally, the CEOs indicated that 68 percent of the *INC.* 500 has a formal written plan. This figure is much higher than that reported by Bhide (1994). His study found that only 28 percent had formal written plans.

Of the *INC.* 500 who have a formal plan, 32 percent indicate that the purpose of the plan is for obtaining financing, 44 percent indicate that the purpose is for managing operations, 6 percent indicate that the plan is used for purposes other than financing and managing, and 18 percent indicate that the plan is used for a combination of obtaining financing, managing and other purposes.

In response to a question concerning how often CEOs participate in formal planning, 8 percent indicated daily, 27 percent indicated weekly, 33 percent indicated monthly, 27 percent indicated yearly, and 5 percent indicated other. In response to the question concerning how often CEOs participate in informal planning, 54 percent indicated daily, 38 percent indicated weekly, 7 percent indicated monthly, and 1 percent indicated yearly.

In response to the open-ended question, "What is the most effective formal planning activity you are involved in?" a large number of CEOs' responses related to traditional business functions (marketing, finance, management, information technology, and

Table 1- Formal Planning

1	Management	4.77[a]
2	Finance	4.76[a]
3	Marketing	4.57[a]
4	Operations	4.53[a]
5	Information Technology	4.03[b]
6	Human Resources	3.64[b]
7	Legal	3.09[c]
8	Social Responsibility	2.90[c]
9	Supply Chain	2.86[c]

(Scale: 1 = no time and 7= significant time)

Note: Means with different superscripts are significantly different from each other

Table 2 - Informal Planning

1	Management	5.47[a]
2	Marketing	5.42[a]
3	Operations	5.17[a]
4	Finance	4.93[a]
5	Human Resource	4.12[b]
6	Information Technology	4.10[b]
7	Social Responsibility	3.30[c]
8	Supply Chain	3.11[c]
9	Legal	3.07[c]

(Scale: 1 = no time and 7= significant time)

Note: Means with different superscripts are significantly different from each other

human resource). However, a unique category that emerged related to offsite planning. One CEO, for example, said, "Once per quarter we go offsite for two days to do a rolling 8 quarter strategic plan. We call them 'Hatchfests.' We emerge with Powerpoint documents we keep and give to stakeholders." Another CEO reported, "Our management team goes offsite one day per quarter to assess progress toward strategic goals and set our targets for the next 18 months." Other CEOs indicated simply, "offsite."

In response to the open-ended question, "What is the most effective informal planning activity you are involved in?" a smaller, but consistent category of CEOs' responses related to traditional business functions (marketing, finance, management, information technology, and operations). In addition, thought-provoking practices were expressed by CEOs, such as (a) daily to do lists, (b) informal meetings in office, weekly staff meetings, (c) daily personal time to research, ponder and plan, personal study and informal discussion, (d) verbal discussion and thinking which leads to bullet items and prioritizing action items, (e) social events, (f) partners lunches, and (g) discussions with trusted advisors (spouse, parents, friends, and board members).

IMPLICATIONS

The implications of this study are categorized into three areas: (1) the most critical functions of informal and formal planning, (2) business plan utilization, and (3) relative importance of informal planning

Figure 1 -Pattern of Interaction Between Planning and Function

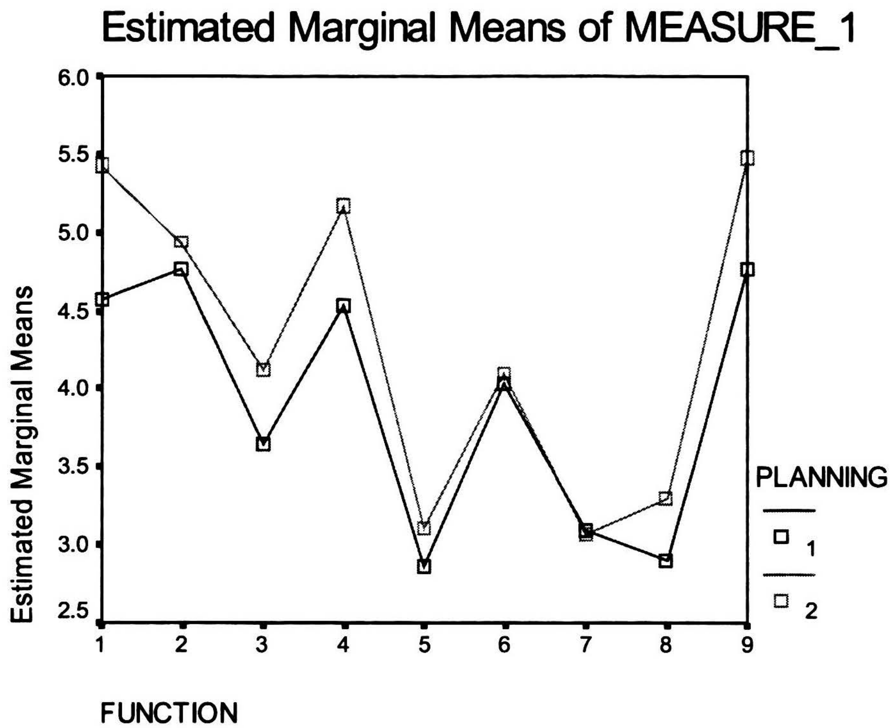

Figure Legend:
Planning: 1= Formal, 2=Informal
Function: 1=Marketing, 2=Finance, 3=Human Resources, 4=Operations, 5=Supply Chain, 6=Information Technology, 7=Legal, 8= Social Responsibility, 9=Management

practices vs. formal planning practices.

Most Critical Functions of Formal and Informal Planning

An important implication is evident in the comparison of the specific business functions within both informal and formal planning. For both informal and formal planning practices, the study indicates that CEOs spend more time on four functions—***management, marketing, operations, and finance***—than on other business functions such as human resources, information technology, legal, social responsibility, and supply chain. Small business owners interested in benchmarking the successful strategies of the *INC.* 500 should prioritize their planning--concentrating the formal and informal planning activities and resource allocation around these four critical business functions.

Business Plan Use

This research reconfirmed an earlier study by Allred and Addams (2006) regarding business plan use. They found that *INC.* 500 CEOs put considerable importance on writing a business plan to obtain outside funding and to manage their operations. The present study indicated that 68 of the 100 responding firms have a formal written business plan. Of those who have a formal business plan, nearly one-half of them use their plan for managing operations. Thus, earlier research studies by Bhide and others pointing to a lack of planning by small firms do not hold up under current practices, according to this study.

Informal vs. Formal Planning

In some previous studies on planning practices, a few inferences have been made that informal planning may be more important to small companies than large companies because of the need to move swiftly as opportunities arise and decisions must be made. This research study substantiates the point that CEOs spend significantly more time on informal planning activities than on formal planning activities. Although rated as important, formal planning clearly took a back seat to informal planning.

Small companies trying to progress rapidly would do well to consider the results of this study of the 500 fastest-growing companies in the U.S. The CEOS of these successful firms are consistently planning informally—mostly daily. Having a written business plan to guide management operations also makes good business sense, according to the majority of the responding CEOs. Management of small firms should also take note of the significant time spent on four functional areas: management, marketing, finance, and operations—for both informal and formal planning practices.

To continue growing in highly competitive, dynamic markets, small businesses must be able to adjust quickly to survive and move even more swiftly to thrive. To do so, small business management needs to understand the importance of effective informal planning practices and to determine the most viable informal planning methods that produce the results desired.

Similarly, small business managers must determine when to use formal planning practices—such as holding formal strategic planning management meetings twice a year offsite or writing a business plan to guide internal operations or to secure additional line-of-credit funding. Thus, a combination of both informal planning practices and formal planning practices is recommended to small business owners and managers. Managers should spend time contemplating the results of this study and then determining the planning practices most beneficial to their businesses. Future studies need to look more deeply into the actual processes, tools, and techniques of informal planning practices.

Is informal planning the key to the success of the *Inc.* 500? The results of this study indicate that both informal and formal practices are needed for optimum success. The combination of formal and informal planning appears to drive the success of the fastest-growing companies in the U.S.

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