ABSTRACT. This paper investigates causal relationships between planning and performance utilizing a longitudinal database with responses from the same 2,956 businesses over a four-year period. Results confirm the association between planning activity and performance that is evident in most extant literature. They also, however, cast doubt on the traditional perception of the causal sequence of that association. Although subject to a number of limitations, the results indicate that planning is more likely to be introduced into a small firm after a period of growth rather than before a period of growth. These results make an important contribution to understanding the planning-performance relationship for two main reasons: they overcome the static data and relatively smaller sample size restrictions of many past studies; and, they provide evidence concerning the sequence of the relationship between planning and performance.

KEYWORDS: Performance, planning, small firms.

1. Introduction

Much of the mainstream research literature relating to both large and small firms continues to emphasise correlation between “best practice” management activities and performance. Research with this emphasis in the small firm area seems to be driven by a need to emulate larger firm activities and establish a set of “desirable” management activities that all small firms should implement. When these activities are passed onto small firm managers through appropriate knowledge dissemination processes there is an expectation of a more efficient and effective small firm sector. Supporting this view are research results that are often used to imply a causal link (that correlated management activities influence performance) when little more than an association has been found. Alternate explanations for the correlation (especially that performance influences the introduction of “best practice” activities) are often ignored.

The research reported in this paper presents the opportunity to test hypotheses about the relationship between one indicator of good management activity (the existence of documented business plans) and performance (as indicated by growth in both employment and sales income). The paper commences with a review of the diversity of attempts to determine operational definitions of the performance construct both in large and small firms. A review of findings in relation to the management practice of planning and its association with performance then follows, providing both a general overview and a more concentrated small firm perspective. A description of the data set used is then presented, followed by discussion of the specific variables utilised, the research questions analysed, and the method of analysis employed. After presenting the outcomes of data analysis, the consequences of the results are discussed.

2. Assessing performance in small firms

Performance is obviously a central construct of interest in research concerned with the planning and performance relationship. However, as suggested by Venkatraman and Ramanujam (1986) “the treatment of performance in research settings is perhaps one of the thorniest issues confronting
the academic researcher" (p. 801). One of the reasons for this is that, unfortunately, it is not always clear what performance means or what are appropriate operational definitions.

As suggested by Murphy et al. (1996), in discussing entrepreneurship research, "definitions of successful performance . . . and the variables used to measure performance vary widely" (p. 15). Proponents of conceptual frameworks for assessing performance in small firms reflect similar views. According to Keats and Bracker (1988, p. 53), performance may have a different set of meanings for small (as opposed to large) firms and consequently it may be inappropriate to apply similar measures to the assessment of performance. Hence, while they represent "performance [as] an undifferentiated, unidimensional construct" they also suggest "the term may imply a number of interpretations and appropriate measurements" (Keats and Bracker, 1988, p. 54). Lumpkin and Dess (1996) are more explicit in recognizing the multidimensional nature of the performance construct. They envision a place for traditional accounting measures such as sales growth, market share, and profitability alongside indicators of overall performance (incorporating goals, objectives and aspiration levels) as well as other indicators of stakeholder satisfaction (Lumpkin and Dess, 1996, p. 153).

This diverse nature of the performance construct is reflected in the variety of operational definitions used in recent empirical studies. Murphy et al. (1996) provide an analysis of publications for the seven years to 1993 that are classified according to dimensions of performance considered. In 51 articles studied, they found 71 different operational measures of performance that they group in eight major dimensions of which efficiency, growth and profit are most frequently used (Murphy et al., 1996, p. 16). Many of these measures are what Reid and Smith (2000) identify as relativist performance evaluation measures that ask "what goals a firm has set, and then enquires into the extent to which these goals have been achieved" (p. 168). However, they identify as a problem with such approaches a neglect of the fundamental requirement that performance evaluation cannot be divorced from the market nexus and that even "life-style" targets must ultimately enable the firm to pass the long-run test of economic survival (Reid and Smith, 2000, p. 168).

This may explain why the most frequently used measures identified by Murphy et al. (1996) are predominantly economic, and in accordance with this reasoning, the performance concern in this paper concentrates on indicators of economic success.

However, even indicators of economic success that could be used to measure performance, such as financial outcomes, are diverse. At the most basic level performance has been categorized according to static annual sales or income measures. The other common approach using financial measures is where returns on sales, assets or equity are incorporated to indicate relative profitability. But not all performance criteria are static and another approach is to differentiate firm performance by considering growth in financial attributes such as sales, income or return measures.

A difficulty with the use of such financial measures in small firms is that they usually have to be ascertained from survey responses of the firms’ owners who often may not appreciate the fine distinction necessary in financial definitions. Reported profit, for example, may be before or after the owner’s own remuneration. The owner’s remuneration may be reflective of a market rate for similar employment, but is just as likely to be adjusted to reflect life-style wishes or personal taxation circumstances. Liabilities may include debt that is arguably equity (debt secured by personal assets) and many personal assets used in the business may not be reflected on balance sheets. Measures involving profit and returns on assets or investment may not, therefore, produce comparable outcomes. Sales growth is likely to suffer least from these potential data problems and hence provide the most consistent and comparable indicator of economic performance from a financial perspective.

Non financial indicators may also be used to measure economic performance. The most common non-financial operational performance measures used seem to be related to the number of employees. These also range from absolute numbers to measures incorporating employment growth. They also include measures of productivity that relate employment to financial