

Pre-start Up Formal Business Planning by New Immigrant Entrepreneurs in South Africa

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ABSTRACT The study investigated the use of formal business plans by new immigrant entrepreneurs during the start-up stage. In addition, the study examined the drivers and barriers to business planning by new immigrant entrepreneurs. The study used the qualitative research technique. The in-depth interview method was used for data collection. Thematic analysis was used for data analysis. Out of the thirty new immigrant entrepreneurs that participated in the study, only four prepared formal business plans. The major drivers of formal business planning were to get external finance and to gain direction for the business. The barriers included lack of skills and financial constraints. Recommendations to improve the level of business planning by new immigrant entrepreneurs were suggested.

INTRODUCTION

De Witte et al. (2012) point out that unemployment is one of the most serious problems facing South Africa. Unemployment leads to the erosion of human capital, social exclusion, crime and social instability. The unemployment rate in South Africa at twenty-five percent is one of the highest in the world (Statistics South Africa 2015; International Labor Organization 2015). Entrepreneurship and small business creation are one the solutions to the high levels of unemployment and poverty in South Africa (Bosma et al. 2007; Kelley et al. 2010; Kamberidou 2013). Immigrant entrepreneurs employ natives and contribute positively to job creation in South Africa (Tengeh et al. 2012).

Immigrants are an important source of human capital, which is vital to the development of entrepreneurship in many countries. Immigrants find it difficult to enter formal employment in their host countries and business creation is one of the means of survival. Self-employment rate amongst immigrants are significantly higher than those of locals (Schuetze and Ancecol 2005). However, the failure rate of immigrant-owned businesses is higher than that of natives. Immigrant entrepreneurs are negatively impacted by the inability to enter the formal credit market (Sinnya and Parajuli 2012; Organization for Economic Cooperation and Development 2013). Immigrant entrepreneurs face discrimination from formal sources of finance (Altinay and Altinay

2008). Access to resources is a key challenge for immigrant entrepreneurs during early venture development (Foss 2010; Fairlie and Lofstrom 2013). Because of the high failure rate of new businesses (immigrant-owned included) it is important to understand the approach to firm creation by entrepreneurs. This can improve the chances of business survival and performance (Gupta et al. 2013).

Business planning can help reduce the high failure rate of immigrant-owned businesses. The opportunities for creating new ventures often arise in the form of unclear market needs. Business opportunities at times begin as rough concepts (Osievskyy et al. 2013). Entrepreneurs need to develop their rough ideas to a point where they have sufficient information and conceptual clarity for starting a business. Some entrepreneurs start a new business with only a rudimentary business concept in mind. Some entrepreneurs prepare business plans (Gruber 2007). A business plan can be informal or formal. Informal business plans are often held in the heads of the business owners. Formal business plans are usually carefully prepared and formally written (Richbell et al. 2006). This study focuses on the existence of formal written business plans by new immigrant entrepreneurs in South Africa. This study was guided by two research questions:

- ♦ Do immigrant entrepreneurs prepare business plans during the start-up phase?
- ♦ What are the drivers and barriers to the preparation of business plans by new immigrant entrepreneurs?

Literature Review

Immigrant Entrepreneurship

Dalhammar (2004) defines immigrants as people who come from another country to a particular host country. An immigrant entrepreneur is an individual who starts a business in the host country. Such businesses are called immigrant businesses (Schuetze and Ancecol 2005). According to Volery (2007), the theoretical framework of immigrant entrepreneurship can be traced to sociology, anthropology and labor economics. Many theories have been used to relate immigrants to entrepreneurship. The theories can be categorized into the disadvantage theory, the cultural theory, the ethnic enclave model, the middleman minority model, the ecological succession concept, the opportunity structure theory and the interactive theory (Zhang 2010). One of the dominant reasons for immigrant entrepreneurship is the disadvantage theory by Light (1979). The theory argues that immigrants become entrepreneurs because of the disadvantages that they suffer in the host countries. Immigrants face disadvantages in entering the labor markets. Thus, self-employment is one of the options available to immigrants. The cultural theory by Masurel et al. (2004) and Volery (2007) contend that immigrants possess some culturally determined features. These features include dedication to hard work, membership of a strong ethnic community, economical living and acceptance of risk. These features can facilitate and encourage entrepreneurship. The ethnic enclave theory by Wilson and Portes (1980) maintains that ethnic enclaves are a distinct form of economic adaptation. Through the ethnic enclaves, resources, customers and labor are obtained. Immigrants are inclined to be spatially concentrated. This concentration leads immigrants to organize businesses to serve their own market as well as the general population.

Another leading theory on immigrant entrepreneurship is the Middleman minority, which was developed by Blalock (1967) and expanded by Bonacich (1973). Middleman minority refers to minority entrepreneurs who mediate between the dominant and subordinate groups. The customers of this minority group come typically from ethnic or immigrant groups that are segregated from the majority group (Blalock 1967). Minority entrepreneurs have some peculiar char-

acteristics. They play the role of a middleman between the producer and consumer, and employer and employee. Middlemen minority tends to have strong ethnic ties (Bonacich 1973). The ecological theory by Aldrich et al. (1989) argues that changes in the environment of a residential area can nurture immigrant entrepreneurship. When the immigrant population increases in an area, the natives tend to move to other areas leading to a decrease in their population. The pattern of change in business ownership of immigrant and natives mirrors the pattern of change in residential succession. The opportunity structure theory by Evans (1989) remarks that linguistically bounded groups of immigrants can form niches that can be tapped by entrepreneurs. Immigrant entrepreneurs have an advantage in obtaining resources and labor from co-ethnics.

The interactive model of immigrant entrepreneurship offers an explanation for immigrant enterprises based on the interaction between the opportunity structure of the host society and the group characteristics and social structure of the immigrant community. Immigrants with limited capital are able to start small businesses because of low entry barriers. In addition, opportunities for ownership arise in the process of ethnic succession. The development of immigrant-owned businesses cannot be linked to a single characteristic but to a complex interaction between opportunity structures and group resources (Waldinger et al. 1990).

Immigrant entrepreneurs contribute to job creation, poverty alleviation and economic growth of host countries. Immigrant entrepreneurship has stimulated many studies in South Africa (Tengeh et al. 2012; Fatoki 2014). The failure rate of immigrant-owned businesses is higher than that of natives (Organisation for Economic Cooperation and Development 2013). Business planning can help improve firm survival rate (Osievskyy et al. 2013).

Business Planning

A business plan can be described as a formal written document that carefully describes the internal and external parts of a new business (Barringer 2009). According to Timmons and Spinelli (2007), a business plan is supposed to carefully explain the requirements, risks and potential rewards of a venture. The business plan is a vital part of new venture creation and should

come after the identification of a viable opportunity. A business plan has three core functions:

1. It is an action plan as it can stimulate the entrepreneur to move into action.
2. It is a roadmap.
3. It is a sales tool that can be used to attract investors.

A written business plan spells out in detail the resources and founding strategies for new venture bankers and investors can use a business plan as a screening device to determine the requirements for the business (Lange et al. 2007; Botha and Robertson 2014).

Honig and Samuelson (2011) point out that the theoretical framework of the importance of business plan to the performance of a venture can be linked to the goal-setting theory, the legitimation theory and the theory of planned behavior. The goal-setting theory by Locke and Latham (1979) and (2002) define a goal as the aim of an action to be achieved within a specific time period. Goals affect performance in four ways.

1. Goals are a directive function. Goals direct effort and attention towards activities that are relevant to the achievement of the goals.
2. Goals have energizing functions. Greater effort comes from high goals compared to low goals.
3. Goals have an impact on persistence
4. Goals indirectly affect action by leading to the discovery and use of task-related knowledge and strategies.

Therefore, goal setting through business planning encourages the business owner to put in substantial effort. Goal directed motivations are an important element in the formation and achievement of entrepreneurial intentions (Honig and Samuelson 2011). The legitimation theory argues that entrepreneurs write business plans in response to external demands. This is a symbolic act by entrepreneurs to gain legitimacy for their actions. New ventures gain by conforming to institutional pressures (Honig and Karlsson 2004; Karlsson and Honig 2009). Legitimacy is a vital resource as it allows the new venture to gain the acceptance of external stakeholders. It also helps obtain financial resources from commercial banks and investors (Honig and Samuelson 2011). The theory of planned behavior asserts that behavior is preceded by one's intention to perform the behavior and perceived control over the behavior (Ajzen 1991). The the-

ory of planned behavior has been widely used to predict intentions and behaviors in many fields including entrepreneurship. Business planning can facilitate the integration of goals into people's behavior and link intention to action (Lortie and Castogiovanni 2015).

Gruber (2007) and Brinckmann et al. (2010) point out that there is a debate in the field of entrepreneurship about the importance of business planning. Research on the impact of business planning on the performance of new ventures is inconclusive. While some studies view business planning as one of the keys to business creation and success, other studies disagree with this assertion (Gruber 2007). The planning school claims that a business plan leads to a systematic, prediction-oriented, and formal approach and can positively impact on venture performance. Planning can help the entrepreneur develop an orientation to the unforeseen environment of the future, understand resource requirements and funding sources and to minimize bottlenecks across the value chain (Brinckmann et al. 2010). Planning allows the pursuit of goals in a systematic way. Business planning allows a new venture to solidify its goals and get funding and support from investors, suppliers and business partners (Barringer and Ireland 2006). Supporters of business planning cite the importance of maximizing resources, rapid decision-making and sequential development process (Honig and Samuelsson 2011). New ventures that engage in business planning are more persistent than those who do not plan (Gartner and Liao 2006). This suggests that business planning can help reduce the high failure rate of immigrant entrepreneurs.

Some researchers dispute the importance of business planning. Their argument focuses on the fact that the business environment of a new venture is highly uncertain (Brinckmann et al. 2010). Thus, entrepreneurs should emphasize on learning, strategic flexibility and controlling resources. Formal planning hinders flexible and adaptive learning processes that are required in uncertain business environments (Richbell et al. 2006). A study by Bygrave et al. (2008) finds no difference between the performance of new ventures launched with or without written business plans. The findings of the study suggest that unless an entrepreneur needs financial capital from equity or debt providers, there is no compelling motive to write a detailed

business plan before opening a new venture. Brush et al. (2008) find an insignificant relationship between business planning and firm performance. Van Gelderen et al. (2005) did not find a significant positive relationship between business planning and the ability of a new venture to become operational.

Richbell et al. (2006) and Brinckmann et al. (2010) agree that the literature is inconclusive about the effect of business planning on firm performance. However, the weight of research evidence points to the beneficial effects of business planning on firm performance. Researchers that argue against business planning for small firms seem to be in the minority. New ventures should be involved in a dynamic approach to planning, learning, and doing. Business planning activities can be undertaken to provide the foundation for the business. As plans are carried out, real world experiences are made, and learning takes place, and the business plan can be changed. This approach combines both planning and learning schools (Gruber 2007). These views are consistent with that of Karlsson and Honig (2009). The researchers argue that despite conflicting findings, many business plans are written each year globally. Entrepreneurs spend precious time, effort and money on business plans. Government agencies that support entrepreneurs, universities and business schools include the preparation of business plans in their curriculum. Thus, recent research seems to reach a conclusion advocating a planning paradigm for new business ventures (Honig and Samuelsen 2011).

RESEARCH METHODOLOGY

The survey was conducted in the Johannesburg Central Business District in Gauteng province of South Africa. The area has a high number of immigrant entrepreneurs and thus suitable for the research. Because of the difficulty of obtaining the population of immigrant-owned businesses in the study area, purposive and snowball sampling methods were used. The study focused on new immigrant entrepreneurs. A new business can be considered as a business that is not older than forty-eight months (Herrington and Kew 2014). The study used the qualitative research technique. This is a research type that is characterized by its aims, which relate to understanding some aspect of social life,

and its methods, which generate words, rather than numbers, as data for analysis (Bricki and Green 2007). The in-depth interview method was used for data collection. In-depth interviews are a qualitative data collection technique that can be used for a variety of purposes. In-depth interviews are very suitable for situations in which the researcher wants to use open-ended questions to obtain information in depth from relatively few people (Guion et al. 2011). Interviews were conducted with the participants and recorded. Each interview took about one hour and was conducted at the convenience of the participant. Participation was voluntary and confidentiality was assured. Thematic analysis was used for data analysis.

RESULTS AND DISCUSSION

Response Rate and Demographic Variables

Fifty new immigrant entrepreneurs were contacted and thirty participated in the research. The participants include twenty-four males and six females. Seventeen respondents were in the retail sector and thirteen in the service sector.

Preparation of Business Plan During the Start-up Stage

The interviews on the preparation of formal business plans by immigrant entrepreneurs are summarized in Table 1. Out of the thirty respondents, twenty-six (86.7%) did not engage in formal business planning during the start-up stage. Four (13.3%) engaged in formal business planning during the start-up stage. The results indicate that a majority of immigrant entrepreneurs that took part in the study did not prepare business plans during the start-up stage.

Table 1: business planning by immigrant entrepreneurs

<i>Business plan</i>	<i>Number</i>	<i>Percentage</i>
Formal written business plan	4	13.3
No business plan	26	86.7

The results are consistent with the findings of Richbell et al. (2006). The researchers found that over half the small businesses surveyed in their study had no business plans. The findings fit well with the general perception of the lack of planning by small firms. Business planning is not a characteristic of the majority of small firms.

Bhide (2000) agrees that only a minority of entrepreneurs, including even holders of Master of Business Administration qualification from a leading business school, commenced their ventures with a formal written business plan.

Business Plan Drivers

The four respondents with formal business plans were asked what motivated them. Some of the responses of the participants are analyzed below.

Participant: *"I needed external finance from a commercial bank to supplement personal funds. One of the requirements for external finance by commercial banks is the business plan."*

Participant: *"I am of the opinion that a business plan can provide direction for my enterprise. I wanted to determine the resource requirements, the competitors and markets and sustainability of my enterprise. Having a formal business plan helped clarify the objectives of my business."*

Participant: *"A formal business plan helped me clearly understand the capital requirements of my business. I was able to clearly understand how much I needed to invest in the business."*

One of the reasons given for the preparation of a formal business plan is the need for external finance from commercial banks. Owner's equity is often inadequate for many small firms. Thus, there is the need for external debt or equity. Access to equity funding from venture capitalists is highly limited for small firms. Debt from commercial banks is one of the financing options for new firms. One of the requirements for the granting of credit by commercial banks to new small firms is a business plan (Fatoki 2014). Another reason given by the respondents is that formal business planning is useful to gain direction for the business. Business planning helps clarify the goals and benchmarks of the business. It also helps in understanding the resource requirements, the market, the competitors and the profitability of the business. Barringer and Ireland (2006), Gartner and Liao (2006) and Honig and Samuelsson (2011) assert that business planning allows the pursuit of goals in a systematic way. Business planning allows a new venture to solidify its goals and get funding and support from investors, suppliers and business partners. New ventures that engage in business planning are more persistent than those who do not plan.

Business Plan Barriers

Twenty-six respondents did not prepare business plans. Some of the responses of the participants are analyzed below.

Participant: *"I do not see the need for a business plan. It is a waste of my time."*

Participant: *"I have never written a business plan and I don't understand how to write one. My business is very small and I could not pay someone to write a business plan for me."*

Participant: *"I have just started my business and presently I do not require funds from a bank. If I need external finance I will get assistance from other traders that are my friends. I cannot see the real benefit of having a business plan."*

Participant: *"None of my colleagues have ever started a business with a business plan. I was involved in this business as an apprentice before I started my own business. I fully understand all the requirements of the business. Having a business plan will not add any value to my business."*

The reasons for not engaging in formal business planning by new immigrant entrepreneurs can be summarized as follows:

1. It is a waste of time and resources.
2. Did not know how to write a business plan.
3. Do not understand the benefit of a business plan.
4. Did not have money to pay a consultant to write a business plan.
5. Do not presently require external finance.
6. The business environment is highly unstable.

CONCLUSION

The study investigated the extent of formal business planning by new immigrant entrepreneurs during the start-up phase. The study also examined the drivers and barriers to formal business planning by new immigrant entrepreneurs. Out of the thirty respondents in the study, only four prepared formal business plans. The results suggest that most immigrant entrepreneurs do not prepare business plans before starting their businesses. One of the drivers of business plan preparation is the need for external finance from commercial banks. Another reason giving by the respondents is that formal business planning is useful to gain direction for the business. Busi-

ness planning helps clarify the goals and benchmarks of the business. It also helps in understanding the resource requirements, the market, the competitors and the profitability of the business. Business planning barriers include:

1. Time and resources
2. Inability to write a business plan
3. Inability to understand the benefits of a business plan
4. External finance not needed

RECOMMENDATIONS

There is a need for personal skill development for new immigrant entrepreneurs. Immigrant entrepreneurs need to develop their skills and competencies that will enable them to prepare business plans. Immigrant entrepreneurs can develop the skills to prepare business plans through the support of institutions and non-governmental organizations that support entrepreneurship. Government agencies that support entrepreneurship in South Africa, such as the Small Enterprise Development Agency and the Small Enterprise Finance Agency, should include immigrant entrepreneurship as part of their strategic framework. These agencies should establish training links with immigrant entrepreneurs. The websites of commercial banks in South Africa contain information on business plan preparation. In addition, there are many sources on the Internet and many software packages that can help with business planning. New immigrant entrepreneurs need to be aware of these sources through education, training and self-development.

FURTHER STUDIES

The impact of pre-start-up business planning on the post-start-up performance of immigrant entrepreneurs is an interesting research area. In addition, the effect of firm and entrepreneur characteristics on business planning is a research area that is worth pursuing.

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