WHAT FINANCIAL BACKERS EXPECT FROM BUSINESS PLANS: EFFECTUAL VERSUS CAUSAL LOGIC

Olivier Daxhelet and Olivier Witmeur

Aim of the Paper
For years, business planning (BP) has played a central role in the teaching and practice of new venture creation. However, existing research has provided us with mixed results about its usefulness. Part of the argument against BP is that it relies on top-down logic while emerging bottom-up logic may be more relevant. Sarasvathy (2001) proposed that successful entrepreneurs tend to be effectual rather than causal. Sarasvathy & Wiltbank (2002) also suggested that business angels (BA) and venture capitalists (VC) tend to be more effectual than causal and should then pay less attention to BP. This paper has two objectives. It first checks to what extent different kinds of financial backers (i.e. BA, VC, and bankers) are generally causal or effectual in their thinking when they analyze new ventures. It then clarifies how greatly the content of the business plan prepared by an entrepreneur differs from one type of financial backer.

Contribution to the literature
This paper advances the literature on the use of BP, especially when entrepreneurs are searching for financial backing. It contributes to a better understanding of the expectations of different financial backers. This paper also clarifies under which conditions a traditional business plan is relevant to achieve financing and defines the type of critical information that must be included in the plan.

Methodology
The research in this paper is qualitative. We relied on in-depth structured interviews of eight Belgian financial backers: three commercial bankers, three VC, and two BA. The interviews followed a systematic and replicable model, which included the “venturing experience” developed by Sarasvathy & al. (2001).

Results and Implications
The three different types of financial backers, commercial bankers, venture capitalists (VC), and business angels (BA), all have clear distinctions that separate them from each other. BAS are more effectual than VCs, whereas commercial bankers are more causal. In addition, the content of the expected business plan usually differs between financial backers. BA and VC pay more attention to the entrepreneur, while commercial bankers pay more attention to financials and the plan itself.

From a theoretical point of view, the research confirms the importance of adopting a contingent approach when analyzing the expectations and behavior of financial backers and what they mean by BP. For practitioners, the research contributes to the discussion about the usefulness of BP and confirms that it is not the time to ‘burn business plans’ since all financial backers are still willing to receive one. However, the results indicate that the time has come for the content of business plans to evolve in order to remain relevant.
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ABSTRACT

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what they mean by BP. For practitioners, the research contributes to the discussion about the usefulness of BP and confirms that it is not the time to ‘burn business plans’ since all financial backers are still willing to receive one. However, the results indicate that the time has come for the content of business plans to evolve in order to remain relevant.
1. **INTRODUCTION**

For years, the writing of a business plan has played a central role in the practice of new venture creation. Indeed, when dealing with the creation or growth of a new business venture, entrepreneurs and their financial backers typically rely on a business plan. The topic of how to run a new project, or venture, has been written about extensively. The overall conclusions suggest that business planning (BP) is the ultimate roadmap. However, existing research has provided us with mixed results about the usefulness of business plans. In the field, the confusion is reinforced by the relentless debates fueled by academics and practitioners. On the one hand, one single search for “business plan” in the book section of Amazon points out more than 2,700 titles, including many very recent ones. On the other hand, there are multiple calls for developing new approaches, giving the impression that the right thing to do may be to “burn your business plan” in favor of a new approach (e.g. Gumpert, 2002).

Part of the argument against the business plan method is that it relies on top-down strategic planning, while the newly emerging bottom-up logic may be more relevant and efficient (e.g. Mintzberg, 1994; Avenier, 1997). In other words, Sarasvathy (2001) proposes that successful entrepreneurs tend to be effectual rather than causal. She further suggests that business angels (BA) and experienced venture capitalists (VC) also tend to be more effectual than causal. This would suggest that both entrepreneurs and their financial backers should pay less attention to formal predictive logic, i.e. business planning. Wiltbank, Sudek & Read (2009) confirm this line of thinking.

This paper refines the above idea and extends its scope. Our main objectives were twofold. First, we wanted to empirically-check to what extent different kinds of financial backers (i.e. business angels, venture capitalists, and bankers) are generally causal or effectual when they analyze new venture projects. Secondly, we wanted to clarify to what extent the content of the document to be prepared by entrepreneurs who are looking for their financial support differs from one type of backer to another. In order to accomplish this, we conducted in-depth and structured interviews of three commercial bankers, three venture capitalists, and two business angels in Belgium.

The following details the structure of the article. In section 2, we review the literature on business planning, investment criteria, and effectuation and then highlight connections. In section 3, we explain the methodology of the study and present our findings. Section 4 is then devoted to the analysis of these findings and the main limitations of the study. Finally, in the conclusion, we present our contribution to the literature and suggest future research.

2. **LITERATURE**

2.1 **The Business Plan**

Business plans are well known by investors, entrepreneurs, and students. “A business plan describes the business’s vision and objectives as well as the strategy and tactics that will be employed to achieve them. A plan may also provide the basis for operational budgets, targets, procedures, and management controls” (Frien G. and S. Zehle, 2004). The underlying logic behind a business plan is to try to predict the future of a company by using specific marketing, strategy, and financial research and planning tools. In fact, while engaging time and money, entrepreneurs desiring to increase their chance of success should plan their business and test it against multiple scenarios. Ettinger & Witmeur (2003) observed four uses for the business plan. First, it is a decision-making tool that helps entrepreneurs review the most important
success factors of a venture. Second, the business plan is an analytical tool. It integrates multiple techniques (e.g. SWOT analysis or Porter’s five forces model), that help to analyze the pros and cons of different options. Third, the business plan is a communication tool that is required when entrepreneurs want to attract new business partners, including financial backers. Finally, the business plan is a controlling tool that can be used to monitor the short and long-term evolutions of the project. A business plan’s typical structure includes four main chapters: the context (including team, opportunity, market, and industry), the strategy (including vision, core business, and position), the action plan (including production, sales & marketing, and R&D plans), and the financials. The financial section should contain the projections and the investment requirements.

2.2 Limitations of Business Planning

Today a huge amount of literature on business planning is available and most business schools offer a business planning course. However, the relationship between the practice of formal planning and superior company performance is far from obvious. Six typical arguments against business planning are briefly summarized in this next section.

First, writing business plans is based on a top-down approach, which is not suitable in every situation. The Segmentation-Targeting-Positioning (STP) formula explained by authors such as Kotler (1994) is widely used by entrepreneurs who have to launch their venture and define who their customers are. However, Sarasvathy (2008) proposes that the entrepreneurial decision-makers do not always start with a predetermined goal or target. She suggests that they rather start with a predetermined set of means and later select a market, i.e. they do not follow the STP sequence. In fact, the ‘reversed’ sequence is more relevant when the market does not yet exist at the inception of the venture.

Secondly, writing business plans is very time consuming. Indeed, it may take a lot of time (about 3 months) to collect data and properly formalize the plan in writing (i.e. most business plan guides advise to write a 30-40 page document). Many specialists suggest this time could be better used doing actual business (e.g. Mintzberg 1994).

Thirdly, writing plans is useless in an unpredictable market. Armstrong (1982) suggested that the relevance of formal planning is limited under high uncertainty. Despite this theoretical view, he made the hypothesis that high uncertainty would require more planning. However, his study could not confirm it.

Fourthly, the importance of BP business planning depends on cultural aspects. Rauch, Frese, and Sonnentag (2000) found that the relationship between planning strategies and success in small-scale enterprises was positively correlated in West Germany and East Germany, but negatively in Ireland. They proposed that business planning only has a positive impact in cultures that value uncertainty avoidance. They also proposed that the professional background of stakeholders has to be taken into consideration. For example, if the entrepreneur only deals with business angels, the importance of planning would be lower than if he deals with commercial bankers.

Fifthly, formal planning is not dynamic and could prevent entrepreneurs from exploiting contingencies. As explained by e.g. Ardichvili, Cardozo, and Ray (2003), opportunities are made, not found. Flexibility in the development of opportunities should then be the entrepreneur’s number one priority. Consequently, rigid business plans could prevent them from properly developing their project when opportunity arises. In other words, Baker, Miner, and Eesley (2003) explained that formal planning obscures the potential value of improvisational skills. They highlighted the necessity of training in improvisational skills so that entrepreneurs can use and combine both rigid and flexible methods when appropriate.
Sixthly, traditional business plans typically look the same and do not always convince stakeholders anymore (e.g. Kirsh, Goldfarb, & Gera, 2009). In fact, business plans often appear as being part of business tradition, but do not include enough valuable insights on the business itself since the plans often pay more attention to form than to substance. Nevertheless, this traditional view of business plans by financial backholders highlights the consensus about the need to write a business plan when entrepreneurs are looking for financial support.

2.3 Relationship between business planning and company performance

Results on the impact of planning on company performance are contradictory. On the one hand, Brews and Hunt (1999) found a positive relationship between formal planning and the company performance. They also suggest that the environment has no influence on these results. As a conclusion, they felt entrepreneurs should always plan. The authors only suggest that plans should be flexible in uncertain markets. After a study on 223 new companies, Delmar and Shane (2003) argue that business planning has a positive impact since it reduces the likelihood of the venture disbanding, accelerates product development, and reinforces organizing activities. On the other hand, Lumpkin, Shraeder, and Hills (1998) analyzed 94 companies and observed that writing a formal business plan had no influence on company performance, neither for established firms, nor for new ventures.

Brinckmann, Grichnik, and Kapsa (2010) applied meta-analysis to reanalyze the empirical findings of 46 studies on 11,046 new and established firms to test the influence of planning on venture performance. They also paid attention to the influence of the context (i.e. newness of the firm, nature of business planning practice, and cultural variables) to mitigate the relevance of business planning. Their findings confirm the positive influence of planning on firm performance, but they also highlight that there are some factors that can strain the relationship. First of all, firm newness reduces the return of planning, i.e. planning should start to be used after the gathering of all information by the entrepreneurs and once the influence of contingencies is being reduced. Secondly, they found that written business plans have the same impact as informal business planning activities. In other words, there is no best way to plan. Finally, they observed that business planning is less effective under high uncertainty. An interpretation of this could be that entrepreneurs that have high uncertainty avoidance may more closely stick to their plan, reducing their scope of decisions.

2.4 Effectuation

Sarasvathy (2001) has introduced the difference between the causal and effectual approaches. The causal approach (i.e. causation) assumes that the goal associated with one opportunity is predetermined and that the entrepreneurs will select the appropriate resources and best way (among many available options) that will lead to the desired objectives. In contrast, the effectual approach (i.e. effectuation) first focuses on existing resources, aspirations, and abilities in order to reduce the uncertainty and increase the controllability of the future. In other words, effectuation proponents suggest that entrepreneurs should start with their means, imagine what they could do with them, and then create new opportunities.

Sarasvathy (2010) explained that effectuation is neither an irrational approach, nor a random process. Instead, it integrates important theoretical insights from existing research but differs from the traditional approach for three main reasons. The first being because the goal is not predetermined, effectual entrepreneurs go through experimentation and learning. In addition, because entrepreneurs do not start with a definite set of means, they often transform possibilities into opportunities. Lastly, because the market is not always known, or in some
cases does not even exist, entrepreneurs are not afraid to create new markets.

To make the distinction between causation and effectuation as clear as possible, Sarasvathy (2001) explains effectuation with four pillars. The first pillar is called, “affordable loss rather than expected returns.” It states that effectual entrepreneurs prefer deciding what they are ready to lose rather than investing the amount that will maximize their returns. In other words, effectual entrepreneurs would rather engage limited time and money and try as many strategies as possible to reach success. According to this process, a scenario that leads to new opportunities is considered as positive, even if it does not directly generate profit. The second pillar is “strategic alliances rather than competitive analysis.” The focus is on strategic alliances and early partnerships that entrepreneurs may develop. Instead of spending time in analyzing the competitive landscape, the effectual process leverages on connections with potential partners whose involvement will help reduce uncertainty. The third pillar is the “exploitation of contingencies rather than exploitation of preexisting knowledge.” It relies on the entrepreneurs’ ability to act according to contingencies and to try to convert them into opportunities. Consequently, effectual entrepreneurs do not worry about surprises, while causal practitioners see unexpected outcomes as negative and prefer developing plans and scenarios to anticipate them. Lastly, the fourth pillar is called, “controlling an unpredictable future rather than predicting an uncertain one.” It suggests that effectual entrepreneurs do not need to predict the future because they focus on controlling it. For example, effectual entrepreneurs do not start with the world population only to then segment it; instead, they start with a small group of people they know as their first customers, and then develop the market with this basis.

According to Sarasvathy (2001), the four pillars are used together by expert entrepreneurs when they create a new venture. Chandler, DeTienne, McKelvie, & Mumford (2009) only partially agree with this statement. They argue that effectuation is a formative and multidimensional construct with three sub-dimensions, which are pillars 1, 3, and 4. They found that pillar 2 is shared with causation. Indeed, partnerships are a key part of the effectual approach, but they are also used in the traditional managerial literature as a way to acquire resources and implement plans. According to these findings, the measurement of effectuation should include experimentation, affordable loss, and flexibility.

3. FINDINGS

3.1 Methodology

In 2008, we conducted interviews of eight Belgian financial partners. The interviews were conducted according to the guidelines on case study research suggested by Yin (2003). We adopted purposeful sampling (Patton 2002) in order to have maximum variation inside the sample with three commercial bankers, three venture capitalists, and two business angels. All interviews were taped. Datasets were encoded in order to allow cross case comparison (Miles & Huberman 1994).

Our sample was made of three commercial bankers, three venture capitalists and two business angels. Three of the four largest Belgian banks employed the commercial bankers in Belgium. They were all branch managers of a local SME Business Unit. The venture capitalists all worked as analysts in established venture capital firms. Their funds were invested in Belgium. Some funds were partially state-financed. Both business angels were former employees of big
corporations (i.e. not previous entrepreneurs) and had decided to invest in new ventures as a full-time job. Their investments were not only located in Belgium. All subjects were between 26 and 55-years-old and were dedicated full-time to their respective jobs for more than two years. Only one of our subjects was female.

The in-depth interviews all followed a systematic and replicable three-step model.

The first step to the interview mimics the “venturing experience” developed by Sarasvathy & al. (2001). Here, financial backers were asked questions about the identification of the market for a given new product. Their answers were then sorted into two categories: one for the effectual approach (coded “EF”), and one for the causal approach (coded “BP”). To do so, we created a situation where a company called “Venturing” wanted to develop and sell a software game. The situation was uncertain and could be addressed with multiple possible strategies. Although imaginary, the project was supposed to be technically feasible and financially viable. The subjects were asked to put themselves in the position of the entrepreneur and had to answer five questions: (i) “Who could be your potential customers for this product?”, (ii) “Who could be your potential competitors for this product?”, (iii) “What information would you seek about potential customers and competitors?”, (iv) “How will you find out this information, what kind of market research would you do?” and (v) “What do you think are the growth possibilities for this company?” Their answers were read several times in order to isolate relevant quotes. A relevant quote can be a sentence or a group of sentences forming a meaningful idea. We then classified all relevant quotes into two groups: “BP” and “EFF.” For example, when someone said: “The only way to know your customers is to use the STP model. After that, I would ask a market researcher to calculate the number of potential customers in the area,” this would be coded “BP” because it demonstrated the causal approach. On the contrary, when a respondent answered: “I do not believe in market research; I would do better crossing the street and asking the Video Store to distribute the game to some clients and see what they think about,” this was coded “EFF” as it is a clear example of the effectual approach. As we wanted to avoid any influence on respondent attitude and answers, we proceeded without telling them the purpose of the study. The concept of effectuation was then only explained after the third step.

In the second step, we tested the four pillars of effectuation individually. As the venturing experience does not necessarily cover all the aspects of effectuation logic, we asked fifteen additional questions related to the four pillars. Three questions (coded E.1.x) tested the first pillar (i.e. affordable loss rather than expected returns); three questions (coded E.2.x) tested the second pillar (i.e. strategic alliance rather than competitive analysis); four questions (coded E.3.x) tested the third pillar (i.e. exploitation of contingencies rather than preexisting knowledge); and five questions (coded E.4.x) tested the fourth pillar (i.e. controlling an unpredictable future rather than predicting an uncertain one). An example of this can be seen in question E1.1, which tested the first pillar. The question was “It is more important to limit losses in case of failure than to maximize profits in case of success. Do you agree?” If the subject answered “yes,” he validated pillar 1, while if he answered “no,” he invalidated it. Another example is question E.3.4: “At which moment in the development would you present your product to the potential clients?” Possible answers were: a) Idea, concept; and b) Final product, ready to deliver. If the subject answered “A” he validated pillar 3, if he answered “B,” he invalidated it.

In the third step, we focused on the relative importance of the six typical elements of a business plan, i.e. (1°) entrepreneur(s) profile, (2°) product description, (3°) market research,
(4°) competitive analysis, (5°) marketing strategy, and (6°) financial plan. In short, we asked respondents to rank the six elements, to elaborate on the meaning of each item, and to comment on their classification.

We present the findings of each step in the next three subsections.

3.2 **Step 1: The venturing experience**

The results for the venturing experience are detailed in the Table 1. The first group, venture capitalists (VC1, VC2, and VC3) use effectual reasoning 63% of the time. The second group, commercial bankers (B1, B2, and B3), use effectual reasoning only 31% of the time. The third group, business angels (A1 and A2), choose effectuation 69% of the time.

<table>
<thead>
<tr>
<th></th>
<th>EFF quotes</th>
<th>BP quotes</th>
<th>% of EFF quotes</th>
</tr>
</thead>
<tbody>
<tr>
<td>VC1</td>
<td>6</td>
<td>3</td>
<td>66%</td>
</tr>
<tr>
<td>VC2</td>
<td>6</td>
<td>4</td>
<td>60%</td>
</tr>
<tr>
<td>VC3</td>
<td>5</td>
<td>3</td>
<td>62%</td>
</tr>
<tr>
<td>B1</td>
<td>4</td>
<td>9</td>
<td>31%</td>
</tr>
<tr>
<td>B2</td>
<td>3</td>
<td>4</td>
<td>43%</td>
</tr>
<tr>
<td>B3</td>
<td>1</td>
<td>4</td>
<td>20%</td>
</tr>
<tr>
<td>A1</td>
<td>4</td>
<td>2</td>
<td>66%</td>
</tr>
<tr>
<td>A2</td>
<td>5</td>
<td>2</td>
<td>71%</td>
</tr>
</tbody>
</table>

We hereafter highlight a few relevant quotes.

The commercial bankers adopt the causal approach around two-thirds of the time. Indeed, they start with a very formal quantitative market research:

- “The market study will tell us which type of customer will buy our product. I believe that the quantitative method is valid because it is a tool that allows us to target more customers. (B1).”

Accordingly, they are even ready to pay for this kind of information:

- “I would pay for a market research. I know that professional associations can provide me with these datasets for EUR 3.000 to 5.000. (B3).”

Many other quotes reveal their causal logic:

- After the analysis of the market, they move to the classical STP (Segmentation, Target, Positioning): It is a lot better to know your customers first. (B2).”
- “I would target my customers. After that, I will try to find a niche market so that my prices can be higher. What you want is to collect monopoly profits. (B1).”

Finally, the commercial bankers focused on financial projections:

- “I would make financial projections on 3 years. (B1).”
- “I would try to make a P&L to have an idea of the future profits, especially if I need bank financing. (B3).”

This last comment highlights the fact that financial analysis is critical for commercial bankers because credit analysts who “care a lot about numbers (B3)” scrutinize credit requests. In fact,
every project has to be quantitatively rated and a positive decision will only be made if minimum ratios are reached.

The venture capitalists, however, used effectual reasoning more than 60% of the time. Their main logic clearly differs from the commercial bankers. They tend to start with what they have and who they know:

• “Well, I will first send an email to my contacts to see what they think. (VC2),”

Early in the process, they try to limit potential losses:

• “I would start on a local basis and later expand step by step, i.e. when I can afford for it. (VC1).”
• “I would not make huge investments at the beginning. At the beginning, you limit costs. (VC1).”

Later on, they will look for more partners:

• “I would show the game as soon as possible to potential clients. To be faster I will find an external commercial agent. Starting alone is a too big challenge, I will not try to do everything myself. (VC1).”

The business angels use effectual logic approximately two-thirds of the time. A notable difference between the business angels and the commercial bankers is their reflex to test the product as soon as possible. They do not spend time planning, prefer testing the product on the market, and adapt it as they get the first feedback. Another recurrent observation is that the business angels would outsource as much as possible:

• “I will first outsource distribution and marketing. I will not take care of the development. It costs too much money, even if you can do it in India. I will try to put in place a network, so that I can meet developers and distributors. I would share everyone's skills to reduce investments. (A1).”

3.3 Step 2: Effectuation Pillars

Table 2 shows the results for every question. If the subject validated the effectual logic, he scored a 1, if not he scored 0. When he was unclear, we marked the area with the symbol ‘/’.

Table 2

<table>
<thead>
<tr>
<th>Pillar 1</th>
<th>Pillar 2</th>
<th>Pillar 3</th>
<th>Pillar 4</th>
</tr>
</thead>
<tbody>
<tr>
<td>E1.1</td>
<td>E1.2</td>
<td>E1.3</td>
<td>E2.1</td>
</tr>
<tr>
<td>VC1</td>
<td>0</td>
<td>0</td>
<td>1</td>
</tr>
<tr>
<td>VC2</td>
<td>1</td>
<td>1</td>
<td>1</td>
</tr>
<tr>
<td>VC3</td>
<td>1</td>
<td>0</td>
<td>1</td>
</tr>
<tr>
<td>B1</td>
<td>1</td>
<td>1</td>
<td>0</td>
</tr>
<tr>
<td>B2</td>
<td>1</td>
<td>0</td>
<td>1</td>
</tr>
<tr>
<td>B3</td>
<td>1</td>
<td>1</td>
<td>0</td>
</tr>
<tr>
<td>A1</td>
<td>0</td>
<td>1</td>
<td>1</td>
</tr>
<tr>
<td>A2</td>
<td>0</td>
<td>1</td>
<td>0</td>
</tr>
</tbody>
</table>

Table 3 summarizes the use of causal or effectual logic by each subject. It summarizes results from Tables 1 and 2, gives the percentage of quotes classified “EFF” or “BP” (data from Table 1) and shows which pillar of effectuation is validated (Yes), unclear (=) or invalidated (No), (data from Table 2).
Table 3

<table>
<thead>
<tr>
<th>% EFF Quotes</th>
<th>% BP Quotes</th>
<th>Pillar 1</th>
<th>Pillar 2</th>
<th>Pillar 3</th>
<th>Pillar 4</th>
</tr>
</thead>
<tbody>
<tr>
<td>VC1</td>
<td>67%</td>
<td>33%</td>
<td>NO</td>
<td>YES</td>
<td>=</td>
</tr>
<tr>
<td>VC2</td>
<td>60%</td>
<td>40%</td>
<td>YES</td>
<td>YES</td>
<td>=</td>
</tr>
<tr>
<td>VC3</td>
<td>63%</td>
<td>38%</td>
<td>YES</td>
<td>YES</td>
<td>YES</td>
</tr>
<tr>
<td>B1</td>
<td>31%</td>
<td>69%</td>
<td>YES</td>
<td>NO</td>
<td>NO</td>
</tr>
<tr>
<td>B2</td>
<td>43%</td>
<td>57%</td>
<td>YES</td>
<td>YES</td>
<td>NO</td>
</tr>
<tr>
<td>B3</td>
<td>20%</td>
<td>80%</td>
<td>YES</td>
<td>NO</td>
<td>NO</td>
</tr>
<tr>
<td>A1</td>
<td>67%</td>
<td>33%</td>
<td>YES</td>
<td>YES</td>
<td>YES</td>
</tr>
<tr>
<td>A2</td>
<td>71%</td>
<td>29%</td>
<td>NO</td>
<td>YES</td>
<td>YES</td>
</tr>
</tbody>
</table>

Since the majority of “Yes” for Pillar 1 is quite surprising, especially for commercial bankers, it needs to be further addressed. Indeed, bankers tend to stick to their financial projections, but according to our results, none of them believe that maximizing returns is critical. Indeed, bank employees would rather generate lower returns and prefer avoiding bankruptcy:

- “If I recommend 5 projects per year and if they all go bankrupt, I will have big problems with the manager (B2).”

Pillar 2 offers mixed results. Commercial bankers think that finding early partners is as important as analyzing competitors. They would definitely not go through SWOT analysis to understand their competitors better:

- “The competition is so huge, that I would not take care at all (B2).”

3.4 Step 3: Business Plan Content

The financial backers were given six components of a classic business plan and asked to rank them from one (most important when analyzing a business plan) to six (least important when analyzing a business plan). We then allocated a score to every element. For each subject, if an element was classified number one, it received 6 points, number two received 5 points, etc. Table 4 details the results. The score column represents the sum of the financial backer’s score for each business plan component.

Table 4

<table>
<thead>
<tr>
<th></th>
<th>B1</th>
<th>B2</th>
<th>B3</th>
<th>Score</th>
</tr>
</thead>
<tbody>
<tr>
<td>Market research</td>
<td>2</td>
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Based on the total scores, we compared the ranking per type of financial backer.

<table>
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Table 5

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<tr>
<th>Bankers’ ranking</th>
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<th>Angels’ ranking</th>
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<td>Entrepreneur(s) profile</td>
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<tr>
<td>Competitive analysis</td>
<td>Financials</td>
<td>Financials</td>
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</tbody>
</table>

The contrast between bankers and equity investors is straightforward. The entrepreneur’s profile and his personality are by far the most important items for venture capitalists and business angels:

- “According to me, you need a good team and the right people. People make the difference. It is really the most important aspect. (VC2)”

According to the commercial bankers in our survey, financial projections are the most important items:

- “I need a P&L on 3 or 4 years, a working capital requirement projection, the projected balance sheet and classical ratios. I prefer them to be conservative. For example, for a hotel, I will only assume a 30% occupancy rate. (B1)”

3.5 **Need for a business plan**

At the end of the interview, we asked each financial backer if he wants to receive a written business plan when entrepreneurs submit a financial request. Despite criticisms about the accuracy of the plans, they all clearly answered, “Yes!”

Finally, we asked each of them to give their best advice to entrepreneurs trying to convince them (beyond the preparation of the business plan). A recurring comment from venture capitalists and commercial bankers was to pay more attention to the preparation of the very first meeting:

- “I would advise them to come with the right team and to be well prepared for the interview. It is not compulsory to have a business plan at the first meeting, but they should be very well prepared. I always say: you only have one opportunity to make a good first impression (VC2).”
A commercial banker also insists on the necessity to be very precise about the needs of the company:
• “Too often, I meet with people who ask for more money than they actually need. Sometimes they do not even need any additional financial support. You should tell entrepreneurs to analyze their financial requirements and call bankers after they determined precisely what they want from us (B3).”

A business angel insisted on his advisor role and on the fact that he is not only interested in financing the project:
• “I do not only invest in projects in order to make money and attend the annual general assembly. Investors take time to coach the entrepreneur and participate in main decisions... I think that entrepreneurs should seek for BA from their own region who have had a successful experience in the business. If they meet with the right investor, it will be much easier to convince him and to take advantage of his knowledge. (A2).”

4. DISCUSSION

4.1 Effectuation vs. Causation?

When comparing the three groups of investors, business angels use effectuation 69% of the time and venture capitalists use it 63% of the time, whereas the so-far unexplored commercial bankers category use effectuation only 31% of the time. Overall, this is in line with the previous work of Sarasvathy & Wiltbank (2002). Our findings confirm their previous results, which suggested that business angels use effectuation as often as expert entrepreneurs do. Nevertheless, we were not able to confirm that experienced venture capitalists should use effectual logic more often than novices should, since our sample was too small. Finally, even if commercial bankers only use effectuation about one-third of the time and tend to stick to a causal approach, they still use effectuation more often than MBA students, whom 78% never use it at all.

Overall, financial backers use both causation and effectuation, even if it remains to a rather different extent. Since the current practice and content of the business planning process mainly reflects a causal process, this suggests that it should be adapted and refined to meet the expectations and needs of financial backers better.

4.2 Effectuation pillars

While testing the four pillars of effectuation individually, we found two unexpected results. First, the “affordable loss pillar” is confirmed by commercial bankers but not by venture capitalists or bank angels. On the one hand, the interviews suggested that bankers tend to focus on the repayment ratio instead of maximizing the return on investment. Even if they do not play with their own money, bankers use the affordable loss principle because they care about their own internal reputation. On the other hand, venture capitalists manage a portfolio of investments. They want to maximize the average return, which is why they prefer high-risk projects with high expected returns, rather than minimizing risks.

The second anomaly, the “strategic alliance pillar,” is not clearly rejected by commercial bankers. Indeed, while focusing on firms at early stages, even commercial bankers believe that partners are important and help entrepreneurs to grow. In fact, new companies dramatically need references to get clients. In this context, a partnership with a well-known agent is a fast way to improve their reputation. Because of this, many commercial bankers
think that it is worth losing part of the profit margin to get support from more experienced partners.
These two findings suggest that the way researchers use the concepts of effectuation and causation need a different theoretical framework when moving from entrepreneurs to financial backers. Indeed, effectuation is a rather new concept and its transposition in other settings than pure entrepreneurial opportunity exploitation still needs to be refined. This is in line with Chandler & al. (2009) who concluded that the search for business partners is also part of traditional planning activities while it was coded ‘EFF’ in our research.

4.3 Business Plan Content

Regarding business plans, all financial backers clearly want to receive a well-written document even if their expectations differ in terms of content. This is in line with Wiltbank, Sudek & Read (2009).
On the one hand, all three groups agree on the importance of product description, market research, and marketing strategy. They all also do not expect much from competition analysis. On the other hand, while venture capitalists and business angels first focus on the entrepreneur(s) and give less importance to the financial plan, commercial bankers prefer to focus on the financial plan and pay less attention to the entrepreneur’s profile.

The fact that every category of financial backer wants to receive a business plan also confirms its ceremonial role (Kirsh, Goldfarb & Gera, 2009). This can be explained by the fact that such preparatory information reduces information asymmetry and eases the work of any financial analyst who does not have to pay for it or do it himself.

4.4 Limitations

The results from this explorative research have to be examined carefully since they may be biased by multiple limitations.
First, elements that characterized the Belgian context have to be taken into account: e.g. the level of entrepreneurial activity in Belgium is low, venture capital is not very developed, the number of business angels is low, and through multiple public incentives banks are driven to finance start-ups. All these elements may influence the behavior of the respondents.
Secondly, there may be a sampling bias. While we paid attention to the balance between the types of financial backers, it has not been possible to randomize the selection of each of them. We selected the interviewees on purpose but only got in touch with those who were ready to play the game. At this stage, it is therefore impossible to claim theoretical saturation.
Thirdly, there may be some biases associated with the way interviewees answered the questions. It is impossible to assess to what extent their answers were biased by the fact they wanted to look smart by giving provocative answers. On the same line, it is not possible to check if their answers to ‘experimental’ questions reflect their day-to-day practice.
Fourthly, there may be an interpretation bias. Further validation of the questionnaire and double blind coding may reduce it.
5. **CONCLUSION**

The research has implications for both research and practice.

From a theoretical point of view, it confirms the importance of adopting a contingent approach when analyzing the expectations and behavior of financial backers and what they mean by a business plan. The research advocates the relevance of the ‘effectuation vs. causation’ framework to do so. The results also suggest that the contingency should not only focus on the kind of ventures but also on the kind of financial backers that are targeted. Furthermore, it highlights that the four pillars of effectuation are not correlated and should be managed with prudence. This is in line with the idea that effectuation is a multidimensional construct (Chandler & al., 2009).

For practitioners, the research contributes to the discussion about the usefulness of business plans. It confirms that now is not the time to ‘burn business plans’ since all new venture financial backers expressed a desire to receive one. However, the results indicate that the content of the business plan should change and that this change of content reflects different conceptions on the business planning process. The typical top-down approach advocated by most of business plan textbooks needs to be challenged with more emergent approaches when entrepreneurs try to attract venture capitalists or business angels. In such cases, entrepreneurs have to demonstrate their ability to exploit an opportunity with predetermined resources, while adopting an emergent strategy to be able to deal with unforeseen with scenarios, both good and bad. As Wiltbank, Sudek & Read (2009) concluded: “Knowing how a particular investor approaches venture development – his or her relative emphasis on prediction and control – can then inform an entrepreneur’s prioritization of different strategic moves as well as the positioning of moves already made, in terms of justifying predictions or demonstrating an ability to control how the uncertainty surrounding the venture opportunity is resolved.”

Due to its exploratory nature, the research suggests multiple avenues for future research including further work on (i) the operationalization of the effectuation framework, (ii) the way to assess an entrepreneurs readiness for emergent strategy and, of course, (iii) a broader and quantitative validation.

6. **REFERENCES**


