

A CONTINGENCY APPROACH TO SMALL SCALE BUSINESS SUCCESS: A LONGITUDINAL STUDY ON THE EFFECTS OF ENVIRONMENTAL HOSTILITY AND UNCERTAINTY ON THE RELATIONSHIP OF PLANNING AND SUCCESS



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ABSTRACT

Planning, environmental conditions and their impact on success of 104 small scale enterprises were studied within a longitudinal design. There was a positive relationship between detailedness of planning and success in the first wave. In both waves environmental hostility and uncertainty (i.e. an unfavorable environment) moderated the relationship between planning and success. There was no direct long-term effect of planning on success. However, there were significant contemporaneous moderator effects with high planning being particularly important for having success in unfavorable environments. Thus, this study supports a contingency view on the relationship between planning and success.

INTRODUCTION

In an early review, Robinson and Pearce (1984) concluded that many small scale enterprises do not plan at all. However, enterprises that do plan have more success in most studies (Robinson and Pearce, 1984). A recent meta-analysis found a small but positive relationship between planning and success (Schwenk and Shrader, 1993). However, there are also studies that do not find clear relationships between planning and success of small business owners (Robinson & Pearce, 1983; Shuman, Shaw & Sussman, 1985; Lyles, Baird, Orris & Kuratko, 1995). Thus, evidence in this area has not been completely conclusive and Schwenk & Shrader (1993) point to the low correlation between planning and success as well. Given this state of affairs, it may be useful to look at moderators that impact on the correlation between planning and success. Good candidates for moderators are environmental conditions. Hostility and uncertainty are prime candidates for moderators of this relationship. When there is high competition, planning should be better. Hostility reduces resources, decreases profit margins, and handicaps maneuverability (Miller & Friesen, 1983). A high degree of planning, makes better use of the scarce resources, reduces production costs, and compensates for the little room one has to maneuver. A hostile environment produces challenges to the firm and efforts must be devoted to plan in details of how to deal with these threats. Thus, in a hostile environment there should be a positive relationship between the quality of planning and success. However in a non-competitive environment, it is not necessary to plan. Additionally, potential disadvantages of planning may have detrimental effects. Planning often leads to an adherence to the plan, and thus, increases rigidity. Since there is no necessity to deal with the difficult situation in a non-competitive environment, there should be either a low correlation or even a negative correlation between planning and success. Obviously, these are

causal hypotheses that can only be studied in longitudinal studies which are unfortunately seldom done in entrepreneurship research (Low & MacMillan, 1988). Therefore, we shall report a longitudinal study in this paper.

A longitudinal study requires to develop some hypotheses about the timing of the effects. The question of timing is, in general, one of the more difficult areas in social science. Planning can in principle have a long term or a short term effect. A long term effect exists when prior planning (e.g. four years ago) leads to better strategic decisions that have later positive consequences. These consequences may be affected by current environmental threats. A business that has used detailed planning right from the start may be better prepared to deal with the problems of a hostile environment later on. In terms of timing, this means that there is a lagged effects of planning because earlier planning leads to *later* success and there is a contemporaneous effect of the environment, because the environmental conditions right now determine its effects. This would imply that there is a lagged effect of planning on success moderated by contemporaneous effects of hostility and uncertainty. We think, however, that this point of view is not plausible. Earlier planning can only have a positive effect on success if it is continuously adapted and kept up. In other words, one's earlier plan is only useful if there are little changes in the environment—an implausible assumption for small scale business owners. For this reason, we hypothesize the effect to be contemporaneous. This should be true even more for moderator effects, because as discussed above we think that the main advantage of planning is to deal with scarce resources and unfavorable situations. Thus, planning *now* should lead to success *now* if there is an unfavorable situation now (in other words all effects are contemporaneously). However, methodologically the "now" in the sentence above should not be interpreted too literally. In a longitudinal study that investigates two waves with a four year time interval, a lagged effect means that the effect is four years of longer while a contemporaneous effect is to be interpreted to be an effect from a few days up to four years (Dwyer, 1983)

Thus, our hypothesis is that planning has a positive relationship with success in a hostile environment, while the relationship between planning and success is absent or even negative in a non-hostile environment. Furthermore, these effects are contemporaneous.

METHODS

Sample

The first wave of the study was done between October 1993 and February 1995. The sample was drawn from Jena in East Germany and the from Giessen in West Germany. Both cities have structural similarities: they are university cities with around 75.000 inhabitants. The participants were randomly chosen from lists, provided by the local chambers of commerce (registration is mandatory in Germany).

The participants were selected by using four criteria: First, the enterprise had to have between one and fifty employees. Second, the enterprises had to be founded between 1990 and 1992. Third, the participant had to be the founder and owner of the enterprise and fourth, the enterprise had to be a stand-alone business or a franchise business. Thus, the first wave sample consisted of young newly founded enterprises. The business owners participated in a one hour interview. In addition, they were asked to fill out a questionnaire. In the first wave, 201 owners provided data. The rejection rate was 42%.

In 1997 and 1998, the second wave of the longitudinal study was done. The second wave of the longitudinal study consisted of 107 participants. Of the original sample, 94 enterprises could not be located again. As much as possible we attempted to locate them, partly by telephone books or by asking neighbors as to the whereabouts of these enterprises. Some of them have failed, some of them may just have moved to other parts of Germany, or may have changed the name of their company so that we could not locate them any longer in the telephone book. The true rejection-rate was 11.4% that is 24 business owners did not want to participate in the second wave any more.

Measures

The measures are based on the interview and on the questionnaires. The reliabilities (inter-rater reliabilities for the interview measures and Cronbach's alphas for the questionnaire based scales) are presented in Table 1. The interviews were coded by two independent raters and their mean ratings were used. The scales were divided by the number of items. Planning was ascertained in the interview. One measure refers to the existence of a start-up business plan. Another measure was based on the ratings of the detailedness and quality of this business plan (for this variable there was a reduced N because all those who did not have a start-up plan, were counted as missings). In the second wave, the *current* business plan was measured. In this case, both existence and quality were included in one index with a 1 being assigned if there was no current plan, a 2 for low quality and a 3 for a high quality plan. A further planning measure refers to the most important targets for the next year (target planning). Again, the detailedness of the plan to reach these targets was rated. Target planning was measured in the first and in the second wave. The reliability of target planning was relatively low in both waves. This means that the chances of getting significant results involving this variable is reduced.

Table 1
Reliabilities of Variables

Variable	Inter-Rater Reliabilities	Cronbachs' Alpha
<i>Interview measures</i>		
1. Quality of the start up business plan (t1)	.84	.91
2. Current business plan (t2)	.65	.80
3. Target planning (t1)	.54	- a)
4. Target planning (t2)	.54	- a)
<i>Questionnaire measures</i>		
5. Hostility (t1)	-	.76
6. Hostility (t2)	-	.69
7. Uncertainty (t2)	-	.71
8. Khandwalla's hostility scale (t2)	-	.73
9. Success (t1)	-	.64
10. Success (t2)	-	.65

Note: a) single item

The environmental conditions were measured in the questionnaire. Hostility was a seven item measure on the degree of competition. In the second wave, Miller and Droege's (1986) uncertainty scale and Khandwalla's (1976/77) environmental hostility scale were included. Table 2 shows that Khandwalla's and our hostility scales were highly correlated.

A multiple measure of success was used to minimize errors which may be due to tax structure, memory problems and reporting biases. It consists of five different success measures. Growth and size of the enterprise were ascertained in the interview, entrepreneurs income, satisfaction at work, and entrepreneur's own judgment about success are based on single questionnaire items. Growth refers to the increase or decrease of the number of employees during the last three years. Size of the enterprise consists of the number of employees and the amount of sales. A third measure was entrepreneurs' income. To take subjective measures of success into account as well, the owners were asked, how successful they thought their enterprises were and in addition they also indicated their own level of satisfaction with their work.

Additionally, six control variables on start-up capital, company age, and industry type (craft, service, trade, and manufacturing) were ascertained by single items in the questionnaire. These controls were based on prior research. The size of the enterprise at the time of their start-up impacts on success (Bruederl, Preisendoerfer, & Ziegler, 1992). Since the size of the enterprise is also a dependent variable, the amount of start up capital was taken as a control variable. There is also evidence, that newly founded enterprises have a higher risk to fail than long established ones (Bruederl et al., 1992). Therefore, we controlled for company age. Finally, we had a study design including various industries and, therefore, controlled for them.

RESULTS

Table 2 describes the intercorrelations of all variables reported here. Success at t1 was highly related to success in the second wave t2. This is not surprising because success breeds success in business. Interestingly, two planning variables at t1—quality of start up business plan and target planning—were related to success at t1. This would speak for a direct relationship of planning with success. However, this result could not be replicated in the second wave: Here there were no significant relationships between current business plan and target planning at t2 with success at t2.

Another significant negative relationship of success was with hostility (most pronounced for Khandwalla's scale) and a positive one with the amount of start-up capital. Those enterprises working in the area of trade were less successful. In contrast to other studies (e.g. Bruederl et al., 1992), age of enterprises had no impact on success. This may be due to the small age range of about two years which results from our sampling procedure. According to our hypothesis the hostility of the environment moderates the relationship between planning and success. This hypothesis was tested with hierarchical moderated regression analyses (Cohen & Cohen, 1975). Controls were included first, environmental conditions in the second step, planning in the third, and the interaction term in the last step. Of course, the most important result is whether or not the last step leads to a significant interaction term and R square increment (not that the beta may have values above 1.0 and that these values may not be interpreted but only their significance, Cohen & Cohen, 1975). Nine moderated regression analyses were done first on a cross-sectional basis for t1 and t2 separately. Four moderators showed significant results: they are displayed in Table 3 (for hostility) and Table 4 (for uncertainty). Significant moderator effects of hostility were found for the relationship between quality of start-up business plan and success and the current business plan and success

Table 2
Means, Standard Deviations, and Zero-Order Correlations of Variables (Two Sided Significance Tests)

	1	2	3	4	5	6	7	8	9	10	11	12	13	14	15	16	17	M	S	Range
1. Existence of start up business plan (t1)		.34**	-.01	.23*	.11	.06	-.05	.05	.27**	.10	-.03	-.02	-.06	.01	.14*	.01	-.09	1.67	.47	1-2
2. Quality of start up business plan (t1) ^{a)}			.34**	.11	.20	-.03	-.08	.12	.15	.17	-.07	-.08	-.05	.04	.11	.30**	-.03	3.41	1.05	1-5
3. Current business plan (t2)				.19	.07	.18	-.01	.28**	.20	.08	-.09	-.06	-.14	.02	.26**	.11	.13	1.99	.87	1-3
4. Target planning (t1)					.14	.05	-.04	.16	.12	.14*	-.02	-.12	.03	-.00	.10	.15*	.11	3.19	1.05	1-5
5. Target planning (t2)						-.09	-.08	.19	-.04	.04	-.16	.04	-.03	-.11	.15	.06	-.06	2.94	1.07	1-5
6. Hostility (t1) ^{b)}							.54**	.26*	.22*	.06	.09	-.09	-.03	.15*	-.12	-.01	.00	.01	.60	-1.38- 1.32
7. Hostility (t2) ^{b)}								.22*	.41**	-.05	.12	-.10	-.05	.19	-.09	.06	-.20*	-.00	.57	-1.34- 1.21
8. Uncertainty (t2)									.39**	-.01	-.02	-.18	.00	.12	.05	.01	-.05	3.71	1.18	1-7
9. Khandwalla's Hostility scale (t2)										-.06	.03	-.10	-.15	.20	.06	-.24*	-.43**	4.32	1.17	1-7
10. Start up capital											-.11	-.13	-.02	.10	.02	.24**	.27**	4.97	2.81	1-11
11. Age of enterprise												.08	-.19*	.17*	-.08	-.14	-.13	6.12	.84	4-8
12. Craft													-.34**	-.29**	-.01	.01	.04	1.12	.33	1-2
13. Service														-.68**	-.23**	.16*	.04	1.44	.50	1-2
14. Trade															-.20**	-.20**	-.20*	1.37	.48	1-2
15. Manufacturing																.05	.21*	1.07	.25	1-2
16. Success (t1) ^{b)}																	.57**	-.01	2.85	-6.68- 15.53
17. Success (t2) ^{b)}																		.07	2.88	-7.85- 6.15

Note: a) N reduction because of non-planners; b) z-standardized score

Table 3
Cross-Sectional Planning-Success Relationships Moderated by Hostility in Both Waves
(Moderated Regression Analysis)

	Success (t1)			Success (t2)	
	Beta	ΔR^2		Beta	ΔR^2
Step 1 Controls			Step 1 Controls		
Start up capital	.25**		Start up capital	.29**	
Age of business	-.07		Age of business	-.06	
Industry type: manufacturing	-.01		Industry type: manufacturing	-.17	
Industry type: trade	-.22*		Industry type: trade	-.17	
Industry type: craft	-.01	.11**	Industry type: craft	.04	.16*
Step 2 Environment			Step 2 Environment		
Hostility (t1)	.02	.00	Hostility (t2)	-.13	.02
Step 3 Planning			Step 3 Planning		
Quality of start up business plan (t1)	.27**	.07**	Current business plan (t2)	.07	.00
Step 4 Moderator			Step 4 Moderator		
Hostility X quality of start up business plan (t1)	.61*	.03*	Hostility X current business plan (t2)	.71*	.07*

*p<.05; **p<.01

Figure 1
Hostility (t2) Moderating the Planning-Success Relationship (t2)

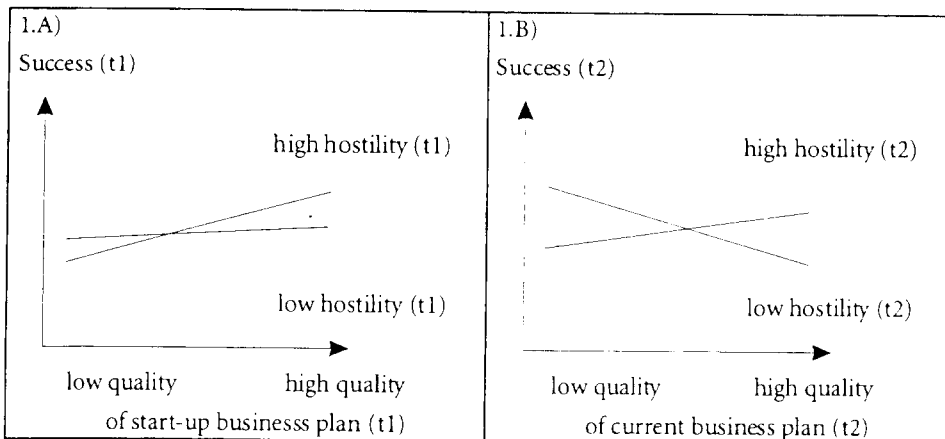


Table 4
Cross-Sectional Planning-Success Relationships (t2) Moderated by Uncertainty (t2)
(Moderated Regression Analysis)

	Success (t2)			Success (t2)	
	Beta	ΔR^2		Beta	ΔR^2
Step 1 Controls			Step 1 Controls		
Start up capital	.29**		Start up capital	.29**	
Age of business	-.06		Age of business	-.06	
Industry type: manufacturing	.17		Industry type: manufacturing	.17	
Industry type: trade	-.17*		Industry type: trade	-.17	
Industry type: craft	-.04	.16*	Industry type: craft	.04	.16*
Step 2 Environment			Step 2 Environment		
Uncertainty (t2)	-.03	.00	Uncertainty (t2)	-.03	.00
Step 3 Planning			Step 3 Planning		
Target planning (t2)	.03	.00	Current business plan (t2)	.08	.01
Step 4 Moderator			Step 4 Moderator		
Uncertainty X target planning (t2)	6.20**	.68**	Miller X current business plan (t2)	1.06*	.05*

*p<.05; **p<.01

Figure 2
Planning-Success Relationships (t2) Moderated by Uncertainty (t2)

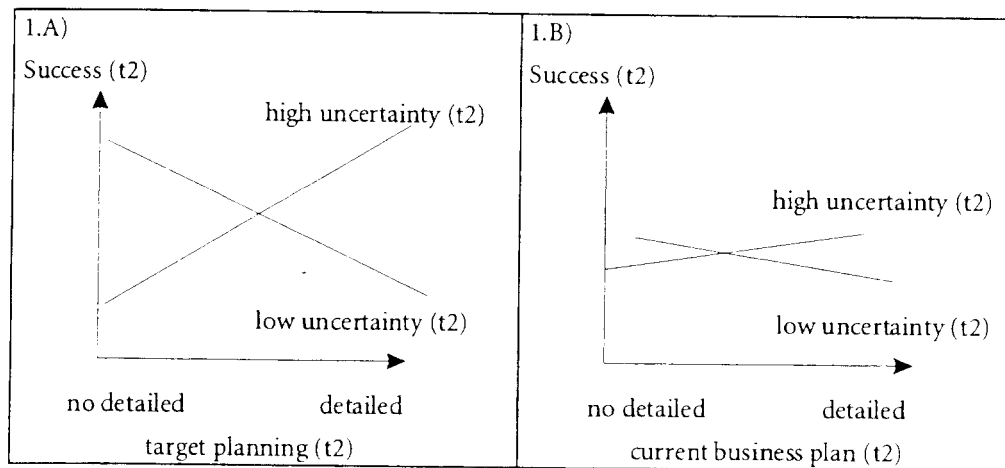


Table 5
Longitudinal Analysis of Moderators of the Planning-Success Relationship

	<u>Success (t2)</u>			<u>Success (t2)</u>	
	Beta	ΔR^2		Beta	ΔR^2
Step 1: Prior Success			Step 1: Prior Success		
Success (t1)	.57**	.33**	Success (t1)	.58**	.34**
Step 2: Controls			Step 2: Controls		
Start up capital	.16		Start up capital	.07	
Age of business	-.03		Age of business	.06	
Industry type: manufacturing	.18		Industry type: manufacturing	.16	
Industry type: trade	-.06		Industry type: trade		
Industry type: craft	.05	.06	Industry type: craft	.00	.06
Step 3: Environment			Step 3: Environment		
Hostility (t2)	-.20*	.04*	Uncertainty (t2)	-.03	.00
Step 4: Planning			Step 4: Planning		
Current business plan	.02	.00	Target planning	.14	.02
Step 5: Moderator			Step 5: Moderator		
Current business plan X hostility	.77**	.08**	Target planning X uncertainty	1.17	.05*

*p<.05; **p<.01

(Table 3). The R square increments were 3 percentage points for the interaction term of hostility and quality of start up business plan and 7 percentage points for hostility and current business plan. These are important results as shown in Figure 1. In a hostile environment, there was a higher relationship between planning and success than in a non-hostile environment (Figure 1).

Table 4 indicates, that environmental uncertainty moderated the relationship between target planning and success (R square increment .07, p<.05) as well as the relationship between the current business plan and success (R square increment=.05,p<.05). Figure 2 indicates that in a more uncertain environment, there is higher relationship between quality of planning and success. In a certain, and therefore more favorable environment more planning is related to less success.

Thus, our research supported a contingency view on the relationship between planning and success. It is the environment which causes challenges to which a small scale enterprise should react with more structured procedures.

So far, the hypothesis was tested cross-sectionally. However, the more interesting hypothesis is whether planning leads to changes in success given favorable or unfavorable environmental conditions. Again, hierarchical regression analyses were used (Cohen & Cohen, 1975). Prior success (t1) was controlled in the first step. The control variables were included in the second step. Step 3 consisted of the environmental condition, and the planning strategies (t2) were included in the fourth

step. In the final and most important step, the interaction between planning and environmental condition was included. Of the 6 analyses done, two showed a significant interaction effect displayed in Table 5. Significant interactions occurred between the current business plan (t2) and uncertainty (t2) as well as between target planning (t2) and uncertainty (t2). Since prior success (t1) was controlled for in this model, we can conclude that planning has a positive effect on changes in success in an uncertain environment. This effect is sizable, increasing explained variance by 5 to 8%.

DISCUSSION

In this study the contingency view was supported. This means that environmental conditions such as hostility and uncertainty act as moderators of the relationship between planning and small scale enterprise success. In a hostile or uncertain environment owners are more successful when they plan more while in a non-hostile or certain environment those owners who plan less are more successful. These results are interesting because they appear quite consistently in cross-sectional analyses but also when we hold prior success constant. The latter implies that our results pass a first test of a causal hypothesis as *changes* in success are affected by the interaction of planning and environmental threats. This means that our predictors can explain how people become more or less successful. This effect is only contemporaneous (as a matter of fact, we tested for lagged effects and there was no significant interaction effect in line with our hypothesis). A contemporaneous effect implies that there is a certain temporal nearness of predictor effects on success—in other words, it is not planning and hostility of 4 years ago that matters but more likely planning to deal with the threats that took place during the last months to a year.

It is interesting that the interaction effect is cross-over, that is under high hostility (uncertainty), there is a positive relationship and under low hostility (low uncertainty) there is a negative relationship between planning and success. Thus, planning only helps in a particular (hostile, uncertain) environment, but is negative in another type (non-hostile, not uncertain) of environment. Planning helps a person to deal with unclear future events because they make them more predictable and manageable (Thurston, 1983). If one has few resources and needs to be particularly careful in one's steps of action (both more likely to exist in a hostile environment), planning helps. But why should planning actually be negative in a non-hostile environment? It is interesting that these data are similar to a study by Rauch & Frese (1997) on planning in Ireland. In Ireland planning seemed to have a negative effect on success, most probably because the environment demanded flexibility rather than strict adherence to a plan (Ireland is one of the cultures with the lowest uncertainty avoidance, Hofstede, 1991). In a non-hostile environment, it is much more important to quickly see opportunities and act on them—planning and sticking to one's plan may only be disadvantageous in such a situation.

The direct relationships of planning to success were not consistent in this study. On the one hand, planning at start-up and target planning were related to success in the first wave; however, there was no equivalent evidence in the second wave and these two planning variables of the first wave also did not correlate significantly with success in the second wave. This means that our study pretty much replicates what other studies have found: Planning is sometimes helpful and sometimes not (Fredrickson & Mitchel, 1984, Tan & Litschert, 1994) It may be interesting to speculate why planning was related to success in the early years of existence. Sophisticated planning is probably useful for newly founded enterprises, for example to get government support, to raise capital or to position the new business in an already established market. In this situation, uncertainty is high

for nearly all business owners. Once the enterprise is well established, planning becomes less important. It reduces flexibility and entrepreneurs may, thereby overlook opportunities.

Our results are in contrast to Matthews and Scott's (1995) findings who reported a negative relationship between environmental uncertainty and planning. They argue that small enterprises are always in a turbulent environment and that it is useful to react with little planning. Our results contradict these speculations. In contrast to Matthews and Scott (1995) who did not look at the moderator effects because they did not have a success variable, we found not only a bivariate positive correlation between uncertainty and planning (see Table 1) but also the above mentioned moderator effect which shows that in a situation of high uncertainty, it is helpful to plan to reach success.

One limitation of this research that it shares with most other studies of small scale enterprises, is the problem of increased variance in success. Since, we only admitted those enterprises into our sample that had at least existed for a year, we excluded all those enterprises that had failed before. However, surprisingly, those enterprises that survived and participated in the second wave were not differently from those who could not participate in the second. The most likely reason for them was that they went out of business and we, therefore, did not find their address any more. One could also argue, that the non-participants of the second wave were those, who did not plan. However, this is not correct, as we did not find any differences in planning between the three different groups: the non-participants, the refusers, and the participants of the second wave (ANOVA).

IMPLICATIONS

The study has important implications. First, studies about the relationship between planning and success in small scale enterprises should distinguish the environmental conditions under which they work. Around 50% of the entrepreneurs stated, that they do not plan at all (this is true of our sample, cf. also Robinson & Pearce, 1984). At least in hostile environments, business starters have to be taught how to plan. On the other hand, it would be a mistake to use planning as a general positive sign because planning may very well lead to reduced success in a non-hostile environment. Thus, the contingency point of view demands that those agencies (such as banks, government bureaus, etc.) which assume without empirically sound reasoning that planning is a "must" for every business person, reconsider this prejudice. Otherwise they reduce chances for a part of the entrepreneurs by forcing everyone into a planning mode.

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