PRACTICAL ADVICE ON PULLING THE PLUG ON A FAILING BUSINESS

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We are taught from a very young age that it is important to persist. Even when we face substantial obstacles or other adverse conditions, by persisting, we can overcome these obstacles, and conditions can change so that we ultimately achieve success. However, sometimes our persistence can be costly and even disastrous. We create a firm to pursue what we believe is an opportunity, but we may find that we are losing money over time. Although we should pull the plug on the business, we often find that we persist despite poor performance. Below, I offer some advice about “pulling the plug” on a poorly performing business.

Flowing from my research (listed below) I offer the following advice for an entrepreneur to pull the plug on a failing business:

1. Throwing good money after bad

Sometimes, despite our best efforts, our venture’s performance deteriorates such that it makes losses. Perhaps conditions will change, and firm performance will turn around, but this will only happen if we persist with the business. However, there’s the chance that performance will not turn around. In this case, persisting means that we invest more of our personal wealth (or increase personally guaranteed debt) in the business, which increases personal losses should the firm eventually close. Persisting after realizing firm closure is highly likely is financially costly. That is, we are “throwing away good money after bad.” There are a number of conditions under which we are particularly vulnerable to persist with our firm despite its poor performance. By highlighting these conditions we can hopefully diminish their influence on terminating the firm sooner (which provides for a quicker financial recovery from business closure).

2. Don’t persist to justify previous decisions

We originally made an important decision to enter into the business having believed that it was an attractive opportunity—that the business would deliver a host of benefits, including profits. Now that we face information that the business is not attractive, we may think the decision to terminate may be seen as a repudiation of our original decision. Most people like to be seen as consistent and competent. Thus, the decision to terminate is a hard one because we look inconsistent (i.e., we decided to get in, and now we are getting out) and we feel incompetent, not to mention how it looks to our loved ones, friends, and business acquaintances.

This need to justify our previous decision to get into the business and therefore persist with the poorly performing business is magnified by specific conditions, which leads to the following pieces of advice:

- Don’t factor in previous investments. We invest a lot more than money into our businesses, including time, energy, and a large part of our identity. This helps to create a strong attachment between us and the business—a bond that is tough to break. This strong attachment clouds our decisions about whether it is the right time...
to pull the plug on the business. We need to consider what investment is required now and what performance will be like tomorrow and try (as hard as it is to do) not to consider the investments we have already made (i.e., sunk) into the business. Place great emphasis on the resources (e.g., time, energy, access to financial resources) you have available now and whether they will get an adequate return and try not to focus on what has already been sunk into the business.

- **Create alternate opportunities.** We do not make decisions in isolation but choose between the alternatives we have at our disposal. If we have not created viable alternatives to the current business, it might not matter how poorly it is performing and how much money we are losing; we are likely to persist. To create a situation in which we can pull the plug on our poorly performing business, we need to be on the lookout for (and/or create) career alternatives to the current business. These alternatives may not be ideal, but to the extent they satisfy some of our psychological needs for competence, autonomy, and belonging, they may be something we are willing to switch to—at least for a period during which we can recover from the business closure to eventually pursue our next entrepreneurial endeavor.

3. **Be aware of your past successes**

When we have achieved business success in the past (with this business or previous businesses), we are even more reluctant to admit to ourselves and others that the current business needs to be closed. Indeed, previous success has a tendency to make us overconfident in our ability to turn the current business around. Ironically, this can make the business failure (when it comes) more costly than it needed to be through the costs of additional persistence. The key here is to leave past successes in the past and to make the termination decision based on current facts.

4. **Be aware of cheerleaders**

Most of the time, it is great to be surrounded by other organizational members who have an optimistic perspective and a strong belief in your business’s ability to achieve success. However, these people can also encourage persistence despite poor firm performance and therefore increased accumulation of losses. Indeed, a group of cheerleaders can be very persuasive, which is all the more dangerous in these circumstances. It requires additional clarity and strength to see through the hype and decide to close the business in the presence of cheerleaders. We have to be extra vigilant to not be seduced by cheerleaders, assess the merits of pulling the plug on the business based on the facts, and not be influenced by their irrational exuberance.

5. **The financial hole is deeper when not motivated by money**

Most of us who create businesses do it not just for the money but for other
benefits, such as gaining independence, creating something from new, and so on. To the extent that we are motivated by the tasks of running the business rather than the financial rewards as an outcome of the business, we are more susceptible to the biases that encourage us to persist (and to rack up additional financial losses). The key here is not necessarily to change our motivation but to recognize vulnerability, try to counter these biases, and try harder to find an alternative to the current business that provides at least some of the pleasures that we derive from running the current business. For example, if you are motivated by independence, then create alternatives that provide at least some autonomy in how tasks get done.

6. Financial cost but emotional gain
Persisting despite recognizing that the business will eventually fail is financially costly. The deeper we dig ourselves into a financial hole, the longer it will take to financially recover from the failure. However, some delay on pulling the plug on the business may actually help our overall recovery. Some delay allows us to anticipate the failure and therefore emotionally prepare for its eventuality. With emotional preparation, the closure event does not have as big a negative emotional impact. We can recover more quickly—we can learn more quickly from the experience and can more quickly regain the motivation to try again (or at least move on to the next big project in our lives). The key is to use the time of persistence to emotionally prepare for the failure and then terminate quickly to minimize the financial losses.

Despite our best efforts there is a chance that our business will perform below expectations and the best course of action is to close it down. Although it is tough to close down your own business, if we do not do it then we are “throwing good money after bad” digging ourselves into a deeper hole. To avoid losing more money on the failing business we need to make our decisions without trying to justify previous decisions, without consideration of previous successes, and without being influenced by cheerleaders in the business. We are particularly vulnerable to these biases when our motivation for the business is primarily driven by the non-financial benefits of running a business. Although delay is financially costly, some delay can help us emotionally prepare for the failure, which helps us recover from the failure when it eventually arrives.

Bibliography

The motivation for this note was to share some of the practical implications of my research, specifically:
