How entrepreneurs can benefit from failure management☆

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BENEFITING FROM BUSINESS FAILURES

Can entrepreneurs benefit from failure? If so, more proactively, how can they use failure systematically? This paper studies this simple question. In order to answer the question, we begin introducing the existing ideas on failure that abounds in at least four categories: (1) *why* we learn from failure; (2) *how* we learn from failure; (3) *what* we learn from failure retrospectively; and (4) how we *use* failure prospectively. We then present detailed research questions designed to fill gaps in existing ideas on failure management.

Why We Learn from Failure

No matter how well organizations are managed, some failures are inevitable and even seemingly ubiquitous. According to the U.S. Census Bureau data, every year 470,000 businesses fail while a smaller number of businesses (400,000) newly start. Such high odds of entrepreneur failures are not so different across industries—no industry has more than a sixty percent survival rate after the first four years.

With business failures expected, the assertion that we can learn from failure is prevalent among numerous management scholars and practitioners. Simply put, failure teaches us what works and what does not. In other words, failures challenge underlying flaws in causality of organizational processes, and thereby lead to more accurate way of doing. Considering our bounded rationality, such learning from failure through experimental approach might be the only way to learn about causal relationships.

As a result of such learning, organizational performances have often been improved by investigating and learning from failures. In detail, failures may help improve process reliability, reduce failure-related costs, and also improve the composition of the portfolio of projects through trial-and-error learning. So much prescriptive advice has been suggested to see failure as an important ingredient of the innovation process. In short, learning is more effective in failure than in success. While success can make decision makers remain where they are, failures can help renew their own strategic directions and practices.

How We Learn from Failure

Despite much evidence that we can learn from failure, the outcomes of learning from failure may vary according to different learning conditions. The learning conditions can be categorized in the following three ways: process of learning; facilitators of learning; and barriers of learning.

First, *process of learning* is crucial to successful learning from failure. This can be approached in the course or procedure of knowledge generation. Focusing on the procedure of knowledge generation, there are three stages of learning from failure: identifying failure; analyzing failure; deliberate experimentation. Besides such organizational processes of learning, the psychological and cognitive nature of learning from failure should be also considered because emotion is strongly involved in the process of recognizing and acknowledging failure.

Second, what are the *facilitators of learning* from failure? We can learn from failure by fostering an organizational system and culture that favors experimentation. Systemically, strategic management using formal planning system can be useful to deal with environment upheavals. From a cultural aspect, learning through failure or adversities can be achieved by being sensitive to warning signs of decline,

normalizing failure, or facilitating improvisation, i.e., developing heuristic contingency plans.

Third, *barriers of learning* are also an important part of learning from failure. For instance, there are four barriers to learning from failure: technical; social; individual; and organizational. In detail, failures of 'learning from failure' are frequently witnessed due to incorrect inferences from small samples or noisy cues, or bias in interpreting causes of failure.

What We Learn from Failure—A Retrospective View

Lessons from failure feature not only failure process but also attribution of the causes of failure. Attribution is an attempt to trace back to the causes of events in order to understand the present and manage the future through corrective measures. In short, what we learn from failure is mainly about causes of failure so as to correct errors and not to repeat the same failures in the future. Hence, examining causes of failure is basically retrospective because it focuses on the past or root of failed event.

Then, what cause failure? According to two factors—(1) if an action leading to failure is unguided or purposeful; (2) if the consequence of action is intended or not, there are four types of failure due to mechanical, accidental, intentional, and inadvertent causes. From other perspective as to causes of failure, failures can occur because of external or internal environments such as poor leadership, ignorance of organizational culture, unbalanced teamwork, or some unfit combination of leadership, capabilities and organizational design. As a provocative fact, entrepreneurs' incompetence or lack of experience may be a much more influential cause of failure than neglect, fraud, or disaster.

On the other hand, biased attributions have been often witnessed in many areas and disciplines. For instance, people tend to attribute their own success to themselves or internal factors, and their own failure to external factors. Conversely, managers tend to attribute others' success to external factors but their failure to internal factors.

How We Use Failure—A Prospective View

In contrast to the retrospective approach to causes of failure, another approach more emphatically focuses on the beneficial impacts of failed events. It should be noted that the retrospective and prospective perspectives on failure are not mutually exclusive because both are closely related to each other as retrospective correction of the past is also used for prospective planning for the future. However, the two views are distinguishable because of their different foci on failure. In other words, the prospective view on failure (regardless of its causes) pays more attention to how we can use failure in search for new opportunities.

TOWARD FAILURE MANAGEMENT

As reviewed earlier, most prior ideas on failure have a gap to be filled: *How we can use failure prospectively and systematically.* In other words, the existing research, theories, and even practical advices on the use of failure do not comprehensively explain prospective benefits from adversity within an integrated framework. Hence, the creative uses of failure are still left to hindsight or improvisation. However, systematic foresight on how we can take advantage of failure and adversity can be used not only as a theoretical framework but also as a heuristic for managerial and strategic decision making.

With this purpose in mind, this study provides a framework on 'how to learn from failure' in pursuit of 'how to use failure prospectively'. In this sense, this paper develops a failure management framework for creative decision making in paradoxical situations at both the individual and organizational levels in search for new insight on causes of failure and also new opportunities thanks to failure.

This study took multiple steps to answer the following questions:

1. *How are the major concepts such as 'failure' and 'failure management' defined operationally?* We begin with operationally defining the basic concepts of success and failure. As a new management perspective that takes advantage of failure, the concept of failure management is also introduced.
2. *What are the types of failure and is there any benefit to managing them?* We examined numerous examples and analyzed many studies to uncover the dimensions, categories, and concepts of a failure management framework. Through an iterative process of grounded theory that included inductive and deductive reasoning, we eventually identified three types of failure and six purposes to use failure advantageously that provided 16 propositions of failure management.
3. *What distinguishes failure management from other related management tools such as risk management and crisis management?* In order to infer the theoretical and practical contributions of failure management, we address the unique characteristics of our failure management framework by comparing it to other related management tools such as risk management and crisis management which failure management is expected to complement.

A FRAMEWORK FOR FAILURE MANAGEMENT

Definitions and Concepts

Magnitude of event that is defined as failure can vary, for instance, in the forms of operational errors or mishaps, or catastrophe such as accidents, or plane crashes. Regardless of magnitude of failure, definition of failure may be in the eyes of beholder because there are usually various goals or references by which success or failure is judged. Setting an agreed-upon organization goal or reference point is especially difficult because of political and narrative nature of the distinction between success and failure.

But such dynamics of establishing official or formal goals to define success and failure is beyond this study. Rather, we judge success or failure as the outcome from a black box in which actions are compromised and negotiated to set, achieve, and evaluate a formal and fixed goal. Specifically, we operationally define success and failure as follows. (1)