

Chapter 5

Failing successfully – theoretical foundations of failure management strategies

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5.1. Optimisation and failure

The view on business failure, which dominates both in the scientific literature and in activities of business practitioners, is not fundamentally different from the statements included in the theory of the firm, according to which an entrepreneur sets goals for an organisation, and those goals become a reference point for decisions and ex-post evaluation of the results achieved – success or failure (Kreikebaum, 2000, p. 98). This approach underlies the concept of maximising profit and the – later formulated – paradigm of growth. Both concepts imply that a business goal is achieved by the optimal use of available resources.

However, it is not a surprise that despite adherence to traditional theoretical recommendations regarding optimisation, business objectives are not always achieved. Therefore, if failure is a possible consequence of taking action, a question arises how to assess this situation and how to deal with it. Failure enforces some action because it prevents the entrepreneur from achieving pursued goals. In theory,

the entrepreneur may correct the mistake; they may rationalise it or start the so-called 'blame game' (Edmondson, 2011), or change the goal.

Failure may not have negative consequences only. It can also have positive effects, especially in the long run. Edmondson (2011), describing the causes of failure, uses a continuum of situations, from 'blameworthy' to 'praiseworthy' ones, including deviance, inattention, lack of ability, process inadequacy, task challenge, process complexity, uncertainty, hypothesis testing, and exploratory testing (Edmondson, 2011). While the first five causes are typically seen as a failure due to lack of commitment, the last four should be perceived as failure resulting from involvement. In those situations, people encouraged to take action and further supported will achieve better results in the future.

It is also worth noting that both theory and practice of management focus on successes, and analyse the actions of winners (Cope, Cave, & Eccles, 2004, pp. 147–148), even though error-making constitutes an intrinsic feature of business undertakings. And despite the opinions that more newborn companies fail rather than succeed, and, therefore, the first scenario should be scrutinised thoroughly (Fridenson, 2004, p. 581), numerous myths exist about failure. As pointed out by Headd (2003, pp. 52, 59), empirical data do not confirm that only one in 10 enterprises survive the first year of existence. On the contrary, 76% still operate after two years. What is more, taking into account all cases why a business activity is terminated, every third concern a situation when a business project is successful. Another common myth is that the risk of business failure is eliminated by introducing new, more restrictive regulations (Mayer, 2017, p. 158). It seems that the general fear of failure is exaggerated and the ways of responding to it inadequate.

In this chapter, the authors will analyse selected characteristics of failure and link those to the theory of the firm to show that failure can be normal and not necessarily bad. Next, the manageability of failure will be discussed, with the aim to work out how the understanding of failure is affected by three major contextual elements: the success factors, different structures of expectation and various types of change. Ultimately, the authors will define three strategy archetypes of failure management and put them into a situational context to introduce the first approaches to set up a failure strategy matrix.

5.2. Failure in business

To understand the meaning of a business failure, a broader look at the business venture collapsing is necessary. The two perspectives: micro- and macroeconomic, should be distinguished. From the first viewpoint, one should realise that when taking into

account particular entrepreneurial undertakings with their financial, human, material and infrastructural resources, there exist many cases when even the second, third or fourth attempt to start a business result in success from which the people involved in – entrepreneurs, employees, community – benefit (Fridenson, 2004, p. 581). Those examples evidence that business failure should not be stigmatised because, quoting Winston Churchill: “Success is not final, failure is not fatal – it is the courage to continue that counts.” However, from the perspective of the entire economy and the value-added generated from the use of its resources, attention should be paid to chronically ineffective businesses (DeTienne, Shepherd, & De Castro, 2008, p. 530), i.e., those whose results are unsatisfactory over a longer period – and yet those entities do not quit their operations. The existence of such organisations raises difficulties for all related parties. Thus the appropriate ‘cleansing’ solution should be their bankruptcy. At this point, however, an individual perspective needs to be considered, in which the acceptance of chronic inefficiency results from preferences to minimise emotional costs of failure, even if that means further financial investments (Shepherd, Wiklund, & Haynie, 2009, pp. 142–143), or from no alternative option.

Similar controversies arise when assessing people involved in business projects that are not successful. Some advocate that the lack of business success does not have to be perceived as something wrong. Such acceptable failure occurs when an ambitious goal cannot be achieved. A positive effect is that people, who make efforts, can manage new initiatives better in the future (Cope et al., 2004, p. 157). Nevertheless, there is a clear line between acceptable failure and acceptance of failure, especially when it is accompanied by the following circumstances: high resources invested, lack of other opportunities, previous successes or a team’s shared belief in success, which makes it difficult to accept the mistake, as well as acting on a dynamically developing market where failure seems impossible (DeTienne et al., 2008, pp. 541–542). In this context, it should be added that not only potentially inexperienced founders of start-ups but also experienced managers of large supranational organisations tend to overestimate their learning abilities on previous mistakes, finding evidence in previous fails which support their next wishful visions and overestimating the probability of success after the past failure (Hong, 2016, p. 17).

This last statement leads to the concept of ‘intelligent failure’, which stimulates the learning process and alleviates grief that may hinder further action. The preconditions for learning from failure are as follows: proper planning of the efforts undertaken (even though they ended with failure), the uncertainty of the result, the moderate scale of the project, commitment, as well as good knowledge about the area of activity where the business venture was located. However, it is worth remembering that rationalising failure may also – due to the reduced emotional charge – reduce the learning outcomes because those issues that do not evoke emotions lose their

priority (Shepherd, Covin, & Kuratko, 2009, p. 592). Rationalisation works well in case of more failures and the need to maintain the ability to act (Shepherd & Kuratko, 2009, p. 455).

Interestingly, concerning the learning process, the experience of both successes and failures impacts the future activities of specific people and the environments in which they operate – and in quite an unexpected way. Previous entrepreneurial experience – regardless of its nature – does not limit the level of mistakes made in the future but tends to discourage those who are not convinced of their ideas. As a result, the percentage of successes is growing (Lerner & Malmendier, 2013, pp. 2442–2443); however, as a side-effect, potentially successful would-be entrepreneurs may also be discouraged.

5.3. Anatomy of failure

The concept of ‘failure’ as it prevails in the management literature concerns the unwanted end of the enterprise and is synonymous with the term ‘bankruptcy’. However, the authors believe it is necessary to pay more attention to a failure in the sense of a ‘(business) mistake’, which does not restrict its meaning to fatal failure only. In this sense, failure/success represents a value of an output variable measured by a metric or a set of metrics that a company may decide to use to capture its performance. Instead of a binary failure [0] versus success [1] situation, this implies a continuum of results ranging from the least to the most desirable ones (0,1), possibly excluding the absolute failure [0] or success [1].

In this context, it can be noted that the meaning of failure/mistake is vast. It covers both ‘trivial’ situations – such as entering an incorrect customer address on an invoice, issuing materials from a warehouse with a different specification than the ordered ones, or placing an old price list on the website – as well as those of a ‘catastrophic’ nature, including removing a healthy body part of a patient due to an incorrect description in the medical documentation, an air crash caused by the installation of a wrong part during a routine repair, or a bankruptcy of the company due to incorrect assessment of the profitability of an investment. Therefore, the severity of failure/mistake results from an area of its occurrence, a situational context, the time of appearance and the time for reaction.

Aiming to clarify the concept of a failure/mistake in the context of management sciences, one can recall the distinction between ‘fallibility’, ‘defects’ and ‘errors’ (Van Rooij, 2015, p. 217). Fallibility results from an excessive attachment to the accepted recipe for success, despite the changing situation, which results in losing a competitive position. A flaw means the maladjustment of the business model over time, which

results in sudden deterioration of results against a previous situation. Finally, the error involves making the wrong decision, considering current knowledge and the given situational context, which results in poor outcomes.

In this research initiative, the authors apply the following understanding of a failure, extending over a broader range of (business) mistakes, as a situation in which someone does not achieve the goal they have set themselves or that has been set to them by a third party. The authors perceive failure as an outcome that, even if measured with pre-defined metrics, is subject to decision-makers' influence on what levels of the outputs are considered undesirable or unaccepted. The following typology of failure can be proposed:

- area of occurrence: technology, economy, social environment, (natural environment);
- cause: accidental, unintentional, intentional;
- intensity: insignificant, within tolerance, important, critical;
- repeatability: one-off, repeatable, cumulative, systemic;
- result: imperceptible, ignorable, possible to compensate, reversible, irreversible.

The importance of a failure can be determined by analysing the following three scenarios of preparation for its possible occurrence: acceptance (called fail-fail situation), prevention (fail-safe option), and minimisation of effects (fail-life scenario). Acceptance of a failure means that a given situation is tolerated (e.g., it has been forgotten to offer additional insurance to the client who purchased a travelling service), but conclusions for the future should be drawn. Prevention of failure means that a given situation is considered possible (e.g., an incorrect operation in the IT system is initiated), but there is protection against undesired consequences (e.g., the necessity of its approval by another employee). Finally, the minimisation of the effects resulting from the failure concerns a situation which was recognised as impossible or very unlikely (e.g., all engines of the aircraft turn off mid-air) and which activates an emergency scenario or leads to the development of such a scenario for the future. The presented approach to the failure will constitute the methodological basis for analysing empirical data collected within this research initiative.

5.4. The manageability of failure

For the analysis of possible situational failure strategies, determinants which are laid down in the theory of the firm and its environment will be examined. Starting from the differentiation between – from the point of view of the organisation – controlled and uncontrolled success factors, alternative structures of expectation will be introduced and linked to a typology of change, which also contributes to outlining the increasing

importance of failure management – understood as a systematic procedure to obtain the benefit of making a failure (Lee & Miesing, 2017, p. 159) – in the future.

The St. Gallen Management Model, from its first version published in 1972, up to the recent 4th generation, has served to facilitate managerial activities by creating a standard set of hermeneutic and visual supportive instruments to integrate different perspectives of the enterprise and its environment in a holistic approach (Rüegg-Stürm & Grand, 2016). The implications of the changes between the 3rd and 4th generation of the model will not be discussed here in detail. In the context of this chapter, they underpin the understanding that success and failure are equally determined not only by what is decided in the enterprise but also by its different surroundings, stakeholders, environmental spheres and interactions.

These latter categories form the framework to which any operative decision has to adapt. It can only be changed in a political process, by economic development, societal change, technological progress or the like. As these are relatively stable and ineffective in a short time frame, the prerequisites for proper consideration and thus failure avoidance, at least for a short period, will be reasonably good.

The uncontrolled variables are much more volatile and thus create a bigger challenge for an organisation in the short term. In particular, stakeholders directly influence the organisation's performance and may affect the success or failure, even if a decision made inside the organisation was correct and 'state-of-the-art'.

So obviously, failure in the described context can result from two sources: a wrong/not state-of-the-art decision of a responsible manager (decision induced) or from changes in the organisation's environment – in the short run primarily in the market (development caused). Since this is not yet the complete picture, the question which is arising is which basic failure strategy an organisation wishes to follow and what determines the decision for the one or the other alternative: to invest to avoid failure where possible and to repair where not, or to allow failure and invest in repair and learning where it occurs (Birkinshaw & Haas, 2016).

5.5. The challenges of a changing world

Today the 'change' is becoming increasingly influential, as it has become much more rapid in recent decades. What might be even more important is that there are several categories of change, and a shift towards the most challenging type can be recognised in many aspects of modern societies and economies. The following Table 5.1 presents a survey about them, also integrating the differentiation of success factors and structures of expectation from the previous sections.

In an environment of deterministic change, it is easily possible to predict what will happen when a decision has been made. In this surrounding, the actor has perfect control of the consequences of the decision. This is the case in any situation based on the determinism of technology and natural sciences. If the system works correctly, every possible action leads to a precisely defined result. This is known in advance, and there is no surprise: pressing the ‘buy’ button launches a transaction. There exists a clear and firm link between action and result: in the deterministic type of change, the probability for one change (c) is 1; for all others, it is 0. In this context, it is sufficient for decision-makers to know the facts and figures and to react accordingly. If a decider has all information necessary, they are in the position to avoid failure by just following the rules of the system. This can be described and coached, and it appears relatively reliable.

Table 5.1. The manageability of change

Change	System dynamics	Structures of expectation	Type of adaptation	Knowledge category
Deterministic	rigid	$p(c) = 1$	reaction, execution	factual knowledge = information
Stochastic	dynamic	$0 > p(c_i) < 1$ $\sum_1^n c = 1$	proactive adaptation	behavioural knowledge = qualification
Open	chaotic	$p(c'_i) = ?$ $\sum_1^n c' = 1$	creative leadership	structural knowledge = competence

Source: (Eickhoff & Turnbull, 2011, p. 5).

Stochastic change needs to build on probabilistic proactive adaptation. Now it is not known ex-ante which change will factually take place. The possible options are known to the decider, and they all have a probability of $0 > p(c_i) < 1$, which add up to 1 ($\sum_1^n c = 1$). In this situation, the decider needs to be competent to decide based on this knowledge, not only about the facts but also on the probabilities, which might be objective or subjective and experience-based (e.g., change of purchasing behaviour in consequence of advertising). Regarding potential failure, this situation is more complex than deterministic change, as failure may arise not only out of a formally false decision making but also out of wrong a priori information about the probabilities. This situation is typical of non-technical social systems, and in a long time, deciders will collect experience to deal with it.

A specific type of stochastic change can be described as ‘Knightian uncertainty’ (Knight, 1921). In this case, the decision-maker knows the options they can select from. Still, they do not have information about the probabilities or the possible future scenarios, co-determining results, nor are they able to find evidence for

them. Laux & Liermann (2005) suggest transferring such a situation into a decision under risk by formulating subjective probabilities, while Knight (1921) takes this as a basis for a description that differentiates an entrepreneur from the bank clerk. The entrepreneur does not try to calculate, but they decide with a gut feeling or intuition. This leads to the third scenario of an ‘open change’.

Deterministic change and stochastic change share a commonality, which differentiates them structurally from the third category of open change. In both types, the link between decision and consequence can be described by ‘if-then’ clauses, not so in the case of open change. Here the decision-maker knows that change might occur, but not when, where, or to which extent. No probability for a specific result exists; it is only known that it is positive. Worse even, sometimes – going beyond the assumptions defining the field of applicability of decision theory (Laux & Liermann, 2005), that all possible alternatives and consequences are known – it might be that none of them is known (Eickhoff & Turnbull, 2011). For this reason, in the equation in Table 5.1, a modified variable c' is used.

At first glance, open change does not seem to have high relevance, as it appears difficult to imagine that a definition of the consequences of a decision or their probability should not be possible. Still, such situations do not only exist, but they are also becoming more important in contemporary development. Open change can be found in the change in the global climate, disruptive innovation, and the increasing digitalisation of business and society. In a situation of open change, failure will be an integral part of creative leadership (Eickhoff & Turnbull, 2011): creativity is needed to develop new solutions for unprecedented problems and leadership to ‘make it work’ in the given situation. As such, regarding open change as an essential contemporary configuring force in business and society, failure and strategies to cope with it will become critical – reflecting what the inspiring quote from (Bennis & Nanus, 1997) indicates, who use this also as a second sub-title of their book on leadership: “Managers do things right, leaders do the right things.”

5.6. Failure strategy archetypes – the proposal

Failure management (Lee & Miesing, 2017) shall be differentiated into three strategic archetypes. They do not necessarily exist in a ‘pure’ form and can also gradually be combined in different situations: a failure penalising situation (Figure 5.1), a failure analysing situation (Figure 5.2) and a failure enabling situation (Figure 5.3).

In a failure penalising situation, an (even potential) failure is seen negatively and communicated in the same spirit (thus red blocks) and cannot lead to further success. The ‘lesson learned’ mechanism is off (grey block), so there cannot be any benefit

to mitigate losses. This might be a result of (culturally driven) risk aversion, or it represents a low level of entrepreneurial spirit. This might be called a bureaucracy approach.

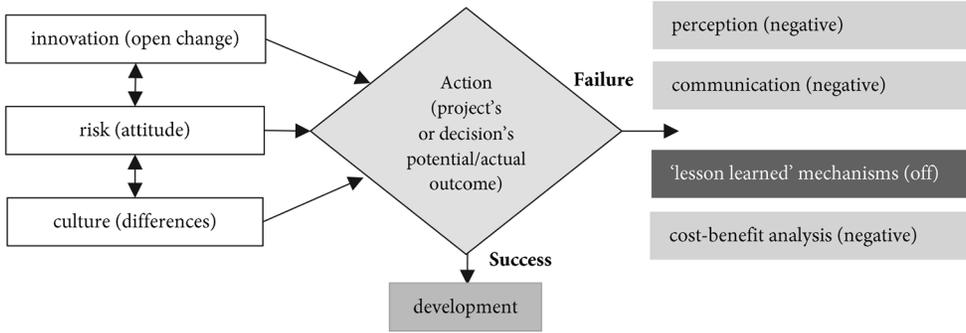


Figure 5.1. Failure penalising strategy

Source: own elaboration.

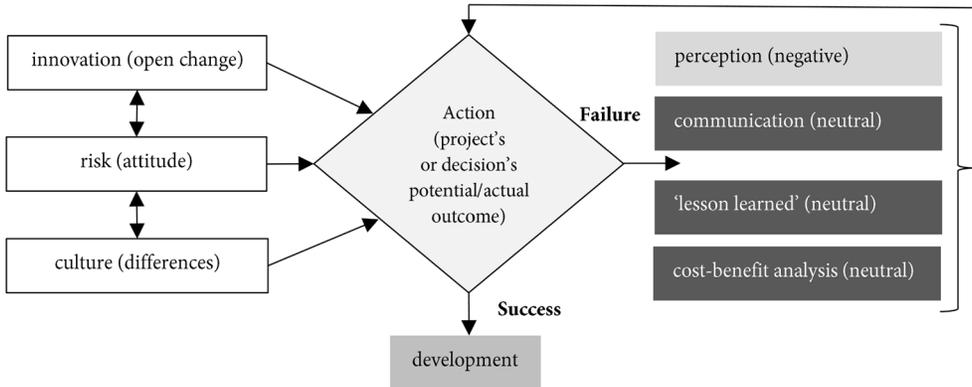


Figure 5.2. Failure analysing strategy

Source: own elaboration.

In a failure analysis situation, an (even potential) failure is seen as a problem with which to cope. The failure is still perceived negatively (red block). The idea is to report a problem, run corrective measures, and mitigate losses (those actions are neutral – professional, thus blue blocks). When a problem is under control, further action may proceed. It is a loop that ends when all the issues are under control. This is the optimising approach (for which methods are developed, e.g., controlling). Again, culture may play a role here. This might be called a managerial approach.

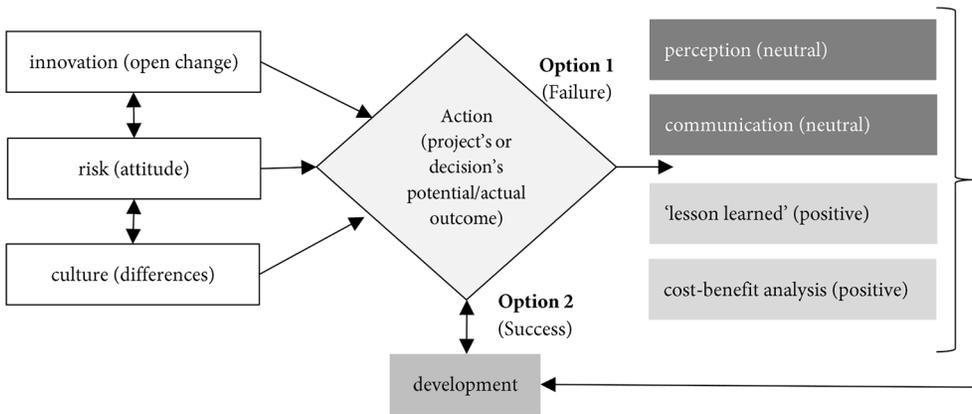


Figure 5.3. Failure enabling strategy

Source: own elaboration.

In a failure enabling situation, an (even potential) failure is seen as one of two options leading to development. The focus would be on learning and turning problems into opportunities (a positive attitude – thus green blocks). Development leads to further action, and so on (think, act, think, act, think, act, ..., instead of think, think, think, act). This might be called an entrepreneurial approach.

None of the described failure strategies is dominant and should be considered the first choice for any organisation. It can instead be assumed that an appropriate strategy will largely be determined by situational influences. A more bureaucratic approach will probably be preferred when the situation can mostly be controlled by the decider and when it is essential to achieve stable and reliable results, e.g., for the sake of equality of treatment. However, it would not be appropriate in an innovative research context, as it can be assumed that there will be a negative impact on the creative problem-solving capacity and incentive of the decider. On the contrary, a failure enabling strategy will probably not be accepted in a situation where a clear relation between decision and consequence can be identified *ex-ante*. In this situation, it would appear as a waste of resources and thus inefficient.

If the choice of a failure strategy appears to be dependent on specific situational determinants, the categories mentioned above of change may be used to define adequate scenarios. The failure penalising strategy could be assumed to work well in a surrounding of deterministic change, while failure analysis strategies correspond well with stochastic change. In the surrounding of open change, when failure is almost inevitable and omnipresent, a failure-enabling strategy might suit best to help the organisation learn quickly to survive.

Besides the characteristics of the task specified by the category of change, the attitude towards risk will be important for the choice of an appropriate failure strategy. Operationalising this by the potentially accepted consequences of failure – on which level does the decider need to find a solution for failure – the following failure strategy–failure level matrix shows possible relationships as seen in Table 5.2.

Table 5.2. The Failure Strategy-Failure Situation Matrix

Situation Failure strategy	fail-fail	fail-safe	fail-life
Penalising	symbolic compensation, if any	liability management and compensation claims (private law)	liability management and compensation claims (public law)
Analysing	reactive: quality control, customer satisfaction research	pro-active: process definition, the 4-eyes principle	causation research
Enabling	test-market introduction	stability tests, simulation modelling	virtual or laboratory simulation

Source: own elaboration.

Assuming that failure management has not been an extensive research focus, a shift of attention can be expected. The currently discussed approaches of ‘Big Data’ may require a complementary toolbox for ‘No Data’ in situations of open change. The value of the theoretical foundations for failure management proposed by the authors stems from challenging the traditional paradigm. The presented framework help to gain a deeper understanding of the nature of failure in different business settings, which may serve as the common basis for developing a model of failure management practices in an increasingly ‘fuzzy’ surrounding. This may be particularly valid for enterprises where failure is an option – including start-ups and those from knowledge-intensive industries. Finally, the failure management framework may form the ground for empirical studies of how contemporary organisations across the world perceive and cope with failure.

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