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TRY, TRY AND TRY AGAIN

In his new book, economist Tim Harford puts forward the thesis that business success always begins with failure. Here, he explains why it's crucial that companies learn to embrace their flops as enthusiastically as they celebrate their hits.

Photographs by John Reardon

In 1450, a German goldsmith and entrepreneur by the name of Johannes Gutenberg produced a poem. Had he merely been the writer of the poem this would have been unremarkable. But Gutenberg was, instead, the poem's printer, and it was probably the first work ever to be produced by a movable-type printing press, one of the most important technological innovations in history. Gutenberg's invention made it possible to mass-produce books and profoundly changed society.

Five years later, Gutenberg was heavily in debt after running up vast costs in the process of printing his celebrated 42-line Bible, perhaps the most famous and valuable edition of any book. He argued with his business partner and, by the end of 1455, Johannes Gutenberg, the man who set the stage for the modern world, was bankrupt.

Failure in business is, of course, always possible. But we tend to run away from a more painful truth: failure in business is commonplace. And not only is failure all around us, but brilliant visionaries such as Gutenberg are by no means immune from it.

The flip side of the coin is that success in business emerges (far more often than we care to admit) from a process of trial and error. That is certainly the experience of Gutenberg's immediate successors. One might have thought that once the movable-type press had been invented, a successful business model for printing would have been clear. It was not. Gutenberg's strategy of competing with the calligraphy and illumination of handmade Bibles seemed obvious, but it was a mistake. Many of his successors made similar errors. Venice soon became the centre of the printing business, but according to the economist Paul Ormerod, three quarters of Venetian printers folded within three years of being established.

Eventually, the nascent printing industry stumbled upon the answer: printing religious 'indulgences', a kind of pre-packaged relief from divine punishment. Rather than printing beautiful books, printers made money by churning out flyers for the church. Even with Gutenberg's world-changing invention at their disposal, early printers had to experiment their way to success.

It is very hard for us to abandon the idea that business success is the result of talented leadership at the helm of objectively superb companies. The truth is that the world is too complex, and it changes too quickly, for us to be confident of that. Many corporations have enjoyed periods of celebrated success, only to stumble and fail to adapt. Others – one could make a case for including eBay, McDonald's and the Nobel-prize winning Grameen Bank – have sprung from nowhere after somebody stumbled upon a brilliant idea, almost by accident.

It might be tempting to conclude that economic success happens despite business failure. But it's probably more true to argue that economic success happens *because* of business failure. It is the failure of once-dominant companies that makes space for new business ideas. Admittedly dominant companies are sometimes able to use government bail-outs, consumer inertia or some other unfair advantage to lock out young competitors with»



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better products and in such cases, the corporate failure rate will be low, but such stagnation is bad news for any economy.

In a recent study published in the *Journal of Financial Economics*, Kathy Fogel, Randall Morck and Bernard Yeung compiled lists of the ten largest employers in each of 44 countries across the world. They found that countries with rapid churn into and out of this elite group also had faster growing economies. More impressively, this relationship appears to be causal - high turnover yesterday is correlated with fast economic growth tomorrow - and holds up after statistically controlling for other important factors. Fogel and her colleagues also argue that the key factor is not "rising stars" but "disappearing behemoths". Failure, it seems, is not only ubiquitous and survivable - it's useful.

Over five centuries after Gutenberg's bankruptcy, two management consultants, Tom Peters and Robert Waterman, published *In Search of Excellence*, a genre-defining business book. It enjoyed far greater financial success than Gutenberg's Bible, and Tom Peters went on to carve out a career as a larger-than-life management guru.

As part of their quest to learn from the best companies in the world, Peters and Waterman settled on a shortlist of 43 excellent companies. But trouble was in store.

In 1984, just two years after *In Search of Excellence* had been published, *Business Week* ran a cover story that said it all: "Oops! Who's excellent now?" The magazine pointed out that almost a third of the companies singled out for

praise by Peters and Waterman had subsequently sunk into serious financial trouble.

Perhaps the authors were rash to create such hostages to fortune. But it is unfair to suggest that their selection of "excellent" companies was uniquely incompetent. A competitive economy is simply too complex to navigate armed with some abstract quality of "excellence". Rather, companies have specific projects and products, some of which match what the market wants and succeed, while others do not, and fail. We cannot simply pick out brilliant leaders or excellent companies and assume they will continue to make the right decisions.

If the rise and fall of business models is an unavoidable part of economic growth, wise entrepreneurs or managers will anticipate the possibility of failure and make sure that failure is survivable. And they'll watch closely for signs of trouble so that failing projects can either be shut down or given a sharp change of direction.

That seems fair enough: we all pay lip service to the idea of "learning from mistakes", or "if at first you don't succeed, try, try again". But we rarely mean what we say.

Psychological research suggests that the process of learning from failure is pretty dysfunctional. Although trial and error is a powerful strategy for success, we struggle quite profoundly to respond to the "error" part as constructively as we should. Most organisations do not celebrate the honest mistake or the promising near miss. Most voters are not enthused by politicians who own up to failures and change their minds when circumstances change either. (The two most re-elected prime ministers in modern British history were Tony Blair and Margaret Thatcher. Blair said that he had

no reverse gear, while Thatcher declared "the lady's not for turning". These attributes, so unattractive in cars, proved irresistible to voters.)

Most profoundly, most people do not react well to the prospect of making their own mistakes. We subconsciously deploy a well-documented range of strategies from excessive caution to denial to reckless loss chasing.

One of the more tragicomic examples of this behaviour emerges from a study of, of all things, the TV game show *Deal or No Deal*. The show assigns contestants a random box, which contains anything from pennies to hundreds of thousands of pounds. Contestants randomly eliminate other possibilities, gradually homing in on a view of what their own box might contain. From time to time, the mysterious Banker phones them and offers them money if they walk away from the contents of their box.

Deal or No Deal was studied by a team of behavioural economists including Richard Thaler, famous as the co-author of "Nudge". Thaler's team wanted to understand how willing contestants were to gamble when offered certain cash from the Banker relative to the unknown quantity of cash in their own box.

The behaviour of one contestant, Frank, is illustrative of what they found. A player in the original Dutch version of the show, he had a chance of winning a huge jackpot and because of this, the expected value of his own box was just over €100,000. The banker offered him €75,000 and Frank turned it down, showing an appetite for risk. Frank was then unlucky: his next choice for elimination turned out to be the box containing the half million euro jackpot, and Frank's expected winnings fell to a mere €2,508.

Now here's the strange thing: the Banker started making Frank offers that were much»



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closer to the fair value of his winnings. The first Banker's offer was €2,400, 96 per cent of the expected value of playing on. The next offer was actually more than 100 per cent of Frank's likely winnings.

Finally Frank had two remaining possibilities in his mystery box, €10 or €10,000. The Banker offered €6,000 to walk away, a generous proposal by any standards. Frank turned down every deal. He ended up leaving the studio with just €10. Having been wounded by the loss of a certain €75,000, Frank began to take absurd gambles.

Frank's behaviour turns out to be typical: *Deal or No Deal* contestants are far more likely to reject the Banker having just made an unfortunate choice of box, despite the fact that objectively speaking the Banker treats them more kindly than other contestants. They prefer to keep gambling and give themselves some chance of redemption.

Analogous behaviour has been found in stock market investors, who cling desperately to sinking shares, because to sell them would be to crystallise their loss; and in professional poker players, who are always at risk of - to use the slang - "going on tilt." We've all seen the business equivalent: the chief executive who throws good money after bad, the manager who just won't let go of a failing cause, or the entrepreneur who wants to play double-or-

quits with his life savings.

This just won't do. We need to find a safer way to screw up. Peter Sims, author of "Little Bets", describes the stand-up comic Chris Rock trying out new material in a local comedy club. Those first gigs will be absolutely agonising. Rock finds it impossible to create great routines sitting at his desk: he has to try, and fail, in a public way, up to 40 or 50 times, before finally taking his material on tour. That's a gruelling process but it's hard to argue with the results. Part of Rock's successful formula is finding that out-of-the-way space in which a failure is not a tragedy. But part of it is simply having the mental toughness to fail in public.

Constructively experimenting in business requires the individual and the organisation to meet each other half way. The trouble is that few companies will tolerate 50 failures, even if there's a clear learning curve going on.

There are some heartening examples of failure-friendly corporate cultures. India's Tata Group has a 'Dare to Try' award, celebrating creative near misses, such as the idea of putting plastic doors on the Tata Nano car. Allina Tugend, author of "Better by Mistake", approvingly cites the 'Golden Egg' award handed out by a business association in Michigan. It's given to "a member who got egg on his face trying something new."

But such awards are not common, which may be why so much economic change consists not of companies reinventing themselves, but of companies being supplanted by young,

innovative rivals. Tugend points out that it's very easy for an organisation to get into the habit of covering up failures, or blaming others.

This may help to explain the incredible rates of economic churn unwittingly revealed by Peters and Waterman. One would expect that longstanding "excellent" firms should easily overshadow upstart competitors. The truth is that established firms often have every advantage except the one that counts: the collective willingness to try something new and daring.

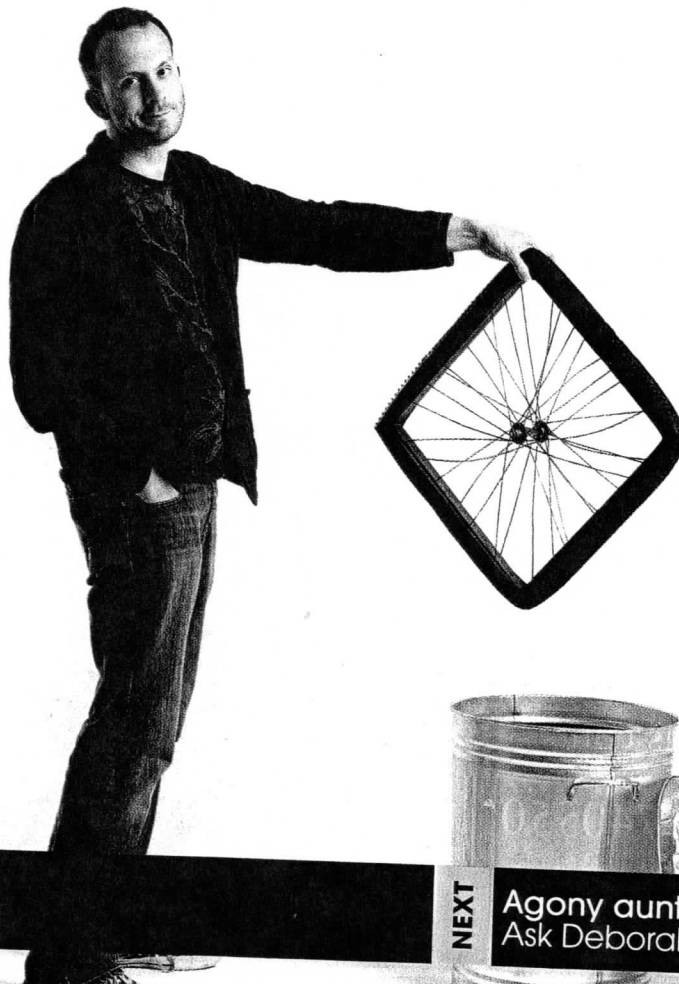
If failure is likely, and a business also regards failure as shameful and unacceptable, it seems to me that there are two likely results. One is that failing projects will be concealed for as long as possible - and this often means nurturing and funding them long after they should have been canned. The second is an organisation that slowly auto-asphyxiates because nobody ever tries anything new. Success and failure become indistinguishable: one long, vague slump into mediocrity.

We all recognise those symptoms: they are classic frustrations of office life. Yet somehow we must find a way to respond more constructively to the risk of failure. If Johannes Gutenberg had been afraid of failure, where would we all be now? ●

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Tim Harford is a columnist for the *Financial Times*. His new book, *Adapt: Why Success Always Starts with Failure*, has just been published by Little, Brown

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