

Acceptable Loss

A Formula For
How to Fail Quickly
and Cheaply, and
Ultimately Succeed

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If I hear one more academic tell me the secret to success is failing more, I am going to run over to the nearest college campus and pull down all the ivy I can find that is climbing up those hallowed halls.

Yes, of course, today when the competition, technology and economy are evolving faster than ever, we all need to experiment more to become more innovative and adaptive in the face of all these disruptions.

And yes, again, some of those experiments are not going to work out which is where all those increased numbers of failures that the academics are advocating are going to come from.

I understand all that.

But what all those eggheads in their tenured garrets don't understand is this: Every time you fail, you lose time, money, and momentum. You staff up to conduct those experiments—be it in introducing a new product or service or radically altering one you already have. That costs money. And if it does not work out your staff is deflated.

And there are opportunity costs as well. (If you hadn't been working on the failure, you might have been working on something else that might have worked out.)

When you add it all up, the costs of having things not work out are huge, and all of a sudden, failing doesn't seem to be a “be all and end all” does it?

So, what is a business person to do?

The academics' premise is right: We do need to constantly experiment. You are either constantly getting better or you are getting worse. But we can't have failed experiments cripple us.

How do we solve this problem?

The answer can be found in a surprising place.

It turns out that the world's best entrepreneurs resolved this tension decades ago. They have created an approach that spurs innovation while negating most of the problems and costs that come with failures.

“Wait, wait, wait,” I hear you cry. “Entrepreneurs can’t teach us anything about failure. They never give up. They fight to their last nickel and/or dying breath to make their idea a reality.”

Well, it makes a wonderful story line and terrific movies, but the reality is that entrepreneurs give up on ideas all the time.

In fact, they know how much they are willing to lose, before they begin.

They apply the basics of risk management that says: If you’re going to play in a game with uncertain outcomes—and there is nothing more uncertain than starting a business—then:

1. Don’t pay/bet more than what you can expect as a return, and
2. Don’t pay/bet more than you can afford to lose.

Both of those ideas can be summed up with the phrase “Acceptable Loss,” a concept where you consider the potential downside of whatever risk you are about to take—such as starting a new company or some other venture that is going to consume a lot of your time, capital, or other assets—and put on the line no more than you would find acceptable to lose should things not turn out the way you want.

It is not that they are risk adverse. They are not. It is just that we want make sure that they get the absolute most out of every asset at their disposal.

You can see that every time they try to start something new.

It turns out there is a formula.

If you looked at the way entrepreneurs act, you would be tempted to conclude there is not a lot to be learned from studying them. You would have to be Bill Gates to start Microsoft and Oprah Winfrey to begin Harpo.

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But if you look at the way they think, you will discover amazing similarities.

When successful entrepreneurs head off into the unknown—and there is nothing more unknown than starting a new company—they:

- Take small steps toward what they think they desire
- Pause to see what they have learned from taking that small step.
- Build off what they have learned and then
- Take another small step.

To reduce it to a formula they: Act. Learn. Build (off that learning.) And Repeat.

But notice what is going on, because the steps are small, so is what it puts at risk. It's another way of keep potential failures from being devastating.

Here's an example of what we are talking about. A 40-something woman who has spent all her time working in corporate public relations departments decides it's finally time to start her own firm. The traditional approach would be to do a business plan; line up investors; find office space for her new public relations firm and open the doors on day one several hundred thousands of dollars in debt. Yikes.

Entrepreneurs take a different approach. They have an idea. (“I want start my own business; I think I will start a public relations firm since that is what I know best”) and they get underway—not by quitting their day job but by calling around after hours and on weekends to see if all those people they think will become clients actually will.

After they have taken that small step—the calls really haven’t cost them anything other than a bit of time and some minutes out of their cell phone plan—they pause to judge the market’s reaction. (“Gee, no one seems to be get overly excited about yet another PR firm. But everyone tells me what they have liked about my work is how well I explain how they should communicate with their employees about what they are trying to do with the p.r. strategy. Maybe, I should forget about p.r., which is about external communication, and concentrate on internal communication instead.”)

Building off that reaction. They make some more phone calls and ask people “do you need help with your internal communication?”

In other words, entrepreneurs are not committed to the plan (starting a PR firm); they are committed to the goal (in this case, “starting a business of my own that would be fun and successful”).

They continue taking small steps toward (the new) goal of starting an internal communication consulting firm in this case until they have what they want (the business is underway) or they

decide they don't want it ("yes, I probably could make a living doing internal consulting, but geesh I think it is going to be boring, so I will pass"); or they find that they want something else instead.

But again, at no point have they ever risked more than they could afford to lose.

That's one wonderful thing about this approach. Here are two others:

First, if you are going to fail (you wanted to start that PR firm but no one was interested) you fail quickly and cheaply. You have wasted either a lot of time or a lot of other resources discovering that your new idea simply won't work. That means:

Second, you get more turns up at bat. Investing hundreds of thousands in starting the PR firm the traditional way would have eaten up lots of your resources and who knows if you would ever have a chance to try a second idea.

That is no small point. Not surprisingly, the number one source of funding for new business is personal funds. If you use up all your money trying to get your first venture off the ground, there may not be a venture number two. At best, it could take you years to gain enough money to launch another company. And if you are trying to get a new idea off the ground inside a large organization, and fail to do so consuming a large amount of resources in the process, your

chances of getting a second bite at the apple are small. Corporations are not in the business of rewarding failure, especially expensive failures. If you take one mighty swing and miss, you are likely to find yourself in charge of “special projects,” or being unemployed.

Finally, if you seeking outside investors, one of the very first questions they are likely to ask is “tell me about your last attempt to start something new.” If it was a costly failure, they are likely to keep their checkbook closed. Investors want to see a proven track record of success and they always want to know that you are going to be very careful with their money.

Taking the approach that entrepreneurs do, one that keeps potential losses to a minimum, allows you try another idea, should the first one not work out.

Sounds like a better approach to us, one that is grounded in the real world.

“Entrepreneurs are not committed to the plan; they are committed to the goal. They continue taking small steps toward goal ... until they have what they want, decide they don't want it; or they find that they want something else instead.”

Solving the Egg Head Dilemma

There is another huge advantage about this approach. If you fail—your idea for that communication firm doesn't work out—it isn't as devastating emotionally.

Another example will show you why. Say you really want to open a restaurant. You could research the market forever; spend months putting together the perfect team; spend more time gathering the investors you will need who can come up with the \$2 million or so that it is going to take to get underway. And, eventually, you will open the doors to Chez Me.

Or, on the very day you think of opening the restaurant you can start asking potential customers what they think of your idea. ("Hey, if I open a high-end French place on Fifth and Main, do you think you would give us a try?")

You learn from that small step. People tell you there are an awful lot of great restaurants in that area—including a fabulous French one—and they are not sure that section of town needs another.

At that point you could simply give up, or head in another direction. ("Everyone told me there is probably not a market for an upscale French restaurant, but they were intrigued by the idea of "gourmet take-out. Hmmm.")

Either way, you learned quickly. And even if you “failed,” i.e. you decide not to open either the restaurant or the gourmet take-out, you did so quickly and at little cost.

That means you have the resources to try again—something that the person who raised (and wasted) that \$2 million might not be able to say. If they meet someone who says, “I haven’t seen you around for the last couple of years. What have you been doing?” The answer to that question is devastating emotionally (and having to face all those investors who provided funding is no walk in the park either).

With all deference to business professors everywhere, that is not the kind of failure you want to have. If you have to fail, you want to fail quickly and cheaply. That’s our first takeaway from this.

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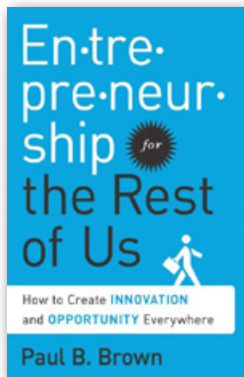
Let me give you three others.

1 | Don't reinvent the proverbial wheel. You don't need to learn everything the hard way. That is especially true when it comes to learning ways to becoming more resourceful and moving faster. Serial entrepreneurs—people who have created two or more successful companies—have a proven approach to creating innovation and opportunity. The approach that has worked for them will work for you, no matter what you do for a living. It doesn't matter if you work for a large organization or are just striking out on your own. Try it, you'll see.

2 | Despite the myths, the best entrepreneurs take small steps—not giant leaps—as they go about creating something new; they work with others and are extremely receptive to feedback and suggestions. The stories about the lone wolf who insists on doing everything on her own and in her own way despite market feedback is exactly that. A story. If you want to avoid failing, and serial entrepreneurs do, you consider every good idea.

3 | The formula the best entrepreneurs follow is: Act. Learn. Build. Repeat. Try it and prosper. 📖

Info



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ABOUT THE AUTHOR | Paul B. Brown is a long-time contributor to *The New York Times*, where he has created several columns for both NYTimes.com as well as the newspaper itself, and still writes for the Sunday business section. He is the author of more than 40 books, including the international best-seller *Customers for Life* which he wrote with Carl Sewell. A former writer and editor for *Business Week*, *Financial World*, *Forbes*, and *Inc.*, he currently speaks on the topics of innovation and entrepreneurship at conferences and seminars worldwide.

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