White Paper 2015-12

How to Overcome the Psychology of Project Failure and Know When to Cut Losses

One of the most surprising observations one can make in the Project industry is the propensity of organizations to persist on Projects that are obviously failing. This psychological trait is observable in many human endeavours, still project-driven organizations could be expected to have a more professional approach on this effect. This White Paper explores the psychology of project failure and gives a framework to overcome the risk of persistence on obviously failing projects.

The psychological effect of perseverance in the face of failure is in fact very widespread in many human pursuits and has been described under the terminology of 'prospect theory': "*Many unfortunate human situations unfold […] where people who face very bad options take desperate gambles, accepting a high probability of making things worse in exchange for a small hope of avoiding a large loss. Risk taking of this kind often turns manageable failures into disasters*" – as explained by Daniel Kahneman in the book 'Thinking, Fast and Slow'.

And the more an organization has an emotional commitment with the Project, the more there is sunk cost in the endeavour, the more this effect is visible, often with dire consequences for the organization from the short to the long term.

We are all subject to this psychological tendency: it is extremely difficult to cut our losses in an endeavour in which we are emotionally involved. It is only with experience and practice that we develop the ability to overcome this natural tendency. Project-driven organizations could be expected to put in place a process framework designed to overcome this effect, for the sake of the organization.

> It is essential for organizations to be organized in a way that project failure is recognized, managed by people that are not emotionally connected with the endeavor.

The 15% loss cutting rule

It is important that the decision to cut losses should be taken early to save the organization or minimize the impact. This requires recognizing the fact that a Project is nose-diving, having a sound view of the probable evolution of the Project, and having defined thresholds beyond which decisive recovery and cut loss actions will need to be taken.

Let us state a very simple rule exposed as the 'Clark rule' by Dan Ward in his book 'FIRE - How Fast, Inexpensive, Restrained, and Elegant Methods Ignite Innovation'. Dan Ward is a program manager for the US armed forces who got fed up by the large overruns in terms of cost and schedule of huge military program and who supports instead the implementation of a larger number of faster and more inexpensive Projects.

> *The rule states: Cancel any Project when its cost growth exceeds 15 percent*

This rule is stated based on the observation, as discussed at the beginning of this Chapter, that when Projects fail, they do fail miserably and probably with far more than 15% overrun. Projects that are successful or average will remain beyond that boundary. Hence 15% is a reasonable heuristic threshold for wielding the axe.

The advantage of having such a threshold formulated is that it will help taking a decision that is otherwise difficult psychologically.

Setting up the organization to avoid persisting on a failing project

As Daniel Kahneman notes, "*The escalation of commitment to failing endeavours is a mistake from the perspective of the firm but not necessarily from the perspective of the executive who "owns" a floundering Project. Boards of directors are well aware of these conflicts and often replace a CEO who is encumbered by prior decisions and reluctant to cut losses*". What is particular important here is to ensure someone with authority has an impartial view on the developments of the failing Project, unencumbered by emotional luggage and historical attachment, to be able to take the right decision.

The people that need to be involved need to be not involved emotionally in the Project so as to have the propensity to develop a rational view of what is happening; as well as experience in the industry to be able to anticipate the probable course of events. Senior personnel outside the entity where the Project is developed (or even outside the organization if the organization is too small) thus need to be mobilized to provide proper advice. In larger organizations, personnel from other geographical areas of operation are often a good choice. They need to be present on a regular basis during Project reports and frequently review the Project (on the ground and in the Project office) as soon as there are signs of failure.

When a Project has been officially recognized as in jeopardy, the options available to the organization need to be carefully weighted. If the organization's survival is at stake, all options are open. If the organization's survival is not an immediate concern, more subtle actions can be undertaken, however, they need to be decisive enough to change the unfolding course of events. In all cases, certain stakeholders will be very upset and they need to be specially managed.

How to address the case of a failing project

Depending whether you are the Owner or a Contractor, and what the agreements are with the other Party and with other stakeholders, the crisis management model will be quite diverse. If the contractual conditions are properly set (ref. White Paper 2015-08 '*How Some Contractual Terms Are Essential At Preventing Killer Project Risks*') in the worst case you should be able to terminate or leave the contract incurring a limited maximum liability. In this section we will just cover some recommendations from the leadership and management perspective.

> **Abide by the Loss-Cutting Rule: Set a loss threshold beyond which loss will be cut whatever the good reasons to keep ongoing.**

The question of whether to remove the Project Manager is always difficult (if he has not yet resigned on its volition, which led to discovering the dire state of the Project – a situation which still happens too often). On one hand, a new management would allow to more easily steer clear of previous decisions, and show determination in changing. On the other hand, the Project Manager in place will have relationships with his team and the Project stakeholders that might be worth keeping. Firing the Project Manager is easy but does not necessarily help in resolving the situation. This is why it is often a good solution to second the current Project Manager with a new strong person that will drive the actual changes, with a clear mandate, while keeping the previous person in charge of maintaining the current state of relationship with the various stakeholders.

When trying to salvage a Project, often, there can be a realization that it is only one area of the Project that is severely jeopardized. The most important issue is then not to let the entire Project rot from the section that is currently spoilt. In this situation, a task force should be assembled to deal with the issue while creating the minimum disruption to the rest of the team, if the performance of the rest of the Project is acceptable.
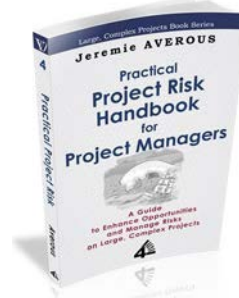
Conclusion

It is essential for organizations to be organized in a way that project failure is recognized, managed by people that are not emotionally connected with the endeavour. A very powerful rule is to set a loss threshold beyond which loss will be cut whatever the good reasons to keep ongoing. We recommend to most of our clients to implement strict loss cutting rules and processes to avoid situations that can turn to be dramatic up to putting the entire organization in jeopardy.

> *Find all these principles of Project Opportunity and Risk exposed in a comprehensive manner in our new Handbook,*
> **Practical Project Risk Handbook for Project Managers**
> (now published, available in Paperback and Kindle versions!)
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