Life after Business Failure: The Process and Consequences of Business Failure for Entrepreneurs

Working Paper No. 117

May 2012

Deniz Ucbasaran, Dean A. Shepherd, Andy Lockett and John Lyon
Warwick Business School’s Small and Medium Sized Enterprise Centre Working Papers are produced in order to make available to a wider public, research results obtained by its research staff. The Director of the CSME, Professor Stephen Roper, is the Editor of the Series. Any enquiries concerning the research undertaken within the Centre should be addressed to:

The Director
CSME
Warwick Business School
University of Warwick
Coventry CV4 7AL

e-mail stephen.roper@wbs.ac.uk Tel. 024 76 22501

ISSN 0964-9328 – CSME WORKING PAPERS

Details of papers in this series may be requested from:

The Publications Secretary
CSME
Warwick Business School,
University of Warwick,
Coventry CV4 7AL

e-mail angela.gibson@wbs.ac.uk Tel. 024 76 523692
Life after Business Failure:  
The Process and Consequences of Business Failure for Entrepreneurs

Deniz Ucbasaran¹, Dean A. Shepherd², Andy Lockett¹ and John Lyon¹

¹Centre for Small and Medium-Sized Enterprises, Warwick Business School, University of Warwick, Coventry, CV4 7AL, UK.  
deniz.ucbasaran@wbs.ac.uk; andy.lockett@wbs.ac.uk; sjohnlyon@aol.com

²Kelley School of Business, Indiana University,  
1309 E. Tenth Street, Bloomington, IN 47405-1701  
shepherd@indiana.edu

Abstract

Where there is uncertainty, there is bound to be failure. It is not surprising therefore, that many new ventures fail. What happens to entrepreneurs when their business fails? We hear of highly successful entrepreneurs extolling the virtues of failure as a valuable teacher. Yet, the aftermath of failure is often fraught with psychological, social and financial turmoil. The purpose of this article is to review research on life after business failure for entrepreneurs, from the immediate aftermath through to recovery and re-emergence. First, we examine the financial, social and psychological costs of failure, highlighting factors that may influence the magnitude of these costs (including individual responses to managing these costs). Second, we review research that explains how entrepreneurs make sense of and learn from failure. Finally, we present research on the outcomes of business failure, including recovery as well as cognitive and behavioral outcomes. We develop a schema to organize extant work and use this as a platform for developing an agenda for future research.

Keywords:

Entrepreneurs; business failure; costs of failure; emotions; learning; sensemaking
Life after Business Failure: The Process and Consequences of Business Failure for Entrepreneurs

The value of entrepreneurship to economic development, job creation, and innovation is well documented (Carree & Thurik, 2010; Lee, Yamakawa, Peng, & Barney, 2011). Yet, a significant proportion of new ventures fail (Headd, 2003; Wiklund, Baker, & Shepherd, 2010). Coelho and McClure (2005: 13) argue that just as dynamic ecosystems depend on death to replace senescent organisms with vigorous growth, the termination of uneconomic ventures is essential to wealth creation. Numerous scholars have shown that business failure is good for the economy and society overall due to the release of knowledge and resources from defunct businesses (Hoetker & Agarwal, 2007; Knott & Posen, 2005), which can in turn “create a fund of floating resources [that can be] reassembled...into new ventures” (Delacroix & Carroll, 1983: 278). Furthermore, business failure can lead to reduced costs for surviving businesses via vicarious learning (Madsen & Desai, 2010).

The effects of business failure on the individual entrepreneur, however, are more complex and arguably paradoxical. While failure may lead to a potentially valuable learning opportunity for the entrepreneur who founded the failed business (McGrath, 1999), it may also be an emotional and traumatic experience (Cope, 2011; Shepherd, 2003) that obstructs learning. Even if learning has taken place, for these learning benefits to materialize, the entrepreneur who founded the failed business must deploy the resultant new knowledge—for example, by embarking on another entrepreneurial venture (Shepherd, 2003; Ucbasaran, Westhead, Wright, & Flores, 2010). If the costs of failure (i.e., financial, social and psychological) are too high compared to the benefits of learning from failure, entrepreneurs may choose to exit their entrepreneurial careers. In such a situation, both the entrepreneur and society may lose out.

In this paper, we review the research relating to the consequences of business failure for the entrepreneur and the underlying processes that shape them. A primary contribution of our review is that we examine the effects of business failure from the entrepreneur’s perspective, which is different from—but complements—strategy and evolutionary perspectives on business failures. First, focusing on the entrepreneur as opposed to the firm
or population yields a different set of research questions requiring different foundational sources of theorizing, such as cognition, emotion, and self-regulation from the psychology literature. Second, we focus on smaller, newer businesses as compared to larger, more established companies because failure is a more frequent occurrence for the former (e.g., due to the liabilities of newness and smallness) (Aldrich & Auster, 1986; Wiklund, Baker, & Shepherd, 2010) and because the individual and his or her business are more tightly entwined (e.g., the entrepreneur is often both owner and manager). Focusing on the extreme relationship between an entrepreneur and his or her business has enabled researchers to build on and extend the boundaries of a number of influential theories—for example, identification, perseverance, and resilience. Finally, to avoid the anti-failure bias that largely exists among scholars and society in general (McGrath, 1999), we did not focus our review on the causes (i.e., antecedents) of failure so failure could be avoided; rather, we focus on studies investigating the consequences of failure (given that failure goes hand in hand with the entrepreneurial process that experiments with the unknown). In doing so, we were able to theorize by drawing on and contributing to theories related to personal recovery, learning from loss, and re-motivation/re-entry.

How entrepreneurs perceive, make sense of, learn from, and respond to failure has attracted considerable interest by scholars and policy makers. In this review, we synthesize and structure the literature on entrepreneurs’ responses to failure. We acknowledge that entrepreneurial activity is frequently collective; however, reflecting the current state of the literature, we focus on individual reactions to failure. Our contribution to the literature is bringing together the different streams of literature informing our understanding of business failure’s consequences for entrepreneurs to create a schematic model. We then employ the schematic model as a platform for developing a research agenda.
METHOD

We adopted the best practice for conducting a systematic literature review outlined by Short (2009) and deployed in recent review articles (e.g., Short, Ketchen, Shook, & Ireland, 2010; Menz, 2012). First, we searched the titles, keywords, and abstracts from the Web of Knowledge (Thomson Reuters), Business Source Premier (EBSCO Publishing) and ABI Inform Global (Proquest) databases for the following keywords: “entrepreneur,” “enterprise,” “self-employed,” or “new venture” AND “failure,” “closure,” “loss,” “bankruptcy,” “grief,” “insolvency,” “liquidation,” “death,” or “declining/poor performance.” We did not extend our search to include the search term “exit” for reasons explained in the “Defining Failure” section below. Given the relatively narrow scope of the focal topic and to cast a wide net, we did not restrict our search to a given period or to a particular set of disciplinary journals. The initial step resulted in a larger number of articles. In fact, some combinations (e.g., “enterprise” AND “failure”) yielded more than 2,000 articles. As a result, we moved on to step two to further narrow the pool of potential articles for our analysis.

Second, we developed a set of screening criteria for deciding which articles to include in our review. Articles were excluded if they displayed at least one of the following characteristics: (a) the keywords were only mentioned in passing and were not discussed in sufficient detail to contribute to the focus of this review or the keywords were used in a way that was inappropriate for the purposes of this review (e.g., the term new venture was used in relation to a new joint venture between two established organizations and not a new business); (b) the focus was on the causes of failure without considering the effects of failure; (c) the focus was on nascent entrepreneurship, so failure did not relate to business termination; (d) the focus was on fear of failure without relating to the actual experience of failure; (e) the discussion of failure did not relate to individual responses (e.g., the focus was on how failure impacted the economy, an industry, or society); and (f) the focus was not on a business (e.g., the focus was on project failures within established organizations for which the project did not involve creating a new business).
Having passed the above screening, an article had to fulfill at least one of the following criteria to be included in our review: (a) offer some insight into the effects of business failure on the entrepreneur, (b) offer some insight into individual-level responses to business failure, and/or (c) offer some discussion on the definition of business failure. In all, 36 articles passed the above screening process.

Finally, a number of book chapters, journal articles and working papers were brought to our attention as a result of our close examination of the 36 articles originally selected and were included in our review (see Short, Ketchen, Shook, & Ireland [2010] for a similar approach). A number of these additional works were not specifically related to entrepreneurship (e.g., Harris & Sutton, 1986; Sitkin 1992; and Sutton & Callahan, 1987) but emerged as seminal pieces upon which some of the original 36 articles drew substantively. In total, 42 articles and book chapters formed the basis of our literature review relating to business failure and the entrepreneur. Table 1 presents a summary of these works, including how they relate to the key themes identified (see the next section); the literature and/or theory base; method; and key findings.
Table 1: Summary of Research on the Processes and Consequences of Business Failure for Entrepreneurs

<table>
<thead>
<tr>
<th>Author(s) &amp; year</th>
<th>Theme</th>
<th>Literature/Theory Base</th>
<th>Method</th>
<th>Key Findings</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Harris &amp; Sutton (1986)</td>
<td>Social costs, emotional costs, and their management</td>
<td>Affect and cognition</td>
<td>Qualitative. Interview and archival data from about 11 parties, picnics, and dinners from six dying organizations.</td>
<td>Parting ceremonies create settings in which people can exchange emotional support and can edit self, social system, and event schemata.</td>
</tr>
<tr>
<td>2. Sutton &amp; Callahan (1987)</td>
<td>Social costs and impression management</td>
<td>Impression management and stigma</td>
<td>Qualitative. Interview, archival, and observational data from four computer firms</td>
<td>Bankruptcy is a discrediting label that creates negative perceptions (stigma) of a firm and its leadership. However, leaders may employ techniques to avert or reduce the stigma of bankruptcy, including concealing, defining, denying, or accepting responsibility as well as withdrawing.</td>
</tr>
<tr>
<td>3. Sitkin (1992)</td>
<td>Learning</td>
<td>Organizational learning theories</td>
<td>Conceptual.</td>
<td>Highlights the potential advantages of learning from failure relative to learning from success. Introduces the notion of “intelligent failures”; small and relatively harmless failure experiences. Argues that it may be difficult to learn from failures that deeply challenge core beliefs and assumptions.</td>
</tr>
<tr>
<td>5. Watson &amp;</td>
<td>Definitional issues</td>
<td>Definitional effects on failure rates</td>
<td>Quantitative. 5,196 small business startups from 51</td>
<td>Reports failure rates of small business startups vary greatly according to the definition of business failure employed with</td>
</tr>
<tr>
<td>Reference</td>
<td>Method</td>
<td>Theory</td>
<td>Analysis</td>
<td>Findings</td>
</tr>
<tr>
<td>-----------</td>
<td>--------</td>
<td>--------</td>
<td>----------</td>
<td>----------</td>
</tr>
<tr>
<td>Cardon &amp; McGrath (1999)</td>
<td>Psychological costs and attribution</td>
<td>Attribution theory</td>
<td>Quantitative. Exploratory analysis on a sample of students with a high propensity for entrepreneurship</td>
<td>Two attribution styles: a helpless orientation whereby failure is attributed to ability and, therefore, leads to a propensity to give up and a mastery orientation whereby failure is attributed to lack of effort and generates motivation to exert additional effort. While there is a greater tendency within the sample towards a mastery orientation, there was some variation also.</td>
</tr>
<tr>
<td>McGrath (1999)</td>
<td>Learning</td>
<td>Real options and cognitive biases</td>
<td>Conceptual.</td>
<td>Highlights an anti-failure bias. Real options reasoning can lead to a more balanced perspective on the role of entrepreneurial failure in wealth creation. Uncertainty should be managed through pursuing high-variance outcomes, but investing should only occur if conditions are favorable. This can increase profit potential while containing costs.</td>
</tr>
<tr>
<td>Zacharakis, Mayer, &amp; DeCastro (1999)</td>
<td>Attribution</td>
<td>Attribution theory</td>
<td>Qualitative (although some counting of responses). Interviews with eight entrepreneurs and five venture capitalists.</td>
<td>Contrary to expectations, entrepreneurs were more likely to attribute the causes of venture failure to internal factors as compared to venture capitalists who attributed their failure to external causes. Both entrepreneurs and venture capitalists were, however, more likely to attribute the causes of failure of other ventures to internal factors.</td>
</tr>
<tr>
<td>Minniti &amp; Bygrave (2001)</td>
<td>Learning</td>
<td>Economic approaches to learning</td>
<td>Conceptual.</td>
<td>Offers a model of entrepreneurial learning in which entrepreneurs learn by updating a subjective stock of knowledge accumulated on the basis of past successes and</td>
</tr>
</tbody>
</table>
They argue that entrepreneurs repeat only those choices that appear most promising and discard the ones that resulted in failure.

### Fan & White (2003)

| Financial costs | Bankruptcy laws and risk aversion | Quantitative. Panel data from 1993 to 1998 with a sample size of around 98,000. | Higher bankruptcy exemption levels benefit potential entrepreneurs who are risk averse by providing partial wealth insurance. Therefore, the probability of owning a business increases as the exemption level increases. The probability of households owning businesses is 35% higher if they live in states with unlimited, rather than low, exemptions. |

### Headd (2003)


### Shepherd (2003)

| Learning, psychological costs, and their management | Psychology literature on grief and emotions and learning from failure | Conceptual. | Highlights grief’s role in learning from failure. Identifies a set of strategies for grief recovery. |

### Simon, Houghton, & Savelli (2003)

| Behavioral outcomes | Prospect theory and risk taking | Quantitative. Sample of 61 managers from 61 Georgia-based high-tech companies. | Less satisfied managers get trapped in a downward spiral as their dissatisfaction with current performance may lead them to take risky action, which generates further disappointment. These effects are particularly pronounced for small organizations as they lack organizational slack and legitimacy. |

### Ucbasaran

<p>| Learning, attributions, Human capital | Conceptual. | The interaction between attribution of causes of failure and |</p>
<table>
<thead>
<tr>
<th>Author(s)</th>
<th>Focus of the Study</th>
<th>Methodology</th>
<th>Findings</th>
</tr>
</thead>
<tbody>
<tr>
<td>Wright, Westhead, &amp; Busenitz (2003)</td>
<td>and behavioral outcomes</td>
<td>cognition, learning, and positive psychology</td>
<td>Explanatory style (learned optimism versus learned helplessness) will influence decisions to engage in subsequent entrepreneurial activity following failure.</td>
</tr>
<tr>
<td>Cope (2004)</td>
<td>Social costs</td>
<td>Business failure and venture capital literatures</td>
<td>Qualitative. Interviews with four U.K. and two U.S. venture capitalists. Highlights the distinction between business, entrepreneurial, and venture capitalist failure. Shows that business failure is not automatically considered a &quot;black mark&quot; by venture capitalists. Venture capitalists in both countries often adopt a tolerant, flexible, and open-minded attitude to failure and are eager to understand the underlying causes of failure.</td>
</tr>
<tr>
<td>Rogoff, Lee, &amp; Shuh (2004)</td>
<td>Attributions</td>
<td>Attribution theory</td>
<td>Quantitative surveys: (i) 189 pharmacy owner-managers; (ii) 213 small business owners; (iii) 16 entrepreneurship experts. Provides evidence of attribution bias among entrepreneurs: Entrepreneurs tend to attribute their success to internal causes (more than entrepreneurship experts) and to identify barriers to their success as external (more than entrepreneurship experts).</td>
</tr>
<tr>
<td>Shepherd (2004)</td>
<td>Learning and psychological costs</td>
<td>Psychology literature on grief and emotions, learning from failure, and pedagogy</td>
<td>Conceptual. Offers suggestions for pedagogical changes to help students manage the emotions of learning from failure.</td>
</tr>
<tr>
<td>Coelho &amp; McClure (2005)</td>
<td>Definitional issues and social costs</td>
<td>Broad based</td>
<td>Conceptual. Argues for the practical benefits of failure: it is better to pull the plug on an uneconomic venture early than to escalate commitments in hope. Perseverance and optimism are</td>
</tr>
<tr>
<td>No.</td>
<td>Authors (Year)</td>
<td>Method</td>
<td>Findings</td>
</tr>
<tr>
<td>-----</td>
<td>----------------</td>
<td>--------</td>
<td>----------</td>
</tr>
<tr>
<td>19.</td>
<td>Rerup (2005)</td>
<td>Learning Behavioral learning theory, mindfulness, and habitual entrepreneurship</td>
<td>Conceptual but with publicly available illustrative cases. Drawing on several literatures, argues that the degree of mindfulness with which entrepreneurs use prior experience can both help and hinder their ability to discover and exploit opportunities.</td>
</tr>
<tr>
<td>20.</td>
<td>Schutjens &amp; Stam (2006)</td>
<td>Cognitive and behavioral outcomes Personality theories, labor economics, and sociology of careers</td>
<td>Quantitative. Longitudinal dataset of 79 businesses that had closed within five years of startup. Finds that the large majority of entrepreneurs who had closed their businesses had restart intentions and almost one in four closures was followed by the creation of a new business. Finds that the drivers of restart intentions and actual restart differ.</td>
</tr>
<tr>
<td>22.</td>
<td>Singh, Corner, &amp; Pavlovich (2007)</td>
<td>Financial costs, social costs, psychological costs, and their management Problem-focused and emotional-focused coping</td>
<td>Qualitative. Based on interviews with five entrepreneurs. Highlights the costs of failure and coping strategies used. More coping and learning occurs in the economic aspects of entrepreneurs’ lives compared to the social and psychological aspects.</td>
</tr>
<tr>
<td>24.</td>
<td>Hasan &amp; Wang (2008)</td>
<td>Financial costs and social costs Bankruptcy law and venture capital financing</td>
<td>Quantitative. 2,753 venture-backed businesses that received first-round funding. The amount of venture capitalist financing received by investee companies is negatively related to bankruptcy exception levels. The number of rounds of financing as well as the amount of...</td>
</tr>
</tbody>
</table>
between 1984 and 2003 (SDC VentureXpert database). Venture capitalist funds is negatively associated with bankruptcy exemptions.

<table>
<thead>
<tr>
<th></th>
<th>Learning and attitudinal outcomes</th>
<th>Learning, entrepreneurial experience</th>
<th>Qualitative case study of a single portfolio entrepreneur.</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Failure may lead to the development of entrepreneurial knowledge as well as founding experiences. However, learning from failure is dependent on the entrepreneur’s personal background.</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th></th>
<th>Financial costs</th>
<th>Effectuation, affordable loss, and behavioral economics</th>
<th>Conceptual.</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Outlines a theory of affordable loss, a means for entrepreneurs to estimate what they are willing to lose in pursuing a course of action. Argues that affordable loss is an important tool for entrepreneurs to make investment decisions and to manage problems associated with commitment escalation.</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th></th>
<th>Social costs</th>
<th>Tall poppy syndrome</th>
<th>Qualitative interviews with 40 entrepreneurs in New Zealand.</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Tall poppy syndrome may discourage entrepreneurs from starting a business. People who have experienced business failure may be reluctant to start another business because of the public reaction to their fall. Entrepreneurs may limit the growth of their ventures to detract attention.</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th></th>
<th>Learning and attitudinal outcomes</th>
<th>Experiential learning theory</th>
<th>Quantitative. Statistical analysis of questionnaire data collected from a sample of 231 Swedish entrepreneurs.</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Suggests that entrepreneurs’ life and work experiences shape their attitudes towards failure. Reports that prior entrepreneurial experience as well as experience closing down a business are associated with more positive attitudes toward failure (e.g., failures give opportunity for reflection and improve outcomes in the long run).</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td><strong>Shepherd (2009)</strong></td>
<td>Social costs, psychological costs, and their management</td>
<td>Grief, sensemaking at the individual and group level, emotional intelligence, and emotional capability</td>
</tr>
<tr>
<td>---</td>
<td>----------------------</td>
<td>-------------------------------------------------------</td>
<td>--------------------------------------------------------------------------------------------------</td>
</tr>
<tr>
<td>30.</td>
<td><strong>Shepherd, Wiklund, &amp; Haynie (2009b)</strong></td>
<td>Financial costs; psychological costs, and their management</td>
<td>Financial and emotional aspects of persistence</td>
</tr>
<tr>
<td>31.</td>
<td><strong>Ucbasaran, Westhead, &amp; Wright (2009)</strong></td>
<td>Psychological costs and behavioral outcomes</td>
<td>Cognition and motivation theories and learning.</td>
</tr>
<tr>
<td>32.</td>
<td><strong>Van Auken, Kaufmann, &amp; Herrmann</strong></td>
<td>Financial costs</td>
<td>Financial theory and bankruptcy</td>
</tr>
<tr>
<td>(2009)</td>
<td>Calls into question governmental objectives to encourage entrepreneurship by modifying bankruptcy laws.</td>
<td></td>
<td></td>
</tr>
<tr>
<td>---</td>
<td>---</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>Argues that highly confident entrepreneurs are more likely to rebound from failure because they are likely to have developed greater emotional, cognitive, social, and financial resilience that can be mobilized in subsequent ventures. These forms of resilience are seen as second-order benefits of overconfidence that provide a counterweight to the more immediate costs of being overconfident (which can increase the chances of failure).</td>
<td></td>
<td></td>
</tr>
<tr>
<td>34. Wennberg, Wiklund, DeTienne, &amp; Cardon (2010)</td>
<td>Definitional issues</td>
<td>Prospect theory and behavioral finance</td>
<td>Quantitative. 1,735 firms and their founders over eight years drawn from RAMS, a Swedish longitudinal databases RAMS (firm level), and LOUISE (individual level).</td>
</tr>
<tr>
<td></td>
<td>High firm failure rates reported in the academic and popular press may be at least partially due to a misinterpretation of entrepreneurs’ exit decisions. In addition, human capital and failure-avoidance strategies differ considerably across four exit routes.</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>Corporate bankruptcy laws are an important formal regulations that influences new firm startup rates. Advocates more entrepreneurially friendly bankruptcy laws as a means of encouraging entrepreneurship.</td>
<td></td>
<td></td>
</tr>
<tr>
<td>36. Ucbasaran, Westhead,</td>
<td>Learning, psychological costs, and cognitive</td>
<td>Cognitive psychology</td>
<td>Quantitative. Statistical analysis of survey data from a</td>
</tr>
<tr>
<td></td>
<td>Examines the extent to which prior (failure) experience tempers comparative optimism (CO) in subsequent ventures.</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Authors</td>
<td>Outcomes</td>
<td>Methodology</td>
<td>Findings</td>
</tr>
<tr>
<td>-------------------------</td>
<td>--------------------------------------------------------------------------</td>
<td>-------------------------------------------------------------------------------------------------------</td>
<td>---------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------</td>
</tr>
<tr>
<td>Wright, &amp; Flores (2010)</td>
<td>Outcomes</td>
<td>(Motivation and cognitive effects of failure and comparative optimism) and learning</td>
<td>Finds that portfolio entrepreneurs who have experienced failure are less likely to report CO but that failure experience has no effect on serial entrepreneurs. Argues that ability to learn from failure is influenced by the context in which experience is acquired due to differential effects on emotions.</td>
</tr>
<tr>
<td>Arora &amp; Nandkumar (2011)</td>
<td>Financial costs and behavioral outcomes</td>
<td>Quantitative. Archival data on 286 startups that entered the information security market from 1989 to 2004.</td>
<td>High opportunity-cost entrepreneurs will invest more aggressively and attempt to cash out (e.g., via initial public offerings or friendly acquisitions) quickly even if it implies a higher risk of failure. Entrepreneurs with fewer outside alternatives may tend to linger longer.</td>
</tr>
<tr>
<td>Cardon, Stevens, &amp; Potter (2011)</td>
<td>Sensemaking and attributions</td>
<td>Qualitative (although some counting of responses). Content analysis of failure accounts reported in major US newspapers.</td>
<td>Demonstrates variation in how communities make sense of failure. Shows regional variation in the extent to which failures can be attributed to misfortunes or mistakes made by entrepreneurs. Examines the implications for individual entrepreneurs.</td>
</tr>
<tr>
<td>Cope (2011)</td>
<td>Learning and cognitive and behavioral outcomes</td>
<td>Qualitative. Interpretative phenomenological analysis drawing on four U.K an four U.S. entrepreneurs who experienced failure.</td>
<td>Contributes to the deeper conceptualization of the process and content of learning from failure. Learning is viewed as a process. Recovery and re-emergence from failure is seen as a function of distinctive higher-level learning processes that allow entrepreneurs to learn about themselves and entrepreneurship. The findings suggest that failure can improve “entrepreneurial preparedness” for subsequent entrepreneurial activity.</td>
</tr>
<tr>
<td>40.</td>
<td><strong>Hessels, Grillo, &amp; Thurik (2011)</strong></td>
<td>Behavioral outcomes</td>
<td>Human capital and entrepreneurial intentions</td>
</tr>
<tr>
<td>41.</td>
<td><strong>Lee, Yamakawa, Peng, &amp; Barney (2011)</strong></td>
<td>Financial costs</td>
<td>Institutions (corporate bankruptcy law) and entrepreneurship development</td>
</tr>
<tr>
<td>42.</td>
<td><strong>Shepherd &amp; Haynie (2011)</strong></td>
<td>Psychological and social costs and their management</td>
<td>Impression management, attribution, and stigma</td>
</tr>
</tbody>
</table>
BUSINESS FAILURE AND THE ENTREPRENEUR: A RETROSPECTIVE

In this section, we begin with issues related to defining business failure. We then depict life after failure for the entrepreneur as a journey in which making sense of and recovery from failure is a process that unfolds over time (Cardon & McGrath, 1999; Cope, 2011). While this process is unlikely to be linear, for expositional purposes, we dissect “life after failure” for entrepreneurs into a number of stages, which we schematically present in Figure 1. The first stage represents the “aftermath” of failure (Cope, 2011), which involves taking stock of the immediate consequences of failure, usually in the form of financial, social, and psychological costs. A number of factors, including individual response and context, may influence the magnitude of these costs. This stage is followed by sense-making and learning processes, which typically play out over the medium term. Finally, we present the “re-emergence” (Cope, 2011) stage and examine the longer-run cognitive and behavioral outcomes associated with business failure for the entrepreneur.
Figure 1: Organizing Schema for Research on Entrepreneurial Business Failure

Business failure event
- Definition

The "Aftermath" (i.e., Costs of business failure)
- Financial
- Social
- Psychological
- Inter-relationships
  - Magnitude
  - Moderator

The social psychological processes of business failure
- Learning
- Sensemaking
  - Moderators

Outcomes
- Recovery
- Cognitive outcomes
- Behavioral outcomes
Defining Failure

Providing a clear definition of business failure is important for (at least) two reasons. First, it enables comparisons across studies. Second, the nature of the definition employed will influence the nature of the outcomes and processes researchers observe. To date, researchers have used numerous definitions for business failure, which vary in terms of their inclusivity ranging from broad (discontinuity of ownership) to less permissive (discontinuity of the business) to narrow (bankruptcy) definitions.

Discontinuity of Ownership. A broad definition of business failure focuses on the entrepreneur’s exit from his or her business (i.e., discontinuity of ownership) (see Watson & Everett [1996] and Singh, Corner & Pavlovic [2007] for a review of early studies using this definition). Discontinuity of ownership (i.e., exit) not only includes businesses that closed but also businesses sold because the owner wished to retire for age or health reasons, those sold for a profit, and those sold because the owner merely wished to move on to another venture (Watson & Everett, 1996). Although a common definition employed by earlier studies, there appears to be consensus among more recent research that equating failure with exit is problematic as entrepreneurs may exit their firms for reasons other than business failure, including business success (Wennberg, Wiklund, DeTienne, & Cardon, 2010).

Bankruptcy. A narrow definition of business failure relates to bankruptcy and emphasizes poor economic performance (e.g., Shepherd & Haynie, 2011; Zacharakis & Meyer, 1999). The advantage of using bankruptcy as a definition is that it relies on an observable, recorded event. Further, while recovery from one form of bankruptcy (i.e., Chapter 11 in the United States) is possible, the chances of doing so are slim (Moulton & Thomas, 1993). Thus, bankruptcy represents a clear indication of a failing firm and a major step toward death (Moulton & Thomas, 1993). However, other indications of a failing business—a business that is not providing a reasonable income for the owner nor a fair rate of return for investors—would not be regarded as business failure under this narrow definition (Watson & Everett, 1996).
Discontinuity of Ownership Due to Insolvency. Shepherd’s (2003: 318) definition of business failure essentially combines the two approaches described above: “Business failure occurs when a fall in revenues and/or a rise in expenses are of such a magnitude that the firm becomes insolvent and is unable to attract new debt or equity funding; consequently, it cannot continue to operate under the current ownership and management.” Similarly Coelho and McClure (2005) consider a business to have failed when it has not survived the market test (i.e., if revenues do not sufficiently exceed costs to make continuing the business attractive).

Discontinuity of Ownership Due to Performance below Threshold. Rather than there being a universal notion of poor economic performance sufficient for business failure (the market [Coelho & McClure, 2005] and/or resource providers [Shepherd, 2003]), some studies have emphasized that entrepreneurs’ expectations represent an important threshold consideration for defining business failure. For example, Ucbasaran et al. (2010) define failure as not only the sale or closure of a business due to bankruptcy, liquidation, or receivership but also the sale or closure of a business because it has failed to meet the entrepreneur’s expectations, which reflects the varying personal thresholds of performance among entrepreneurs (Gimeno, Folta, Cooper, & Woo, 1997).

The discussion above indicates that business failure has been defined and operationalized in a number of different ways. The choice of how to define failure has important implications for researchers, and we explore this issue in the future research section of the paper. For the purposes of this review, we define business failure as the cessation of involvement in a venture because it has not met a minimum threshold for economic viability as stipulated by the entrepreneur. We now shift our attention to examining the “aftermath” of business failure as reflected in the costs of the failure. In each case, we examine the nature of the costs and moderators of the relationship between failure and costs, including how individual entrepreneurs manage business failure to minimize costs.
Costs of Failure

The costs of failure are the negative consequences of business failure that impact the entrepreneur. Based on our review, we classify the primary costs of business failure as financial, social, and psychological.

Financial Costs of Failure. At a minimum, failure is likely to impose a financial cost on the entrepreneur in the form of a loss of or reduction in personal income. While a degree of financial cost is to be expected following failure, an interesting issue relates to how entrepreneurs manage and/or absorb these costs. For some entrepreneurs, financial costs may take the form of personal debt that takes years to clear (Cope, 2011). In contrast, based on the theoretical notion of risk diversification, an entrepreneur with a portfolio of wealth or ventures may more easily absorb the financial costs associated with a single business’ failure. Contributing to behavioral economics theories, Arora and Nandkumar (2011) report that entrepreneurs with high opportunity costs (i.e., those with numerous outside alternatives to the focal venture) are likely to be more impatient for success and invest more aggressively in their ventures, thereby increasing the chances of large financial gains or large financial losses. As such, in the case of business failure, the entrepreneurs may incur considerable financial costs. Nevertheless, given the availability of alternatives (e.g., employment or other ventures), they may also be able to absorb these costs more readily.

Moderators of the Financial Costs of Failure. A number of studies have pointed to moderators in the relationship between business failure and resulting financial costs. First, building on institutional theory, the financial costs of business failure the entrepreneur incurs may be moderated by the institutional setting in which the failure took place, particularly in terms of the “entrepreneur-friendliness” of the bankruptcy law to which they are subject (Armour & Cumming, 2008; Fan & White, 2003; Lee, Peng, & Barney, 2007; Lee, Yamakawa, Peng, & Barney, 2011; Peng, Yamakawa, & Lee, 2010). In bankruptcy, the owner must give up assets above a fixed exemption level, which varies from state to state. Fan and White (2003) argued that higher bankruptcy exemption levels benefit potential entrepreneurs who are risk averse by providing partial wealth insurance. Bankruptcy laws that are more entrepreneur-friendly (e.g., reducing or eliminating personal liability and
allowing a fresh start more quickly) reduce the personal financial costs of business failure (Van Auken, Kaufmann, & Herrmann, 2009).

Second, building on theories of commitment (Staw, 1981; Staw & Hoang, 1995), scholars have recognized that entrepreneurs may escalate commitment to a losing course of action, which both delays failure and increases its cost when it eventually occurs (Shepherd, Wiklund, & Haynie, 2009). Failure could be delayed to such an extent that it creates businesses that have been referred to as “permanent[ly] failing” (Meyer & Zucker, 1989), “unproductive” (Baumol, 1990), “chronic failures” (van Witteloostuijn, 1998), and “the living dead” (Ruhnka, Feldman, & Dean, 1992), which ultimately places a strain on the economy (McGrath, 1999). DeTienne, Shepherd, and DeCastro (2008) found that more extrinsically motivated (by economic considerations) entrepreneurs were less influenced by factors that contribute to commitment escalation than those who were less extrinsically motivated (with the exception of sunk costs) and would thus bear fewer costs associated with delaying the failure decision. By explaining the variance in factors contributing to commitment escalation, this study advanced the general escalation of commitment model.

Third, McGrath (1999) offered real options reasoning (i.e., relatively small staged investments in ventures) as a means of managing uncertainty and truncating the downside costs of failure. As these uncertainties are resolved, the entrepreneur is able to invest more if the venture holds promise. Alternatively, if the venture is increasingly unlikely to generate the desired benefits, then it can be terminated without imposing significant financial costs on the entrepreneur. While this type of reasoning was developed and applied in a corporate setting (McGrath & MacMillan, 2000), entrepreneurs may also view their individual businesses as part of a wider activity portfolio over time. Evidence suggests that more experienced entrepreneurs (also known as habitual or repeat entrepreneurs [Baron & Ensley, 2006; Ucbasaran, Westhead, & Wright, 2006]) are more likely to employ this kind of reasoning (McGrath & MacMillan, 2000; Mitchell, Mitchell, & Smith, 2004). This entrepreneurship research has offered a new theory (i.e., real options reasoning building from the notion of financial options) for managing uncertainty, and managing the failure of entrepreneurial initiatives is central to this reasoning.
Finally, based on a study of expert entrepreneurs, Sarasvathy (2008) demonstrated how entrepreneurs seek to minimize the financial costs of failure by deploying the “affordable loss principle.” Affordable loss involves decision makers estimating what they might be able to put at risk and determining what they are willing to lose in order to follow a course of action (Dew, Sarasathy, Read, & Wiltbank, 2009). Dew et al. (2009) argued that deploying this principle not only provides the potential entrepreneur with the resolve to move forward but also the emotional backup required to quit when the time comes, thereby protecting the entrepreneur from escalating commitment (Staw, 1976). Setting an affordable loss threshold places emphasis on the downside of a venture and can result in the entrepreneur under-investing relative to the actual ex post investment curve. However, should the venture fail, those relying on the affordable loss principle are likely to lose less than those who focused on expected returns (e.g., by deploying NPV calculations) (Dew et al., 2009). The principle of affordable loss is one of the pillars of a broader theory of entrepreneurial reasoning—effectuation theory (Sarasvathy, 2008).

**Social Costs of Failure.** Failure can lead to social costs in relation to its impact on personal and professional relationships. For instance, Singh et al. (2007) and Cope (2011) point to the breakdown of marriages and close relationships following failure, while the failure and ultimate death of a business can result in the loss of an important social network of mutual obligations (Harris & Sutton, 1986). The quality of relationships after a failure can be diminished as a result of the stigma associated with failure (Sutton & Callahan, 1987). More specifically, stigma is the social devaluation of a person who deviates from a social unit’s norms (Efrat, 2006) and is deeply discrediting (Sutton & Callahan, 1987). Analyzing major U.S. newspaper accounts of business failures, Cardon, Stevens, and Potter (2011: 87) note that the most frequently reported impact of failure was creating a sense of stigma around the entrepreneurs who had experienced failure (e.g., “failure leads to exile and an abrupt end to one’s career path”). Stigma can also lead to negative discrimination with respect to employment opportunities and access to future resources (e.g., financial and human) (Cope, 2011; Shepherd & Haynie, 2011; Sutton & Callahan, 1987). These experienced or anticipated social costs resulting from the stigma of failure may explain why some entrepreneurs engage in self-imposed social distancing and withdrawal (Cope 2011; Shepherd & Haynie, 2011; Singh et al., 2007). Research on the social costs of business failure
has provided a context to bring together social exclusion theories and network theory to both provide new insights into the social consequences of business failure and contribute back to these source theories.

**Moderators of the Social Costs of Failure.** Institutional and cultural forces can lead to differing attitudes toward failure. First, as highlighted above, bankruptcy laws around the world vary by “entrepreneur-friendliness” (Armour & Cumming, 2008; Fan & White, 2003; Lee et al., 2007; 2011; Peng et al., 2010). While these laws impact the financial costs of failure (as argued above), they may also reflect societal attitudes and norms toward business failure. Legislation may validate the social meaning of an act, thereby making an act more or less socially acceptable and even prompting the erosion of well-established norms (Efrat, 2006). To illustrate this point, Efrat (2006) details how legislative reform in Japan has reduced the entrenched traditional stigma of bankruptcy; he points to evidence reporting a causal relationship between the increasing leniency of insolvency laws and a decline in suicide (which has historically followed the shame associated with insolvency and bankruptcy). In summary, extant work suggests that the more the law penalizes failure, the greater the likelihood that failure is stigmatized.

Second, notwithstanding the above evidence, bankruptcy laws need to be considered within the wider cultural context as their effects on entrepreneurs’ decision making may be diminished if they are not consistent with cultural values and norms (Lee et al., 2007). Kirkwood (2007) suggests that the “Tall Poppy Syndrome” of knocking high achievers (which is engrained in New Zealand’s culture) discourages individuals who have experienced business failure from starting again because of the strong negative public reaction to their “fall.” Yet, she argues that the extent to which failure is stigmatized, and thus the extent to which the entrepreneur’s reputation can be repaired, is influenced by the extent to which the “fall” can be attributed to external circumstances rather than the entrepreneur him/herself. Cardon et al. (2011) also support this idea and report that newspaper accounts of business failures depend on the geographic area in which the failures occur. Specifically, in some regions (e.g., Chicago, New York, and Washington, DC) substantially more failures were attributed to entrepreneurs’ mistakes than misfortunes. The most frequently reported impact of failure in these regions was the stigmatization of the entrepreneur involved in the
failure. Although not formally analyzed, Cardon et al.’s study suggests a positive relationship between blame attributions directed at the entrepreneur and stigmatization.

One important (social) group for entrepreneurs (especially if they want to “try again”) is venture capitalists and other funders of entrepreneurial ventures (e.g., business angels). In environments with a strong venture capital presence (e.g., Silicon Valley), there are many failures and a correspondingly more tolerant attitude toward failure (Cardon et al., 2011)—at least for some types of failures for some types of entrepreneurs. In a study of venture capitalists’ attitudes toward failure, Cope, Cave, and Eccles (2004) found that venture capitalists distinguish between acceptable and less acceptable failures. That is, they are less tolerant of entrepreneurs who have failed if they display flamboyance and machismo and those who “never understand what it takes and probably never will” (Cope et al., 2004: 157). In contrast, acceptable failures involve entrepreneurs who try to build a successful company but fail often due to luck, timing, or other external factors (see also Zacharakis, Meyer, & DeCastro, 1999). Venture capitalists tolerate such failures even if the entrepreneur was a major contributor to the failure as long as the entrepreneur is honest and demonstrates awareness of his/her strengths and weaknesses and a willingness to supplement his/her skills where necessary. In fact, Cope et al. (2004) reported that all else being equal, the decision to invest in an entrepreneur is not negatively impacted to any significant degree by prior failure experience. Overall, their evidence suggests that the venture capitalist community (in the United States and United Kingdom) treats venture failure with a degree of tolerance, acceptance, and open-mindedness.¹

The above research on business failure highlights how social attitudes toward failure are influenced by attributions that can vary by country, region, and social group, thereby contributing to theories of stigma by highlighting the roles of institutional context and culture.

**Psychological Costs of Failure.** Our review of the literature suggests there are two interrelated psychological costs associated with entrepreneurs’ experience of business failure: emotional and motivational.
A number of negative emotions have been associated with business failure, including pain, remorse, shame, humiliation, anger, guilt, and blame as well as the fear of the unknown (e.g., Cardon & McGrath, 1999; Cope, 2011; Harris & Sutton, 1986; Shepherd, 2003; Singh et al., 2007). Common across these studies is the notion that business failure has parallels with the loss of something (or someone) important. Shepherd (2003: 320) focused on grief as an umbrella term characterizing a number of negative emotions generated from losses associated with failure; grief is a negative emotional response to the loss of a business capable of triggering behavioral, experiential, and physiological symptoms (Shepherd, 2003: 320). For example, Singh et al. (2007) and Cope (2011) note that in the entrepreneurs they studied, grief was accompanied by anxiety, panic attacks, phobias, anger and—in some cases—physiological symptoms like exhaustion, high blood pressure, insomnia, and weight loss. These emotional and physiological effects of business failure can manifest themselves as depression with varying degrees of severity (Singh et al., 2007), which in turn can adversely affect individuals’ motivation.

Theories of entrepreneurial grief have also deepened our understanding of motivation. The motivational effects of failure can be twofold. First, experiencing failure can have adverse motivational effects by generating a sense of “helplessness,” thus diminishing individuals’ beliefs in their ability to undertake specific tasks successfully in the future and leading to rumination that hinders task performance (Bandura, 1991; Cardon & McGrath, 1999; Shepherd, 2003). Conversely, experiencing failure in a domain relevant to an individual’s self-definition has been found to heighten the motivation to compensate for self-definitional shortcomings and reassures the individual that he/she is capable of achieving the self-definitional goal (Brunstein & Gollwitzer, 1996). The only evidence of which we are aware on this issue is Cardon and McGrath’s (1999) study of students who reported a “mastery reaction” to failure. This reaction involved attributing failure to a lack of effort (as opposed to ability) and, as a result, led them to redouble their efforts.

Moderators of the Psychological Costs of Failure. A number of studies have investigated the role individual differences play in psychological responses to failure. First, education and experience may influence the relationship between business failure and the entrepreneurs’ psychological costs. Cope (2011: 614) found that entrepreneurs who had previously owned
successful businesses were more able to remove themselves from the “powerful emotional shackles of failure” than those who had not previously owned a successful business. That is, successful serial entrepreneurs were able to turn to their past accomplishments for reassurance. Similarly, Ucbasaran et al. (2010) argue that the emotional costs of failure may be “diluted” for portfolio entrepreneurs (i.e., repeat entrepreneurs who own multiple businesses simultaneously) who have at least one other business to concentrate and fall back on. In contrast, serial/sequential entrepreneurs (i.e., those who own one business at a time) may feel the psychological costs of failure to a much greater extent than their portfolio counterparts.

Second, although experience may moderate the relationship between business failure and the entrepreneur’s psychological costs, the nature of this moderation may be quite complex. For example, although a single failure may lead to reactance (i.e., greater motivation to overcome setbacks [McGrath, 1999]), multiple failures in the absence of success may result in a loss of faith and the inability to conquer adversity (Brunstein & Gollwitzer, 1996). An entrepreneur may maintain confidence in his/her own ability if a business failure is viewed as an anomaly; however, as the proportion of failures increases, the ability to “explain away” the failure as an anomaly is diminished, adversely impacting motivation. These arguments are further supported by Ucbasaran, Westhead, and Wright (2009), who found an inverse U-shaped relationship between the proportion of failures experienced and entrepreneurial opportunity identification. They argue that when the proportion of failures is low, the entrepreneur is motivated to try harder and thus identifies more opportunities. However, beyond a certain point, failure becomes more difficult to “stomach” and reduces the entrepreneur’s motivation to identify future opportunities.

Third, drawing on positive psychology, Ucbasaran, Wright, Westhead, and Busenitz (2003) suggest that entrepreneurs displaying “learned optimism” (Seligman, 2006) are more likely to make sense of failure in a way that aids recovery and propels them to undertake future entrepreneurial activity (similar to the notion of mastery orientation described by Cardon and McGrath [1999]). Individuals displaying learned optimism are likely to see the cause of a problem as being transitory and narrow in its effects. Consequently, optimistic individuals are more likely to treat adversity as a challenge, transform problems into
opportunities, attempt to adapt/develop skills, maintain confidence, rebound quickly from setbacks, and persist (Seligman, 2006). Similarly, Hayward, Forster, Sarasvathy, and Fredrickson (2010) argue that confidence (i.e., an emotionally laden belief in one’s abilities) and even over-confidence can create positive emotions that facilitate entrepreneurial resilience. Although Hayward et al. (2010) did not explicitly investigate the costs of failure, an implication of their theorizing is that entrepreneurs’ confidence may decrease the emotional costs of failure (even if it increases the likelihood of failure [Hayward, Shepherd & Griffin, 2006]).

Finally, Shepherd (2009) proposed that more emotionally intelligent individuals may be better able to recognize and use their grief to process information about their loss. Furthermore, they are more likely to effectively use grief recovery strategies (discussed below) to make sense of failure and quickly recover from it and are more likely to identify suitable people who can help them oscillate between grief orientations to more quickly recover and learn from the failure experience.

The above studies inform our understanding of business failure and advance theories of experiential learning, positive psychology, and emotional intelligence. In addition, two broad sets of strategies have been identified in the literature for managing the psychological costs of failure—the first draws on (and contributes to) theories of grief and recovery, and the second draws on (and contributes to) the psychoanalytic tradition of coping.

In terms of grief, Shepherd (2003) argues that an individual has recovered from grief when his/her thoughts about the events surrounding and leading up to the loss of the business no longer generate a negative emotional response. Drawing on the wider grief literature and adapting it to the context of entrepreneurial business failure, Shepherd (2003) identifies three grief-recovery strategies: loss orientation, restoration orientation, and oscillation/transition orientation. Loss orientation involves confronting the loss, revisiting the events before and at the time of the failure, and “working through” some aspects of the loss experience. Entrepreneurs with a loss orientation may seek out people to talk about their grief, spend time remembering creating and nurturing the business, and ruminate over the circumstances and events surrounding the failure. Confronting loss in this
way can make negative thoughts and memories more accessible and acute, in turn slowing the recovery process. A restoration orientation, in contrast, is based on both avoidance of (e.g., founding a new business) and a proactiveness toward secondary sources of stress arising from the failure (e.g., applying for jobs and/or moving to a less expensive neighborhood to alleviate the loss of financial income from the failure). A restoration orientation is less emotionally taxing but involves suppression that can adversely affect longer-term recovery from the failure. An oscillation orientation involves switching to and from a loss and restoration orientation, which enables the individual to benefit from each while minimizing the costs of maintaining one for too long. In a later study, Shepherd (2009) argues that individuals’ emotional intelligence (see above) as well as their family members’ emotional capabilities (i.e., the family’s norms and/or routines for dealing with negative emotions associated with failure) may help entrepreneurs’ effectively manage grief (i.e., appropriately use the grief-recovery strategies outlined above), especially in cases where the failure involved a family business.

Coping, more generally, has been related to minimizing the psychological costs of business failure. Singh et al. (2007: 333-334) define coping with entrepreneurial failure as cognitive and behavioral efforts to manage the taxing demands posed by venture failure. They identify two major kinds of coping: problem-focused coping relates to managing or changing a problem causing distress, and emotion-focused coping regulates emotional reactions to a problem. Singh et al. (2007) found that in the majority of their cases, problem-focused coping was used to deal with the financial aspects of the failure, such as attempts to take legal action to be released from debt, borrowing from friends and family, and selling assets to get debt relief. In contrast, emotion-focused coping was aimed at addressing the psychological consequences of failure and tended to take two forms: reality distortion and self-deception (e.g., distraction/avoidance behavior, denial strategies, and venting) to reduce the generation of negative emotions and secondly restoration, which emphasized positive imaging, personal re-examination, and reframing.
Interrelationships between Financial, Social, and Psychological Costs. Although we classified the costs of business failure to the entrepreneur in terms of financial, social, and psychological costs, these categories are often inter-related, and research has begun to look at these intersections.

First, financial costs may have a psychological dimension. Business failure typically generates a financial cost, and delaying business failure due to cognitive biases (e.g., commitment escalation and procrastination) can increase those costs. In contrast, Shepherd et al. (2009) offer an emotion-based explanation for delaying failure even when it is financially costly to do so, arguing that some delay of business failure may help the entrepreneur emotionally prepare for the failure and thereby reduce the level of grief triggered by the failure event. Under certain circumstances, delaying business failure can help balance the resulting financial and psychological (i.e., emotional) costs, thereby enhancing the entrepreneur’s overall recovery and the chances of subsequent entrepreneurial action. Although this implies an additive relationship between financial and psychological costs, the authors suggest that there may also be an interaction effect whereby greater financial costs induce greater emotional costs.

Second, the social costs of failure can have financial implications. Theory-building research using a case study design has produced evidence that even when the direct financial costs of failure are not particularly high, indirect financial costs of failure may accrue due to the social costs of failure (Cope, 2011; Singh et al., 2007). If failure is a stigmatizing event, then entrepreneurs may find it difficult to raise funds for future endeavors and may even struggle to gain subsequent employment. However, if social costs can be reduced, perhaps the financial impact of business failure can also be reduced. For instance, Sutton and Callahan (1987) investigated impression-management strategies used by leaders of firms that had filed for Chapter 11 bankruptcy. These strategies ranged from attempting to conceal the failure, defining and explaining it to stakeholders, denying or accepting responsibility, and withdrawing. While Sutton and Callahan (1987) do not offer propositions on the relative effectiveness of these impression-management strategies, they do expand on accepting responsibility as a stigma-management strategy. Accepting at least partial responsibility for failure may provide the illusion that the entrepreneurs are in
control, allow them to garner sympathy and present themselves as “good people who have tried their best” (p. 429), and to signal they have learned from their mistakes. Such impression-management strategies may facilitate external stakeholders’ willingness to continue their relationship with such entrepreneurs in the future, thereby reducing both the social and financial costs of business failure for the entrepreneurs.

Third, social costs can have a psychological impact. Building on Sutton and Callahan (1987) and self-verification theory (Swann & Read, 1981), Shepherd and Haynie (2009) theorized on the relationship between impression-management strategies and the psychological wellbeing of the entrepreneur following bankruptcy. They argue that most of the literature on impression management is based on the implicit assumption that individuals will go to great lengths to maintain a positive view of the self in response to the negative attributions of others and maintain (or build) others’ positive view of them. This view, however, does not explain the “accepting-responsibility” strategy of impression management presented by Sutton and Callahan (1987), whereby leaders internalize blame for their firms’ failure. Shepherd and Haynie (2009) suggest that there are some conditions when entrepreneurs may approach impression management from a negative self-view. Specifically, entrepreneurs of bankrupt firms are more likely to have a negative self-view if they strongly identified with their ventures, if the environment and venture conditions were favorable such that the entrepreneurs blamed themselves for the bankruptcy, and/or if there were no or few similar others with whom to share information about the stigma of bankruptcy. Thus, the use of impression-management strategies and their effect on entrepreneurs’ psychological wellbeing is likely to be contingent upon entrepreneurs’ attributions following failure and the resultant self-view. In building on self-verification theory to understand responses to business failure, this study advanced theories of impression management by challenging a key assumption that all individuals want to enhance others’ impressions of them.

Finally, the psychological costs of failure may have a social impact. Although Cope (2011) finds support for earlier work emphasizing the psychological (i.e., emotional) effects of failure, particularly in relation to grief (Shepherd, 2003; Shepherd et al., 2009), he calls for a more socialized view of loss, arguing that the emotional impact of failure is inextricably
linked to its complex social costs. For example, Cope (2011) highlights one entrepreneur who found it hard to accept that his inventions were not going to have a return on investment, which led to feelings of guilt and impotence. Such feelings can lead to social distancing and withdrawal (Cope 2011; Shepherd & Haynie, 2011; Singh et al. 2007). The result is that the entrepreneur feels unable to turn to certain network contacts and social support mechanisms that previously existed in the normal course of business (Cope, 2011). Social isolation or withdrawal may in turn result in missed opportunities to speak to individuals who have experienced failure themselves and/or are tolerant of failure (Shepherd, 2009). For instance, focusing on family businesses, Shepherd (2009) highlights the important role family members can play in managing emotional responses to failure. He suggests that the collective emotional capability of the family may help individual family members make sense of and recover more quickly from failure.

Social Psychological Processes Associated with Failure

In this section, we review studies focusing on the social psychological processes of failure in which the inter-related theories of learning and sensemaking have dominated. We begin by examining learning and sensemaking as individual responses to failure and then examine how learning and sensemaking processes may be moderated by attributions and emotions.

Learning from Failure. The reasons why the relationship between business failure and learning has attracted considerable scholarly attention among both management (e.g., Cannon & Edmonson, 2005; Madsen & Desai, 2010; Sitkin, 1992; Wilkinson & Mellahi, 2005) and entrepreneurship scholars (e.g., Cope, 2011; McGrath, 1999; Minniti & Bygrave, 2001; Politis, 2005; Rerup, 2005; Shepherd, 2003) is illustrated in the following quote:

Learning from failure is a hallmark of the technology business. Nick Baker, a 37-year-old system architect at Microsoft, knows that well. A British transplant at the software giant's Silicon Valley campus, he went from failed project to failed project in his career. He worked on such dogs as Apple Computer's defunct video card business, 3DO's failed game consoles, a chip startup that screwed up a deal with Nintendo, the never successful WebTV and Microsoft's canceled Ultimate TV satellite TV recorder. But Baker finally has a hot seller with the Xbox 360, Microsoft's video game console launched
worldwide last holiday season. The adventure on which he embarked four years ago would ultimately prove that failure is often the best teacher. (Takahashi, 2006)

Scholars assert that entrepreneurs can learn from business failure once they can use information about why their business failed (i.e., feedback) to revise their existing knowledge of how to effectively manage their own business (Shepherd, 2003). Though not an exhaustive list, this knowledge often relates to one’s self as an entrepreneur, manager, and leader; issues surrounding the management of cash and investment; managing internal and external stakeholder relationships; building and managing partnerships; managing the challenges of growth; and understanding the marketplace and competition (Cope, 2011; Shepherd, 2003; Singh et al., 2007). Failure represents a “clear signal” that something went wrong and motivates individuals to allocate attention to understand what that something was (Sitkin, 1992). This signal can encourage learning because the individual is more likely to conduct a postmortem to understand what led to the failure, thus informing and motivating changes to his/her mental models (Minniti & Bygrave, 2001; Politis, 2005; Ucbasaran et al., 2009). While successes can increase confidence in one’s existing mental models (Sitkin, 1992), making sense of failure likely motivates a change in mental models.

Discontinuous experiences (e.g., failure events) during the entrepreneurial process can stimulate distinctive forms of higher-level learning that prove fundamental to the entrepreneur in both personal and business terms (Cope, 2011). For higher-level learning to occur, Cope (2011) calls for critical reflection whereby personal assumptions and behaviors are challenged. While the failure experience can promote such reflection, it is unlikely to occur immediately. Cope argues that entrepreneurs need time to recover from the hurt and trauma generated by failure before they can engage in critical inward self-reflection. One process that may interfere with their ability to engage in such critical reflection over time is hindsight bias, which involves a systematic distortion of the past. Cassar and Craig (2009) provide evidence supporting the assertion that what entrepreneurs believe they experienced and what they actually experienced may not be equivalent.
**Sensemaking following Business Failure.** A number of scholars have argued that learning is observed in the form of behavioral change (Daft & Weick, 1984; Huber, 1991) and is part of the sensemaking process. The sensemaking process consists of the three interrelated dynamics of scanning, interpretation, and learning (Gioia & Chittipeddi, 1991; Thomas, Clark, & Gioia, 1993; Weick, 1979). Sensemaking as an interpretive process requires people to assign meaning to occurrences (Gioia & Chittipeddi, 1991) and involves ongoing interpretations in conjunction with action (Thomas et al., 1993). It involves both the cognitive and emotional aspects of the human experience of interaction with environments (Schwandt, 2005).

Entrepreneurship scholars have recently applied sensemaking to the study of business failure (e.g., Shepherd, 2009; Cardon et al., 2009). In essence, Shepherd (2003) argues that while a loss orientation strategy (i.e., confronting the loss, revisiting the events before and at the time of death, and working through some aspects of the loss experience) enhances entrepreneurs’ scanning and interpretation of a failure, relying too much on a loss orientation can prolong grief and its associated emotions. These emotions, in turn, restrict cognitive capacity and increase rumination, which can hinder learning.

One distinguishing feature of sensemaking is its emphasis on plausibility over accuracy. Rather than being a rational, unbiased process, it is a process whereby perceptions are driven by pre-existing personal identities and one’s interpretation of the existing world is placed in partnership with ongoing enactment of that world (Miller, 2005; Weick, 1995). A lack of accuracy in sensemaking is not necessarily a problem because action generates new data, enabling people to assess causal beliefs that subsequently lead to new actions. Over time, as supporting evidence mounts, significant changes in beliefs and actions evolve (Weick, Sutcliffe, & Obstfeld, 2005), and such changes can be viewed as learning (Daft & Weick, 1984). Although business failure may send a clear signal that something has gone wrong, it is an equivocal outcome that is open to multiple interpretations and lends itself to sensemaking (Maitlis, 2005). Indeed, Schwandt (2005) argues that sensemaking’s emphasis on the swift and pragmatic reduction of equivocality leaves little room for critical reflection. Thus, learning based on the sensemaking dynamics of scanning and interpretation may not necessarily yield better results in the short term (e.g., if there has been a misattribution of
failure or if heightened emotions have induced coping mechanisms geared toward protecting self-esteem), but it does help the entrepreneur move on, and through the development of more plausible stories, sensemaking likely helps the entrepreneur move forward (discussed below).

**Moderators of Sensemaking and Learning.** Two key factors have been proposed as influencing the learning and sensemaking processes following business failure: attributions and emotions. Attributions are mechanisms through which people explain their own behavior, others’ actions, and events in the world (Heider, 1958) and represent a variant of sensemaking. By making attributions about an equivocal outcome or event, individuals are able to make sense of causes and effects in a way that is plausible to the individual (Parker, Arthur, & Inkson, 2004). Hieder (1958) suggested that people are prone to a self-serving bias (such as attribution bias) and thus attempt to enhance or protect their self-esteem by taking credit for success (i.e., internal attribution; e.g., “it’s because of my skills and abilities”) and denying responsibility for failure by attributing it to external factors (i.e., external attribution; e.g., “it’s because employees didn’t work hard enough”). Zacharakis et al. (1999) observed that while entrepreneurs do engage in internal attributions (i.e., identify causes for failure emerging from within the venture; e.g., lack of managerial skills and vision), they tend to view others’ failures more harshly, suggesting a degree of bias. Self-serving attributions (e.g., discounting and augmenting⁴) can result in entrepreneurs learning little from failure. Indeed, these self-serving attributions can lead to hubris (i.e., overconfidence), which may result in suboptimal resourcing and investment decisions in subsequent ventures, thus making business failure more likely (Hayward et al., 2006).

The negative emotions generated by failure (discussed above) can also adversely affect learning. Shepherd (2003) argues that grief can interfere with individuals’ allocation of attention when processing information. More specifically, the entrepreneur may end up focusing on emotional events (e.g., dwelling on making announcements to employees and other stakeholders about the business closure) rather than on feedback information (e.g., the actions and/or inactions that caused the failure). Further, Shepherd argues that the negative effects of grief may be exacerbated when there are high levels of feedback. Given individuals’ cognitive limits, situations that can place greater demands on attention and
information processing (e.g., unexpected, new, and emotionally charged situations like business failure) can make individuals more prone to emotional interference. Drawing on evidence from neuroscience, Baron (2008) illustrates this point by explaining how brain regions related to reasoning and emotions are activated in individuals who are made offers they consider unfair. Greater amounts of activity in the emotional-processing regions of the brain, however, tend to increase the likelihood that individuals will make decisions contrary to their economic interests. Openly confronting failure and assessing one’s culpability in a failure can be a daunting prospect (Rogoff, Lee, & Suh, 2004) since associated feelings of guilt, shame, and remorse are generally unpalatable. To reduce their sense of vulnerability (Janoff-Buhman, 1992) and maintain self-esteem, entrepreneurs may suffer from the self-serving bias described above (Rogoff et al., 2004; Ucbsaran et al., 2010). Shepherd (2003) argues that a reliance on an oscillation orientation for coping with grief (detailed above in the section on the moderators of the psychological costs of failure) can aid learning. While a loss orientation gives the individual an opportunity to process information surrounding the failure, which in turn assists learning, an extended period of loss orientation can draw attention to the emotions associated with grief that adversely affect learning. Switching to a restoration orientation can divert attention away from these negative feelings, which “frees” cognitive capacity for information processing when a loss orientation is re-engaged.

Overall, business failure represents both an opportunity to learn and a context in which it is difficult to do so. Research in this area has begun to advance theories of learning from experience and processes of making sense of events that help individuals move forward.

Outcomes of Failure

The final section of our retrospective analysis of business failure relates to outcomes. Outcomes are the longer-run effects shaped by the interplay between the costs of business failure and how entrepreneurs made sense of them. Our review of the literature suggests there are three types of outcomes associated with business failures: recovery outcomes, cognitive outcomes, and behavioral outcomes.

Recovery from Business Failure. Faster recovery from grief over the loss of a business enhances entrepreneurs’ emotional and physical wellbeing, thus rendering them more productive (Shepherd, 2009). Shepherd (2003) suggests that individuals have recovered
from failure-related grief when their thoughts about the events surrounding and leading up to their business loss no longer generate a negative emotional response (Shepherd, 2003). Cope’s (2011) inductive analysis led him to conclude that recovery from failure is composed of three inter-related phases. First, there is an initial hiatus during which the entrepreneur psychologically removes him/herself from the failure in order to heal (similar to Shepherd’s [2003] restoration orientation). Second, there is a period of critical reflection during which the entrepreneur engages in a determined and mindful attempt to make sense of the failure (similar to Shepherd’s [2003] loss orientation). Finally, there is a period of reflective action during which the entrepreneur attempts to move on from the failure to pursue other opportunities. Cope refers to the final recovery stage as “higher-order” restoration, which he distinguishes from “lower-order” restoration involving distraction and suppression (the first phase described above). The “higher-order” critical reflection phase of recovery is associated with habitual/repeat entrepreneurs whereby the entrepreneur moves on from the previous failure to create or purchase a new business.

**Cognitive Outcomes.** Scholars have also become increasingly interested in the relationship between failure and other cognitive constructs, such as confidence/optimism. While researchers have offered (over-) optimism as an explanation for the high new venture failure rate, such optimism may also serve as a resource upon which entrepreneurs can draw to help them bounce back from failure (Hayward et al., 2010). However, optimism may diminish following failure as the entrepreneur receives feedback suggesting his/her initial optimism was unfounded. Ucbasaran et al. (2010) offer some insight into this issue by focusing on the relationship between prior business failure and current comparative optimism (i.e., people’s tendency to report that they are less likely than others to experience negative events but more likely to experience positive events). They find that the likelihood of reporting comparative optimism following failure is dependent on the context in which the failure took place. Specifically, portfolio entrepreneurs are less likely to report comparative optimism following business failure. Conversely, business failure does not reduce the comparative optimism for serial/sequential entrepreneurs. The authors suggest that this pattern of results may be driven by the emotional costs of failure being “diluted” for portfolio entrepreneurs because they have (at least) another business to fall back on, allowing them to better calibrate (i.e., be less likely to report comparative
optimism) following failure. For serial entrepreneurs who put forth all their energy and resources to one business, the effects of a business failure are likely to be relatively more emotionally challenging, thus obstructing their ability to calibrate or learn from failure. Ucbasaran et al. (2010) suggest that serial entrepreneurs may have a high stock of dispositional optimism at the start of their careers, which may explain why they choose to concentrate on one venture at a time rather than spread risk like portfolio entrepreneurs. Hence, future studies need to control for dispositional optimism when studying state optimism. The above studies trigger a number of interesting research questions that, when addressed, are likely to advance theories of motivation, particularly after setbacks.

**Behavioral Outcomes.** Research shows that many entrepreneurs who have experienced business failure not only develop strong intentions to start subsequent businesses (Schutjens & Stam, 2006) but actually do so (Hessels, Grilo, Thurik, & van der Zwan, 2011). If a key benefit of failure is that it provides a learning opportunity, then we might expect subsequent businesses owned by entrepreneurs who have experienced failure to perform better. Unfortunately, there is an absence of research testing this proposition, which is not surprising given the need for a large longitudinal panel database containing a large number of entrepreneurs. However, using a slightly different approach, Ucbasaran et al. (2006) examined the performance of 378 U.K. businesses (using a variety of subjective and objective performance measures). Controlling for human capital, venture characteristics and industry, they did not detect any significant performance differences between businesses owned by entrepreneurs who had experienced business failure and those who had not. This evidence led the authors to question entrepreneurs’ ability to learn from their failure experience. One of the potential limitations of focusing on venture performance to examine the learning benefits of failure is that entrepreneurs who have experienced failure may have different motivations for their subsequent ventures (Wright, Robbie, & Ennew, 1997). This makes performance comparisons problematic. For example, some entrepreneurs who have experienced failure may have learned that growing a business rapidly can drain cash and may adopt a more conservative approach with their next ventures. While these new ventures may not be associated with high growth, such entrepreneurs may be highly satisfied with their new ventures because they feel they are applying what they learned from past experience. Given that learning represents cognitive and behavioral change
(discussed in the section “the social psychological processes associated with business failure”), there may be other clues in the literature relating to the impact of failure experiences.

Building on this logic, Ucbasaran et al. (2009) found that entrepreneurs who reported experience with business failure (i.e., the termination of at least one business) identified more business opportunities in a given period than those with no such experience; however, they did not find a significant association between entrepreneurs’ experience of business failure and the innovativeness of their current ventures. These results suggest that while business failure may enhance entrepreneurs’ propensity to identify opportunities, the opportunities they exploit are perhaps no more innovative. Changing the way in which failure is framed relative to expectations, however, can influence behavioral outcomes. For example, drawing on prospect theory, Simon, Houghton, and Savelli (2003) found that small business managers with lower initial levels of satisfaction relative to expectations (i.e., dissatisfaction with a current business) pursued product introductions that were riskier with respect to market unfamiliarity and had higher resource requirements.

Given the high levels of uncertainty and the costs associated with business failure, studies of entrepreneurial action and modes of entrepreneurial action have made advancements to theories of optimism, overconfidence, framing, and behavioral intentions.

**BUSINESS FAILURE AND THE ENTREPRENEUR: A PROSPECTIVE**

In this penultimate section, we outline a (prospective) research agenda for business failure and the entrepreneur structured around the schema presented in Figure 1.

**Definitions of Business Failure and Future Research**

Our review of the literature revealed a number of different definitions for business failure. In many cases, these definitions relate to the operationalization of business failure without providing a conceptual justification for the definition. As our focus is on the individual entrepreneur’s experience of a failure event and because we wanted a broad—yet comprehensive—definition that reflected our focus, we defined business failure as the cessation of involvement in a venture because it has not met a minimum threshold for
economic viability as stipulated by the (founding) entrepreneur. However, the definition of business failure a researcher employs should depend on the study’s research question.

For research questions investigating the financial costs of business failure, definitions based on “bankruptcy” or “discontinuance of ownership due to insolvency” seem well suited for the task. For research questions focused on the social costs of business failure, it is important that others know about the failure. Of course, it depends on who the “others” are. If it is family, then they are most likely to be “aware” regardless of how business failure is defined, but when the research interest is in a broader social group (e.g., local community or even a national network), then a more public announcement of the failure situation is important. In such a situation, employing the bankruptcy definition enables researchers to investigate the social costs of business failure. For research questions about the psychological costs of business failure, an appropriate definition might be one that relies on the entrepreneurs’ realization that their business has failed, not in denying it happened (although understanding why some deny failure and for how long is an interesting research question in itself). In such a situation, employing the “discontinuance of ownership due to performance below threshold” definition appears to be appropriate for investigating the psychological costs of business failure.

Furthermore, there are research opportunities to theorize and empirically investigate differences across definitions of business failure. How (and why) do the results of a study differ by the definition of business failure used? For example, how (and why) are the psychological costs of business failure from exit (“discontinuance of ownership”) different from bankruptcy and from failure to reach the entrepreneur’s performance threshold?

Future Research on the Financial Costs of Business Failure

First, we believe it is important to understand how some entrepreneurs are able to recover more quickly from the financial costs of business failure than others. Furthermore, perhaps the notion of recovery is too restrictive in that it implies simply “overcoming” the financial costs of business failure without really considering whether there are financial benefits to business failure in the long run. That is, business failure ceases one (insufficiently profitable) path and, in doing so, may open up other highly profitable entrepreneurial
opportunities. Alternatively, long-run financial success after a business failure may require a spell (a period) as an employee to rebuild a financial foundation before re-entering business ownership. Future research should explore entrepreneurial career paths to help better understand how entrepreneurs overcome the financial costs of business failure to achieve long-run financial success.

Second, while the financial costs of business failure are borne by the entrepreneur, his/her family members are also likely to experience the effects. Multi-level research on the entrepreneur nested within a family is likely to provide important insights into the financial costs of business failure to the entrepreneur. Although the immediate direct financial costs of business failure may be the same for two entrepreneurs, differences in family wealth may lead to differences in business failure's long-run financial costs. It seems obvious that the financial costs are less detrimental to entrepreneurs embedded in wealthier families; however, it might be that those nested in less wealthy families engage in more risky behavior (e.g., perceive they are in a loss situation and act in ways consistent with prospect theory). If this is the case, perhaps the dispersion of financial outcomes after business failure will be greater for those with less family wealth than those with more. Given this risk taking, the long-run financial costs of business failure on average might be less for those with less family wealth (although the standard deviation of outcomes is greater). Of course, our speculation requires further theorizing and empirical testing.

Finally, consistent with studies highlighting the importance of financial slack to fund both experimentation necessary for entrepreneurship (see George, 2005) and startup costs/early-stage growth (Gilbert, McDougall, & Audretsch, 2006), we might expect the financial costs of business failure to be a major obstacle to subsequent entrepreneurial activity—at least in the short term. However, the resource scarcity created by business failure’s financial costs may create a context that encourages bricolage (i.e., “making do with whatever is at hand” [Baker & Nelson, 2005: 330]). Resource scarcity can spur entrepreneurial activity, turning an initial financial cost into a financial advantage (i.e., the creation of a valuable resource combination).
In conclusion, because business failure for the entrepreneur typically generates a personal financial loss, terminates his/her current income source, damages his/her reputation as an entrepreneur, and results in negative financial consequences for his/her family, business failure represents an extreme context in which theorizing on career paths (including stints as an employee and as entrepreneur) can probe the boundaries of and thereby advance theories of careers to gain insights into the long-term financial costs of business failure. Such research can extend current theories by addressing calls for more research on career constraints (Arnold & Cohen, 2008) and on adapting to new careers (Savickas, 2002), especially when a previous career path has been terminated (Haynie & Shepherd, 2011) and the individual carries a financial burden. Business failure also represents an ideal context to extend theories of bricolage because it represents a context of considerable resource scarcity (due to the financial costs of failure). Perhaps both theories can be advanced by exploring how entrepreneurs of failed businesses can use bricolage to create new career opportunities.

Future Research on the Social Costs of Business Failure

We believe that the extant literature has only revealed the “tip of the iceberg” when it comes to the social costs of business failure for the entrepreneur. First, although we know a great deal about the nature of relationship ties and how they influence entrepreneurial activity (Antoncic & Hoang, 2003; Jack, 2005), there is much work to be done in understanding what happens to these ties as the result of business failure. There is an opportunity for multi-level research exploring what happens to entrepreneurs’ formal (business) relationships when inter-organizational relationships are terminated (due to business failure). Are these relationships damaged beyond repair or can they be rebuilt (if yes, then how)? To what extent can entrepreneurs rely on “past” relationships for resources to aid recovery and/or subsequent entrepreneurial activity? How do others’ attributions of failure influence these relationships? There is ample opportunity for future research to investigate the termination, use, and rebuilding of relationship ties in the aftermath of business failure.

Second, we have an understanding of how entrepreneurs try to manage a stigmatizing situation (Sutton & Callahan, 1987) but not a deep understanding of why business failure
represents a stigmatizing event. Over and above entrepreneurs’ impression-management strategies, are there certain types of business failure and/or types of entrepreneurs that generate greater stigma? For example, are women entrepreneurs in so-called “masculine” industries stigmatized more by business failure than both women in “feminine” industries and men in “masculine” industries? Because entrepreneurship is recognized as an important source of national economic wealth generation (Carree & Thurik, 2010; van Stel, Carree, & Thurik, 2005), how can institutions and cultures be changed to reduce the social costs of business failure? For instance, the European Commission’s “second chance” policy seeks to reduce the stigma associated with business failure by producing communication materials for both policy makers and the general public (http://ec.europa.eu/sme2chance). Perhaps reducing the social costs of failure requires institutional entrepreneurs to create new institutions (or revolutionize old ones). For instance, in his study of the decline of bankruptcy stigma in the United States, Efrat (2006) argues that the government, media, and legal profession have consciously or unconsciously acted as institutional entrepreneurs to promote new societal perceptions about personal bankruptcy. First, as the media began reporting more bankruptcy filings (particularly by celebrities), the public began to perceive bankruptcy filings as common and hence acceptable. Second, some legislators altered norms through the symbolic act of labeling—namely, moving away from referring to bankrupts as deceivers, frauds, cheaters etc., to a process of “debt resettlement” to overcome problems of stigmatization (e.g., in France & Germany). Finally, with respect to the legal profession, as bankruptcy attorneys started to appreciate the monetary value of this specialty practice, they started advertising aggressively, thereby contributing to the public perception that bankruptcies are common and acceptable.

Finally, although we have a good understanding of the social benefits of entrepreneurs’ business successes, there is more to do to gain an equivalent understanding of the social costs (and benefits) of entrepreneurs’ business failures. For example, parents experiencing entrepreneurial success act as role models for children, demonstrating that entrepreneurship is both feasible and desirable and thereby stimulating their children’s entrepreneurial intentions and behaviors (Davidsson & Honig, 2003). However, how does the failure of a parent’s business impact the “next generation” of potential entrepreneurs? Perhaps children who witness and experience (directly and vicariously) the negative
implications of business failure may be less likely to pursue entrepreneurial careers because business failure has become a highly salient potential outcome of entrepreneurial action. Yet, a parent’s ability to recover from failure and demonstrate resilience may reduce the child’s fear of failure and, in doing so, help develop a more positive attitude toward failure (for initial evidence see Politis and Gabrielsson [2009]).

Similarly, research has investigated entrepreneurs’ work-life balance (Shepherd & Haynie, 2009a, 2009b), but the question remains: how do entrepreneurs effectively manage their work-life balance when the work side of the equation has ended in failure? For example, is failure compartmentalized into the work micro-identity such that it has little impact on other micro-identities (e.g., the “spouse” micro-identity) or are there spillover effects? Further, are divorce rates higher in the aftermath of business failure, and can variation in this social cost be explained by how micro-identities are managed after business failure? Addressing these questions will make an important contribution to helping us better understand the social costs of business failure and, hopefully, to ultimately being able to reduce them.

In conclusion, business failure represents an interesting context in which to advance network theories and theories of work-life balance. It is an interesting context because for both theories, one side of the equation is immediately gone. That is, at the organizational level, the (inter-organizational) tie is terminated (but perhaps can still exist at the individual level), and the work role has also been terminated. As discussed previously, entrepreneurs of failed businesses may need to work as employees for a while (e.g., to recover financially) before re-entering entrepreneurial careers. This context is ideal for advancing theory on re-activating dormant ties (e.g., Jack, 2005), especially when the ties may have been damaged immediately before becoming dormant. Network theory and theories of stigmatization can also be advanced by exploring why and how these ties are damaged by business failure and the difficulty in re-activating them. Of course, not all ties become dormant. As such, business failure represents an ideal context in which to further develop theories of tie change by investigating how the strength of an individual’s ties (and what is transmitted through them) are impacted by a significant negative event (i.e., business failure). Additionally, the forced change of “work” and the subsequent stints of employment and
entrepreneurship provide an ideal context in which to further develop theories on the dynamism of work-life balance.

**Future Research on the Psychological Costs of Business Failure**

Consistent with research into the financial and social costs of business failure, we have a solid foundation of research on the psychological costs of failure from which to build. First, Shepherd (2003, 2009) used grief as an umbrella term for any negative emotions generated from the loss of a business and theorized on how grief impacts cognitive processes (related to learning). Research on emotion, however, indicates that different types of negative emotions have different sources and different effects on cognition (Bodenhausen, Sheppard, & Kramer, 1999; Keltner, Ellsworth, & Edwards, 1993). This raises the question: do different business failures have different psychological outcomes because they generate different types of negative emotions impacting cognitive processes in distinct ways? Further, could the combination of specific negative emotions of an entrepreneur’s grief (contingent and/or configuration) provide a better explanation of the psychological costs of business failure than the effect of each of these emotions independently (main effects)?

Second, while it is natural to focus on the psychological costs of the negative emotions generated by business failure and while there is much more to do in that regard (see previous point), the positive psychological implications of grief over business failure should not be overlooked. The grief literature suggests that among those who experience grief over the loss of a loved one, some experience personal growth as a result of the grieving process (Hogan, Greenfield, & Schmidt, 2001). There is an opportunity to gain greater insight into this notion of personal growth above and beyond learning from the experience (described above), which raises a number of interesting questions. After experiencing business failure, do entrepreneurs learn about the emotional and cognitive resources they did not know they had, and/or does the failure experience enable them to build these resources? For example, perhaps dealing with business failure helps entrepreneurs build coping self-efficacy, emotional intelligence, and other sources of resilience. Another interesting possibility for understanding personal growth from business failure is the role of positive emotions and self-regulation. For instance, Fredrickson (1998, 2003) found that positive emotions can undo the impact negative emotions have in narrowing attention and information processing.
and help build resources to deal with adversity. As such, do entrepreneurs with greater levels of dispositional optimism (e.g., see Hmieleski & Baron, 2009) and positive affect (e.g., see Baron, Tang, & Hmieleski, 2011) benefit more from failure experiences (e.g., recover more quickly, learn more effectively, experience personal growth, etc.)? Do entrepreneurs proactively use positive emotions to effectively deal with grief over business failure, and if so, how do they generate such emotions in the context of an important loss? Self-regulation theories suggest that individuals possess self-reflective and self-reactive capabilities enabling them to exercise some control over their thoughts, feelings, motivations, and actions (Bandura, 1991). For example, Bandura (2001) highlights that when confronted with setbacks, people engage in self-enabling or self-debilitating self-talk. This raises the question: which self-regulatory strategies influence cognitive, emotional, motivational, and behavioral reactions to business failure? We believe future research building on the positive psychology and self-regulation literatures to theorize and test models of personal growth (or otherwise) from business failure will make important advancements to our knowledge of the effects of business failure.

Finally, although we are gaining a deeper understanding of the psychological costs of business failure for entrepreneurs, there have only been a few studies touching on the notion of multiple failures (e.g., Shepherd, Haynie, & Patzelt, 2012; Ucbasaran, et al., 2009; Ucbasaran et al., 2010). This raises the question: in what ways are the psychological costs of business failure different for a second failure than for the first? It could be the entrepreneur is more psychologically prepared to deal with a second failure given his/her failure experience, or alternatively, there could be unresolved issues from the first failure that exacerbate issues associated with the second failure. Perhaps differences between those experiencing their first, as compared to second, business failure can be explained—at least in part—by the trial-by-fire model (Swaminathan, 1996). That is, of those who experience failure, only the “psychologically” strong (through self-selection or learning) try again and, therefore, suffer lower psychological costs from business failure the second time than those experiencing failure for the first time. We believe there is much to learn about the role of multiple failure experiences in understanding the psychological costs of business failure for entrepreneurs.
In conclusion, for most theories, we have suggested that business failure is an extreme context and, therefore, provides opportunities to draw from established theories and extend the boundary conditions of those theories, thereby advancing our understanding of both business failure and the source theories. When it comes to theories of grief, it is not likely that business failure is an extreme form of loss (e.g., not as extreme as losing a loved one), but it still offers the opportunity to shift the boundaries of grief and bereavement theories in new directions. For example, by combining theories of distinct emotions with different reactions to business failure, entrepreneurship scholars have the opportunity to offer finer-grained theories of bereavement. Similarly, just as the loss of a loved one has informed our theorizing on how entrepreneurs react to and cope with business failure (Shepherd, 2003), entrepreneurship scholars can build on the literatures of positive psychology, learning from failure, and the motivation to try again to advance theories of grief that might help others cope with different losses, such as those associated with divorce, amputation, and cardiac surgery. To the extent that entrepreneurs do try again, they run the risk of experiencing subsequent failure. Both the entrepreneurship literature and theories of grief will benefit from theorizing on the emotional consequences (and perhaps accumulation) of multiple losses.

**Future Research at the Intersections of Financial, Social, and Psychological Costs.**

Although the above discussion suggests ample opportunities for future research to contribute to each category of the consequence of business failure, future research at the intersection of these categories perhaps holds the greatest promise for new interesting insights.

First, as we gain a deeper understanding of the social costs of business failure, we will generate new insights into its financial implications. For example, what are the financial implications for the entrepreneur going forward from the damage to his or her business and informal networks? The direct financial costs of business failure (loss of wealth and money owed) may cause less hardship than the indirect financial costs arising from a damaged reputation and a loss of status. If so, initial recovery attempts may be better focused at trying to maintain one’s network (or quickly repairing it) than overcoming direct financial costs. By gaining a better understanding of the relationship between the social and financial
costs of business failure for the entrepreneur, we move a step closer to understanding why some recovery strategies are more effective than others.

Second, while the loss of a business is often felt in a personal way (e.g., grief [Shepherd, 2003]), business failure is often a public event as employees are told the business is closed, the factory or office is vacated, and customers and suppliers learn of the business failure. How does the public nature of business failure (and its associated social costs) impact the entrepreneur’s psychological costs? The literature on bereavement indicates that some losses are likely to lead to complicated grief—elevated grief and grief over an extended period (Neimeyer, 2006). For example, parents who lose children to suicide often experience complicated grief, and their feelings of grief are often exacerbated by feelings of shame and embarrassment, which make it more difficult to “talk through their grief” with others (Mitchell et al., 2004). In turn, it is more difficult for others to initiate discussions for fear of saying the wrong thing (Nolen-Hoeksema & Davis, 1999). Shame and embarrassment are psychological costs generated by the anticipation of others’ assessments. Correspondingly, do all business failures involve some level of shame and embarrassment over loss, which in turn leads to complicated grief? Alternatively, under what conditions (i.e., attributes of the entrepreneur and/or the social context) are feelings of embarrassment and shame over business failure minimized or even eliminated? It could be that the psychological costs of business failure for the entrepreneur are lower and reduced more quickly in social contexts that are more forgiving of failure.

Third, there is an opportunity to further explore the relationship between financial costs and psychological costs. What are the financial implications of an entrepreneur’s psychological costs arising from business failure? It could be that not only are the psychological costs of business failure an obstacle to learning from failure, but they may also represent an obstacle to moving on to generate new sources of income (the delay of which exacerbates the financial costs of business failure). For example, ruminations over business failure may stop the entrepreneur from interviewing for a job or looking for new venture opportunities. Alternatively, the psychological costs could be sufficiently apparent to potential employers in the interview process (e.g., the person does not display sufficient enthusiasm and self-belief to convince the employer that he/she can successfully complete
the designated tasks) such that the individual fails to secure the job. When it comes to recovery from financial and psychological costs, is sequence important? Does an individual need to reduce the psychological costs of business failure before tackling the task of recovering from financial costs (securing employment and pursuing the next entrepreneurial venture) or does he or she need to reduce the financial costs first which will diminish one of the major stressors of business failure and thereby help reduce the psychological costs? Research on the inter-relationship between financial and psychological costs (perhaps as a spiral) will likely make an important contribution to our understanding of the consequences of business failure.

Finally, we see value in exploring the role of social skills in understanding entrepreneurs’ responses to failure, including the role of social perception, expressiveness, impression management, and social adaptability. Baron and Tang (2009) point to numerous studies demonstrating the strong effect of these skills on important outcomes in many situations, including entrepreneurship. Individuals with highly developed social skills may not only be more adept at minimizing the social costs of business failure (e.g., through skillful storytelling and sensegiving to others about the failure and the role the entrepreneur played in that failure) but also the psychological costs. Individuals high in various social skills tend to have wider and more diverse social networks (Diener & Seligman, 2002) upon which they can draw to discuss failure and obtain various forms of support. We see exploring the role of social skills in managing the social and psychological costs—and indirectly the financial costs (see above)—of failure to be a fruitful avenue for future research.

In conclusion, research at the intersection of the different categories of business failure costs holds great promise. We suspect that such research is likely to require multi-disciplinary and/or multi-level theorizing and empirical testing. For example, investigating the inter-relationship between financial and social costs may require building on (and ultimately making contributions to) theories of both stigmatization and venture capital markets to gain a deeper understanding of why entrepreneurs in some regions are able to raise the funds necessary to begin their next entrepreneurial venture, while entrepreneurs in other regions have difficulty doing so. Given the extreme change in the social context (in the case of a business’ public failure) and the often extreme feelings of loss after business
failure, research at the intersection of the social and psychological costs of business failure would make important extensions to existing theories of social cognition. Similarly, investigations of the often large financial losses associated with business failure, the entrepreneur’s need to decide on a new career, and the psychological costs of dealing with the loss of a business provide a rich context in which to explore new theories that could advance the field of behavioral economics.

**Future Research on Sensemaking and Learning**

Learning and sensemaking have been central to research on business failure and are likely to continue to be so. First, because plausibility is important in explaining subsequent action (Weick et al., 2005), we need to further explore the process by which entrepreneurs create/generate plausible stories of business failure. It could be that more plausible stories are created/generated by entrepreneurs who (i) take action, (ii) have greater prior knowledge of an opportunity, (ii) feel moderate levels of grief, (iv) have higher levels of education (i.e., general human capital), (v) have a greater meta-cognitive awareness, (vi) have more positive emotions and other creative abilities, (vii) have more self-compassion, (viii) adopt a particular attributional style, (ix) are more mindful, (x) engage in counterfactual thinking, etc. All of the above warrant further attention, and we believe that making sense of business failure represents an extreme context in which to push the theoretical boundaries of story construction surrounding a negative event.

Second, plausible stories of a business failure should be viewed as interim outcomes of a sensemaking process. Over time, one plausible story of business failure is replaced by another “more” plausible one. What is unclear, however, is how this process progresses and when it ends. Perhaps, in the immediate aftermath of business failure, stories are created rapidly and are updated as information becomes available to provide feedback to enhance plausibility. In contrast, over time the “story” may reach a point of saturation where additional data reveals little new information. Alternatively, or in addition, it could be that sensemaking morphs from making sense of business failure to making sense of the current situation (for which making sense of business failure is a diminishing component). Therefore, we suggest that research is required to better understand the patterns of plausible stories of business failure—specifically, to explain the antecedents to and
consequences of differences in patterns of “plausibility updating.” Relatedly, future research could explore if, how, and why attributions surrounding business failure change over time.

Third, the role of others in sensemaking and generating plausible stories represents an interesting area for exploration. Collective sensemaking can facilitate the formation and reformation of social structure (the social roles and relationships among some group of actors) after crises (e.g., Weick, 1995), but what happens when the organization around which that social structure was built no longer exists (i.e., in the case of business failure)? Do individuals (e.g., entrepreneurs, investors etc.) simply engage in their own sensemaking and move on, or is there a collective sensemaking process? Some entrepreneurial team members and/or employees may engage in collective sensemaking that aids learning and recovery. Does collective sensemaking among entrepreneurial team members reduce the likelihood of attribution bias (i.e., developing more plausible stories) or might this kind of bias extend to the team? Answers to these questions may depend on the characteristics of the team, such as the level of emotional capability (see Shepherd, 2009) or cognitive diversity within the group (Kilduff, 2000).

Future research could also usefully explore collective sensemaking between internal and external stakeholders (e.g., among entrepreneurs and investors). For example, what happens when the failure is “contested” (which may occur when the business’ performance has met the expectations of one group but not the other)? To what extent do some entrepreneurs engage in proactive sensegiving efforts to influence others’ sensemaking? In exploring these areas, we take heed of Bell and Taylor’s (2011) call for a differentiation between collected and collective responses because each requires different methodological and analytical strategies to enable their exploration. Collected responses focus on aggregated individual experiences following failure, whereas collective responses relate to a shared experience, emphasizing symbols, language, events, and social and cultural experiences of bereavement.

Finally, both mindfulness and counterfactual thinking have been identified as key factors in promoting learning and represent a foundation upon which future research can deepen our understanding of why some learn from their failure experiences and others do not or
are slow in doing so. Rerup (2005: 452) defines mindfulness as the quality of attention enabling entrepreneurs to minimize errors, remain vigilant, and respond effectively to unexpected events. He argues that mindfulness makes entrepreneurs aware of what they do and what they tacitly know as well as how distinct practices have positive and negative consequences when they are extrapolated from one venture to another. Mindfulness may increase the likelihood of “intelligent failures” (Sitkin, 1992), which are defined as failures for which expectations are not met but something useful is learned for the future. They result from “thoughtfully planned action” in which results can be compared with plans to achieve increasing understanding. Thus, mindfulness may be a way of maximizing the learning benefits of failure experience. Rerup also notes, however, that mindfulness is not costless; it requires time and cognitive resources that could be used for other purposes.

Counterfactual thinking (CFT) may also have a bearing on one’s ability to learn from failure. First introduced by Baron (1999: 80) into the field of entrepreneurship, CFT refers to imagining “what might have been” in a given situation, reflecting on alternative outcomes that might have occurred if the person in question had acted differently or if circumstances had been different. On the one hand, CFT is typically triggered by negative outcomes and is, thus, accompanied by negative emotions that—as highlighted above—can interfere with learning and sensemaking. On the other hand, by imagining outcomes other than those that actually occurred, individuals engaging in CFT may have a broader perspective of the factors that lead to the outcome (i.e., business failure). On balance, Roese (1997) argues that CFT produces net beneficial effects for individuals. Empirical evidence on the relationship between business failure and CFT is sadly lacking but represents an interesting opportunity for future research.

In conclusion, there are many situations requiring individuals to engage in sensemaking, and we suggest that none is more important than when an entrepreneur experiences business failure. The cause of business failure may not be clear given the high levels of uncertainty surrounding the pursuit of a (believed) opportunity; the complexity of the markets, technologies, and/or macro-economic conditions; the substantial costs of the failure (financial, social, and psychological) for the entrepreneur; and the need to move on. Just as the extreme context of high-reliability organizations has advanced our understanding
of sensemaking to avoid catastrophic failures, we believe that the extreme context of business failure provides an opportunity to advance our understanding of how individuals who have had one path terminated make sense of the termination to move on and construct a new path forward. It also clarifies how (and when and with whom) entrepreneurs update their plausible stories of business failure, what impact these stories have on their motivation to try again, and what impact their motivation to try again has on subsequent stories.

**Future Research on the Outcomes of Business Failure**

To date, the longer-term outcomes of business failure for individual entrepreneurs have received relatively limited attention. We see a number of opportunities to address this imbalance. First, research tracking an individual after business failure may advance theories of career adaptation. Research on the long-run implications of business failure can help advance theories of career paths by distinguishing between immediate career constraints and long-run career constraints to investigate their antecedents and consequences as well as the effectiveness of actions to overcome these constraints.

Second, plausible stories (as described above) enable individuals to move forward. However, many who experience failure are slow to move forward, and some do not move forward with an entrepreneurial career at all. How can these different outcomes be explained? What is it about certain individuals, business failures, and/or the nature of the stories that obstruct—rather than generate—action? It could be that the most plausible story is that one is not suited to the entrepreneurial task. Is there a threshold of plausibility that a story must first meet before it informs and motivates action, and can we explain variance in those thresholds across individuals and/or situations?

Finally, assuming that the entrepreneur moves on from failure, what form does subsequent action take? Failure may propel some individuals to engage in subsequent entrepreneurial endeavors in an attempt to apply their knowledge. Knowledge from failure, however, may not only be applied in subsequent ventures but may be transferred in the form of educational activities, including mentoring. What informs these choices and how do they influence the individuals who have made them? For those who engage in serial
entrepreneurship, there remain many unanswered questions surrounding the characteristics of their subsequent businesses. While some serial entrepreneurs move on to own businesses in new domains, others remain in their domain of expertise. To what extent then do serial entrepreneurs’ subsequent ventures resemble their failed ventures? It may be difficult to apply lessons from previous ventures if the new venture is highly dissimilar, such as in a completely different industry. Thus, to understand the learning, behavioral, and performance effects of prior failure, scholars may benefit from examining the degree of similarity or change between failed and subsequent businesses in terms of domain, relationships, design/business model, and performance expectations.

In conclusion, research that tracks an individual after business failure can advance theories of career paths, bricolage, networks, work-life balance, grief, and sensemaking by prompting a range research questions as follows. Are actions in response to a new career path adaptive in the short run but more or less adaptive in the long run? Given the immediate costs of business failure (i.e., financial, social, and/or psychological), is bricolage unachievable (cognitively) immediately after failure but “kicks” in shortly after? Although weak ties might be damaged after a period of dormancy, can they be re-activated? Does the relationship between work and life roles fluctuate widely before a new “balance” is achieved? Having already experienced business loss, do subsequent losses generate less grief (if there is sufficient time between losses, otherwise does it accumulate)? Are there distinct patterns in the construction of stories of business failure and subsequent career success?

CONCLUSION

In this review, we have addressed the following question: what happens to entrepreneurs when their businesses fail? Drawing on research relating to the immediate and longer-term consequences of business failure for the entrepreneur and the associated underlying processes that shape them, we have synthesized findings into a schematic model (see Figure 1). Specifically, we highlight the costs of business failure (i.e., financial, social, psychological and their inter-relationship), the social psychological processes of sensemaking and learning, and the outcomes of business failure. Building on insights from the schematic model, we have developed a research agenda for each of these areas. Our
aim, through providing a clear research agenda, is not to constrain future research on business failures but simply to offer some suggestions to encourage more research on this important topic and, in doing so, further unravel some of the mystery surrounding the effect of business failure on the entrepreneurs involved.
FOOTNOTES

1 Note, however, Hasan and Wang (2008) provide contrasting evidence—namely, that there is a negative association between the lenience of bankruptcy laws (in terms of exemption rates) and the supply of venture capital financing.

2 Scanning dynamics refers to the selective attention to and collection of information that might be important in the sensemaking process. Interpretation dynamics refers to the development of ways to comprehend the meaning of information by fitting information into structures suitable for understanding. Learning dynamics refers to any significant changes in ongoing practices and involves the actions taken.

3 Discussed in the section on the social costs of failure.

4 Discounting relates to the tendency to attach less importance to a potential cause of behavior if other plausible potential causes are also present. For example, while a number of factors may have caused business failure, such as poor market conditions, limited resources, lack of knowledge and skill by the entrepreneur, the entrepreneur may discount the latter explanation for failure and instead focus on poor market conditions and limited resources as the cause of the business failure. Augmenting involves a tendency to attach greater weight to a potential cause if the effect occurs despite the presence of other inhibitory factors. For example if the failed business was operating in a munificent industry environment, the entrepreneur may be more likely to attribute the failure to his/her shortcomings.

5 We thank the editor for drawing our attention to the distinction between conceptual definitions and operationalizations of business failure.

6 Institutional entrepreneurs are defined as organized actors who envision new institutional configurations as a means to advance the interests they value highly yet are suppressed by extant types of logic (DiMaggio, 1988).
REFERENCES


Baron, R.A. 1999. Counterfactual thinking and venture formation: The potential effects of thinking about “what might have been”. Journal of Business Venturing, 15: 79-91


Cardon, M., & McGrath, R.G., 1999. When the going gets tough...Toward a psychology of entrepreneurial failure and re-motivation, paper presented at the Frontiers of Entrepreneurship Research Conference. Babson College.


Weick, K.E. 1979. The social psychology of organizing (2nd ed.). Reading, MA: Addison-Wesley.


