

## Throw good money after bad? Sometimes

By Sheryl Nance, featured blogger, July 19, 2010

Companies all too often stick with losing ventures despite signs of trouble, critics contend. But they acknowledge that it is often difficult to determine just how long is too long.

Still, the experts point to AOL, Google, Gillette, Michelin and Research In Motion as recent or current examples of companies that have refused to pull the plug, or delayed doing so, on products and services where margins, market share, relative growth rates and or other competitive benchmarks indicate that they would be better off investing the money tied up in them elsewhere.

The RIM BlackBerry, for instance, is losing market share to other smart phones (notably Apple), yet the company insists it will rebound soon. Michelin is still pushing the PAX run-flat tire, even though it fizzled in the market. Gillette is sticking with a strategy of marketing more and more blades on a single cartridge even though it is running out of steam. And while Google has ended its ill-fated foray into the radio business, observers say it took way too long.

The problem, as they see it, is that whatever cash these efforts generate, it is not enough to make up for lost opportunities in products and services with higher potential profitability. And that's far from the worst-case scenario—a loss-making black hole of a business that shows no sign of turning cash-flow positive in this century or next.

"The majority of companies I work with have no rigorous process for disengaging at all, with the result that it usually ends in a nasty mess," says Rita Gunther McGrath, an associate professor at the Columbia University business school. Instead, Gunther McGrath says, they explain away declines in these benchmarks, even though they are indicative of larger potential problems. And without a plan to turn things around, those problems will inevitably materialize, she says.

The first step toward avoiding them, says John Reddish of consulting firm Advent Management International, is to determine how many quarters must go by before any bleeding from a project will be stopped. Second, he says, establish measures to be implemented at "stage gates" during the life of a project. The gates reflect goals for a minimal level of profitability to justify further investment. If those measures do not succeed by the next stage gate, the project should be terminated.

Without such a formal system in place for justifying investments, a company may depend on too many assumptions about them. AOL's troubled Bebo acquisition, for instance, rested on the assumptions that the doomed social networking site would bring them new customers in a desirable demographic, would pave the way for 'engagement advertising," and would help the company expand internationally. "Eight hundred and fifty million dollars later, we finally learn that these assumptions aren't warranted at all," adds Gunther McGrath.

CFOs at such companies, however, can expect to hear those assumptions trotted out by managers committed to the project whenever it is questioned, she says. And the longer it goes on, the more weight are placed on those assumptions, a process she calls an "escalation of commitment to a failing course of action."

In such cases, companies often allow individual businesses to hijack their resource-allocation process. So the people in power are those who put that business on the map and who are naturally terrified about shutting it down. If they have the capability to starve other, more competitive businesses of vital investment, the result can be that the whole enterprise suffers.

That doesn't mean that businesses that aren't as profitable as they were once imagined to be should be shut down, especially when there aren't others likely to replace them, by you or competitors. If the pipeline is empty in such cases, experts say, keep selling. "As long as there are buyers, there's opportunity, and if competitors exit and you become a sole source, you can actually raise prices (until customers update to new options)," says Reddish.

R&D enters the picture, assuming it is effective, by identifying line extension opportunities. The decision here amounts to determining if there is a "new and improved" option or if current resources can be re-deployed into something else that's more lucrative, given the people, cost structure, technology and trade skills involved.

But that decision should not be limited to internally generated possibilities, Reddish warns. More and more R&D both looks for "what can we make/sell" and what we can acquire through purchase and/or license, he adds.

In any case, there may be good reasons to try to turn around a product line rather than abandon it. For example, you may need the business line to support certain customers whose loss would cost you more. Same if it's generating at least some cash without adding to overhead. The question to ask is, "What does it *really* cost to carry this product?" notes Rob Barnett, managing director of consulting firm Conway MacKenzie.

Such cases may be the exception, rather than the rule. And the complaints managers may hear from others may be a sign that one is not the former, says Gilles Gade, chairman and CFO of Cross River Bank. "When your stakeholders - employees, vendors and suppliers, lenders, etc. - start telling you it's time to pull the plug, listen to them," says Gade.