



# SUNK COST PRESENTATION

**ANNA DESPLACE, LAURA BERCHOUX**

# INTRODUCTION

## REMINDER :

- An **economic cost** : The firm's expenses while utilising resources during production.
- This takes into account ALL costs associated with production.
  - **Fixed & Variable costs**
- **But..** there are other costs such as **opportunity costs**
  - This is the benefit a company loses when choosing an alternative over another.
- Costs must be carefully assessed by the firm to make informed decisions about their production.
- Another cost is to consider is **SUNK COST**

## FIXED AND VARIABLE COST



(Wang & Zang, 2010 )



# LET'S THINK....



- **PRODUCT : " GOOGLE GLASSES"**
  - DIRECTIONS, NOTIFICATIONS & CONTEXTUAL DATA ALL IN YOUR VISION FIELD
- MASSIVE PRE-RELEASE HYPE
- BUT... ONCE RELEASED FAILED TO MEET CUSTOMER EXPECTATIONS & PRIVACY CONCERNS
- DID NOT PERFORM WELL PRODUCTION WAS STOPPED

**WHAT TYPE OF COST DO YOU THINK IT IS ?**



# WHAT IS A SUNK COST ?

## DEFINITION

- **Sunk costs:** costs that have already been invested by a firm or an individual and cannot be recovered.

## CONCEPT

- Sunk cost is an important notion
- EVERY FIRM incurs in a sunk cost at some point.
- The firm does not need to shut down
- **RESPONSE TO A SUNK COST :** It must ignore the sunk cost and move on when the economic benefits are greater than the cost incurred.



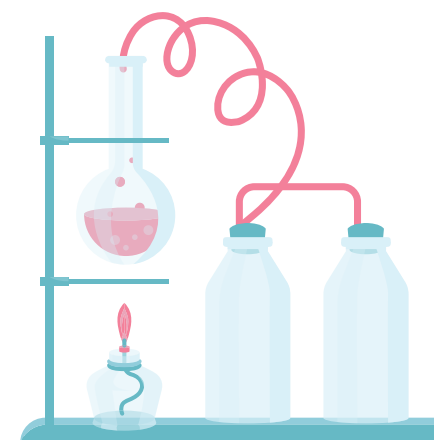
AMOUNT PAID



EQUIPMENT



TECHNOLOGY



RESEARCH



SUNK COST =  
IRRECUPERABLE

# BACK TO THE GOOGLE GLASSES

- The **Development and research** associated with producing google glasses is a sunk cost.

## WHAT WAS GOOGLE'S REACTION ?

- It was exemplary : google did not stay stuck with the product and moved on to other business decisions.
- Same with fixed costs, temporarily stopping production will not recover these fixed cost.
- One must ignore the sunk cost and continue .

What do you think would have happened if google had continued to invest ?

More advertisement more awareness ?



Further sunk costs ?



recovering sunk costs ?





More advertisement more awareness ?



- Google already had enough hype and awareness



Further sunk costs ?



- Not necessarily
- One must make an independent decision about further investing and the potential future costs
- based on prospective return of investment & future benefits



recovering sunk costs ?

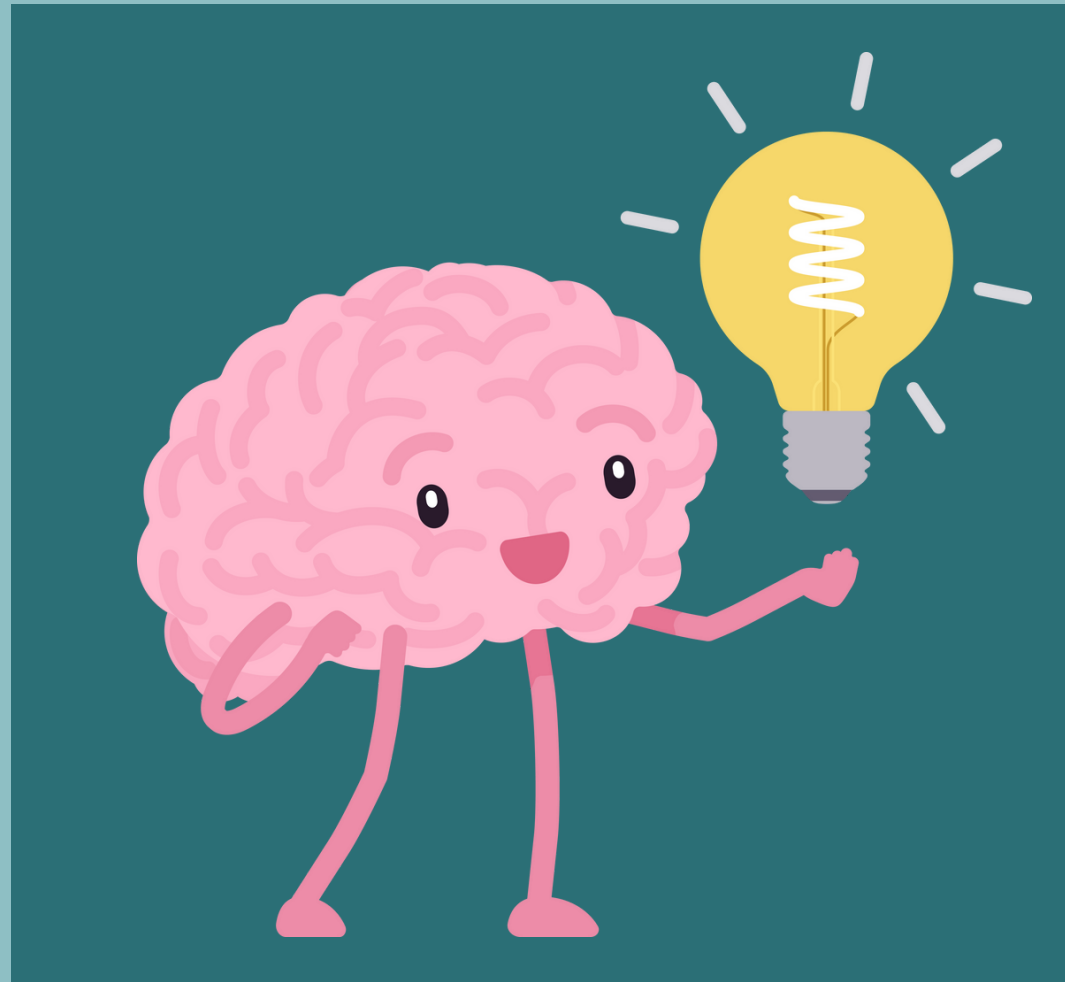


- by definition a sunk cost cannot be recovered under any circumstances

**ANSWER**

**CONCLUSION**

When individuals continue to invest into failing plans, they lose resources that could be invested into other rewarding alternatives (Arkes & Blumer, 1985) .



**Why would firms/agents continue to invest ?**



# ECONOMISTS

Economists usually assume that people are rational and that individuals pride themselves on internal consistency (Friedman et al., 2007).

## IRRATIONAL AND RATIONAL PEOPLE

# PSYCHOLOGISTS

In fact psychologist consider the fact that people are guide by there emotions.

People are not always rational and don't always take the best decision (Haitah-Falah et al., 2017).

# SUNK COST FALLACY (Thaler, 1980)

- Sunk cost fallacy is what happens when companies continue to invest.
- Companies continue adding further investments into failed innovations in the hope that the incurred sunk costs can somehow be recovered.

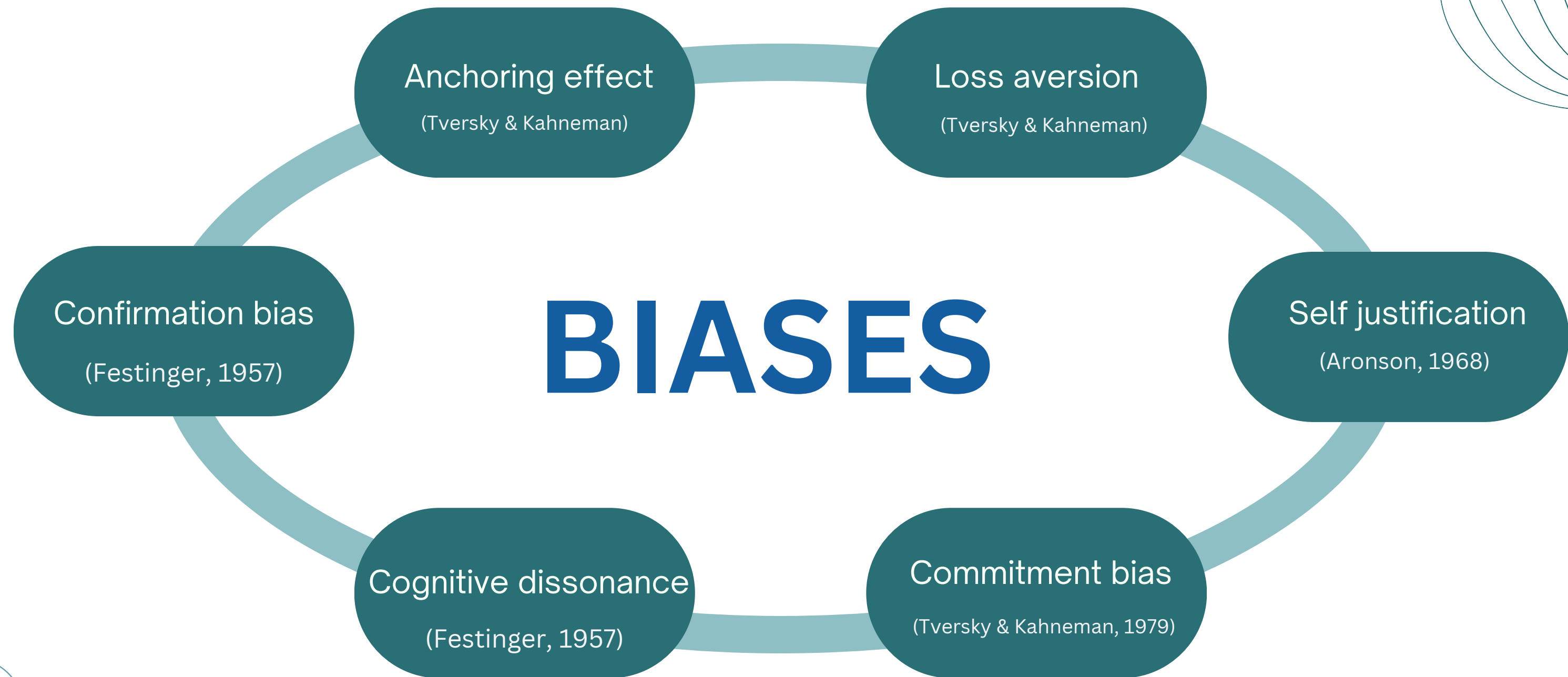
## DEFINITION :

- cognitive bias
- Describes the tendency to follow through on an endeavor already invested in before, whether this be money or time, whether or not the current costs outweigh the benefits.
- This may lead to decisions that may not be in the best interest due to being overly influenced by past commitments.

THESAURUS



# WHY DOES THE SUNK COST FALLACY OCCUR ?



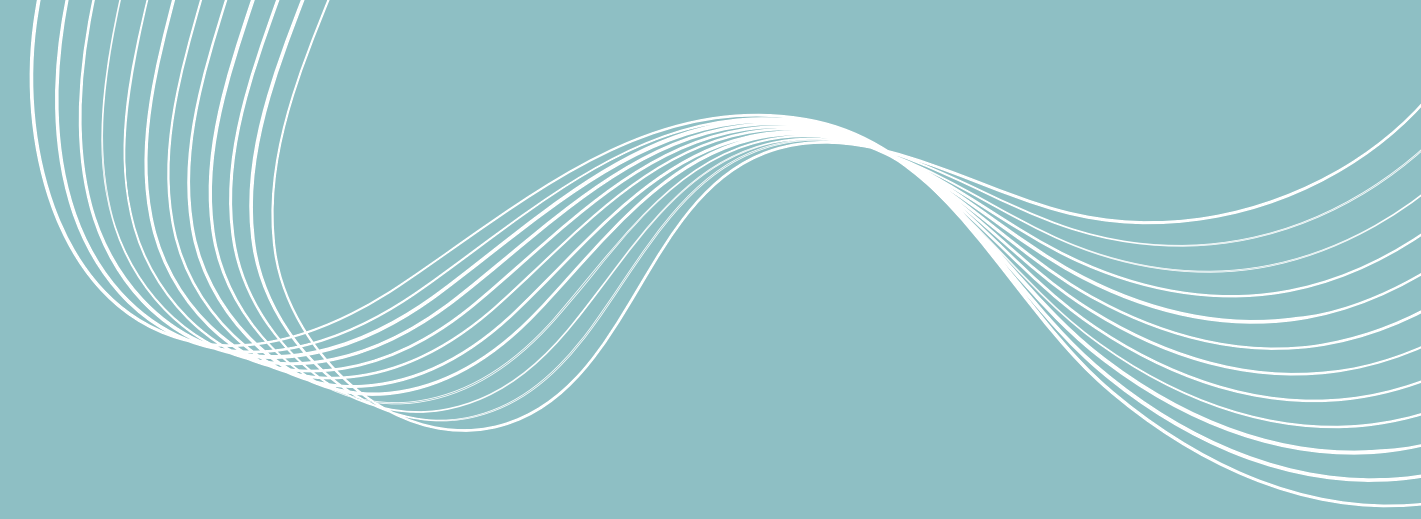
And others ...

# How susceptible are we to the Sunk Cost Fallacy?

- Harvard researchers measured this effect with a series of hypothetical scenarios. (Ronayne et al., 2021).
  - Including all different ranges of cost that can be sunk (money, time, effort, emotion).
- They used 18 different scenario questions with a scale to measure how much people continue even if they know that it's a sunk cost.

Scenarios	Resources (sunk costs)				
	Effort	Time	Money	Emotion	Belief
Making a Halloween cape	●	●			
Writing a wedding toast	●			●	
Painting your bedroom	●				
Terminating a project		●			
Changing your investment strategy			●		
Ending a relationship		●		●	
Deciding how to vote	●	●			●
Calculating a route	●	●			●

# Scenario example of study



You have been looking forward to this year's Halloween party. You have the right cape, the right wig, and the right hat. All week, you have been trying to perfect the outfit by cutting out a large number of tiny stars to glue to the cape and the hat, and you still need to glue them on. On the day of Halloween, you decide that the outfit looks better without all these stars you have worked so hard on.

Which point on the scale below best describes what you would do?

Wear stars   o   o   o   o   o   o   Go without

# RESULTS

No one is immune  
it depends on our susceptibility

- 23% stayed with the inferior asset after having put time and energy to earn it.



This demonstrates the susceptibility to the effect.



- It was also found that certain aspects enabled individuals to not fall prey to the effect.

- It was found that experience or stock of knowledge reduced the susceptibility to the sunk-cost fallacy.



"crystallised intelligence"

But.. seasoned decision makers at the top of large firms still may succumb to the fallacy.

# Overcoming the sunk cost fallacy

In a study conducted by Strough et al., 2016. The researchers explored how to diminish and overcome the sunk-cost fallacy.

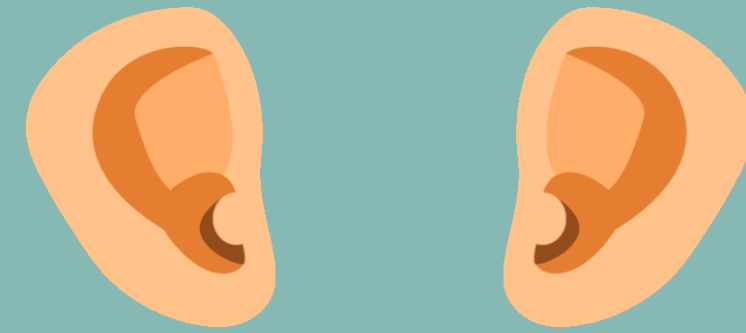
## RESULTS



**Experience & Affect**  
(decrease of fallacy with older age)



**Introspection**



**THANK YOU FOR LISTENING**  
**ANY QUESTIONS?**





# CITATIONS

- Arkes, H. R., & Blumer, C. (1985). The psychology of sunk cost. *Organizational behavior and human decision processes*, 35(1), 124–140.
- Wang, X. H., & Yang, B. Z. (2001). Fixed and sunk costs revisited. *The Journal of Economic Education*, 32(2), 178–185
- Friedman, D., Pommerenke, K., Lukose, R., Milam, G., & Huberman, B. A. (2007). Searching for the sunk cost fallacy. *Experimental Economics*, 10, 79–104
- Judgment under Uncertainty: Heuristics and Biases Amos Tversky; Daniel Kahneman Science, New Series, Vol. 185, No. 4157. (Sep. 27, 1974), pp. 1124–1131.
- Tversky, A., Kahneman, D. Advances in prospect theory: Cumulative representation of uncertainty. *J Risk Uncertainty* 5, 297–323 (1992).
- Festinger, L. (1962). *A theory of cognitive dissonance* (Vol. 2). Stanford university press.
- Aronson, E. (1969) The theory of cognitive dissonance: a current perspective. *Advances in Experimental Social Psychology*, 4, 1–34.
- Haita-Falah, C. (2017). Sunk-cost fallacy and cognitive ability in individual decision-making. *Journal of Economic Psychology*, 58, 44–59.
- Abelson, R. P., Aronson, E. E., McGuire, W. J., Newcomb, T. M., Rosenberg, M. J., & Tannenbaum, P. H. (1968). *Theories of cognitive consistency: A sourcebook*.
- Ronayne, D., Sgroi, D., & Tuckwell, A. (2021). How susceptible are you to the sunk cost fallacy?.