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# PHILEQUITY CORNER

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## The economics of spilled milk

“Don’t cry over spilled milk” is an adage we remember. As a principle, it has an economic equivalent on how we view investment and even social relationships. In cost accounting learned at business school there is the principle of “sunk cost”. It holds that a cost already incurred, or sunk, is no longer material or even relevant for later decision-making.

Thus, the cultural value of “sulit” (Getting your money’s worth) goes against the concept of sunk cost. In an “all you can eat” offer at a restaurant, the diner availing of the offer feels compelled to eat even more than all he can. To pass up a dish that has already been paid for is considered a waste of money. The resulting binge can lead to heart palpitations and even a fatal stroke.

The misplaced feeling of losing out from skipping dishes in a buffet table persists even if eating more does not affect the already sunk cost. It is irrelevant then if one only has soup and salad instead of heaping a plate with roast beef and cakes and coming back for more. It is no longer having a nice lunch but making the most out of an already sunk investment that distorts judgment.

In trying to win the favor of an object of desire, the suitor may treat her to expensive dinners or hard-to-get concert tickets or gift her with the latest smart phone. What if she meets and grows fond of a triathlete in training at her gym? The loser in this love triangle can treat the sunk costs as no longer relevant, and simply move on to stamp collecting instead. Past losses can still be extracted for the lessons they can teach—avoid the gym.

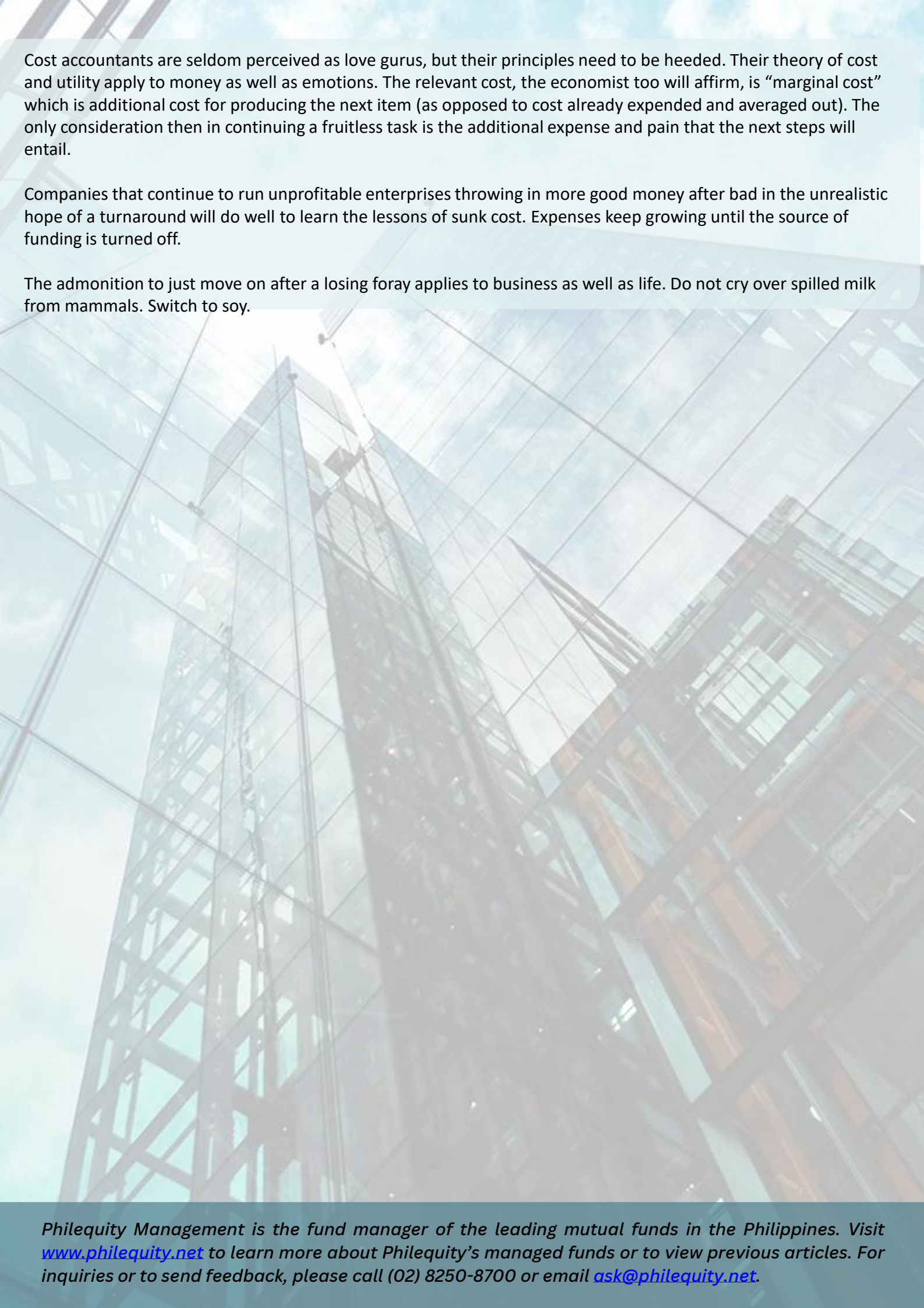
Giving up the chase and stopping the financial bleeding may lead to greater happiness. It is not always a virtue to follow the maxim—if at first you don't succeed, try and try again. This bullheaded approach can be a waste of both time and money. Better to say if at first you don't succeed, just find something else to do.

Many pursuits, including those for fame or political favors, rely on investments of time and money. These do not always work out well, especially when it comes to dealing with experienced exploiters. When is the best time to just write off sunk costs in these foolish ventures?

It is in investments (Yes, Dear Reader this is a financial column after all) that the theory of sunk cost most applies. In the stock market, the selling decision should be ruled by the theory of sunk cost. Should you hold on to a losing stock indefinitely? The already invested amount should no longer matter in deciding to unload dog stocks.

Without the cost accounting mindset, the emotional investor sells the winners and holds on to the plunging stocks. The market gain is readily claimed on winners. “Marking to market” now exposes the folly of holding on too long to losers. Averaging down on a stock can be less rational than just setting a loss limit and then exiting entirely.

Personal relationships that turn sour go through the process of trying to be rescued. Can the effort to save a doomed connection, whether romantic or corporate, lead to even bigger losses moving forward? Isn’t it better to avoid grief and write off past mistakes as sunk cost and move on to something more likely to succeed?



Cost accountants are seldom perceived as love gurus, but their principles need to be heeded. Their theory of cost and utility apply to money as well as emotions. The relevant cost, the economist too will affirm, is “marginal cost” which is additional cost for producing the next item (as opposed to cost already expended and averaged out). The only consideration then in continuing a fruitless task is the additional expense and pain that the next steps will entail.

Companies that continue to run unprofitable enterprises throwing in more good money after bad in the unrealistic hope of a turnaround will do well to learn the lessons of sunk cost. Expenses keep growing until the source of funding is turned off.

The admonition to just move on after a losing foray applies to business as well as life. Do not cry over spilled milk from mammals. Switch to soy.