THE HALO EFFECT

dedicated to clear thinking about business and management

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Study Guide for Business Journalists

Much of *The Halo Effect* is aimed at academics and management gurus who claim to have conducted serious, rigorous research about company performance. Very often, their work does not meet the test of science at all, but is little more than storytelling.

For that reason, it's worth taking a close look at business journalists. It's often said that journalism is the first draft of history, and that's true when it comes to business research. Many studies, including some of the best-known from recent years, rely heavily on articles from the business press—and if journalists systematically misunderstand the drivers of company performance, the case studies and books that rely on the press are likely to be misguided, too.

Furthermore, the business journalists often write stories that present business research to a broader audience. It would therefore be useful for journalists to have a better ability to differentiate between good and bad research, so that they don't simply pass on flawed research, conferring upon it the legitimacy of solid and valid work.

This Study Guide is intended to be helpful for business journalists. It can be used as part of individual reading and reflection, or as part of a course or training program. It is organized in three lessons:

Lesson 1: Making Sense of Company Performance

Lesson 2: The Words We Use

Lesson 3: Evaluating Business Research

Lesson 1: Making Sense of Company Performance

Business journalists are often asked to report on a given company, and find themselves having to make sense of firm performance. Profits and share price may be up—what accounts for the company's success? Or maybe profits have tumbled and the share price is plunging—what's the reason behind company failure? In either case, how do we explain what happened?

As I write in *The Halo Effect*, people are not so much rational creatures as they are *rationalizing* creatures—we all want to offer stories that provide a satisfying explanation of events. Journalists, too, share a natural desire to tell a coherent story—to offer a credible explanation, a satisfying story that places responsibility in one place or another. One difference, however, is that journalists often they labor under a deadline and have limited resources with which to understand the context of company performance.

Here are a few questions that journalists would do well to keep in mind as they report on company performance.

1. *Have we identified causes of performance, or have we made attributions based on performance?*

The issue here is the Halo Effect, which is perhaps the most basic idea in my book, and discussed at length in the first four chapters. The Halo Effect plagues a great deal of research and thinking about business, and affects journalists as well. In a word, many of the things we often believe are drivers of performance are, in fact, attributions based on performance. The human mind grasps things that are salient, tangible, and seemingly reliable, and makes attributions about other things that are less tangible. For example, when a company is doing well, we naturally tend to infer that it has a brilliant strategy, a visionary leader, highly competent people, strong execution capabilities, superb customer orientation, and more. When the same company falters, we are quick to make the opposite attributions: the strategy was misguided, the leader became arrogant, the people were complacent, execution was botched, and customers were overlooked. Sometimes companies really do get worse in these ways, but often they don't change much—it is our attributions that change based on performance. For example, please refer to the examples in my book about Lego, WH Smith, and Nokia (all in Chapter 1), Cisco (Chapter 2), ABB (Chapter 3), and IBM (Chapter 4). I spend considerable time on these examples, so as to lay the basis for criticisms of subsequent research that rely on Halo-infected data.

Lesson for Journalists: Rather than make easy attributions, ask instead whether your explanations are shaped by what you know to be the eventual performance, or whether they are arrived at independent of company performance. Will this make a journalist's work harder? Yes, no question—it is always easier to write a quick story that makes a plausible case for responsibility. But unless there is an effort to deflect easy attributions, the explanation may be deeply flawed. Just see what happened at Cisco, ABB, and others.

2. *Have we focused too quickly on a single explanation, rather than considering a broad range?*

The issue here is linked to the fallacy known as the *fundamental attribution error*—which is the natural tendency to ascribe reasons to one, fundamental, cause. Thus, the success or failure of a company is linked to a single cause—they failed to innovate, they made a bad acquisition, they hired the wrong CEO—rather than understand that outcomes often have a multitude of causes. The implication for journalists: look beyond the single, salient reason for performance, and dig more deeply.

Lesson for Journalists: Rather than focus narrowly on the reason for success or failure, consider a variety of reasons or causes. What seem, at first glance, to be the causes of performance may be symptoms of other causes.

3. *Have we looked mainly at internal reasons, rather than fully considering external forces?*

One of the most important ideas in *The Halo Effect* is that in business, performance is better understood as *relative* rather than *absolute*. Companies do not succeed or fail on the merits of their actions alone; their performance is always affected by the actions of competitors. I give the example of Kmart, which by many objective measures—inventory management, logistics, use of technology, etc.--improved during the 1990s. Why then did its market share and profits fall? Because on those same metrics, rivals such as Wal-Mart and Target improved to an even greater extent. Kmart's failure was a relative failure, not an absolute one. Journalist after journalist criticized Kmart for its sloppy execution, its frequent shifts in strategy, its poor culture, and more—yet overlooked in all the damning stories was the central fact behind Kmart's failure: the dramatic rise of extremely efficient rivals.

Lesson for Journalists: Rather than make the quick attribution of success or failure to things that are internal—customer service, execution, culture, and the like—have we considered that performance may have been strongly shaped by competition?

4. *Do we infer that bad outcomes necessarily result from a mistake?*

A major theme of *The Halo Effect* is that the business world involves a large dose of uncertainty, and that clear cause-and-effect relationships are not always present. Related to this notion is the fact that outcomes and inputs are imperfectly connected. Good results are not always the result of brilliant decisions, and unfavorable outcomes do not always mean that someone blundered. It is, of course, far easier to infer that bad outcomes resulted from a mistake, but that is retrospective sense-making, and not always an accurate way to understand business decisions.

A current example, as I write this in February 2007, concerns Dell. When it was successful—in 2005 it was named the World's Most Admired Company by *Fortune* magazine—Dell was heaped with praise. Now, with performance slumping, Michael Dell has removed CEO Kevin Rollins and taken the reins to revive the company he founded. How have journalists explained Dell's problems? *Business Week* wrote: "Dell succumbed to complacency in the belief that its business model would always keep it far ahead of the pack." It was "lulled into a false sense of security." Its disappointing acquisition of ConvergeNet was said to be an example of "hubris."

In fact, a closer examination suggests that Michael Dell and his top lieutenants had long known that their dominance in personal computers wouldn't last forever, and had identified new growth opportunities. They focused on their core strength—a disciplined fast-cycle manufacturing process—and identified related hardware products where they might apply this capability, such as computer storage, printers, and televisions. Had they tried to stay exclusively in PCs, that would be *complacency*. Had they moved into entirely new field, such as software or services, that might be *hubris*. But Dell did neither of those things—it took an entirely reasonable approach of building on its core strengths and finding new areas of application. Dell's recent performance is indeed disappointing, but mainly for relative reasons, namely the improvements of rivals like HP and Lenovo. It faces serious problems, no question, but that's very different than blaming Dell, long after the fact, for either "complacency" or "hubris," neither of which is justified. Such judgments misunderstand the nature of business performance in a competitive market economy.

Lesson for Journalists: It's always easy to take a poor outcome and look backwards to affix blame. But the question needs to be asked: are we confusing a bad decision for a decision that turned out badly? Good reporting should do more than affix blame after the fact; it should be fair in appraising the decisions that were made within the context of the time.

5. *Do we tell plausible stories that are diametrically opposed to other, equally plausible stories?*

Elsewhere on this website, I wrote a short article, "Secrets of Greatness" According to *Fortune* Magazine, www.the-halo-effect.com/articles/FortuneSecrets.pdf It shows how *Fortune*'s reporters were quick to explain the reasons for Sony's success in terms of openness—tearing down barriers between R&D departments, as well as openness to customer needs by listening closely to the market. Yet just a few pages later, the reasons for Motorola's successful RAZR mobile handset were said to be letting the research group work in secret, undisturbed by any interference, and by going with their own intuition rather than listen to market research. Both stories make sense, but when you put them side by side, you find that the lessons from Motorola are exactly the *opposite* of the lessons from Sony. Part of the problem is the Halo Effect. As long as Sony and Motorola are successful, we make attributions to explain that success, to make the picture seem sensible and coherent. Of course, had the companies been unsuccessful, the reporter could have made the opposite attributions! Sony's failure could then have been explained by an inability to work in isolation from outside interference, and Motorola's failure could then have been blamed on extreme secrecy rather than openness. Either way, there's a satisfying story—but of course, there is no reliable explanation, just ex post rationalization.

Lesson for Journalists: If your story is plausible, but an opposite story is equally plausible, think again—you may be doing little more than weaving one of several possible interpretations!

These five lessons are useful ways to force journalists to reflect on their explanations about company performance. They all tend in the same direction: to think beyond the initial, immediate explanations for company performance, and to look for more complete but also more accurate explanations.

Lesson 2: The Words We Use

Explanations of company performance are closely linked to the words we use—but the question of words is so important that it merits a separate lesson.

The words we use to describe company performance are hugely consequential. In Chapters 1 through 3 of *The Halo Effect*, I describe how the choice of words tends to change depending on whether companies are successful or not. The patron saint is George Orwell, who recognized that the words we use are not neutral, but shape our thinking. A quote from Orwell that I particularly like comes from *Politics and the English Language* (1946):

> A man may take to drink because he feels himself to be failure, and may fail all the more completely because he drinks. It is rather like the same thing that is happening to the English language. It becomes ugly and inaccurate because our thoughts are foolish, but the slovenliness of our language makes it easier for us to have foolish thoughts.

The same holds for business. Casual thinking leads us to describe company performance with foolish words, but the repeated use of inappropriate words makes it harder to have clear thoughts.

There are numerous examples in my book of how words are chosen based on outcomes. In Chapter 1, I describe how Lego, after a bad year in 2003, was criticized for *straying from the core*, and how WH Smith was accused of *drifting* into stationery and other product lines. These terms are used to describe corporate moves that turned out badly. Successful diversification is described with different words—such as to "expand" or "venture to new markets." What is the difference between "straying" and "expanding"? The former is often used when we know the outcome was unfavorable, whereas the same initiative might be described with the latter term when we know it was successful.

Chapter 2 highlights the words that were used to describe Cisco Systems. When it was doing well, Cisco was described in glowing terms; when it fell on hard times, the terminology changed. More broadly, successful companies are "free-wheeling" and "dynamic"; unsuccessful ones are "chaotic" and "undisciplined." Successful companies are "disciplined" and "prudent"; the same company, if unsuccessful, might be terms "risk averse," "timid," or "complacent."

There are many more examples in my book—about ABB, about IBM, about Nokia. There are also examples about individuals, in addition to those about companies. For instance, when Microsoft was successful, Bill Gates was said to be *laser-focused*, *tenacious* and *principled*, an exemplar of *authentic leadership*. When the same actions appeared to lead toward negative results, he was *stubborn* and *inflexible*. As I write in the book, winners are *confident*, losers are *arrogant*.

Lesson for Journalists: Journalists should be acutely aware of the terms they are using. As Orwell said, careless thinking leads to the casual use of words—which in turn makes it harder for readers and managers to think clearly. Journalists work in the medium of words, and must take seriously the words they choose to use. At any moment, they should ask themselves: "Is my choice of words shaped by the company's performance?" Otherwise stated, "How would I describe the company's actions if I didn't know how they had eventually turned out?" The challenge for journalists is to describe the phenomenon in question independently of performance. It is, metaphorically, to set aside what you know about the company's success or failure and to ask: if I was judging this company on its own merits, without knowing its performance, what would I say about it?

Lesson 3: Evaluating Business Research

Journalists don't just report about the fortunes of companies—they also write articles that present research findings and communicate them to a wide audience. Quite often, however, that research is of a questionable quality. Business journalists would therefore do well to improve their ability to evaluate research, so that do not confer legitimacy and credibility to poor work.

I won't repeat all of the guidelines that I expressed in the Study Guide for Business Researchers, although it would be helpful for business journalists to read it. For now, I will cover four points:

1. *Problems with large scale surveys*

A staple of business journalism is the large scale survey, where hundreds or thousands of executives are asked to complete a form that will name the Most Innovative Company (*Business Week*, presenting research conducted by BCG), the Most Admired Company (*Fortune*, presenting research conducted by Hay Group), and more. These studies present themselves as rigorous and impressive, and indeed there is a massive amount of data, but there are signs of the Halo Effect. If executives are merely asked to rate companies, their impressions will almost inevitably be shaped by what is known about performance. These sorts of studies will only be valid if independent variables are gathered in a way that is truly independent of performance—in other words, if things like innovativeness or product quality are measured objectively, using metrics that are not reflections of overall impressions.

Lesson for journalists: Rather than sponsor and publish large scale surveys that are flawed due to the Halo Effect, journalists should insist upon data independence, making sure that independent variables are measured objectively and fairly. In addition, when reporting about large scale surveys, they should raise appropriate questions about the interpretation about findings, and not merely accept them and pass them along.

2. *Interpreting correlation and causality*

Many studies show a correlation between some variable and company performance, from which causality is inferred. For example, on p.63 of *The Halo Effect*, I mention an article, "Champions in Hearts of Employees" the *International Herald Tribune*, which reported the findings of the *Great Places to Work* institute that ranking high in employee satisfaction is a driver of high performance. It accepted the claim that since companies with high employee satisfaction had five year returns of 9.56%, while companies that had lower employee satisfaction returned 3.81%, it followed that companies could more than double their performance substantially if they worked to raise employee satisfaction. Whether the positive correlation reported here was a driver of performance, or whether it was the result of performance, is an entirely open question.

Lesson for journalists: Journalists should not only refrain from making statements of causality based on correlation alone, but should also raise questions when they observe this error committed by others.

3. *Connecting the winning dots*

Other studies report about successful companies or managers, and make claims about what they have in common—and suggest that these things are drivers of success. The problem here isn't one of correlation and causality, it's one of comparing successful companies with unsuccessful ones. Pointing out what successful companies have in common is what I describe as the Delusion of Connecting the Winning Dots. To have any meaningful inference about causality, it's important to compare successful entities with less successful ones.

Lesson for journalists: Journalists should be vigilant about conclusions based on a sample of high performers, or a sample of low performers, but should insist on a fair comparison.

Summary

Journalists play a vital role in the world of business: they are our source of daily information about companies and management. Their articles have a profound impact on shaping our thinking, and also constitute an important source of input for subsequent studies that claim to be rigorous and thorough. For all these reasons, it's imperative that business journalists be more than storytellers, quick to make easy but erroneous attributions, or pass along questionable research to a wide public. They have a role to be critical and vigilant both in their original reporting, and in their reporting of the research by others.