

THE HALO EFFECT

dedicated to clear thinking about business and management

© 2007 by Phil Rosenzweig
www.the-halo-effect.com

January 2007

Study Guide for Managers

The Halo Effect can be used by managers as the basis for a discussion about improving company performance.

By addressing the questions in these four lessons, managers can achieve a sharper understanding about their companies—and improve their chances of success.

This Study Guide is organized in four lessons:

Lesson 1: Evaluating Company Strengths and Weaknesses

Lesson 2: Myths We Manage By

Lesson 3: Strategic Choices

Lesson 4: Excellence in Execution

Running a Study Session

Invite a suitable number of managers. One approach is to convene small group of managers, perhaps up to 12. A second approach is to convene a larger group, up to 40, with small breakout sessions.

Assign appropriate readings in advance. Each of the lessons identifies related readings from *The Halo Effect*.

Appoint a facilitator or discussion leader. Such a person could be a current manager, or an in-house trainer, or an outside instructor. In any event, my aim is for these sessions to stand alone, and not require a professional instructor.

Follow the lesson plans. I have sketched out sample lesson plans, with a sequence of discussion questions. Naturally, you may wish to adapt these for your specific circumstances. The key, in all lessons, is to stimulate open and thoughtful dialogue. These lessons do not impart a “right answer,” but seek to give managers a basis for improved critical thinking.

Conclude with a review of key points, and a decision about what next steps to take. These could involve specific actions, or may be a decision to investigate further.

Lesson 1: Evaluating Company Strengths and Weaknesses

Lesson Objective

To take a fresh look at strengths and weaknesses, without letting our views be shaped by the Halo Effect.

Key Ideas

- Many of our perceptions about companies are shaped by the Halo Effect—an overall impression based on financial performance.
- If we set aside the Halo of overall performance and rely on objective evidence, we may see more clearly the company's strengths and weaknesses.

Overview

Our perceptions of company strengths and weaknesses are often shaped by the Halo Effect. When employees of a successful company are asked to explain why it is performing well, they often talk about the quality of its people, the strength of its culture, or the vision of its top management. When the same company falters, people naturally make opposite attributions: the people are thought to be complacent, the culture is stodgy, and the leader lost his or her way. In fact, these and many other common explanations are often attributions made based on an overall impression of high performance. By allowing the Halo of company performance to affect our judgments, we reduce our ability to assess strengths and weaknesses in an accurate manner.

The key insight of this lesson is to insist upon measures that are independent of overall performance. For example, suppose we believe we are good at customer orientation. The next question is: how do we know? Do we have objective measures, or do we infer that we're good at customer focus because of our strong performance? The aim in all of this is to shake off the pervasive nature of the Halo Effect, and to understand our strengths and weaknesses more clearly.

Readings from *The Halo Effect*

Chapter 2, "The Story of Cisco."
Chapter 3, "Up and Down at ABB."
Chapter 4, "Halos All Around Us."

Lesson Plan

1. Ask managers to list some of the most important elements that shape company performance.

These sorts of things typically emerge:

People – the capabilities and skills of our employees

Leadership – the vision and abilities of our top managers

Strategy – the basic choices that guide our actions

Customer orientation – our ability to listen to customers and respond to their needs

Corporate culture – the culture or way we do things in our company

Focus – our ability to focus on a narrow set of goals and persist in achieving them

Innovation – our ability to devise new and better products, services, and business models

Execution – the ability to deliver results by mobilizing people and resources

2. For each item on the list, ask:

How good are we?

Ask managers to rate the company on a scale from 1 (Poor) to 5 (Excellent)

3. Once these answers are tabulated, ask:

Why do we think we are good or bad?

On what basis do we arrive at this assessment?

What evidence do we have?

The intention is to assess whether there exists objective data that is independent of performance, or whether it is likely that our evaluations are shaped by what we know about company performance.

This discussion can quickly lead to some subtle but difficult issues. For example: Does a successful company by definition have good leadership—and an unsuccessful one by definition has poor leadership? Some may ask: Is not performance the criterion upon which we assess leadership? On the other hand, some may point out that many things affect company performance, and that good leadership does not always result in good performance in each and every year.

4. Discussion can then shift toward a third question:

How can we improve our ability to measure objectively and independently?

That is, if our evaluations are often shaped by the Halo of company performance, how can we make sure that we gather independent data?

Here, again, the participants can address each item, asking how they might gather objective data. For example, rather than merely infer that a successful company must have a strong customer orientation, it can be decided to measure things such as: customer inputs in product design,

speed of customer service, levels of customer satisfaction, inclusion of customer satisfaction in employee performance evaluation, and more.

Similarly, rather than simply infer that a successful company is good at execution, it can be decided to measure specific elements of the company's activities, such as product quality, production cycle time, working capital management, inventory turnover, and the like. The intention is to shift the company from easy attributions based on performance, to an objective and data-driven evaluation.

Conclusion

The session can end with a summary of lessons learned regarding company strengths and weaknesses. Perhaps some things that were usually felt to be a strength need to be looked at in a fresh way. Or perhaps some things that have been believed to be a weakness are not, in objective terms, bad at all.

Finally, there may be implications for how the company should improve its ability to measure and monitor performance, relying on objective measures rather than easy attributions.

Lesson 2: Myths We Manage By

Lesson Objective

To identify some of the unspoken myths that guide management decisions, and to replace them with clear thinking about company performance

Key Ideas

- Business decisions are often guided by strong—but usually unspoken—ideas about what leads to company performance.
- Sometimes these myths have been propagated by recent business best-sellers, but are based on faulty thinking.
- It's useful to expose these unspoken assumptions and replace them with a more accurate understanding of company success and failure.

Overview

Since the publication of Peters and Waterman's *In Search of Excellence* in 1982, managers have been subjected to a stream of business books that claim to offer the secrets of success. Some of the supposed elements of success have become so well-known that they constitute a sort of received-wisdom about company performance, a common lore that which many managers accept without question. Some of the ideas may be valid, at least in part, but some are deluded. As a first step, it's useful to stand back and ask whether management decisions are guided by implicit theories. Only then can they compare the assumptions that guide their decisions, and discuss whether these principles are useful—or whether they are myths that are potentially dangerous.

Readings from *The Halo Effect*

Chapter 6, "Searching for Stars, Finding Halos"

Chapter 7, "Delusions Piled High and Deep."

Chapter 8, "The Schizophrenic Tour-de-Force."

Lesson Plan

The first step is to identify common myths, and then to discussion whether company managers subscribe to them. It may be hard to begin a discussion by asking managers to identify the assumptions or myths that guide their decisions—by definition, implicit assumptions may not be consciously held. One approach, therefore, is to begin by examining seven common myths, as follows.

1. *Is it more important to have the "right people" than to have the "right strategy"?*
2. *Does employee satisfaction lead to high performance?*
3. *Is there a "blueprint for lasting success"?*

4. *Is high performance “a matter of choice”? That is, can a company “choose” to be great?*
5. *Can a company achieve success by following a formula, such as the 4+2 formula of What Really Works or the steps in Good to Great?*
6. *Does “focus” lead to high performance?*
7. *Is “execution” more important than “strategy”?*

Discussion about each one might reveal that managers hold misperceptions. Some explication of each is as follows:

1. *Is it more important to have the “right people” than to have the “right strategy”?*

This is a basic notion from Jim Collins’s *Good to Great*—which he describes as “First who, then what.” According to Collins, it’s vital to “get the right people on the bus” and “the wrong people off the bus”—and only later to decide upon a direction for the company. It’s a comforting notion, since most companies feel they have good people, but is dangerously simplistic. People don’t come with labels that say “good” or “bad.” A person might have skills and talents that make them an important contributor as long as the company pursues one strategy, but that are ill-suited to another. Finding the match between strategy and people works in both directions; it is not a simple linear process.

2. *Does employee satisfaction lead to high performance?*

It’s common to believe that satisfied employees leads to success—it’s a notion explicit in the *Best Companies to Work For* poll, in recent books such as *The Enthusiastic Employee*, and more. Without question, there is some truth to this view, but the relationship between employee satisfaction and company performance is much more complex. In fact, most studies that claim to demonstrate such a causal relationship suffer from the *Delusion of Correlation and Causality*. On closer analysis, employee satisfaction turns out to be as much a *result* of performance as it is a *cause*. Rather than spending an inordinate amount of time making employees “satisfied,” it may be wiser to make the choices that help make the company a high performer—through smart strategic choices and disciplined execution. (See Chapter 4, page 75)

3. *Is there a “blueprint for lasting success”?*

This one comes from *Built to Last*. All companies want to achieve enduring success, and managers are tantalized at the prospect of such a blueprint—something that authors Jim Collins and Jerry Porras claim exists. However, as shown in Chapter 6, this study suffers from sample selection based on outcomes, coupled with data that were compromised by the Halo Effect. The existence of long-term high performance is largely a delusion, observable only in retrospect. The truth, as shown by Richard Foster and Sarah Kaplan (see pp.101-104).

4. *Is success just “a matter of choice”? Can a company “choose” to be great?*

This notion also comes from *Good to Great*. Once again, it is comforting to believe that company performance is entirely up to us and our actions, and that companies can simply make a choice to become great. But such a view misunderstands the relative nature of performance in a competitive market economy. High performance depends on more than just ourselves—it also depends on actions of competitors. Success comes from being better than others, which means making calculated choices under conditions of uncertainty, which means running risks, which means courting failure. Companies do not merely choose to become great, follow a formula, and enjoy high performance.

5. *Can a company achieve success by following a formula, such as the 4+2 formula of What Really Works or the specific steps of Good to Great?*

No formula can guarantee high performance, and for a simple reason: in a competitive market economy, company performance is not absolute, but better understood as relative. It is always dependent on what rivals are doing. This is the Delusion of Absolute Performance, which I describe with the example of Kmart on pp.111-116. A company can get better in absolute terms and still falter. Consider: if everyone in the industry followed the formula, would all of them be outstanding performers? Obviously not, because they compete against each other—which is why formulas cannot be guaranteed to work.

6. *Does “focus” lead to high performance?*

This view is explicit in the work of Chris Zook at Bain & Co as well as in *What Really Works*, and is implicit in *Good to Great*, with its emphasis on being a narrowly focused “hedgehog.” This view is in fact shaped by the *Delusion of the Wrong End of the Stick*. Empirical research does indeed suggest that unrelated diversification does not lead to high performance, but it does not suggest that a doggedly narrow focus, even at times of great adversity, lead to success. Agility and adaptability are important, too.

7. *Is “execution” more important than “strategy”?*

A common notion, and very popular among CEOs. (I write about this in my article, posted on this website, called *Is Success 10% Strategy and 90% Execution, Or is the reverse?*) Without question, disciplined execution—objectively measured, and not merely inferred from the Halo of company performance—is very important for success. But so are basic strategic choices. It may be true that a strategy, however brilliant, cannot succeed without strong execution, but it is also true that if you’re running in the wrong direction, it doesn’t matter how fast you run. Both are important, and both involve uncertainty—neither one lends itself to a neat formula or a guarantee of success.

Conclusion

Having identified some of the implicit assumptions by which a company is managed—the myths we manage by—managers can ponder whether these myths have shaped decisions in an important way. Has the company, for example, persisted in a course of action longer than was wise, due to an assumption that dogged persistence leads to success? Has it focused on things such as employee satisfaction as though they are the driver of performance, rather than recognizing that the direction of causality is in both ways, and probably stronger from performance to satisfaction? The result should be a sober but open-minded consideration of the ways that unexamined assumptions may have shaped key decisions—perhaps for the wrong reasons.

Lesson 3: Strategic Choice

Lesson Objectives

To replace a formulaic approach to strategy with a recognition that strategic choice involves decisions made under conditions of uncertainty, and to identify key choices that can raise the company's chances of success.

Key Ideas

- Strategy means choice, and choice involves risk.
- Good strategic decisions do not always lead to success, and unfavorable outcomes do not always mean that a mistake was made.
- The process of strategic choice is based on a sober assessment of external forces—industry, competitor, customer, and more—coupled with a realistic evaluation of internal capabilities and resources.
- Rather than thinking in terms of formulas, “immutable laws,” or “virtual guarantees,” strategists should think of those key decisions that have the greatest chance of raising a company's chances of success.

Overview

The task of strategic leadership is not to follow a given formula or set of steps, but to gather appropriate information, evaluate it thoughtfully, and to make choices that provide the best chances for company success, all the while recognizing the fundamental nature of business uncertainty. The ability to make the sorts of difficult judgments that are complex yet pivotal for a company's fortunes is, in the last analysis, the most important contribution of business executives.

One element of business performance is strategic choice—which means choosing to be different from rivals in some meaningful way. Choice always implies risk. Intelligent choices may not always lead to favorable outcomes—and the fact they do not lead to favorable outcomes does not mean they were mistaken. Faced with this basic uncertainty, wise managers think in terms of probabilities. Their objective is not to find keys to guaranteed success, but to improve their odds for success through a thoughtful consideration of factors. Some of these factors are outside the company—including industry forces, customer trends, and the motivations of competitors. Others are inside—capabilities, resources, and risk preferences. On the basis of that analysis, the role of the business strategist is to make decisions that improve a company's probabilities of success, while never imagining success to be simply a matter of choice.

Readings from *The Halo Effect*

Chapter 9, “The Mother of All Business Questions, *Take Two*”

Lesson Plan

Note: *The Halo Effect* aims to unmask the errors and mistakes in so many common treatments of business and management, but does not seek to set forth an explicit alternative model—which would have called for a full book on its own. For that reason, the chapters of my book are not, by themselves, sufficient to conduct this lesson, which aims to identify the key strategic choices a company should make to improve its chances of high performance. A different set of readings might be useful. In my work at IMD, I often rely on managerial articles, including these:

“Are You Sure You Have a Strategy?” by Donald Hambrick and James Frederickson, *Academy of Management Executive*, 2001

“What is Strategy?” by Michael Porter, *Harvard Business Review*, 1996

Those articles, and others like them, recognize that strategy is about making choices under uncertainty, not about following formulas that are said to lead predictably to success.

For the purposes of the present exercise, a constructive discussion can cover three topics.

1. *What are the key forces at work in our competitive environment?*

Managers can conduct an analysis of their industry, examining the nature of competitive rivalry, the customers, suppliers, and trends. Next, they can devise some scenarios for the future, not with the expectation that their forecasts will be correct, but that they represent likely directions.

2. *What are our capabilities and resources?*

Managers should also consider the company’s internal resources and capabilities. What are its unique skills? What resources are available? What is its risk preference?

3. *What specific choices should we make?*

Based on first two analyses—one external and one internal—managers may list and debate the choices that must be made to improve the company’s chances of success. These should include the three basic dimensions of strategic choice: a) In what combinations of products and markets shall we compete? b) What activities shall we perform, and what shall we leave to suppliers, subcontractors, or other partners? c) How shall we differentiate ourselves from rivals?

Conclusion

At a minimum, this lesson begins to shift managers in the direction of thoughtful strategic analysis based on choice, and away from simplistic dictums about focus or persistence or formulas for success. At best, this lesson can lead to the identification of important choices that the company should make to position itself for high performance. In so doing, it takes us well beyond the formulaic approach in so many business books—that companies should focus, or persist, or innovate—and insists that company performance is linked to strategy, which means choices made under uncertainty. Of over-riding importance is to create the right mindset: not one that expects simple formulas that lead to predictable results, but one that understands company performance as based on risky choices in a competitive environment.

Lesson 4: Excellence in Execution

Lesson Objective

To identify those few, specific elements that demand superior execution in order to achieve high performance, and to find explicit measures to monitor execution.

Key Ideas

- Excellent execution is necessary for high performance, but it's not enough simply to implore employees to execute flawlessly.
- Rather, managers need to identify what few, vital dimensions of execution are most important for success.
- If we're not careful, general impressions of company performance—the Halo cast by financial results—will likely shade the way we think about execution.
- Metrics therefore need to be devised in order to measure execution in a rigorous and explicit manner.

Overview

Many senior executives implore their employees to achieve “flawless execution,” but do not address the practical steps, or recognize the inherent uncertainty, surrounding the execution of strategy in a complex organization. This session suggests that instead of a long list of good intentions, companies focus on a handful of key objectives that, together, have the greatest leverage on overall performance, then set in place the systems to monitor and measure.

Readings

- Read Chapter 9 in *The Halo Effect*, especially pp. 150-156, with particular attention to the references to AlliedSignal and Dell on p.154. In each instance, a key to successful execution was to focus on a handful of issues that were particularly important for success of that company. The idea was to get everyone to focus on a few, vital objectives—which is far better than to have a long list
- As noted in Lesson 3, *The Halo Effect* does not provide a thorough guide to setting strategy, and the same holds for execution. An additional reading that is valuable for this topic is: *Execution: The Discipline of Getting Things Done*, by Larry Bossidy and Ram Charan, 2002.

Lesson Plan

1. *What are the company's key strategic choices?*

Review the strategic choices in Lesson 3. Execution follows from strategy—and therefore any discussion of execution has to be grounded in the key choices the company has made, or is

planning to make. A review of those choices, so that there is a common understanding, is an important point of departure.

2. *What are the vital, few objectives for execution?*

One of the problems inherent in discussions about execution is that there are dozens of possible dimensions of execution, all of them important for the company. Yet imploring managers to “execute flawlessly” is not helpful—it’s little more than a statement of the obvious. Who, after all, is in favor of flawed execution? A more useful avenue is for managers to identify those few, vital dimensions of execution. Which ones comprise the short list that is most essential for high performance? It’s sufficient to say “All of them.” Ask: what short list is most vital for our success? The discussion that follows is vital, as it triggers an exchange of views and an attempt to narrow the focus.

3. *How can these elements of execution be measured objectively and rigorously?*

Once a vital few dimensions of execution are identified, they must be measured in a clear, objective, and rigorous manner—one that is free from the Halo Effect. The final step, therefore, is to discuss the information needed, the means of gathering, the metrics to ensure objectivity, and the evaluation mechanics.

Conclusion

The two keys to company performance are strategic choice and excellent execution—both of which involve decisions under uncertainty. The aim is not to “guarantee” success, but improve the chances of success—first by making key choices that differentiate a company from its rivals in a way that is valuable to customers, and second by focusing on a handful of key dimensions of execution and rigorously measuring process.