The Halo Effect: … and the Eight Other Business Delusions That Deceive Managers

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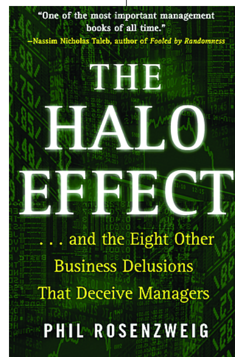
Publisher: Free Press, February 2007 **ISBN:** 0743291255

While most books about business do not focus on risk, once in a while we find one that manages to provide gems of insight for risk managers. *The Halo Effect* by Phil Rosenzweig is one of these rare books. That it also tears apart the logical illiteracy of many pithy best-selling business books is just a bonus.

Ever since *In Search of Excellence: Lessons from America's Best-Run Companies* became a best seller (Warner Books, 1982), bookstore shelves have been filled with a parade of similar types of books. This is an interesting genre. As a general rule, the authors choose a single, successful company, or a group of them, and look for common traits. They then list these commonalities and present them as an instruction manual on how to be successful.



These works conclude that if successful companies share common attributes, these attributes must be correlated to success. They also suggest that a strong correlation must indicate a causal relationship. And finally, they tend to draw their evidence from interviews and from articles in other business publications.

With these secrets of corporate success so abundantly available to the general population, one would think that running an "excellent" company would be as easy as assembling a bicycle: just follow the instructions and, voilà, business nirvana!

At first glance, this would seem to make sense. Acting like GE should result in GE-like performance. Unfortunately, however, this type of advice does not work nearly as well as the best-selling authors might suggest. So why is the promised excellence not delivered?

Enter Phil Rosenzweig. In *The Halo Effect: … and the Eight Other Business Delusions That Deceive Managers*, Rosenzweig carefully deconstructs the conclusions and delusions of several best-selling business books with remarkable common sense and a very sharp pen. It is clear that Rosenzweig has been following the *In Search of Excellence* genre carefully. It is also very clear that he does not approve. This makes sense, because these types of books are rife with flawed logic, highly subjective data and wrong assumptions.

Of course, it is easy to second guess the conclusions of others. But Rosenzweig goes far beyond a simple critique. He identifies nine common delusions to which these books fall prey. Each delusion is either a logical fallacy, a faulty assumption or some violation of the scientific method. As a result, *The Halo Effect* is not so much a critique of a few business books, but rather a bright light illuminating the blind grasping for answers that pervades much of what passes for reason in the world of modern business literature.

While all of the delusions are compelling, a few stand out and deserve some detailed explanation:

Delusion One is the *halo effect*. This is the tendency to look at a company's overall performance (or that of a person) and to then attribute its success to its culture, leadership, values or any observable trait that seems likely to drive success. The term "halo effect" was created by American psychologist Edward Thorndike in World War I. He noticed that officers gave high grades in all categories of performance to soldiers with good posture and handsome faces — even if they performed poorly in the categories being graded.

Rosenzweig defines the halo effect as "a sort of rule of thumb that people use to make guesses about things that are hard to assess directly." For example, he writes, "we may not know if a product is good, but if it comes from a well-known company with an excellent reputation, we might reasonably infer that it should be of good quality."

Likewise, if a successful company has a customer relationship management (CRM) program, we might infer that a CRM program is a good thing to have. It might be. But when we assume that it is simply because the company has a halo of success, we are not making a well-reasoned conclusion.

Delusion Two is the delusion of correlation and causali-

ty. For example, finding that employee satisfaction is correlated with the success of the company, one might be led to conclude that happy employees caused the company to do well financially. It makes sense that engaged employees would work harder and drive better results. But correlation does not prove causation. It could be that employees are simply happier because the company is doing well — because it is paying bonuses, high salaries and other things that make employees satisfied with their work. Rather than happy employees causing success, it might be that success is creating happier employees.

Delusion Three is the delusion of single explanations. Rosenzweig writes that while it may be true that a particular factor, such as "strong company culture or customer focus or great leadership," leads to improved performance, it is also true that many of these factors are highly correlated. Therefore, he reasons, the effect of each one of these factors is usually less than suggested. This delusion occurs, for example, when 10 owners of 10 different initiatives all want to take credit for 50% of the recent increase in sales.

Delusion Eight is the delusion of the wrong end of the stick. "This is … known as survivorship bias," Rosenzweig writes. "It may be true that successful companies often pursued a highly focused strategy, but that doesn't mean highly focused strategies often lead to success. Imagine that one thousand companies had focused strategies, and only five survived after 10 years. If one looks only at the five survivors, one could credit their success to having a 'focused strategy.'" Then, however, how can one explain that 995 companies with the same focused strategy failed?

Assertions and Delusions

In the first two-thirds of *Halo*, Rosenzweig analyzes the main assertions of several best-selling business books by comparing them with the nine "delusions." This is not merely a self-serving attempt to fit reality into his particular paradigm; Rosenzweig's logical approach makes it self-evident that the business best sellers are wildly irresponsible in their conclusions.

It is particularly entertaining to follow Rosenzweig as he walks us first through the glowing praise that is lavished on successful companies, and then as he quotes article after article written about the same company after its streak ended. The very same traits that drew wide acclaim during the good years are blamed for the companies' downfalls when things go south. A company that was praised for being "highly focused" when it was on a roll is faulted for being "too highly focused" when it falls on hard times.

The debunking of the myth of a business "silver bullet" will be a delicious sort of vindication for those who have felt that business books promising "excellence" are simply piffle. But Rosenzweig delivers far more value than just this. He also gets to the heart of the challenge that has dogged so many dedicated professionals: how can you tangibly and objectively show the value of your work?

In any professional function that does not directly produce revenue, such as human resources, customer relations, legal services or risk management, objectively proving the value of one's work is very hard to do. This is an especially poignant issue among enterprise risk management (ERM) practitioners. There is a great deal of discussion about the value of ERM, so it would be very nice if one could conduct a study that tied ERM directly to something like free cash flow or revenue.

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Rosenzweig turns the "value" question on its head by asking whether or not it is even possible to tie the value of a single program to outcomes objectively. His conclusion, backed by searing logic and detailed review, is clearly that this can't be done.

But he goes further. In some of the best prose written about risk, Rosenzweig concisely details the value of risk management. "The fact is, strategic choices always involve risk. The task of strategic leadership is to gather appropriate information and evaluate it thoughtfully, then make choices that, while risky, provide the best chances for success in a competitive industry," Rosenzweig writes.

Indeed, risk management doesn't guarantee a specific outcome. It simply can't. But it can improve ones odds of success. This is a very simple point, but one that is missed time and time again.

This type of insight into the nature of business is rare. Rosenzweig delivers one of the most intelligent, perceptive business books in print. Although risk is not presented as a main focus, his insights into the nature of risk, uncertainty and risk management are elegant and penetrating. This book should be on the reading list of every business person — and risk managers in particular. ■

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