The Halo Effect

Caplan

Phil Rosenzweig

The halo effect is a cognitive bias that affects our judgements. We tend to evaluate people positively across the board or negatively across the board, rather than judging them accurately in different areas. This is why we sometimes believe that rockstars have something interesting to say about climate change.

The halo effect is also a feature of satisfaction measurement—customers or employees tend to give mostly high scores or mostly low scores. This is not to say that customers are incapable of distinguishing between product quality and speed of service, but their overall perceptions do influence the way they score specific aspects of performance.

Rosenzweig's book is targeted at a similar halo effect that afflicts the supposedly level-headed world of business scholarship. In a nutshell, he argues that many of the factors we see as leading to superior performance are actually judgements based on performance. In other words, if a company is doing well financially then we believe they are customer focused, have motivated employees, are making wise strategic choices, and so on.

The problem is that it is hard to measure these factors independently. Rosenzweig gives the example of Fortune's Most Admired ratings—the scores for 8 different factors are very highly correlated, and research shows that financial performance is what determines many of the other perceptions.

"So many of the things that we—managers, journalists, professors, and consultants—commonly think contribute to company performance are often attributions based on performance."

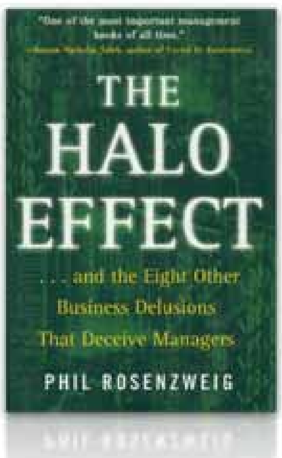
The halo effect is only one of a series of delusions lambasted by Rosenzweig, such as the classic of mistaking correlation for causation. Giving the example of employee engagement and company performance, he argues that proper research (tracking performance over time) shows that financial performance influences employee satisfaction more than the other way round.

Rosenzweig also criticises over-simple explanations—there are always variables that we can't control. Often business authors claim they have the one secret to success; whether it's customer loyalty, employee engagement, great leadership or structural change. Rosenzweig argues that all such factors have been shown to account for a total of 32% of difference in performance. Simple explanations are almost always wrong, however appealing.

Even more tellingly, he points out the fallacy of believing that improvements you make are all that matters—the delusion of absolute performance. He points out that Kmart failed not because they were inefficient, but because Wal-Mart got better, faster.

"Kmart got better in absolute terms and yet fell further behind at the same time—and the gap between the two retailers was growing ever wider."

The Halo Effect is definitely a book I'll be keeping close at hand as an antidote to, well, pretty much all the other business books. Rosenzweig punctures the semantic games, business writers (and leaders)



use to present stories in place of genuine analysis. These stories may be inspirational, and they definitely make us feel good, but they tell us very little about how to build a successful business. So what does?

Firstly acknowledge the uncertainty of choices—there are no guaranteed routes to success, and strategic decisions are inherently risky.

"..competitive advantage demands calculated risks."

Good management, then, is all about acknowledging uncertainty both in strategic choices and in measurement of key variables. But robust research is possible, and is preferable to anecdotes and stories however appealingly dressed up. Explicitly countering the halo effect and the other delusions identified by Rosenzweig is a good start for improving your understanding of your own business.

"Anyone who claims to have found laws of business physics either understands little about business, or little about physics, or both. S