

# THE HALO EFFECT

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## **A Field Guide to Business Delusions:**

### **How to Tell the Nuggets from the Nonsense in Business Research**

In my book, *The Halo Effect ... and the Eight Other Delusions that Deceive Managers*, I expose a number of errors that are commonly found in the business world. I show how these errors affect many articles in the business press, some academic research, as well as the most popular business best-sellers of recent years. I go into some depth regarding the major flaws of some recent blockbusters, including Jim Collins's best-seller, *Good to Great*.

But what about books and articles that I don't discuss in my book? How can managers and students of business know whether a study is sound, or whether it is flawed? This article is intended to serve as a field guide to assess business research. The basic ideas are also relevant for other sorts of research, but my focus here is on the world of business and management.

There are three main problems that rob business studies of validity: errors of Design, of Data, and of Drawing Conclusions. Many studies are weakened by problems in one or more of these categories, and some fall short in all three. Let's look at them one by one.

#### **The First D: Design**

Research design refers to way a study is structured: what population is selected for study, over what time period it is studied, and what variables are selected to test what hypotheses.

First, consider the selection of the population. A common tendency in business research is to select companies that are, say, high performers, and then try to see what they have in common. That's what Peters and Waterman did in their 1982 book, *In Search of Excellence*. It's a mistake, of course, because looking only at high performers can *never* tell us what makes them successful. We need to have some low performers to compare them with. In the language of research design, selecting only winners—or only losers—is called *selection on the dependent variable*. It's a basic error in design.

A better approach is to select a group of companies that have varied performance, some high and some low. In their 1994 book, *Built to Last*, Collins and Porras recognized the mistake of selecting only high performers, and therefore paired each of their *Visionary*

companies with a comparison firm that had achieved only modest performance. That was a smart move, and avoided a design problem that undermined the findings of *In Search of Excellence*.

A second issue is whether the design is *cross-sectional* (gathering data at a single point in time) or *longitudinal* (gathering data over time). This is a critical decision depending on the hypotheses for study. A cross-sectional design makes it easier to gather data, of course, but often can do little more than suggest correlation, not causality. If a study hopes to test a hypothesis of causality—for example, whether employee satisfaction leads to high performance, or whether investments in social responsibility lead to improved performance—it's imperative to incorporate a longitudinal dimension, so that actions at one moment in time can be studied for their effect on outcomes at a subsequent time. If the design relies on cross-sectional data only, we will not be able to tell what causes what. It could be that a policy of corporate social responsibility leads to high performance—but it could also be true that only high performing companies have the resources to invest in social responsibility. Unless our design allows for a longitudinal dimension, we may not be able to say much about causality.

A third design issue has to do with the period of observation. Are companies to be studied in real time, or in retrospect? Many scientific experiments—in chemistry, for example—can be conducted quickly, then repeated after making small adjustments. Unfortunately, business performance unfolds over many years. It's very hard to conduct studies of company performance in real-time—it's often not practical to observe companies for a period of many years. Therefore it is entirely understandable that many studies identify companies after the fact, then look backwards to try and determine what led to high or low performance. Understandable, yes, but such a design choice leads to a next challenge, which has to do with the data itself.

## **The Second D: Data**

The second place to look for problems in research is the nature and quality of the data. A basic question has to do with *validity*. Are the data fair and accurate in capturing the variables in the research design? Do they allow us to test the hypotheses of interest?

When it comes to research about company performance, a basic problem is the Halo Effect. Here's how it often works in the world of business: When a company is performing well, with higher sales and profits and a booming stock price, people are often quick to infer that it has a capable leader, strong execution skills, a vibrant corporate culture, that it is highly customer focused, and more. When that same company experiences a dip in performance, it's irresistible to infer that the leader became ineffective, execution skills deteriorated, the culture became complacent, and customers were ignored. Perhaps the company really did change in these ways, but often the explanation is simpler: a decline in performance led to a different set of attributions. The fact is, concepts like corporate culture, leadership, customer focus, execution capabilities, and more, are rather fuzzy. They are often not carefully defined and measured in a way that is truly independent of performance. This problem is very serious, since many of the things we commonly believe *drive* company performance are in fact attributions *based on* performance. Many studies of business and management, including some of the best known books from recent years,

are fundamentally flawed because they are based on data that are corrupted by the Halo Effect. Their findings need to be viewed with skepticism.

Some business studies exhibit errors of design and also errors of data. First, they select their sample based on the dependent variable—studying, for example, high performing companies, or successful innovations, or great leaders. Next, they compound the error of design by relying on data that are gathered from sources that are questionable due to the Halo Effect. With problems of both design and data validity, it's hard to have much confidence in the findings. At best, you'll have an appealing story that seems to make sense—largely because it is based on common attributions. But as rigorous research, as a persuasive explanation that may have predictive power, the study will be lacking.

### **The Third D: Drawing Conclusions**

Even if the design is solid and the data are valid, there may be a final problem, this time having to do with drawing conclusions. A common example is what I call the *Delusion of the Wrong End of the Stick*. Consider the recent study by Bain & Co's Chris Zook, which argued that companies do best when they stay focused on their core. In a study of 1,854 companies over 10 years, he found that of those companies that had achieved high performance—defined as *sustained, profitable growth*—fully 78% had focused on one core business. The conclusion: companies that focus on their core outperform those that do not.

The design is not bad, as Zook looked at a wide sample of companies, not just high performers. The data are taken from reliable financial databases; there is no worry here about the Halo Effect or other problems of data validity. Rather, the problem is one of *interpretation*. It may be true that 78% of high performing companies had a single core business, but it does *not* follow that having a single core improves your chances of success, because we don't know the proportion of companies in the total population that had one core versus those that had more. We need to make sure we grab the right end of the stick. The key question is not how many successful companies have a focused profile; rather, it's whether companies with a focused profile achieve success—which is an entirely different matter! Indeed, a change in strategy might not be the *cause* of bad performance as much as the *result*, since companies normally stay with a winning formula.

Thinking clearly about the Three D's—Design, Data, and Drawing Conclusions—isn't rocket science. We're talking about the fundamental principles of good research. Yet it's remarkable how many prominent studies commit basic errors of either design, or data, or drawing conclusions—or some combination of the three. Thoughtful managers should not be taken in by the hyperbole and false promises of so many business studies, but should develop their skills of critical thinking. That way, they may be able to see flawed research for what it is, and separate the nuggets from the nonsense.