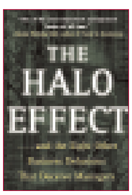
Knowing What You Don't Know

By Susan Webber



The Halo Effect
. . . and the Eight Other Business Delusions That Deceive Managers
By Phil Rosenzweig
Free Press, $25.00

Some time ago, I heard this story about a client I was serving:

A team of consultants was briefing a manager in a Japanese retail-banking operation on best practices in asset-liability management. The officer, Mr. N, was hunched forward during the presentation, listening intently. He suddenly stood up, shoved the document aside, and stormed around the room, declaiming: "You do not understand! We are barbarians. We live in a little village. We are happy believing the world is flat. You tell us the world is round. We do not want to know!" Needless to say, that put an end to the discussion.

Now, what could Mr. N's rejection of modern banking possibly have to do with Insead professor Phil Rosenzweig's excellent new book? Actually, quite a lot. Rosenzweig tells us that our beliefs about business success are largely, perhaps entirely, wrong, distorted by the halo effect—in this case, the idea that once we consider a company successful, we tend to see it as doing *everything* right. Business gurus, he charges, chart a flat, comfortable world in which a handful of top firms are to be emulated, no questions asked.

Among the follow-the-leaders classics that the author condemns as fatally flawed: Tom Peters and Robert Waterman's *In Search of Excellence*, John Kotter and James Heskett's *Corporate Culture and Performance*, Bruce Robertson's *What Really Works*, and Jim Collins' *Built to Last* and *Good to Great*. Their glib assurances about the path to corporate success are satisfying, but the stories are not necessarily helpful or accurate. We have no way of knowing whether to believe their analyses of why their case-study champions achieved success: Rather than factual, objective metrics, the gurus rely on anecdotes, retrospective impressions, and press reports.

That irresponsible but supremely confident analysis—boiled down to a magic three (or is it eight? or fifteen?) secrets to making your company a winner—is what all too many people are looking for. By contrast, Rosenzweig leaves readers with little solace: The world is full of uncertainty, and the wise understand the limits of their knowledge.

For those raised on the-eight-secrets-of-success programs, Rosenzweig's message may be tough to take, and it helps that his style is reminiscent of Warren Buffett, without the cornpone. He writes with a relaxed sense of mastery, uses simple but compelling examples, is rigorous without being pedantic, and bends over backward to be fair to the so-called experts he demolishes.

Rosenzweig focuses on what he feels is the fundamental question in business: What leads to high performance? And he finds a disturbing pattern. Most research on both individuals and organizations has been hopelessly tainted by the halo effect.

In World War I, psychologist Edward Thorndike asked commanding officers to rank their subordinates on a series of qualities. He found the answers to be highly correlated; in other words, the officers saw the soldiers in broad-brush positive or negative terms, as either all good or all bad. (Consider that we generally view physically attractive people

Illustrations by Philip Hackett

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as more intelligent than ugly people. If we see one positive attribute, we tend to attribute other positive attributes, relevant or not, to the same person—or company.) Have you ever heard of a company with falling profits lauded for excellent customer service? But clearly this takes place. In fact, a company might be doing badly because it *over*invested in customer care.

To illustrate his point, Rosenzweig goes through case studies of Lego, Cisco, and ABB. For example, when its fortunes were rising, Cisco was praised for "extreme customer focus," skill in acquisition and integration, and highly motivated employees. Yet when performance fell, critics saw many of these previously admirable attributes as causes of failure. Cisco's problem wasn't that it had ridden a bubble that collapsed—no, it had "a cavalier attitude toward customers." Its deals had been haphazard, employees had been "too busy taking orders and cashing stock options to bother with efficiency, cost-cutting, or teamwork." Academics joined the media in this reputational pump-and-dump. As the author explains: "No one was saying that Cisco had changed between 2000 and 2001. It was just that now, in retrospect, Cisco was described through a different lens—one of failing performance. . . . Placing these accounts together, the impression is nothing short of Orwellian—a rewriting of history that thrusts facts into the past, rearranging the record . . . reinterpreting the past to suit present needs."

Indeed, much of what passes for research into performance is halo effect writ large: "So many of the things that we—managers, journalists, professors, and consultants—commonly think *contribute* to company performance are often attributions *based on* performance."

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The author sets forth the impossibility of subjecting corporations to scientific research—for one thing, you can't conduct experiments. But with a well-chosen sample, you can come close by isolating the impact that certain factors, called independent variables, have on an outcome, called a dependent variable. You need to measure the variables objectively (merely identify distinctive qualities of your sample, and you can get what Rosenzweig calls the Delusion of the Wrong End of the Stick). You need to be sure of causality—that action A led to result B—which means that measurements must take place over time (violate that, and you get the Delusion of Correlation and Causality). And even high-quality studies can have limited value, Rosenzweig tells us, because they look at only one variable in isolation (the Delusion of Single Explanations), so we still don't know how this factor interacts with other things we might do.

Most investigations of corporate performance have at least two major failings. First, winners-only studies such as *In Search of Excellence* tell us little that's useful (the Delusion of Connecting the Winning Dots): "The scientific term for this is sample selection based on the dependent variable—this is, based on outcomes," the author writes. "It's a classic error. Suppose we want to find out what leads to high blood pressure. We'll never find out if we only examine patients who suffer from high blood pressure; we'll only know if we compare them to a sample of patients who *don't* have high blood pressure."

But the second, glaring error is that much of the data in these studies is garbage. They rely on news items, retrospective interviews, case studies, *Fortune* Most Admired Company ratings, and other information sources hopelessly

A Game as Old as Empire
The Secret World of Economic Hit Men and the Web of Global Corruption

Edited by Steven Hiatt
Berrett-Koehler, $24.95

Money laundering, tax evasion, extortion, and violence.

If "economic hit man" (or its distillation: EHM) has become part of our language, it's due to John Perkins' 2004 book *Confessions of an Economic Hit Man*. In that exposé, he speaks about a *corporatocracy* (another of his coinages)—that group of people who run the world's multinational corporations and major governments, who control "history's first global empire." Perkins writes an extended I-told-you-so introduction to *A Game as Old as Empire*, in which he argues that many of the charges in his earlier book—of collusion, corruption, and manipulation—have been subsequently documented by events, which in turn are documented by this book.

If anything, he argues, the EHM game today is "more complex, its corruption more pervasive, and its operations more fundamental to the world economy and politics." And certainly the chapters that follow, written by investigative journalists, activists, and other EHMs, give credence to his charges. Bleak and dire as their "snapshots" of money laundering, tax evasion, extortion, and violence are, Perkins says these are "a mere introduction to the many nefarious deeds that have been committed by the corporate elite—often in the name of altruism and progress."

If even a fraction of the charges leveled in this book are true, the indignation of Perkins and his colleague is understandable. Still, even while one reads of these "nefarious deeds," one wonders whether they tainted by the halo effect. And efforts to add yet more bad data don't make the results any more credible (the Delusion of Rigorous Research).

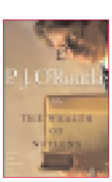
Yet possibly the most important of Rosenzweig's delusions is the one that tells us not about the limits of what we can learn but the limits of what we can achieve: the Delusion of Lasting Success. Two-thirds of *In Search of Excellence*'s showcased companies underperformed shortly after that book was published, as did more than half the *Built to Last* firms. Rosenzweig cites a McKinsey study: "the corporate equivalent of El Dorado, the golden company that continually performs better than the markets, *has never existed*. It is a myth. Management for survival, even among the best and most revered corporations, does not guarantee strong long-term performance for shareholders."

What does the author prescribe instead? It's cold cheer. While companies may be able to improve their odds of success, nothing is assured. The best that companies can hope for is to string together a series of short-term achievements, and those depend in turn on strategy and execution. The performance gurus focus entirely on execution, even though good tactics cannot salvage a bad strategy. Rosenzweig urges managers to recognize and understand the uncertainty of their environments, to think in terms of probabilities rather than absolutes, and gives us U.S. Treasury Secretary Robert Rubin, Intel's Andy Grove, and Logitech's Guerrino De Luca as managers who recognize the limits of information and frame decisions in that context.

Mr. N may have called himself a barbarian, but he was sophisticated enough to recognize and admit to his resistance to a radical new way of doing things. And in the end, he came around. Time will tell if readers of *The Halo Effect* will muster the courage to face the business world's uncertainties head on, or whether they will revert to the comfort of simple-minded but false prescriptions for success.

The Invisible Hand, Revealed

By Ken Goldstein



On The Wealth Of Nations
By P.J. O'Rourke
Atlantic Monthly, $21.95

The Authentic Adam Smith
His Life and Ideas
By James Buchan
Norton, $23.95

The world changed in 1776. Thomas Paine wrote *Common Sense*, Adam Smith wrote *The Wealth of Nations*, and tea and rum importers from Boston joined tobacco exporters from Virginia in an experiment to change subjects of the crown to citizens of the state. Papa Haydn was already writing his symphonies; Mozart had yet to pen *Don Giovanni*. James Watt was shortly to find the trick in harnessing steam power.

These fires of imagination in the arts, science, and public affairs obeyed Smith's now-identified "invisible hand." The wealth of nations increased—not without troubles and hardships, to be sure—and living standards improved. Indeed, globalization was born in 1776.

In *On The Wealth of Nations*, the irascible P.J. O'Rourke argues that the lessons

truly are all part of one vast Western conspiracy to control the Third World. It's tidy to think of it that way, but bad things sometimes happen without a misguided intelligence behind them.

The Secret to GE's Success

By William E. Rothschild
McGraw-Hill, $27.95

Because Jack Welch was CEO of General Electric for more than two decades, because his management style and policies influenced a generation of managers at GE and beyond, because he was a celebrity CEO of the first order, we still (despite his successor's strong leadership skills) tend to link Welch and GE in a ham-and-eggs, Hope-and-Crosby sort of way.

A mistake, as Rothschild's book about this 126-year-old corporation makes clear. At heart this is an intellectual history of GE—what it did, how it did it, and the thinking behind its decisions—and a very readable history it is. And *The Secret* is a knowledgeable one: Rothschild worked at GE for more than thirty years and helped develop its competitive strategies. He also holds strong opinions about current issues—for instance, he believes in term limits for both CEOs and directors.

Although Rothschild frequently cautions the reader to adapt rather than adopt practices associated with "the GE way," in some ways it's unavoidable, given the book's title, offering nothing less than a "secret." But is developing flexible strategies a secret? Is continually investing in high-potential people a secret? Is maintaining discipline and consistency a secret? These are among the "success factors" that Rothschild says account for GE's outstanding track record. Ultimately, as his book makes