

Rosenzweig, Philip – The Halo Effect

Free Press, 2014, [Behavioural Finance] Grade ★★★★★

The Halo Effect is something as paradoxical as a business book about how bad business books are. The main objection is that while most management books describe their formulas for success as the result of scientific study they are in fact often just pseudoscience combined with good storytelling. The author, Philip Rosenzweig, has written several books on business performance and behavioural finance. After earning a PhD at Wharton he spent six years at Harvard Business School. He is now a professor of strategy and international business at IMD in Switzerland.

The key premise is that it is hard to know why one company is a success and another is a failure. It is therefore difficult to distil a simple formula for success, as so many management books try to do. An important business delusion that Rosenzweig discusses is the halo effect. It means that a company's performance creates a halo that affects how the company is perceived. The story of Percy Barnevik and ABB is given as an example. When profits tripled between the years 1988-1996 Barnevik was described by the business press as brilliant, hardworking and humble. A part of the success was also attributed to ABB's unique organizational structure that made the company action orientated and nimble. But when ABB's fortunes turned in the early 2000s and profits declined the story changed significantly. Suddenly Barnevik was arrogant, imperial, and resistant to criticism. The organizational structure which was previously a key success factor was now labeled as chaotic and a reason for the company's problems.

Hence, Rosenzweig argues that there are no simple answers to the question: *What leads to high performance?* According to him company performance is the result of strategic choices and execution. But there is no simple generic formula that works for all companies and situations.

The book starts with describing the challenges of studying company performance objectively. After

some real-world examples, the author describes 9 different delusions when it comes to understanding business performance, focusing on the halo effect. Rosenzweig ends the book with some proposed solutions to the described challenges. The book is a quick, easy and enjoyable read.

The ideas covered in the book are important and I agree with Rosenzweig in his critique against most management books and how business performance is analyzed. Companies that have had recent financial success are often assigned positive and maybe even unique attributes. In a way the book deals with physics envy. Business and management are not exact sciences like physics and should not be treated as such. There are no exact formulas that will tell you how to achieve success. As a manager and investor, you need to be able to handle uncertainty and change. This book is a great reminder of that.

That said, I think the book is a bit unbalanced in terms of how it is structured. Rosenzweig spends the majority of the book discussing the halo effect and criticizing two management gurus and their books. Although those gurus are famous, the majority of authors, journalists and analysts are subject to similar cognitive biases. I would have liked the book to be broader in terms of discussing different pitfalls in analyzing business performance instead of just focusing on the halo effect and the three mentioned books.

Although the book is mainly written for managers, the described delusions are important to keep in mind for investors as well. For example, it is sometimes tempting to assign a competitive advantage, a superior culture or excellent management to a company that happens to be on a good performance streak. The lessons from this book might prevent that mistake.

So, if you enjoy reading management books or analyzing businesses, the sooner you read *The Halo Effect*, the better.

Mikael Tarnawski-Berlin, January 11, 2018