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Beware of fad-loving analysts

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It could get worse, of course. The markets, I mean. “The worst is not/So long as we can say, ‘This is the worst’,” as Edgar cheerfully points out in King Lear.

Several big institutional investors expect to see another major banking collapse. A survey of 146 of them, carried out recently by Greenwich Associates, the US financial services consultancy, found that almost 60 per cent believed another failure would take place within the next six months.

Serves them right, you might say. All that absurd financial engineering was bound to end in tears. The former editor of The Economist, Bill Emmott, wrote last week that our sympathy for the Masters of the Universe should be limited. “The past year has actually not been very bad at all – unless you are a banker, a bank shareholder or Gordon Brown,” he said.

Now the financial wizards – or at least some of them – are copping it from another, unexpected quarter. A paper presented at last week’s annual gathering of the US Academy of Management in California suggested that there is something else we can blame the investment banks for: the spread of management fads.

Ann-Christine Schulz and Alexander Nicolai of the University of Oldenburg in Germany asked the provocative question: “Are security [sic] analysts fashion victims?”

To answer it, they looked at the response of investment analysts during the 1990s to companies that had said they were committing themselves to the then highly fashionable “core competencies” approach.

This concept had been popularised by the management gurus Gary Hamel and CK Prahalad in a number of Harvard Business Review articles. Their book, Competing for the Future (1994), formally established core competencies as a Big Idea. That idea being that, by focusing on core strengths and abandoning activities and markets in which your company was merely an also-ran, you could establish a strategic advantage over competitors.

Core competencies was certainly hot back then. As the authors of the new paper discovered, the number of articles in the business press covering the idea rose from 10 in 1990 to a peak of 600 in 2000.

What did their study of the investment analysis of the time reveal? Not only that the analysts had tended to overestimate company earnings in general but also that they had gone especially over the top with the self-confessed disciples of core competencies. As the volume of media coverage of core competencies went up, up too went the analysts’ forecasts for the “refocusing” companies.

These findings would not surprise Barry Staw and Lisa Epstein of the University of California at Berkeley. Their paper – “What bandwagons bring: effects of popular management techniques on corporate performance, reputation and CEO pay” (2000) – also found that companies that signed up publicly to new approaches were rated higher, even if their performance was no better than that of their peers.

What is it with fads, managers, and their insufficiently sceptical audience of financial analysts – and, yes, the business press too? Why are they (we) so easily impressed and so quick to seize on the new, new thing?

Thomas Davenport and Laurence Prusak, in their 2003 publication *What’s the Big Idea?*, answered that one. Partly, they explain, it is because of our weakness for the overblown rhetorical promises made by some “thought leaders”. Simple solutions to complicated problems can be seductive.

But business leaders make other sad mistakes. They adopt new ideas regardless of how well they might fit their organisation. They drop all former initiatives in favour of the latest idea to come along. And they talk about implementing an idea without committing the necessary resources to make anything good happen.

Hence Messrs Davenport and Prusak’s neat definition of management fads: “short-lived states of enthusiasm that rarely deliver real benefit or change”. And hence, too, their defence of the intellectual merit of good management ideas that are abused in the execution: “It’s not the idea itself that is faddish but rather how the organisation adopts it. In short, there are no faddish ideas – only faddish managers and companies.”

Ultimately everyone is implicated: gurus, managers, analysts and hacks. Between us, we perpetuate the fad cycle. But what is it that the investment community could do better? The German academics argue that analysts should operate as “a corrective mechanism that limits the dissemination of strategy fashion”. Too often, it seems, their work “promotes faddish behaviour and restricts a manager’s chances of pursuing unique strategies.”

It’s all the fault of MBAs, naturally. “Many analysts can boast MBA qualifications earned at elite business schools,” they say, “but can provide little actual experience in business practice. [They] are likely to have...a natural tendency towards standardised solutions.”

So listen up analysts. Do your job. Good luck, managers. You have been warned. And journalists? We shall just have to try harder.

This column returns on September 2

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