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HOW TO BUILD HOGAN ASSESSMENT SYSTEMS

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Between 1987 and today Hogan Assessments grew from a 5-person startup to a substantial business with offices in 54 countries, and we did it with no prior business knowledge or experience or help from "real" businesspeople. Along the way I learned several lessons that I suspect are typical. This essay recounts the lessons in the order in which they were learned.

What's It Mean? Implications for Consulting Psychology
Over 90% of new businesses fail. Our new business succeeded. The essay provides some commonsense guidelines for avoiding failure.

Keywords: factions, debt, strategy, leadership

This essay concerns the key lessons I learned in developing Hogan Assessments—which I call "the family business." I am not a businessman and I am not motivated by money, but I am very competitive and, when I start something, I like to win. My background is physics and engineering, and I am strongly data-oriented. However, I have always been more interested in human performance than in quantum mechanics—and that led me to a PhD in psychology (specializing in personality assessment) in 1967. At Johns Hopkins University in the mid-1970s, my wife Joyce and I began doing contract research with the U.S. Department of Defense. We secured several government contracts and, when we moved to Tulsa in 1982, we took some with us. We planned to start a consulting business in Tulsa modeled after Marvin Dunnette's plan for Performance Dimensions International (PDI) with the University of Minnesota—that is, use graduate students in industrial-organizational (I-O) psychology at the University of Tulsa as a labor pool. It worked well for PDI in Minnesota, and it worked well for us in Tulsa.

We incorporated Hogan Assessment Systems in 1987 and struggled until 1991, when we finally made $100,000.00. From 1991 to the present the family business has grown steadily, doubling and even tripling in revenues annually in the early 2000s. Today the business is profitable and would be valued in the nine-figure category. Developing Hogan Assessments has been the biggest challenge I have ever undertaken. To run a business, one must make many decisions every day—usually without enough data or time—and its success is the sum of those decisions. Being forced to make decisions with no data has been a problem for me, but there are no alternatives. Moreover, from the start I was keenly aware that

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90% of all new businesses fail, and I didn't want that to happen to me. I can summarize the key lessons learned in building the business in terms of 17 points. (Really. That is how I think.)

1. Find a Need and Fill It

In the summer of 1956—after my first year in college—I got a job as a laborer in the coke ovens at the Kaiser Steel Mill in Fontana, California—I got the job because I knew someone in human resources (HR). Henry J. Kaiser, the legendary industrialist, made a vast fortune building liberty ships during World War II: His steel mill was an extension of his shipbuilding business. All around the massive premises of the mill were trucks carrying the slogan: "Find a need and fill it." This struck me as an important clue about how to build a business: Do not start a business and then hope clients will come—as I had seen my father do. Rather, start your business with an idea about what you will do and why you should do it.

In our case, three events created the need. The first was the Civil Rights Act of 1964 that made discrimination in the hiring process illegal. The second was the creation of the Equal Employment Opportunity Commission (EEOC) in 1973, designed to enforce the antidiscrimination part of the Civil Rights Act. And third was the practice, endorsed by mainstream I-O psychology, of using IQ tests for selection, knowing full well that such measures discriminated against minority job applicants. In 1973 the EEOC sued AT&T for their discriminatory hiring practices; it was a $200,000,000 settlement, the largest in the history of American labor law at the time; this lawsuit created a need for us to fill. We had substantial data showing that our measure of normal personality, the Hogan Personality Inventory (HPI), predicted job performance better than measures of cognitive ability but did not discriminate—Whites and Blacks got the same scores, men and women got the same scores, and older applicants got better scores than younger applicants. In addition, the Justice Department was familiar with our research and began recommending us to defendants. Consequently, we found an important need to fill, and in filling that need we simultaneously advanced the cause of social justice and offered a way for organizations to make better hiring decisions.

2. Be Disruptive

From the beginning I wanted to disrupt the standard model for test publishing. Traditional test publishers acquire a catalogue of tests, wait for orders to arrive, and then fill the orders. I developed the Hogan Personality Inventory (HPI) in the early 1970s, and then, in 1979, at the recommendation of Jim Butcher, the Minnesota Multiphasic Personality Inventory (MMPI) guru, I sold the HPI rights to National Computer Systems (NCS, now Pearson), who also published the MMPI and the Strong Vocational Interest Blanks, the gold-standard measures of psychopathology and vocational interests, respectively. At the time NCS was seen as the premier psychological test publisher in the country. I had been using the HPI in our contract research business, and when I closed the deal with NCS, I had sales calls scheduled for Greyhound Bus and United Airlines. NCS informed me that they were not interested in those meetings and that I should not attend because they owned the HPI. I realized I had lost my baby (the HPI) and there was nothing I could do about it. Between 1979 and 1989, I focused on other matters while NCS let the HPI dwindle. In 1989 NCS called to say that they had really screwed up the HPI; they offered to return the rights to me if I promised not to sue them. I agreed, we got the HPI back, and I began selling it again. My view: Test publishers of the future should actively call on clients rather than wait for the phone to ring. This is a critical lesson for all businesses: Think about how you can disrupt accepted business models.

3. Avoid Debt

Interest rates have been low for several years now, and many young people seem to regard debt as free money. For most of my career, however, interest rates were substantially higher than they are today, so it made financial sense to stay out of debt. Debt is fine as long as the economy is expanding, but economies inevitably contract, and when they do (as Warren Buffett put it), we can see who has been swimming naked. So in building the family business we always had a supplemental source of income (university salaries), we avoided debt, and we only expanded when we could afford the additional costs.

4. Location

I thought carefully about where to locate the family business and finally chose Tulsa for three reasons. First, it is almost exactly in the center of the country. I knew we would be required to travel to do business. It is possible to go to any city in the United States from Tulsa and arrive in time for a lunch meeting. That turns out to be a benefit that is also a competitive advantage. Second, I hypothesized that the local labor pool would have a great work ethic, because most people in Tulsa (professional or clerical) will be no more than one generation away from the farm. This is important because it is impossible to train work ethic; people either have it or do not. As it turns out, my hypothesis was largely correct—smart young working-class people in Tulsa are very hardworking, and that is a big deal when you run a business. Third, the cost of living in Tulsa is .85 times the national average, which makes large purchases more affordable.

5. It Takes a Team

It is an important truism that all significant human achievement is the result of collective effort. In addition, the fundamental task of leadership is to build (and maintain) a high-performing team. This is true for combat units, sports teams, and especially your business. And it is crucial to staff your business correctly. You need one person to initiate and innovate ("Why don't we try it this way?")—and that was me. You need one person to implement and follow up with the initiatives and innovations (initiators and innovators are often not very good at implementation)—that was my wife. You will need one person dedicated to business development—that was also me for a long time. You will need a clerical person and some form of information technology (IT) support. (In short, we started with five people: me, my wife, a super-smart secretary, and two computer-science graduate students.) Then you need to persuade these people to get along and to work together, and that is where most of the problems occur. Early on, I met with the CEO of a big electrical supply company; he was a physicist and a very smart guy. He told me he spent 90% of his time dealing with staff issues and 10% of his time dealing with clients—and he didn't know how to change that pattern. My numbers resemble his.

And please note two final ironies. First, although you will need psychologists to help with the content of your products and with service delivery, your most important people will be your sales group—this is something I learned from Developmental Dimensions International. Second, to build a successful psychological-services business, you will not need many psychologists and you probably will not need any academic psychologists. In our case, we started with two programmers, a clerical/accounting person, and the two Hogans. Obviously, we were not staffed optimally, and that may explain why we struggled so much at the start.

6. Early Churn

One of the many problems you will encounter in starting a business is finding and keeping talented employees: This will be a major concern, and staff issues will be your biggest single problem on a daily basis. When you begin you will necessarily have to hire some less-than-satisfactory people. After you become successful, good people will come to you. But before they do there will be problems and constraints. I constantly reminded myself early on that you do not get the players you want; you get the players who are available and that you can afford. If an NFL team could have any player it wanted, it would never lose, but the reality is, you get the players that are available and who fit the salary cap. In addition, as your business grows and matures, you will outgrow many of your initial hires. I learned this lesson early when Microsoft hired us to do career counseling for 10 people. These people were pretty mediocre; they were part of the initial team of employees, and the company had simply outgrown them. At Hogan, I have had employees who, early on, seemed talented and performed beyond my expectations; a couple of years later they appeared unable to perform routine tasks. I then remembered my Microsoft experience. These individuals had not grown with the business. The role they were performing 3 years earlier was no longer needed, and the new role was too big, too frightening, and too different and paralyzed their performance. It is also helpful to remember this rule: Hire hard, fire easy. It becomes easier to follow as your company becomes more successful.

7. Customer Service

Jeff Bezos has always been clear that the key to Amazon's success is great customer service. Amazon focuses intensely on the nature of the customer experience and on trying to be easy to do business with. Peter Drucker often said that most organizations do not know what business they are in. Nonetheless, all businesses have customers, and most are in the customer-service business. Consider as an example universities. They think they are in the education business, but in reality they provide housing and entertainment to older teenagers—universities are in the hospitality business where customer service is crucial for student retention. The same will be true for your business. Amazon automates the customer interface—which is brilliant. You may not be able to automate your customer-service function; consequently, it is crucial to ensure that your customer-facing employees radiate charm and goodwill. We have always placed a premium on customer service and tried to reinforce it in every way possible. Client feedback suggests we are pretty good at it.

8. The IT Challenge

Technology presents its own devilish demands. Passive-aggressive behavior first appeared as a psychiatric diagnostic category in the British Army during World War I; passive aggression was a way for talented enlisted personnel to deal with incompetent officers. These days, IT is the natural home for passive-aggressive personalities. The pattern involves smiling, pretending to agree with your idiot boss, and then doing what you intended to do in the first place. IT can be the place where hopes, dreams, and future profits go to die. Learning to manage IT is a nearly impossible challenge. Give the IT people a deadline and guess what? Passive-aggressive people do not like deadlines. One solution is to outsource the IT work, but this means hiring people who live in India or the Philippines and over whose work you have no control. A second solution is to hire an IT manager whose interests are aligned with yours and then treat him or her with great respect. The only alternative to entering the IT Hall of Mirrors is to fall behind in terms of your technical capabilities—as seen by your clients. It is a case of "Pay me now or pay me later." (If you aren't updating your technology daily, you are falling behind.)

9. What Business Are You In?

As noted above, Peter Drucker thought that many companies do not know what business they are in. Hogan Assessments started as a contract-research, selection business designed to help clients make better hiring decisions. Working with clients we tested incumbents in various job categories, gathered performance data, ran analyses, and then created profiles of the high performers in each job category. After that we would sell tests and collect fees. One day in 1995 I visited a small business that had sampled our selection process. The owner said she was not going to buy tests from us but from a small company in Canada whose name I didn't recognize. I knew there was no comparison between our assessments and the Canadian test seller's in terms of validity, so I asked her why she chose the Canadian product. She replied, "Look at the report they send me; now look at your report." The Canadian report contained pages of unsupported text; our report was one page with some scores and norms.

The thought hit me like a thunderbolt: We sell research-based validity coefficients that can be used to make defensible hiring decisions, but clients want detailed feedback on their job candidates. Clients with no training in psychology didn't want what we were selling. (In my defense, in the mid-1990s, big companies had PhD I-O psychologists on their staffs, people who appreciated validity coefficients.) I went back to my office and started writing the first report in our report series. And this is when we became a true psychological-services business: We now sell reports, services associated with interpreting the reports, and developmental recommendations based on the reports.

10. Revisiting Decisions

John Holland is the person I most admired in my academic career; he was the most productive psychological researcher in America in his day, and he also developed a successful test-publishing business. He had a rule that I try to follow: At least once a year, ask yourself if what you are doing is worth continuing. Go through your practices, personnel, and products and evaluate every one of them. When you find something that no longer makes any sense, be ruthless and stop it. This rule also applies to your private life; go through your clothes closet and kitchen cabinet once a year and throw away anything you haven't worn or used in 12 months.

Our business rests on data derived from three assessments that we call measures of (a) the bright side of personality (people's filtered behavior), (b) the dark side of personality (people's unfiltered behavior), and (c) the inside of personality (people's core values). A few years ago, based on constant client requests, we added a measure of cognitive ability. These four measures are the assessment base for our business, and I doubt we need to add anything else (cars need engines, transmissions, suspensions, and brakes and that is about it). What changes over time is the way we report the results of these assessments; these are our reports that we develop in response to client requests. We make 80% of our revenue from about four reports and 20% of our revenue from all the others (20+) combined. We generate new reports based on what is hot in the human resources (HR) community at any given time. We have developed reports for emotional intelligence (typically referred to as EQ), agile leadership, learning agility, digital leadership, and so forth. That is, we develop reports in response to market fads, and most of them fail in a year or two. Lots of new Apple products also perform poorly in the market.

The data show that half of all business decisions are wrong. This means business decision-making is a random walk, and good judgment is not about making the right decisions. Good judgment involves paying attention to the consequences of your decisions, recognizing when decisions are wrong, and then fixing them. Good judgment involves recognizing and fixing bad decisions.

11. Staff Morale

The data are very clear: The way managers treat their staff drives staff morale, and staff morale is correlated with every index of business-unit productivity, positive or negative. When morale is up, productivity, quality, and customer-service ratings go up, and absenteeism, shrinkage, and turnover go down—and vice versa. I believe the span of control for any manager is about seven people, plus or minus two. If you are a superb manager, you can deal effectively with about nine people. Once your crew exceeds that number, problems will begin to occur—people will feel ignored, neglected, uninformed, or unappreciated. In addition, compensation surveys show that 100% of the staff in any organization think they are above-average performers, and 90% think they are in the top 10% in terms of performance. Consequently, compensation will always be a sore point. Then there is the problem described in point 6 above—namely, that over time, the business will outgrow many of your early employees. Consequently, no matter how hard you try and no matter how talented you are as a manager, about 10% of your staff will be inconsolable and, in time, will become alienated and possibly try to undermine you. Nonetheless, you still need to make every effort to keep people informed, give them feedback on their performance, be a good role model, and treat everyone with respect.

12. Moments of Truth

A fundamental law of human groups is that factions always arise, and a fundamental task of leadership is to find ways to deal with the factions. This is true for families, political parties, and your business. No matter how talented you might be as a leader, and no matter how careful you are in dealing with the staff, factions will emerge. This has happened three times at Hogan Assessments since 1987. The histories were all the same. At some point, one of our most talented and charismatic managers would decide he or she could run the business better than me, recruit staff to support his or her breakaway movement, and then announce his or her intentions. In each case, I had no idea an attempted coup was coming. Each case was also surprising because the leaders of the factions lacked the power, support, or financial resources to pull off the coup. And in each case, the leaders of the factions left Hogan Assessments and started small but successful businesses of their own.

13. Marketing

Marketing is crucial for building your business. There are strategic and tactical aspects to marketing. Both require asking how your offerings appear to potential clients—as compared to your competition. Getting marketing right is hard and depends on serious thinking and strong research. The strategic part involves deciding what the most important claims of your competitors might be, then figuring out what your most important claims are. After you have determined that, then the trick is to figure out how to position yourself so as to put maximum distance between you and your competitors while highlighting your unique strengths. It is important that you get some external input on this and do not just imagine your strengths. Ask clients what you do well and what your competitors do well—be as empirical as possible. These data will be the strategic core of your marketing message. For example, at Hogan, we focus on technical quality and "kaizen psychometrics"—quality and constant improvement. After you have defined your message, the tactical bit involves taking steps to get the message out regarding your unique value proposition. This is advertising, and there are many ways to do it: social media, ad placements, TV commercials, and so forth. We prefer to appear as conference speakers, which often generates some ancillary buzz. No matter how you choose to advertise, there are three rules: (a) You have to do it, (b) it can be very expensive, and (c) you will have no idea whether it is worth the money. Consider, for example, Chipotle, founded in 1998 and today serving an estimated 750,000 customers per day around the world. Starting in 2008, and especially between 2015 and 2018, Chipotle experienced multiple incidents of food-borne illness, and by the end of 2018 the stock was down 50%. Founding CEO Steve Ells resigned in February 2018, and Chipotle hired Taco Bell CEO Brian Niccol to fix things. He was so immediately successful that CNN named him CEO of the year for 2018; in 2019, Chipotle stock grew 76%, one of the best performances in the S&P 500, and *The Wall Street Journal* reported that Brian Niccol had returned Chipotle to robust profits. How did he do this? He had three strategies: (a) better delivery through Door Hub, (b) a loyalty program, and (c) a carefully constructed program of marketing and advertising involving social media, TV ads, sponsorship of season sports finals, and a partnership with the NBA. The big question is, which strategy delivered the best results? The answer is, no one knows, but marketing had to be a big part of it.

14. Work Your Ass Off

The data suggest that 90% of all new businesses fail. The principal cause of failure is bad management. How is bad management manifested? See points 1 through 10 above. But we should add to that list: not working hard enough. Some people start a business so they can work according to their own schedule. If there is an unquenchable demand for their services, this may work. I live on an island in Florida where a retired Army guy started a restaurant with his Thai wife; he opens when he is in the mood and they get by. Some businesses are so immediately successful that the owners become complacent. Lodgenet, located in Sioux Falls, South Dakota, pioneered movie services in hotel rooms. The business was wildly successful from the outset; the owners made a great deal of money and then became complacent and soon enough found themselves facing bankruptcy. Sheer persistent effort is required to run a business successfully, but that assumes one cares about being successful and not everyone does. If you are not prepared to devote your life to the business, things will begin to fall apart.

15. Some Business Is Not Worth Having

When you start your business, you will be eager and grateful for any work you can acquire, in order to have cash flow. Clients vary a great deal in terms of how easy they are to do business with. Some are courteous, professional, and pay promptly. But there will be a long tail of clients heading in a less desirable direction. Some large multinational companies seem to specialize in not paying small vendors as a matter of policy. Inevitably, you will arrive at a place where you have to choose between having a prestigious client on the books and getting paid. That which always tips the balance for me is a client who will not pay in a timely way and who treats Hogan staff with disrespect. (Do you want to talk about the client whom you can never please?)

16. Avoid Fee for Service

One night, when we were first starting our business, we had dinner with a very smart and successful labor lawyer at his beautiful house in Beverly Hills. In a room surrounded by expensive objets d′art, designer furniture, and all the trappings of an affluent lifestyle, he complained bitterly and at length about his business. The problem, he said, was that he was in the fee-for-service business and didn't know how to get out. I had never thought of fee for service as a problem. You fly to a location, spend time with a client, write a proposal, spend time at the client's location doing research and solving problems, write a report, and then send the client a bill and move on. That was life as I knew it and expected it to be. So how do you get out of fee for service? You need products that you can sell, as well as your time, products that create recurring revenue. Some businesspeople are like aging theatrical performers (e.g., The Rolling Stones are still touring) who think their audience (clients) cannot get enough of them. They are only alive while they are on stage, and they live to live. Such people are a good fit with sales, but their business model is inherently limited, because they can only be paid when they are on stage. If you have a product with recurring sales, you get paid 24/7.

17. Professional Management

By 2004 we had millions of dollars flowing through the business, and the cash flow was being managed by amateurs. At the time, I thought there must be a body of knowledge specific to business, knowledge that people trained in business could bring to bear on the management of the business. In other words, I thought we needed some professional management, so I hired two experienced MBAs to be CFO and COO. They had degrees from good business schools, good resumes, and solid endorsements from their previous employers. I told them the most important problem facing us at the time was to fix our bonus system; if they could do that, it would solve an important morale issue for the company. They worked on the problem for a month and came up with an ingenious solution: They would give themselves a salary increase and a 50% bonus and the rest of the staff would be evaluated on a case-by-case basis.

Today there is abundant evidence that MBAs, despite their evident expertise, have two problems as a group. The first concerns understanding the business at the level of the shop floor. The theory behind the MBA curriculum is that there are certain formal principles of business that, once mastered, make knowledge of the specifics of any particular business irrelevant. However, when you are a manager, people come to you all day long with questions. If you do not understand the business at the level of the shop floor, you will not be able to answer their questions, and your credibility and judgment as a manager will be undermined accordingly. Second, the data show that MBAs as a group are greedy—the reason they pursued the degree is to make more money.

Summing Up: Gordon Bethune

I have always been interested in the topic of leadership. In graduate school I discovered that the party line in academic psychology was that there is no such thing as leadership, and consequently there is no such thing as individual differences in the talent for leadership. Leadership depended on situational contingencies (I call this the *shit happens theory of leadership*). Around 2001 I finally immersed myself in the leadership literature and discovered that there was no consensus about the determinants of leadership effectiveness—regardless of the situation. Taking a cue from Sigmund Freud and Jean Piaget (i.e., it is useful to study errors and mistakes), I decided to study incompetent leadership, and this proved to be productive. I first asked about the base rate of incompetent leadership in corporate America and concluded that the number is 65 to 75%. The next question concerns the reason why this number is so high; I decided that the answer is found in the dark side of personality. And finally, I began searching for examples of managerial excellence, of which there are a few. One of my favorites is Gordon Bethune, retired CEO of Continental Airlines.

Bethune joined the Navy in 1958 at age 17; in an amazing career he went from seaman recruit to full lieutenant in 20 years, retiring in 1978. In 1978 he joined Braniff as a maintenance manager. He rapidly climbed the commercial-airline career ladder, working at Western, then Piedmont, then Boeing, before becoming CEO and president of Continental in 1994 and chairman of the board in 1996. When Bethune arrived, Continental was a failed organization teetering on the edge of bankruptcy. During the next 10 years he took Continental's stock price from $5.00 per share to $50.00 per share. *Forbes Magazine* named Continental Airlines as one of the world's best-run companies for 6 consecutive years and the World's Best Airline in 2004, 2005, 2006, 2007, and 2008. Einstein once said that, if you know what you are talking about, you can explain anything to anyone quite simply. Bethune gave an interview to *The New York Times* after he retired. The reporter asked him how to run an airline (or any business). Bethune said there are five steps to running a business:

1. Find something that people want and are willing to pay for.
2. Give it to them reliably and consistently.
3. Control your costs.
4. Earn the trust and loyalty of your staff.
5. Earn the trust and loyalty of your customers.

Please note how smart Bethune's summary is; it applies to any business. Please note as well that you have to win over your staff before you can win over your customers—staff morale is crucial. Bethune understood that airlines are in the hospitality business, and customer service is crucial. Finally, please note the parallels between Bethune's 5 points and my 17.

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