Economics' seven deadly sins

Are we teaching students the things they need to know? Not according to **Eve Poole**

Before he died Sumantra Ghoshal wrote a piece called "Bad Management Theories Are Destroying Good Management Practices".

It was published posthumously in the *Journal of the Academy of Management Learning & Education*.

That was in 2005, post-Enron but pre-Credit Crunch. Professor Ghoshal was the canary in the coalmine. But apart from some defensive shoring up of the holy trinity of ethics, governance and sustainability, have business schools really changed their tune?

Not when it comes to Ghoshal's main complaint, agency theory. Nor, frankly, when it comes to much of the economic theory that underpins the entire curriculum.

Here are the Seven Deadly Sins that are still taught in Econ 101.

1. Competition

This is still assumed to be the default business strategy. But Game Theory argues that co-operation is a better generic strategy because it yields superior outcomes over time.

Winning at all costs is necessary to survive wars or in one-off transactions. But in business companies want longer-term customer and supplier relationships. Of course, brands still need to compete for market share; but not over every aspect of their business.

Maths shows that co-operation and sharing information increases the size of the pie instead of restricting the argument to cutting up the one you already have. And absolute competition isn't just mathematically questionable, it is sexist, too. While male fight-or-flight physiology favours competition, particularly in challenging environments, it ignores the role that female physiology has to play.

Research conducted on female subjects suggests quite a different physiological response, one dubbed "tend-and-befriend". So being hooked on competition may compound a tendency towards sub-optimal outcomes, reinforced through a traditionally masculine business environment.

2. The "Invisible Hand"?

This is just an optimistic myth, offering a reassuring but inaccurate justification for self-interested behaviour. While order may rise from chaos, there is no evidence to suggest that this always tends towards the good and certainly none sufficient to justify society's reliance on it.

Birds flock into jet engines and fish shoal into the mouths of sharks. The crowd is sometimes wise but not invariably so. In reality, leaving things to the Invisible Hand skews the market in favour of the strongest because they have more "votes". This maximises their utility but not that of society at large.

3. Utility

Is maximising it really the best way to measure the success of the market? No, because it only stacks up as a metric if the "invisible hand" really exists. This is because the concept is an empty one – utility for what?

If there's no guarantee that individually selfish behaviour produces a good outcome overall, a system based on this thinking cannot be moral without help. And the sort of help this requires – government intervention – is exactly what most economists try to avoid because it interferes with the smooth functioning of the market and gets political, fast.

Even if utility made sense, the idea that "Economic Man" is a rational agent is wildly optimistic. We're all subject to irrational behaviour through peer pressure or emotion. And assuming we are all robots just leads to poor modelling.

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4. Agency Theory

Still an MBA stalwart, Adam Smith's original notion about the different interests of owners and managers has had catastrophic consequences. It has used negative psychology to generate HR policies that assume employee recalcitrance, limiting the ability of organisations to unlock human potential.

Worse, it has been used to justify the disastrous ubiquity of executive shareholding. This practice, hand-in-hand with the idea of the supremacy of the shareholder, has made corporate strategy defiantly short-termist and manipulative. Why do we still teach a view of humanity that so few psychologists would support?

5. Market Pricing

Do you remember your equilibria graphs? They depict the assumption that the price mechanism, left to its own devices, will settle scientifically where supply meets demand. This ignores the potential for both supply and demand to be manipulated.

As well as airbrushing out the historical debate about "just" prices, market pricing ignores historical questions about cost. This obscures the important debate about hidden costs or "externalities" such as the environmental cost of pollution. In an age where the limits of the Earth are being felt, it is vital that this debate about the market's embeddedness is not ignored. There's no cod left in Newfoundland and the planet is running out of other commodities all the time.

6. Shareholder Value

The unswerving belief that the shareholder is king owes more to a romanticised ideal about the nature of shareholding than to reality.

The average time for which a share is now held? About 11 seconds. Blink and you'll miss it.

Even ignoring the extremely limited legal sense in which shareholders actually own businesses, automated trading makes "the shareholder" a rather bizarre and fleeting concept. Sticking to the idea that the shareholder is a nice old bloke who founded the company just drives short-termism.

In an attempt to keep him in socks by keeping share prices high, companies neglect wider issues of accountability and ignore other company stakeholders. This mythology has fuelled the exponential rise of boardroom pay and an overly narrow measurement of corporate performance. But, a bit like Santa Claus, the threat of him is still used to make us all behave.

Equilibria graphs depict the assumption that the price mechanism, left to its own devices, will settle scientifically where supply meets demand. This ignores the potential for both supply and demand to be manipulated

7. Limited Liability

Ninety-eight per cent of companies currently registered in England and Wales have limited liability. The monopoly this model enjoys is extremely risky. In a global economy, the resilience of the system will always depend on diversity. No single model should prevail.

In institutionalising moral hazard, the dominance of this particular model plays into an increasingly irresponsible shareholder culture because there is no downside. More encouragement in law, policy and professional services of alternative models for enterprise would introduce healthy "competition" between business models. And more employee ownership and mutualisation would spread risk, as well as creating a wider range of businesses with different models of success.

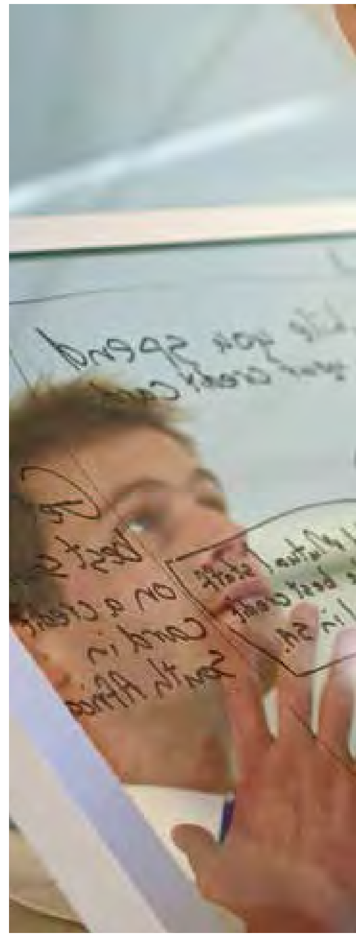
So how can leading business schools break away from these out-dated orthodoxies?

People come to business schools to learn, to question, to understand, to develop. So many of these myths will simply dissipate if they are expressed as ideas or hypotheses and not as hard facts.

Imagine the rush of creativity when people first allowed themselves to think about what it meant to circumnavigate the globe. So calling out these "truths" as not being self-evident is the first step.

Then, the difficult task of joining the dots across the curriculum. If competition should be more rarely deployed and more tightly focused, how should strategy, operations and marketing be taught? And what safeguards are still necessary?

If the Invisible Hand is imaginary, how should businesses exercise genuinely muscular global citizenship rather than gesture-CSR?



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Cost/benefit? ROI? Business Case? Business schools could bridge this gap by devoting more of the curriculum to virtue ethics and character-building. And their consulting arms could work harder to help teams establish patterns of virtuous practice

If agency theory is not the best explanation of stakeholder tensions, how might this affect corporate strategy, governance, compensation, trade union relations and HR policy more generally?

If business is genuinely about far more than maximising shareholder value, how should success be measured, furthered and rewarded? And what needs to be added to the curriculum to make sense of this change in perspective?

One quick win is to use the myth about utility to reinvent the ethics curriculum.

At the moment, most schools cover ethics with a case study or two. The night before class, students read about some breach of standards to do with food safety, human rights or the environment. Then they discuss it in groups, and act out a version of Management v NGO in plenary.

All this teaches is risk analysis, role play and an unhealthy habit of pretending to be an abstract business leader. It assumes that utilitarianism is the best ethic for business and it avoids any need for the student to bring their own conscience into the equation.

When I teach ethics, we start by defining and refining personal world views and belief systems before we go anywhere near a case example, which makes it far harder to de-couple the student from their own conscience thereafter.

Meanwhile, businesses are also defining and redefining their corporate values, using them to drive recruitment and promotion. But they have yet to translate this thinking into general decision-making, which remains defiantly utilitarian.

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One promising idea is the concept of a corporate Lent. Most religions have periods of austerity, penance and preparation, which are therapeutic as well as ritual. So which values are the least often deployed, and how could their suppleness be strengthened by a temporary commitment to, say, email-free Fridays, walking meetings, duvet days, 28-day payment of invoices, corporate apologies, weekly volunteering?

Perhaps some of these pilots might even be worth keeping when Lent is over and perhaps these kinds of gentle experiments are the best way to ease our way out of the neo-classical economic cocoon in which we have been so very comfortable.

ABOUT THE AUTHOR

Eve Poole is an Associate at Ashridge Business School in the UK, where she teaches leadership, emotional intelligence and ethics. She is Chairman of Gordonstoun, a boarding school in Scotland, and author of Capitalism's Toxic Assumptions: Redefining Next Generation Economics, *Bloomsbury, London.*