ECONOMICS AND MANAGEMENT

WHY DOES A BUSINESS PERSON NEED ECONOMICS?

Juan J. Toribio, Professor of Economics
Chair of the International Center for Financial Research, IESE

How is economics relevant to management? Has the relationship between these two disciplines changed over the past half-century? This article analyzes the role of economics in the world of management.

"WE HAVE STILL NOT FOUND A FULL FIT BETWEEN MACROECONOMICS AND MANAGEMENT, BUT SENIORITY (WHAT A EUPHEMISM!) HAS PROBABLY MADE US A LITTLE LESS IMPATIENT AND – WHO KNOWS? – PERHAPS MARGINALLY WISER."

What was the business leader´s view of economics´ role in management 40 or 50 years ago? What has changed since then? I don't know if young people are interested in this type of question, but I can't pass up the chance to step back in time to 1963, when I joined IESE, adding my efforts to those of two other young economists (Bernie Villegas and Antonio Argandoña), who had also just joined.

Back then no one said that we worked in a "business school", or at least I never heard the expression. If someone had said it we might not have understood them properly, as this concept did not exist then with the same clarity as it does today. What is true is that "management" and "economics" were academic fields that were closely intertwined. "Business administration" was taught in economics departments as a specialization in the final year of the degree program. The first four years were identical for both students who aspired to work in economics and those planning to work in business.

People at IESE seemed to have slightly clearer ideas, although they must have also been products of their time, because in 1964 they were talking about launching a master's in economics and management, from which one could glean that they also regarded economics and management as closely related. We should also recall that the same year that IESE was founded a group of business leaders (not specialists in "macro") created an institution in Barcelona that was called the Circle of Economics, not of "management." This was the prevailing culture.

It is a fact that back then, using the term "economics" added a certain luster and prestige to everything related to business management, something that is very difficult to comprehend nowadays but that at that time seemed to make some sense. In my opinion, there were two reasons for this:

a) The economics departments had been created in Spain a few years earlier and, to give them a university aura, they had absorbed the former students from the higher vocational schools, where some of us had gotten our education.

b) Economics had suddenly come to the fore in the Spanish news, displacing politics. After a long period of international isolation, the West opened some of its doors to the Spanish dictatorship, yet this breath of fresh air – as slight as it was – led to a veritable pneumonia, economically speaking, in Spanish society. The state had been overspending, its intervention in the economy had been absolute, the private sector was barely breathing, the foreign deficit was constantly climbing, and the Bank of Spain had no currency reserves. This was the state of Spanish society at the time.

The Francoist government understood that the country's immediate future lay in the simple, tough, difficult, prosaic realm of economics.

Economists formed part of a group of "technocrats," or scientists and technical experts, that seized the reins, forcing Spanish society into an abrupt about-face aimed at stabilizing and liberalizing the economy. Most business people guessed that new horizons would be opened, a true break with the past would be made with consequences that were not easy to predict, making it necessary to fully grasp the parameters of the new situation. And they welcomed the economists with open arms.

Yet neither they nor their disciples (that is, youngsters like Profs. Argandoña, Villegas and myself) fully grasped what concepts like national accounting, balance of payments or input-output tables, which was what they had taught us in the economics department, could contribute to sound business management (IESE´s mission). Since I must have been the most naïve of the three, I dared to publicly pose this question to the first dean of IESE, Antonio Valero, during the faculty assembly held in a hotel on the coast. I remember being floored by his response, delivered in an outpour of categorical reasons, declarations and statements.

I understood very little of it. I only guessed that the elements of economics were one of the basic ingredients in business policy (see Prof. Eduardo Ballarín's article), and that strategic planning had to seek decisive guidelines in an appropriate economic prospective. Still, I could not see my way clearly through the issue, and only one senior professor (Rafael Termes) admitted that he shared my doubts and that he, too, was unable to find a convincing academic link.

In the quest for better guidance, I started a doctorate in the department of economics at the **University of Chicago**. Professors who would later win Nobel Prizes for Economics (five of them) dazzled us students with their efforts to test our work ethic and the logical consistency of our reasoning. One of them (the unforgettable Milton Friedman) signed me up for a seminar on "Money and Banking," which I joined in the hope of finding a close relationship with the world of corporate finance. Instead, the seminar led me to write a doctoral dissertation on something as apparently esoteric as "*The Demand for Money in a Context of Repressed Inflation*." Friedman congratulated me for capturing the true scope of the Keynesian "liquidity trap," reducing it to a particular case, and everyone knows that the loftiest intellectual objective for any good Friedmanite was to pour cold water on Keynes.

That obviously pleased me as an economist, but I knew that I had to go back to IESE, and who there might be interested

"I STILL DON'T KNOW WHAT THE INTELLECTUAL NEXUS IS BETWEEN ECONOMISTS' MENTAL FRAMEWORKS AND MANAGERS' DAY-TO-DAY JOB, BUT IF HEARING OUR OPINIONS HELPS THEM, WHAT DOES IT MATTER IF WE WAIT ANOTHER 45 YEARS TO FIND IT OUT?"

in something as theoretical as the Keynesian "liquidity trap"? Obviously, no one was, except for a handful of economist colleagues from the department of business policy, who were, by the way, as lost as I was. Nevertheless, the participants in IESE's programs wanted to know how the economy worked, the foundations of economic thinking, the techniques for properly assessing the economic environment and the foundations of applicable policies.

To my mind, it was never clear how all that fit into either business planning or business policy. In fact, my economics colleagues and I went from leading case studies in general management or corporate social responsibility (which had a different name back then, too) to outlining the elements of short-term economic indicators, or the errors of Marxist economic thinking. All of this lacked a common thread that might tie it all together.

MACRO VS. MICRO

And yet, it seemed to work perfectly, according to the feedback. Sometimes we were tempted to replace the sessions in the MBA on macro with "the principles of microeconomics," taking advantage of the fact that at the time Michael Porter and his followers were already drawing up an academic course on "competitive strategy" that would draw heavily from microeconomic analysis. Yet we did not dare get rid of the sessions on macroeconomics that were so popular (among other reasons, because the situation changed every year), and the head of the program couldn't find a gap in the curriculum. Only very recently have we managed to include a few sessions on microeconomics in the MBA.

And so years and decades have gone by. In my opinion, we have still not found a full fit between macroeconomics and management, but seniority (what a euphemism!) has probably made us a little less impatient and – who knows? – perhaps marginally wiser. For reasons beyond me, business leaders are keen to learn about economists' discoveries, errors, successes and failures. Perhaps they would like to understand what the specialist media is talking about, or perhaps macroeconomics fascinates them.

And so we march onward. Since 1963, the global economy has undergone decisive changes. After four decades of cumulative global growth at four percent per year, the world today is made up of much more prosperous societies with business opportunities that weren't even dreamed of back in 1963. It is true that along the way almost 80 percent of the large companies that existed 40 and 50 years ago have disappeared and surely many of those still standing today will follow in their footsteps in the decades to come. But it is also true that those companies that disappeared were replaced by others that are better suited to the new circumstances.

As for the rest, today many economies are much more open, technological innovations spread much quicker than in the past, information networks are much more complete and complex, international capital movements are much more widespread, and cultural interactions are much closer. I do not know how successfully we manage to convey these circumstances in our program. All I know is that they clamour to know more.

Even now, 45 years after I joined IESE, I continue to wonder about the relevance of economics – as a field of knowledge – for management. Last August the subprime crisis surfaced, causing upheaval in international finances, most likely with irreversible effects on much of the world economy. I once again saw good business managers´ faces clouded with looks of concern, just like at the low points of the economic cycle back in 1974, seven years later (1981), 12 years later (1993), five years after that (1998) and in another similar recent relapse (2001-02). They once again asked me – and my economics colleagues – the same questions: "*Tell us your opinion about the economic crisis, its effects and how long it might last*". I still don't know what the intellectual nexus is between economists' mental frameworks and managers' day-to-day job, but if hearing our opinions helps them, what does it matter if we wait another 45 years to find out?