

Business Education

Trendy subject taught with aplomb

PROFESSOR TO WATCH
LUIS GARICANO

Della Bradshaw meets an academic who is bringing economics to life for the business community

The current fashion among business schools for teaching students the softer skills of management is not for Luis Garicano. Indeed, he questions whether softer skills can be taught at all. What does excite him is rigorous economic analysis.

Not that Prof Garicano comes across as some traditional fusty economics professor. Exactly the opposite, in fact: a Spaniard with a gregarious nature, Prof Garicano is one of a new breed of young economists who is bringing a technical discipline to life for the business community.

A professor of economics and strategy at the University of Chicago Graduate School of Business and, from this month, the director of research in the department of management at the London School of Economics, he is working in the area of organisational economics.

One of the trendiest areas in the economics discipline, the rapid growth and increasing relevance of organisational economics is due to the increasing availability of data about the internal structure of companies due to the proliferation of computer technology. Until recently the application of economics to business was largely intuitive: economists worked on a case by case basis. Today, says Prof Garicano, access to large data sets means that business people and professors alike can take a more scientific approach to developing strategy.

He cites the example of traders on Wall Street or in the City of London. "Twenty years ago traders needed good gut instincts," says Prof Garicano. "Now they have a PhD in physics."

Prof Garicano uses numerous examples to illustrate how his branch of economics can help businesses develop strategy – what he calls evidence-based management, in which the best scientific evidence is used to help make decisions and develop



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Daniel Lynd

strategies. One such example is the spread of video hire stores. When video rental was first fashionable, the local stores were usually run by family businesses who were in tune with local tastes. But the growing availability of customer data meant that customer tastes could be analysed and stores could predict what customers wanted to rent, so fuelling the development of video rental chain stores.

A critical issue in organisations, he says, is the metric used to determine promotions and other rewards. When those metrics are not sufficiently related to performance, it may be counter-productive to use high powered incentives. He cites some work he did on the US intelligence services with Richard Posner, a US Appeals Court judge. The

evaluation and promotions of CIA field agents was based on the number of informants each agent signed up; while with analysts it depended on the number and length of reports they produced. In each case, the impact of these incentives was to induce the wrong kind of performance, as the actual value of the intelligence was unlikely to be related to these metrics.

They suggested two solutions. First, reduce the power of incentives, so promotions would be again more based on seniority and less on measured performance. And second, to use the quality of the information gathered as a criterion for pay and promotion, rather than the quantity.

In professional services, such as law firms and medical prac-

tices – Prof Garicano originally studied as a lawyer himself – he believes peer review is frequently the best way of assessing good work. This is not always the way competence is assessed. "A lot of reform in the public sector is

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In the case of heart surgeons, for example, those whose patients have the lowest mortal-

ity rates might also be the ones who are carrying out the safest operations. Working out how external data combined with the internal operations of an organisation can form strategy is central to this new type of economics. And Prof Garicano believes professors such as himself can give students the rigorous analytical training needed to develop the tools to do just that.

That is why he and John Sutton, fellow economics professor at LSE, and an expert in industrial organisation, have devised a 10-month MSc programme in management and economics, which began this month. Prof Garicano will also be working with the head of LSE's department of management, Saul Estrin, to develop new initiatives in the department.

Although evidence-based management is still in its infancy, Prof Garicano believes it will increasingly be adopted in many areas of business. "My sense is that marketing, finance and human resources are all going to move towards evidence-based management," he says. Indeed, as he points out, the worry is that they do not already use such tools. "You would think all businesses would do this but the shocking truth is that they don't."

His work has not gone unnoticed. Next month Prof Garicano will return to his native Spain to collect the Premio Banco Herrero award for the best business, social and economics research by a Spaniard under the age of 40. It is an award of which he is particularly proud.

