ECONOMICS AND THE LONDON BUSINESS SCHOOL

by

ROBIN MURRAY

December 1967

"The ideas of economists and political philosophers, both when they are right and when they are wrong, are more powerful than is commonly understood. Indeed the world is ruled by little else. Practical men who believe themselves to be quite exempt from any intellectual influences, are usually the slaves of some defunct economist. Madmen, in authority, who hear voices in the air, are distilling their frenzy from some academic scribbler of a few years back."

J.M.Keynes

This paper discusses five questions : the definition of Economics as a subject; the relevence of Economics to businessmen; the limitations from a businessman's point of view of Economics as it is traditionally taught in British universities; the Economics course which we are developing at the London Business School; and the relationship between economics and other parts of the curriculum.

1. Economics

Economics, said Lionel Robbins in a celebrated phrase echoed by Samuelson, Burling and Friedman, is "the science which studies human behaviour as a relation between ends and scarce means which have alternative uses". It is an ambitious definition, for it defines Economics as a mode rather than a field of human activity. It offers Economics as a theory of action.

As such, it loses distinctions that it is important to preserve, for Economics by the behavioural definition given above, comes to include the technical problems of Operations Research, Lasswellian socio-political problems of power, or even, as Massé pointed out, the art of the military. There seems no good reason why the range of Economics should be drawn so wide, since economists both see themselves and are seen to be concerned with behaviour in a particular field. As well as defining itself by its combination of scarce means to achieve certain ends, Economics also concerns itself with specific economic means and ends.

When we speak of economic ends, however, we should immediately discount any suggestion that economics sets the ends. The ends are given, and economics is concerned with elaborating the implications of various combinations of the scarce means in the light of these given ends. Yet even though the ends are given, it is these ends which provide the basis for one of the distinctions which marks off economics from other disciplines. These ends are presented as some social demand for goods and services. This demand may be a simple aggregate (a growth rate, for example) or it may have some weighting (in the market system this weighting is determined by demand in the market).

To clarify the point let us consider the difference between a technical OR problem and an economic one. The technical problem might be how to space the telephones in a coal mine so as to minimise the time taken to get people out of the mine in case of a flood. This is a physical problem. To make it into an economic one we have to ask whether it is worth the cost of putting in the telephones in order to reap the benefits - cost here meaning the foregoing of other goods or services. That is to say, we have to elaborate some sort of value criteria in order to decide between the different combinations of means. In economics this value criteria is given and relates to human demand for goods and services.

One final addition to the definition must be made. Economics is a social activity. It therefore has to observe certain 'rules of the game' which form the context for economic activity. It is these rules which distinguish economic activity from burglery or military campaigning.

Economics is thus defined by a mode of activity, a context of activity, and an end for activity.

Economics and the Businessman

Business is the central institution of a market economy. It is the relator of the means to the ends. It combines and transforms the means in the process of production, and it then distributes the fruits of production in accordance with certain ends.

Yet what is to ensure that such a transformation is carried out efficiently, that the economic agents which economists depict as rational profit maximisers do in fact conduct themselves according to such rationality? Adam Smith considered economic rationality a given fact of human nature. Oscar Lange considered it one of the sociological data of a particular system. Both these writers from very different ends of the spectrum, assumed rationality.

The main justification for a businessman studying economics is that we drop this assumption. That is to say, a businessman can still desire to be rational, but acknowledges that such rationality in an economic sense (maximising profit) requires techniques and concepts which are not acquired spontaneously, but must be learnt.

Nor should his interest stop there, for as well as the principles of business management (and we should remember that economics is derived etymologically from the Greek 'oekonomia' meaning the study of household management) he must study and understand how the structural data change. Thus macro-economics, the structure of industry, the principles of international trade and investment, and the development of the economic system in which he plays a part, all become areas the understanding of which can lead to business decisions growing increasingly rational.

Lastly, too, the businessman faces a problem of ends. Those members of my classes who have had some industrial experience had an immediate reply when I posed this problem to them - "profits". But we find that not only are there a number of definitions of profit, but that for many firms long-run growth (and thus long-run profits) also becomes one of their ends.

Thus I would argue that the businessman has a natural interest in the subject-matter of economics, as a behavioural guide, as an aid to understanding changes in the structure within which business behaviour operates, and as a clarifier of economic ends.

Neo-classicism and the Businessman

Economics as taught in British universities is fundamentally based on the neo-classical system. It is a self-contained, and coherent system, capable of being expressed in equational form. It has a theory of value - the utility theory - which provides the fixed point in terms of which the variables of the system can be expressed. Goods, services, factors of production have a value determined by the amount they contribute to utility - the general end of the system.

The coherence of the system is the point which must be emphasised, for it helps explain the reluctance which has been shown to abandoning the basic structure of the model. This structure assumes away many of the problems in Economics which we have noted are of interest to the businessman. Ends in the model are given and independent of each other : the end of an individual is utility, of a firm it is profit.

As we have seen above, behaviour is assumed to be rational, and as far as the structure is concerned, again many of the points in which we are most interested have been assumed away. In its early form the model assumed a perfectly competitive market structure, and perfect knowledge. It also presumed price was the major variable for a firm - indeed price became the key element in the system, acting as a ubiquitous Pandar uniting what should be united. The system was essentially static, and micro-orientated.

The early flowering of neo-classical marginalism dates from the last thirty years of the 19th century. Economists since then have, of course, recognised the limitations of this theoretical system in accounting for many of the factors that have become major problems in the 20 century: the growth of the large corporation which differs from the atomistic firm not only in its ability to affect price and the actions of other firms, but in its organisational problems; the growth of advertising; the question of imperfect knowledge - i.e. of information of the past, present and future; the role of the state in economic life.

To these new features of economic life, responses have varied. Some economists have sought to change the real world to suit the purity of the original economic construct. Others have sought to bring the new features into the system by making them determinate. This has certainly been the case with monopoly. Though monopoly, oligopoly, polyopoly, and monopolistic competition were acknowledged to introduce imperfections into the system, they were nevertheless imperfections which, in the inter-war period, were able to be determined. In the case of bilateral monopoly and oligopoly there was clearly a question of strategy and indetermination. It was to this that Games Theory in the immediate post-way years addressed itself.

Yet as Weiner noted in the first edition of his Cybernetics, published in 1948 shortly after Von Neumann and Morgenstern's classic, Games Theory could cope with two person games - just - but in most cases where there were more than two players, "the result is one of extreme indeterminancy and instability. The individual players are compelled by their own cupidity to form coalitions; but these coalitions do not generally establish themselves in any single determinate way, and usually terminate in a welter of betrayal, turncoatism and deception, which is only too true a picture of the higher business life, or the closely related lives of politics, diplomacy, and war."

The same applies to similar attempts to meet the problem of uncertainty, notably those of Shackle, Arrow and Debreu. Their efforts to render the future determinate by both specifying all future eventualities of relevance to an action, and then attaching a probability to each eventuality, is theoretically elegant, but instrumentally limited.

Such attempts to expand the system have usually been linked with a denial that the model is a description of reality. Rather it constitutes an ideal type, in a Weberian sense, or if not that, then it performs the essential function of a model, it accounts for the principle economic facts which we observe.

Certainly the great majority of economists would not argue that many of the facts of economic life can be accounted for in this way. But there are some which quite clearly are not. Take the questions of information, of the growth of firms, and of the organisation of firms as examples. These have not been entirely neglected. There have been certain theorists, markedly anti-neo-classical, who have attempted to theorise about such things: one immediately thinks of Galbraith, Myrdal, Perroux and the European structuralists. But most of their work is theoretically woolly, though often perspicacious.

Alternatively, we have seen pragmatic approaches to the questions, using the advanced techniques of statistics, Maths, OR and so on. This last response to the 'neo-classical crisis' has in many ways been fruitful, but it tends to lack two things - a relevant body of concepts and theory, and that great quality of neo-classicism, the consciousness of a system.

I have gone into the 'neo-classical crisis' at some length principally because I think it is important that people from other disciplines understand the context in which most of us have been schooled, and the difficulties that economics currently faces. Most particularly, the Business School is making exactly those demands on economic theory that economics in its traditional form is least able to meet. Lastly, only by outlining the difficulties which we face, can we underline with the right force, the necessity that the economists feel for inter-disciplinary work.

The Economics Course at the London Business School

The Economics Course as it has been designed and developed for all three courses at the Business School has tried to meet the needs of a businessman as I outlined above. Rather than starting from the system we have started from the firm. We have started to evolve what we might call 'existential economics'. The basic principle of existential philosophy is that existence precedes essence. In neo-classical economics the essence of the firm precedes its existence. We hope to be reversing the process.

The course begins by outlining the basic principles of economic behaviour in terms of a simple model. We go on to make this model more sophisticated, bringing into our course some of the techniques the students have already learned in other parts of the course. We then examine the economic environment and its relations with the individual firm.

1. The Basic principles of economic behaviour:

This constitutes the starting point and the central core of the course. Dennis Robertson once said that Economics was no more than the continual repetition of demand and supply in different contexts. Our aim initially is to get these fundamental concepts firmly embedded in the approach of the students, - the concepts of marginalism, of costs and demand, of optimisation.

In both the EDP and MSc. courses we begin with the problem of costs, what cost is from an economist's point of view, how cost varies both in the short and the long run and how we can specify certain regular forms which these variations take. Further, given a number of inputs we show how cost concepts can be used to give us an economically optimal combination of these inputs.

We then turn to demand, the other blade of Marshall's scissors. We explain the model of consumer behaviour which lies behind our discussion of demand. Then, as with costs, we show how data can be used to reveal relationships, and what the main forms of demand relationship are. What are the effects on the demand for a product of a change in its price, in a competitor's price, in the advertising budget, in a rising National Income?

Both costs and demand are then integrated, with the help of a case, and the issue of optimisation (which runs through both the costs and demand discussion) is elaborated.

The course then expands on this basic model. It distinguishes various forms of market structure, and also various type of costs (the nature of wages, interest, profits and rent are introduced here). This brings us on the MSc. programme roughly to the end of the first term.

The second term is concerned with two things: pricing, and the economic implications of the structure of firms, particularly from the point of view of objectives. Both are elaborations of the basic model, and are part of an attempt to integrate our principles into increasingly complex and realistic business structures.

To take pricing first, we discuss the role that prices play in the economy, then pricing as it affects price takers, price makers, discontinuous producers, producers with administered prices and so on. We have also come increasingly to stress that price may be only one of a number optimising variables. Clearly advertising is another, but there are, too, those brand products, where the optimising problem becomes not how much one charges, but how much of the product one gives at a set price. These can be called price-minus products.

The study of firm goals returns to an elaboration of objectives. Can we talk about the objectives of a firm, or solely about those of groups of people concerned with the firm in various capacities? What is the trade-off between short term profits and long term growth? Does such a trade-off involve organisational conflicts? More specifically, even if we are short-term maximisers, what should we aim to maximise? If profit, how do we measure profit?

The above outline constitutes the framework for the first two terms of the MSc. course, 'Economic Analysis for Business Decisions', and the EDP course of a similar title. The EDP course spends much less time proportionately on the detailed elaboration of various pricing procedures, and the structure of the firm.

2. The Economic Environment

Other than electives there are four courses which are nominally environmental; macro-economics, industrial and business structure, international trade and development, and managerial dynamics.

Macro-economics has been reasonably straightforward. We discuss national income accounting, the determination of national income, business cycles, monetary theory, banking and the structure of the capital market, public policy measures for stabilisation and control, and the current issues of inflation, balance of payments, growth and economic planning.

The course of Industrial and Business Structure relates closely to the core course, discussing in much greater detail the problems of ownership and control, of the growth of firms, of concentration and of government anti-monopoly legislation. It also looks closely at the field of state industry, their investment criteria, pricing policies and cost benefit analysis. This course is close, too, to the macro-economic course in its concern with the role of government agencies and industries as influences for stability and growth, most notably in the field of industrial location and regional policy. Most recently it has introduced the important topic of consumer co-operation.

The International Trade and Development course was originally conceived as providing an understanding for businessmen dealing abroad. It outlines the main determinants of trade flows, the balance of payments mechanism, the international monetary framework, the causes of capital movements and of labour movements. It also analyses the nature of the Western European economies in the Common Market, and the main problems presented by under-development.

The course in Managerial Dynamics comes at the end of the second year and looks at the development of the market system as we know it. It further discusses the problem of the growth of the modern corporation, and the economic and social forces which have shaped this growth. It further takes up the dynamic problems of innovation, research, technical change and the role of entrepreneurship in the development process.

Two comments should be made on the Economic Environment Courses. Firstly, such courses are traditionally taught in British universities from the point of view of some 'unhidden hand', macro-economics from the viewpoint of the Chancellor of the Exchequor, industrial structure from that of the President of the Board of Trade, international trade from that of the head of GATT, the IMF, or even Mr. Macnamara. We hope to gradually swing the approach to that of the businessman.

Thus in the course of Industrial and Business Structure particular groups of firms are taken and their problems when faced anti-monopoly action are examined. In macro-economics we are writing a case on what a large firm can do when faced with the possibility of devaluation. In the Trade and Development Course we discussed a case study of the Development Plan in Zambia from the viewpoint of a financial advisor to the country and one of the large copper firms.

The Zambian example is also relevant to the second comment I would like to make on the courses. In many of the so-called environmental fields, we have come to realise that a firm is not simply in a passive relation with its 'environment' - it often plays a role in the shaping of this environment. This is very clearly so, of course, in an underdeveloped country where a firm may provide 1/3 of the National Income or half the export proceeds. But on a smaller scale it is also true of firms in advanced countries as well. It may be a question of industry representatives sitting on Neddy, being consulted by the Treasury, or bringing out a statement on devaluation. But it might also be the effect of a shipbuilding firm's decision on the regional economy of Northern Ireland, of an oil firm's decision on the price of petrol, or of a company like Rolls Royce on our export proceeds.

We find in effect that the relation between the micro and the macro is not a one way process where the macro affects the micro, but a two way process where both have influence on each other. In certain sectors indeed, we have what one might call a mecro level, half way between the micro and macro. The need to recognise this has been increasingly apparent, particularly in government cyclical and planning policy. But it is apparent, too, among certain of our business leaders who have very real responsibilities in the macro-economic field but who appear to lack the training to adequately carry them out. It is in this respect that our environmental classes may gain a special point, particularly the new course on Managerial Dynamics which is designed to give what we hope will be future industrial leaders a real grasp of the nature of the economic system in which they play a role.

Teaching methods:

This year we have conducted a labour intensive experiment in the teaching of the core course to the MSc. There are no formal lectures, but each tutor (there are five classes of eight students each) teaches part by lecture, part by class discussion. The value of this system is its flexibility. In the first year we found a wide range of experience and ability as far as Economics was concerned. The new system allows us to concentrate on the particular needs of the group.

We make certain use of case studies - there have been three major cases for the 1st year MSc. this term - as well as weekly question sheets containing a number of mini-cases.

A problem we found last year was the low level of writing ability. Most of the course found it difficult to organise their thoughts on a subject and then write it down in clear prose. Accordingly we encouraged short written contributions, and a major essay of 5,000 words in the second term. Clearly, this is a problem which will continue to press on us, particularly because many of our students come from disciplines where they have not been required to write essays or reports in any regular way.

Finally, last Summer term we experimentally organised four case studies on international firms in the non-ferrous metal industries. The MSc. group was divided into four groups of 9 students each. They were responsible for organising themselves, getting bibliographies and evidence, and carrying through a sustained project. Our aim was not only to further understanding of the specifically international aspects of an international firm, but to encourage group work, writing, and experience in project development. We also hoped that the groups would apply the principles and techniques which they had learned in the first two terms to the analysis of these sectors.

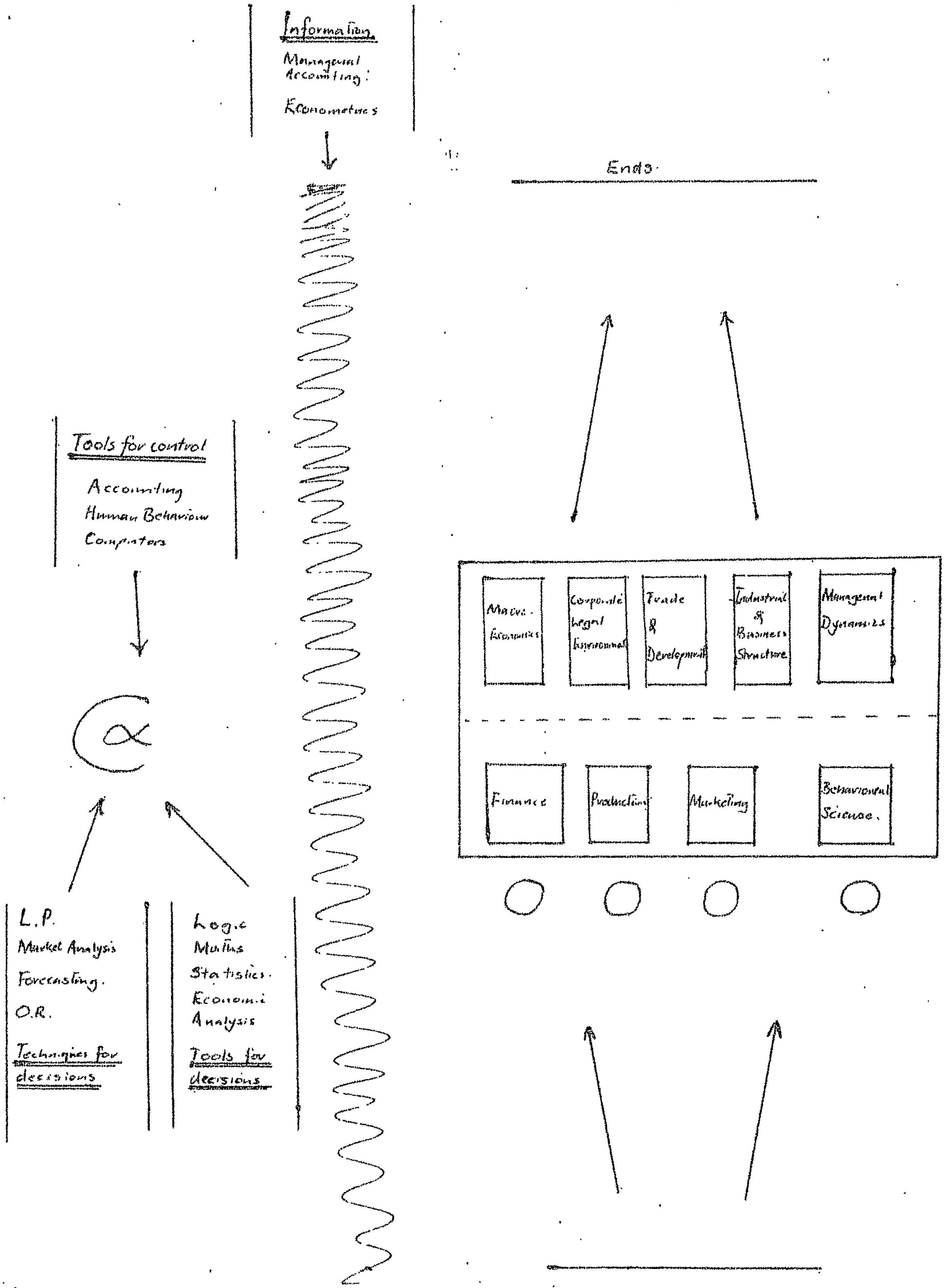
In many ways the projects were a success. The reports produced contained material of real interest and expertise. There was clearly a problem of time in the summer term, as well as one of getting the class as a whole to use their techniques and concepts in new fields. We hope to plan another project this summer which will learn from these difficulties.

Economics and Other Disciplines:

Analysing the role of economics in the MSc. and ECP course as a whole, I would first like to make a distinction between what might be called the 'bricoleur' part of the course, and the other more specific part. There is no exact translation of the French term 'bricoleur' in English. Neither 'handyman' nor 'odd-job man' has got the professionalism of the 'bricoleur'. He can do anything, and the essence of his tools are that they are adaptable. He has a rod in his bag: it could be for opening a jammed door, holding up a ceiling, acting as a measuring rod.

The nature of the quantitive methods and analysis part of the MSc. course is to make our students a business bricoleur - the tools will be useful wherever he goes. The other part of the course is more specific - it is conceivable that some students may have little cause to use particular courses throughout their business life. In this part of the course there is the further distinction between functional and environmental studies. These distinctions are depicted in the figure on page 12.

I make these distinctions because without them one cannot so clearly see where economics fits in, and where it most closely knits with other courses. In respect to the latter point, the first important place of interdisciplinary overlap is on the right hand, structural side of the diagram. Our model for the economic core course makes assumptions as we have seen about behavioural and organisational questions and also about demand. In particular, we as economists often set problems and cases in which we realise, a little uncomfortably, that there are other variables in these fields which we are holding constant, when in real business life they may be dominant and decisive. As long as we and the students realise our partiality, the danger is minimised, but we should perhaps be aiming to integrate the disciplines reasonably early on in the course.



Key:

α the business decision maker.

▯ environmental 'files' where data cannot be influenced.

▯ ○ functional 'files' with representatives, where data can be manipulated.

fog.

Secondly, as our structural environment becomes more realistic, we would want to integrate the other bricoleuresque disciplines into our solutions. There is a problem of timing here, and perhaps some form of project in the summer term might be a useful gathering ground.

Thirdly, there is the problem of information, the shadow between the general and the specific. In our model we initially tend to assume this away, but of course this becomes one of the central problems of the businessman. This problem has an economic side, the economics of information, on which we have been putting increasing stress.

The ideal, of course, in the question of allying the general techniques and the specific structures, would be for the examples in the former to co-ordinate where-ever possible. I realise the difficulties involved in this.

Conclusion

My principle conclusion leads on from what must, in many ways, be an uneasy discussion of interdisciplinary co-operation. For again and again we find our difficulties arise because the traditional disciplinary bounderies are unsuited to the discussion of key problems. Take the theory of the firm as an example. This has been the title of many a basic Economics course at British universities. Currently, however, the Behavioural Scientists working with economists have produced what have been called modern theories of the firm, whose emphasis is not on the basic economic principles but the behavioural structure of the firm in relation to business activity. Is The Theory of the firm Economics or Behavioural Science? The question is parallel to others frequently raised at the Business School. Is 'cost' Economics or Accounting? Is Demand analysis Economics, Marketing or Behavioural Science? Should the Economics course deal with business decisions under certainty, and OR deal with those under uncertainty, as is done on the M.Sc. course at the moment?

In most of these cases we arrive at a feasible division of labour. There is some overlap. We hope that not too many vaccuums are left in between. But what of course the teaching of businessmen necessitates is that we should all be ready to drop our own traditional concepts of where a discipline begins and ends, and rather create courses based on the needs of the subject and not the disciplines : courses on demand, for example, on the growth of the firm, on resource allocation, on business information, in which teaching by necessity would have to be interdisciplinary.

We began by quoting Keynes on the role and importance of economic theory in business life. Let us end by recalling his aside on the necessary attributes of the Master Economist: "He must be m athematician, historian statesman, philosopher - in some degree ... He must study the present in the light of the past for the purposes of the future. No part of man's nature or his institutions must lie entirely outside his regard. He must be purposeful and disinterested in a single mood; as aloof and incorruptable as an artist, yet sometimes as near the earth as a politician".

This is an ambitious penumbra for an economist, so ambitious, indeed, that in the light of our discussion, we might come to regard such a man as a Master Human Scientist rather than Master Economist.

However, whether or not we disolve Economics into a wider "Human Sciences", we could well substitute in Keynes' remark 'Master Business-man' for 'Master Economist' and in so doing fashion from the aside an excellent school motto.

Robin Murray