

# Professor to watch

## – Luis Garicano



Luis Garicano joined LSE's Department of Management this autumn as director of research. He spoke to *Financial Times*' journalist **Della Bradshaw** about why businesses need to embrace evidence based management.

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 Professor Garicano comes across as some traditional fusty economics professor. Exactly the opposite, in fact: a Spaniard with a gregarious nature, Professor Garicano is one of a new breed of young economists who is bringing a technical discipline to life for the business community.

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 Professor 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. '20 years ago traders needed good gut instincts,' says Professor Garicano. 'Now they have a PhD in physics.'

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

LSE has been named top institution in the UK and joint second in the world for master's in management programmes. LSE won its position in the 2007 *Financial Times* rankings for its MSc in Management. It is the only UK institution in the top ten. See [www.lse.ac.uk/collections/management](http://www.lse.ac.uk/collections/management)

The TRIUM Global Executive MBA has been ranked second in the world in the 2007 *Financial Times*' Executive MBA rankings. Launched in September 2001, the programme is offered jointly with New York University Stern School of Business and HEC Paris. See [www.triummba.org](http://www.triummba.org)

related to performance, it may be counterproductive 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, 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 practices – Professor 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 about measuring output, but you should only measure output if it makes sense.'

In the case of heart surgeons, for example, those whose patients have the lowest mortality 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 Professor 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 LSE professor John Sutton, an expert in industrial organisation, have devised a ten month MSc programme in management and economics. Professor Garicano will also be working with the head of LSE's Department of Management, Saul Estrin, to develop new initiatives.

Although evidence based management is still in its infancy, Professor 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. '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 Professor 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. ■

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