Management and Market Failures

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Do Managers Try to Maximize the Right Objective Functions?

Yes

Financial/Institutional/Legal Critiques of the System

No

Do Managers Manage to Maximize Their Objective Functions?

Yes

“Managerialist” Writings (for managers)

No

Are Those All the Reasons to Be Worried?

Yes

No

Market Failures/Limitations (small numbers, uncertainty, externalities)

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Market Failures Expand the Scope for Management Failures

- **Small numbers.** Poor decisions by managers at a company are of more concern if the company is one of a few or, even worse, a monopoly.

- **Uncertainty.** Choices about how high to set investment hurdles and the logic of discounting expected cashflows are more likely to be issues under conditions of high uncertainty/ambiguity.

- **Externalities.** Managers are likely to be more confused about what to internalize and what to ignore (externalize) when there are some externalities.
Three Questions

• Free markets always lead to vigorous competition.
• Farsighted companies can be trusted to do well by the environment.
• Smart companies can handle risks and market volatility on their own.
US Survey Results:
Degree of Agreement

Vigorous Competition
No Real Externalities
No Risk Problems

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US Survey Results

- BA/Fin masters consistently guessed highest and econ/other social science/humanities masters lowest.
- Significance of business education dummy variable survived controls for self-declared Republican orientation
- Also survived controls for age, gender and income category.
Inferential Issues

- Before business school?
- During business school?
- After business school?
Curricular Social Responsibility
Some Modest Proposals

• Include some material on market failures in the core of the curriculum
• Discuss the interactions between managerial failures and market failures
• Emphasize that coordination, regulation, other forms of collective action required to complement individual acts of heroism.
• Name-and-shame companies/industries as well as naming-and-acclaiming.