Put an economist on your board

Having them throw cold water on unrealistic forecasts and on bad strategy ideas are just two ways shareholders could benefit. **BY ROBERT C. FRY JR.**

In my 30 years as a corporate economist, I often spoke to the boards of directors of my employer and its major customers. In retrospect, I think I could have helped those boards more as a member of the board than as a guest speaker. I'm not unique in that regard. Economists have knowledge and skills that can make us valuable as directors. Every company should put an economist, ideally a business economist with real-world experience, on its board.

Why? Don't most boards already have accountants to help them with the numbers?

You may have heard that the difference between economists and accountants is that, while both have a facility with numbers, economists lack the dynamic personalities needed to become accountants. All joking aside, the real difference is that while accountants are good at telling you what the numbers are, economists are good at telling you what they mean and, more importantly, when they mean nothing.

Economists know that cash is a fact, earnings an opinion. They also know that managers and analysts pay too much attention to magnitudes measured in percentage points and not enough attention to magnitudes measured in dollars.

Economists, especially business economists, take a long view of history. Ask an accountant for history and you're likely to get data for this year and last. Ask an economist for history and you'll get insight going back decades, and, as a bonus, insight into the future.

Economists, because they understand history and numbers, are unusually good BS detectors. When an executive or consultant or investment banker comes to the board and makes an unrealistic forecast, an economist can say, "That has never happened before."

Economists are more likely than others to point out when the emperor isn't wearing any clothes. When asked what an economist was, Keith Collins, former chief economist of the U.S. Department of Agriculture, said, "Someone who throws cold water on the bad ideas of other people."

Economists can be especially valuable in this role when management wants to make a cash-for-stock acquisition. We know that such deals are almost always bad for the shareholders of the acquiring company because buyers almost always overpay.

Economists understand the difference between cycles and trends. If you calculate a growth rate starting at the bottom of a cycle, you'll overstate growth. If you extrapolate that growth rate and use it as a forecast, you'll be disappointed. Remember Herb Stein's Law: Anything that can't go on forever will stop.

Economists know the difference between long- and short-run price elasticity of demand, so they know that a price increase that boosts revenue and earnings in the short run can hurt the company in the long run. It's one of the most important distinctions in economics and business, and a failure to understand it eventually will lead a company to price itself out of business.

Finally, economists understand incentives. In particular, because they've studied the Black-Scholes options pricing model, they know that compensating senior executives with stock options creates an incentive for them to increase the volatility of their company's stock price. They do this by making promises they can't keep over the long run and pulling out all the stops to make their targets in the short run. This forces up the stock price, allowing them to reap big gains on their options. Then, when reality sets in and the stock price falls, they get new options at a lower strike price. This process is repeated until the board of directors catches on and replaces the CEO. With an economist on the board, maybe this game would stop and management would stop sacrificing the long-term future of their company to deliver the short-term earnings needed to make their stock options pay off.

Convincing a CEO to put an economist on the board might be a hard sell. Pointing out unrealistic forecasts, throwing cold water on bad ideas, and questioning the abuse of stock options will only be viewed positively by the most secure and forward-thinking of CEOs. But if a company has a CEO who isn't afraid of the truth, putting an economist on the board of directors will benefit the company and its shareholders over the long run. ■

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