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## The Economic Man



*Prepared by:*

Jeffrey S. Ray, PMP, CSEP, P.E., Esq.  
Doctoral Candidate, SMC University  
[jeffrey.ray@student.swissmc.ch](mailto:jeffrey.ray@student.swissmc.ch)

*Prepared for:*

Swiss Management Center  
Learning Center – Zurich  
Seestrasse 463  
8038 Zurich - Switzerland  
Tel.: +41 (0)41 500 16 22  
[administration@swissmc.ch](mailto:administration@swissmc.ch)  
<http://www.swissmc.ch>

## Abstract

This paper questions how economic systems are using knowledge to support economic decision making. Scientific knowledge collected by centralized planners is not the right type of information to base economic decisions on since it does not have the capacity to consider local opportunity factors. These concerns, originally espoused by Frederick Hayek when analyzing the economy as a whole, can be decomposed to focus on individual businesses. A large corporation, encumbered with a traditional vertical organizational structure, typically has an executive management team taking on the role of the centralized planners in Hayek's model, and is forced to make decisions without the local opportunity knowledge that may be available in their low-level business units. Economic decisions must fundamentally be based on accurate information that considers local opportunities, and must be made rapidly in today's dynamic market place. To get access to local knowledge from their low-level business units, executive management teams should consider implementing learning organizations with horizontal management structures that encourage collaboration. Companies with centralized organizational structures simply move too slowly to be competitive.

The "Economic Man" is an economist's creation designed by Mr. Hayek to show how unlikely it is that economic decision makers could ever accurately predict future economic conditions. A hypothetical "Economic Man" with "perfect foresight" was described, in essence, to allow readers to visualize the futility of the assumptions underlying our current economic theories. Yet in today's competitive business environment, perfect foresight is precisely the standard we impose on our executive managers. The perfect knowledge assumption is said to mislead these economic decision makers into a false believe the problem is simpler, from the perspective of the information needed to support such decisions, than it actually is. This results in poor investment decisions by managers that collect the wrong economic data. The division of labor concept notices that complex jobs can be more efficiently completed by a number of workers performing specialized tasks, than by one worker trying to complete the entire job. By dividing up the required skills on complex tasks across multiple workers, they can become specialists and work their assigned area more efficiently. The level of knowledge required to make workers skilled specialists is essential for the division of labor concept to be effective. Further knowledge is required to quantify economic input variables to the extent that decision makers in executive management can accurately predict how the marketplace will unfold and, in so doing, achieve an "economic man" like stature.

No matter how we materialize or describe the problem; it seems the effective acquisition and use of knowledge is the correct answer. Peter Drucker relates the economic successes a corporation has with their ability to create "core competencies" that lead to market leadership positions. He begins to abstractly define the type of data that should be collected to help managers of these corporations monitor the strength and relative position of their core competencies. This relates to Mr. Hayek's concern that managers need accurate, *but relevant*, information to base their decisions on. Just when things were looking bleak for our hypothetical "Economic Man," these important steps define feasible types of real time information processing that can support economic decision makers monitoring the strength and position of core competencies. While it's not quite as good as the perfect foresight imposed on our "Economic Man," relevant, near real time economic data is a giant leap forward.

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### Introduction

This paper reviews three economic journal reports and evaluates them against some core management constructs advocated by renowned economist Frederick August Hayek<sup>1</sup>. First, economic decisions must fundamentally be based on accurate information. If decision makers make assumptions about future conditions based on accurate input data, they have a much better chance of investing wisely. Second, things happened quickly in the market place today so it is critical to be able to make decisions rapidly. Companies with a centralized management structure are said to move slowly to their disadvantage, while decentralized organizations are found to make decisions faster and, in so doing, become more competitive.

The first report, *Economics and Knowledge*,<sup>2</sup> is used to support the propositions that our beloved equilibrium analysis is based on a faulty premise. The equilibrium principle asserts that economic markets can withstand all kinds of adversity simply by adjusting the price of goods to increase or decrease consumer demand as appropriate. If a disaster affects the ability to manufacture a product, then the price of that product will raise to find a point of natural equilibrium. This magical point of equilibrium is assumed by economist to be the price established at the intersection of the supply and demand curve. Hayek calls out the faulty premise: that merely by possessing knowledge of the equilibrium point (price value), all Individual Economic Decision Makers, herein “IEDMs,” are universally assumed to get the “totality” of the information they need to base their economic decisions on. They can interpret market conditions by rising and falling price values and predict market conditions accordingly. This means that believers of our current economic principles are mislead into basing their investment decisions on information that, as Mr. Hayek points out, is not able to accurately model market conditions.

In the second report, *The Use of Knowledge in Society*,<sup>3</sup> Mr. Hayek questions how economic systems are using knowledge to support economic decision making. He points out that scientific knowledge collected by centralized planners is wholly inadequate since it does not have the capacity to consider local opportunity factors. From Mr. Hayek’s point of view, local conditions reflected by wage rates and the price of raw materials, for example, seem to be relevant to economic decisions but are discounted by traditional economic theories.

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<sup>1</sup> Friedrich August von Hayek (8 May 1899– 23 March 1992) was an Austrian-born economist considered to be one of the most important economists and political philosophers of the twentieth century. Best known for his defense of free-market capitalism, Hayek’s work on how changing prices communicate signals that allow investors to coordinate their plans is widely regarded as an important achievement in economics. In 1974 Hayek shared the Nobel Memorial Prize in Economics with Swedish economist Gunnar Myrdal for his pioneering work in the theory of money and economic fluctuations.

<sup>2</sup> Hayek, Friedrich August (1937). *Economics and Knowledge*, *Economica Journal*, New Series, Vol. 4, No. 13, February 1937, pgs. 33-54.

<sup>3</sup> Hayek, Friedrich August (1945). *The Use of Knowledge in Society*, *The American Economic Review*, Vol. 35, No. 4, September 1945, pgs. 519-530.

In the third report, *The Information Executives Truly Need*,<sup>4</sup> Mr. Drucker relates the economic successes a corporation has with their ability to create “core competencies” that lead to market leadership positions. He begins to abstractly define the type of data that should be collected to help managers of these corporations monitor the strength and relative position of their core competencies. This relates to Mr. Hayek’s concern that managers need accurate, *but relevant*, information to base their decisions on. By focusing on obtaining core competency information, our society can limit the damage brought to light by Hayek’s contention that IEDMs require information systems that distribute the “totality” of economic data to all participants in the market place, but impliedly are not capable of being delivered, since central planners have no way to ascertain how end users will leverage it to suit local opportunities.

### So Who is the “Economic Man”?

The “Economic Man” is an economist’s creation that was, more than likely, designed by Mr. Hayek to show how unlikely IEDMs could ever accurately predict future economic conditions. A hypothetical “Economic Man” with “perfect foresight” was described, in essence, to allow readers to visualize the futility of the assumptions underlying our current economic processes. Yet here comes Mr. Drucker to help us set up information systems, potentially with dashboards full of economic data, which will help corporations monitor the strength and position of their core competencies, relevant information to be sure! Like Neil Armstrong’s first step on the moon, one might argue that Mr. Drucker made one small step for man, but one giant leap for (economic) mankind. We are now a step closer to providing information systems that provide managers the economic data they need to predict market conditions in near real time and react quickly enough to ensure corporate prosperity. In other words, we are one large step closer to achieving Hayek’s “Economic Man” (with perfect foresight) standard.

### Accurate Information is Fundamental for Decision Making

From a high level perspective, Mr. Hayek notes that economic theories that lead to verifiable conclusions consist of propositions about the acquisition of knowledge.<sup>5</sup> The acquisition of knowledge that serves as the basis for economic decision making is a central theme of his. Individuals base their economic decisions on input data that gives them the confidence to anticipate the actions of others. It is essential with respect to economic compatibility across the plans of different stakeholders, that the plans “of the one contain exactly those actions which form the [input] data for the plans of the other.”<sup>6</sup> (Clarification Added). This constraint, categorized as a “difficulty” by Mr. Hayek, is apparently avoided by the assumption that the input data, in the form of supply and demand curves, is given universally to all individuals who, despite acting on the same perceived economic premise, will somehow lead to (their individual) plans becoming adapted to each other.”<sup>7</sup> (Clarification Added).

Our current economic models are therefore based on an assumption that all IEDMs have a totality of knowledge to base economic decisions on. This unrealistic premise has the negative impact of stifling

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<sup>4</sup> Drucker, Peter F. (1995). *The Information Executives Truly Need*, Harvard Business Review, January – February 1995, pgs. 54-62.

<sup>5</sup> Id., Hayek, F. A. (1937), pg. 38, para. 1.

<sup>6</sup> Id., Hayek, F. A. (1937), pg. 38, para. 1.

<sup>7</sup> Id., Hayek, F. A. (1937), pg. 38, para. 2.

the acquisition of relevant "local opportunity" knowledge by misleading proponents into believing a centralized planning authority can develop and implement a unified plan that can direct all economic investment decisions.

### Discarding the Concept of Equilibrium

In *Economics and Knowledge*, Mr. Hayek challenges the underlying assumptions that form the basis of the Concept of Equilibrium. It asserts the intersection of the supply and demand curve establishes equilibrium price values where a buyers willingness to pay for a product essentially equates to a sellers willingness to sell it. Although the Concept of Equilibrium is one of today's bedrock economic principles, the only justification for it "is the supposed existence of a tendency towards equilibrium."<sup>8</sup> But what exactly is a tendency towards equilibrium? It means that, under certain "conditions of knowledge,"<sup>9</sup> the intentions of different buyers and sellers within the economy come more or less into agreement. The author points out that a major shortcoming of the equilibrium analysis is that models of the economic process should account for the cause and effect interrelationships of IEDMs with the cause and effect decisions made by others.<sup>10</sup> The problem with our current economic theories is they fail to address these interrelationships; i.e., they fail to account for the knowledge these decision makers must have by basing the whole equilibrium analysis on an assumption of what Hayek refers to as "correct foresight."

Mr. Hayek contends that "a tendency towards equilibrium is clearly an empirical proposition, that....ought....to be capable of verification."<sup>11</sup> (Emphasis Added). He goes on to say that "equilibrium analysis only describes the conditions of equilibrium without attempting to derive the position of equilibrium from the data."<sup>12</sup> The whole concept of equilibrium, however, is based on a circular argument where responses to questions about how equilibrium comes about and are solved by "apparent demonstrations [that] amount to no more than the apparent proof of what is already assumed."<sup>13</sup>

### Correct Foresight and the "Economic Man"

"Correct foresight" involves an individual's ability to accurately anticipate the cause and effect decisions made by others, and is the underlying assumption used to justify the concept of equilibrium. Equilibrium is said to occur when an IEDMs foresight is correct" in the sense that every persons plan is based on the expectation of just those actions of other people which....are based on....the same set of external facts, so that nobody will have any reason to change his plans.<sup>14</sup> Mr. Hayek hammers the point home when he states "[c]orrect foresight is then not...a precondition which must exist in order that equilibrium may be arrived at. It is rather the defining characteristic of a state of equilibrium."<sup>15</sup>

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<sup>8</sup> Id., Hayek, F. A. (1937), pg. 44, para. 1.

<sup>9</sup> Id., Hayek, F. A. (1937), pg. 44, para. 2.

<sup>10</sup> Id., Hayek, F. A. (1937), pg. 38, para. 2.

<sup>11</sup> Id., Hayek, F. A. (1937), pg. 44, para. 2.

<sup>12</sup> Id., Hayek, F. A. (1937), pg. 44, para. 1.

<sup>13</sup> Id., Hayek, F. A. (1937), pg. 44, para. 3.

<sup>14</sup> Id., Hayek, F. A. (1937), pg. 41, para. 2.

<sup>15</sup> Id., Hayek, F. A. (1937), pg. 41, para. 2.

To support his contention that the equilibrium analysis requires a perfect market assumption, Mr. Hayek describes the "economic man"<sup>16</sup> as a "quasi-omniscient individual" that knows "automatically all that is relevant for their decisions." In other words, the "economic man," which is similar to the hypothetical "reasonable person" used in law to analyze legal issues, must have perfect foresight. How the "economic man" learns from experience and acquires knowledge, therefore, constitutes "the empirical content of our propositions about what happens in the real world<sup>17</sup> [that can be verified]." (Clarification Added).

The problem lies with the knowledge assumption. It is the basis of our current economic theories, as visualized by the "economic man" model with perfect foresight, but is clearly wrong. There simply isn't any way to calculate an economic price structure that would achieve equilibrium. The price expectation of consumers is only a small part of the knowledge needed. How the different commodities can be obtained and used, which can never be predicted with certainty, is important information and highlights the authors point that "the subjective data to different persons correspond to the objective facts."<sup>18</sup> While this knowledge is assumed to exist in equilibrium analysis, it cannot be rationally determined.

To gain a perspective on just how unrealistic the perfect foresight assumption embodied in Mr. Hayek's "Economic Man" standard is, consider if we sent our hypothetical "Economic Man" to Las Vegas and demanded perfect foresight. Armed with the ability to accurately predict as applied to gambling activities, our Economic Man would obviously do quite well. Unfortunately, the concept is just too unlikely to believe. Our bedrock economic principles (that presuppose an unrealistic premise such as perfect foresight) is similarly not believable.

### Expanding Division of Labor into a new Division of Knowledge Proposition

Another economic principle discussed in the paper is the division of labor concept where complex jobs can be more efficiently completed by a number of workers performing specialized tasks, than by one worker trying to complete the entire job. By dividing up the required skills on complex tasks across multiple workers, they can become specialists and work their assigned area more efficiently. Division of labor is the basic principle underlying the assembly line in mass production systems.

Mr. Hayek proposes that there is also a division of knowledge that is just as important a concept as division of labor. Not only has a division of labor evolved from the price system, but also "a coordinated utilization of resources based on an equally divided knowledge has become possible."<sup>19</sup> In addition to data relevant to the price-cost relationship of products, Mr. Hayek asserts "the basic fact of how the different commodities can be obtained and used"<sup>20</sup> is also important. In the division of labor construct, the knowledge required to enable a worker to perform a specialized task is the key ingredient for success. We refer to that ingredient as a "skill." Switching back to the division of knowledge concept, further knowledge is required to be able to comment on the economic processes of society. Knowledge

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<sup>16</sup> Id., Hayek, F. A. (1937), pg. 45, para. 1.

<sup>17</sup> Id., Hayek, F. A. (1937), pg. 45, para. 3.

<sup>18</sup> Id., Hayek, F. A. (1937), pg. 50, para. 1.

<sup>19</sup> Id., Hayek, F. A. (1945), pg. 528, para. 2.

<sup>20</sup> Id., Hayek, F. A. (1937), pg. 50, para. 1.

in this sense is essentially the level of knowledge required for correct foresight since, as Mr. Hayek says, all knowledge supports the capacity to predict. To summarize, the level of knowledge required to make workers skilled specialists is essential for the division of labor concept to be effective. Further knowledge is required to quantify economic input variables to the extent that decision makers can accurately predict how the marketplace will unfold and, in so doing, achieve an "economic man" like stature.

### The Price System to the Rescue

While discussing commodities as an example, Hayek noticed that whether an increase in demand, or a decrease in supply, creates a concern that the commodity is becoming scarce, the price of the commodity will naturally increase and act to coordinate the separate actions of either cause. The "price system" was said to save the day since "[t]he whole acts as one market....because their limited individual fields of vision sufficiently overlap so that through many intermediaries the relevant information is communicated to all."<sup>21</sup> The price system, therefore, is a mechanism for communicating information. If the price of a commodity goes up, for example, manufacturers know to investigate and see if a shortage is developing. Mr. Hayek emphasizes this point by stating,

"[t]he marvel is that in a case like that of a scarcity of one raw material, without an order being issued, without more than perhaps a handful of people knowing the cause, tens of thousands of people whose identity could not be ascertained by months of investigation, are made to use the material or its products more sparingly."<sup>22</sup>

While the price system is "one of those formations which man has learned to use," the author suggests that it was stumbled upon, and that it cannot be calculated. So, while prices are known to correspond to costs,<sup>23</sup> society has stumbled onto a price system that communicates relevant knowledge effectively without knowing what is relevant to all concerned. Such a price system supports Mr. Hayek's division of knowledge concept originally described in *Economics and Knowledge*, and elaborated in *The Use of Knowledge in Society*. In today's terminology, we cannot resolve to get an economy into a state of equilibrium by calculating some miracle price structure like our current economic principles seem to imply, but it can be done by letting the market price to cost relationship find its own natural equilibrium. While equilibrium from scientific knowledge is not possible, it can be achieved if economists "but out" and let the cost-price relationship naturally seek equilibrium.

### Combining New Tools and Relevant Information on Core Competencies

In *The Information Executives Truly Need*,<sup>24</sup> Mr. Drucker starts defining the information managers need to grow their businesses. He points out that new tools drastically change the tasks that need to be performed when he states, "[c]oncepts and tools....are mutually interdependent and interactive. One changes the other."<sup>25</sup> Advances in information systems now allow for near real time collection of

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<sup>21</sup> Id., Hayek, F. A. (1945), pg. 526, para. 1.

<sup>22</sup> Id., Hayek, F. A. (1945), pg. 527, para. 2.

<sup>23</sup> Id., Hayek, F. A. (1937), pg. 49, para. 2.

<sup>24</sup> Id., Drucker, P. F. (1995), pg. 54, para. 5.

<sup>25</sup> Id., Drucker, P. F. (1995), pg. 54, para. 3.

relevant economic data to be reported to managers in the form of dashboards designed into effective Graphical User interfaces (GUIs) tailored to their specific purposes. If the information needs Mr. Drucker describes could be extrapolated down to specific information fields in a relational database, or populated via publish and subscribe web services, then effective decision making focused on “core competencies” can result.

Defining the information executives need, however, presupposes that industry knows what information to collect and for what purpose; i.e., that industry is involved in effective economic monitoring of their core competency areas. Most companies today, however, use traditional cost accounting processes that contend the total manufacturing cost is the sum of the costs of individual operations and base their economic monitoring processes accordingly. Unfortunately, as Mr. Drucker points out, the cost that actually matters “for competitiveness and profitability is the cost of the total process,”<sup>26</sup> which activity-based costing tracts. Activity-based costing (ABC) is a costing model that identifies activities in an organization and assigns the cost of each activity resource to products and services according to their actual consumption.<sup>27</sup> It allows indirect costs associated with overhead to be assigned and incorporated into direct cost accounts. In so doing organization can precisely estimate the true cost of its individual products and services and identify and eliminate those which are unprofitable. More importantly, it can give managers the insight to lower prices of products that are overpriced (due to an unfair allocation of indirect costs) so they will become more competitive. From a corporation’s perspective, the ABC methodology assigns an organization's total resource costs to the products and services provided to its customers by way of tracking activities and, as such, is used as a tool for understanding product and customer cost and profitability. The ABC methodology can therefore be used to support strategic decisions in the areas of price setting, outsourcing, and identification and measurement of process improvement initiatives.

In Mr. Drucker’s words, ABC is based on the premise “that manufacturing is an integrated process that starts when supplies, materials, and parts arrive at the plant’s loading dock and continues even after the finished product reaches the end user. Service is still a cost of the product, and so is installation, even if the customer pays.”<sup>28</sup> The last sentence is enlightening. Even across corporate boundaries, ABC can tract the cost of purchasing, installing and servicing products so that ultimately all costs can be managed to give the customer the best value and make the sellers offerings optimally competitive. It appears, therefore, that our desired information systems should implement the ABC methodology.

In addition to the ABC methodology, Mr. Drucker offers interesting comment on benchmarking. According to him, productivity information in the form of benchmarking, or comparing one’s corporate performance to that of the best performers in the industry, can help a company improve their competitiveness by making employees realize they must be at least as good as the standard set by the industry leader in order to be competitive.<sup>29</sup> He then suggests that combining Economic Value Added

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<sup>26</sup> Id., Drucker, P. F. (1995), pg. 55, para. 3.

<sup>27</sup> As reported by Wikipedia on their website at: [http://en.wikipedia.org/wiki/Activity-based\\_costing](http://en.wikipedia.org/wiki/Activity-based_costing), Article was posted October 21, 2010.

<sup>28</sup> Id., Drucker, P. F. (1995), pg. 55, para. 3.

<sup>29</sup> Id., Drucker, P. F. (1995), pg. 59, para. 3.

(EVA) and benchmarking information together provides “the diagnostic tools to measure total-factor productivity and to manage it.”<sup>30</sup> Expanding the concept into a discussion of “core competencies,” Mr. Drucker references Gary Hamel’s work in the area.<sup>31</sup> Successful companies are said to be “able to do something others cannot do at all or find difficulty to do even poorly.”<sup>32</sup> Logically, it does make sense that core competencies in the form of a special ability of a supplier can create market or customer value.

From an information perspective, therefore, companies should be defining information systems to identify and monitor their core competencies, preferably to the point where they could measure and report out their strength and position in the industry. This would enable them to identify and track how many core competencies they have, and of what strength it will take for each one to maintain a leadership position in the field. In my opinion, developing an information system that can matter-of-factly report out, in dash board metrics, the position and strength of a corporation’s core competencies will be the most influential to the next generation of economic planners. Armed with integrated core competency, ABC, EVA and benchmarking information IEDMs will close the gap to becoming Mr. Hayek’s “Economic Man.”

The importance of raising management’s awareness of their core skills is enormous. In my personal experience I have twice, through Government funded programs, developed core competencies in a team that led to leadership positions in industry. In 1997 while at TRW Systems Integration Group (SIG) we developed a then state-of-the-art software guard coded in Java. Similarly, in 2004 we stood up a Nuclear, Biological and Chemical (NBC) integration and test lab full of state of the art sensors and created a leadership position regarding integration of NBC sensors into military vehicles. In both cases not only were we not fully supported by the company to pursue new opportunities and grow the business area, but other operating units in the company propped groups up during reorganizations and funded them to compete against us. Although Mr. Drucker implies it, I feel compelled to say if more forcefully: if you do not leverage your core competencies and apply aggressive, innovative path forward planning to stretch your leadership position, then your business will die a quick death because some of your competitors will. If you don’t focus on improvement to maintain core competencies, then you are really just saying you will work this project until it is finished, layoff or transfer the staff, and wait for another opportunity in another area to surface.

So how can senior management help avoid these tragic losses? The first step is to understand what your core competencies are, and develop the interest, corporate drive, and dedicate the resources to develop and execute a plan to leverage them in order to maintain them. Significantly, Mr. Drucker actually summarized, albeit at a top level, the information that information systems could monitor to track core competencies. Relevant information objectives might include:

- Information tracking how well your organization is performing in core competency areas
- Information tracking how well your competitors are performing in your core competency areas

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<sup>30</sup> Id., Drucker, P. F. (1995), pg. 59, para. 3.

<sup>31</sup> Hamel, G. (1990), *The Core Competence of the Corporation*, Harvard Business Review, May-June, 1990.

<sup>32</sup> Id., Drucker, P. F. (1995), pg. 59, para. 4.

- Information tracking unexpected successes that occur in the industry of your core competency areas with a special focus on why they happened
- Information tracking non-successful efforts that occur in the industry of your core competency areas and justifications regarding why they happened
- Information tracking your sales performance to look for unanticipated customer groups.

Mr. Drucker points out the market values paid for the special services you are offering can be evidence of how strong the core competency area is.<sup>33</sup> Similarly, non-success case studies, whether they are your organizations, or those of competitors, can be evidence of when the market area you have a core competency in is beginning to weaken. Now that relevant information (within a construct of an effective economic model) has been identified, the next step is for corporate organizations to define their information systems with dashboards capturing these topics to keep their management aware of the strength and position of their core competencies.

### Centralized Planning Averages out Local Opportunity Input

Centralized planning slows down decision making by attempting to direct whole economic systems in accordance with one unified plan based on centralized data that has averaged out local opportunity input. Companies that rely on centralized decision making move more slowly and are at a disadvantage since many production issues require decisions to be made quickly by employees with the local knowledge of the circumstances, which a central planner does not have. Centralized decision makers necessarily require local employees to first communicate all their knowledge up the management chain to the decision maker, and, after the information is reviewed and considered, a decision is rendered. The considerable time it takes to move issues up a company's organizational structure defeat its ability to respond rapidly.

Friedrich August Von Hayek addressed the issue when he said, "it would seem to follow that the ultimate decisions must be left to the people who are familiar with these circumstances, who know directly of the relevant changes and of the resources immediately available to meet them. We cannot expect that this problem will be solved by first communicating all this knowledge to a central board which, after integrating all knowledge, issues its orders."<sup>34</sup> (Emphasis added). In addition to slowing down decision making, a centralized approach is also vulnerable to producing poor or politically based decisions as successive layers of management filter the real issues in the information they pass up the management chain to protect their standing.

In his comments on centralized planning, Mr. Hayek defines "planning" as "the complex of interrelated decisions about the allocation of our available resources,"<sup>35</sup> defines "central planning"<sup>36</sup> as trying to direct the whole economic system in accordance with one unified plan, and uses the "economic planning center" in the context that while it is not disputed that economic planning should be done, it is

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<sup>33</sup> Id., Drucker, P. F. (1995), pg. 59, para. 7.

<sup>34</sup> Friedrich August von Hayek, "The Use of Knowledge in Society," *Austrian Economics: A Reader*, ed. Richard M. Ebeling, Hillsdale, MI, 1991, pg.s 254-255.

<sup>35</sup> Id., Hayek, F. A. (1945), pg. 520, para. 3.

<sup>36</sup> Id., Hayek, F. A. (1945), pg. 521, para. 1.

disputed that it should be done "centrally."<sup>37</sup> The probability of a plan's success is related to the amount of existing knowledge that is used, some of which must necessarily include what Mr. Hayek refers to as local "knowledge of the particular circumstances of time and place."<sup>38</sup> This "body of very important but unorganized knowledge" cannot be scientific knowledge leading one to conclude that it cannot be used effectively by a central planning center.<sup>39</sup>

The problem confronting a centralized planning authority trying to construct a rational economic order is how IEDMs can utilize knowledge not given to everyone in its totality.<sup>40</sup> How can the best use of resources be secured with knowledge not totally provided to everyone, and where the end use of the knowledge and its relative importance to the end user is only known to the end user? An example of local knowledge that a central planner would not have access to is how to put a machine to use that is not fully employed. Central planning, which takes local knowledge information, lumps it together, and averages out the significant aspects of the local data with respect to local time and place opportunities, simply "cannot take direct account of these circumstances."<sup>41</sup>

### Decentralized Decision Making and the Division of Knowledge

A decentralized decision making approach speeds up decision making. It facilitates a division of knowledge where IEDMs can utilize relevant "time and place" information about local opportunities, which allows the best use of resources to be secured and applied against the economic endeavor. Most companies employ centralized, top-down communication structures with poor response mechanisms to support decision making. A decentralized approach should be implemented in these companies to speed up decision making, and to improve the quality of the decisions being made; e.g., by eliminating decisions made by centralized managers based on filtered, inaccurate data. Commitment and motivation can be harnessed if employees are authorized to make decisions relevant to their operational responsibilities.

### Summary

Mr. Hayek does a masterful job of convincing the reader that accurate economic information is necessary for IEDMs to predict market conditions, to the extent they can, and make successful investment decisions. The ability to calculate a magic price value that will result in a state of economic equilibrium, where buyers and sellers are equally happy to proceed with a transaction, is not possible. Such decisions would necessarily have to be made by central planners that would not have access to local opportunity information. The perfect knowledge assumption also misleads our economic decision makers into a false believe the problem is simpler, from the perspective of the information needed to support such decisions, than it actually is. This results in poor investment decisions by managers that collect the wrong economic data. Although Mr. Hayek contends that mankind may have just stumbled upon it, and that it is not capable of being calculated by a central planner, the price system, when left on

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<sup>37</sup> Id., Hayek, F. A. (1945), pg. 520, para. 4.

<sup>38</sup> Id., Hayek, F. A. (1945), pg. 521, para. 4.

<sup>39</sup> Id., Hayek, F. A. (1945), pg. 521, para. 4.

<sup>40</sup> Id., Hayek, F. A. (1945), pg. 520, para. 1.

<sup>41</sup> Id., Hayek, F. A. (1945), pg. 524, para. 2.

its own, seems to be able to naturally reflect the state of the economy and adjust the price of commodities to support the demand.

Mr. Hayek expands the Division of Labor concept into a Division of Knowledge proposition. He asserts that knowledge above that required to make workers skilled specialists that can support a Division of Labor based economy, is required to quantify economic input variables to the extent that IEDMs could predict the marketplace in order to support our Division of Knowledge based economy. A difficult task as described by Mr. Hayek for sure. Just when things were looking bleak for our hypothetical “Economic Man,” who merely by an assumed premise is said to require perfect foresight to support economic decision making, Mr. Drucker takes the first important steps towards defining the types of information modern information systems can process to support economic decision makers with near real time data monitoring the strength and position of core competencies. While it’s not quite as good as the perfect foresight imposed on our “Economic Man,” relevant, near real time economic data is a giant leap forward for economic mankind. So who knows, maybe sometime in the future we will be able to go to a BestBuy store and purchase economic dashboard software for \$50.00 that allows managers to select a core competency area from a drop down list and immediately start monitoring relevant economic data. It could be implemented via a number of net-centric, push-pull, or publish and subscribe information services tailored for each industry. The sample below is based on a Thomson Reuters Eikon dashboard<sup>42</sup> service supplemented with Mr. Drucker’s recommended information categories.



Figure 1. Sample Financial Dashboard with Core Competency Tracking Data Containers

Perhaps Thomson Reuters will be the ones to create such a dashboard?

<sup>42</sup> Thomson Reuters offers the Eikon dashboard services tailored to the next generation of financial profession. The sample was taken from their website at: [http://thomsonreuters.com/products\\_services/financial/eikon](http://thomsonreuters.com/products_services/financial/eikon).