

# MBA's Gone Wild

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**M**ore than twenty years ago, the sociologist Robert Nisbet described the emergence of a particular character type that was beginning to dominate basic American political, economic and social institutions. Building on Samuel Johnson's description of an unconstrained individual, who, like a parasite, "hung loose upon society", Nisbet called this new character type the "loose individual." The loose individual isn't bound by norms, like fairness or equity, that have arisen as the moral distillations of generations of social experience. He eschews allegiances to social institutions like nations, firms or even occupations, and lacks a sense of "moral responsibility", often "playing fast and loose with the other individuals in relationships of trust and responsibility." Outside of their intimates, their relations with others are anchored only in self-interest.<sup>1</sup>

Since Nisbet wrote, many other observers across the political spectrum have noticed the same character type—from Zygmunt Bauman's concept of "liquid modernity" to George Soros's distinction between relational and merely transactional economic engagements.<sup>2</sup> Today, economic collapse and an almost decade-long cascade of sordid revelations stretching from Enron to AIG make it clear that rather

too many loose individuals have been admitted to the inner sanctums of American capitalism. Once associated with confidence games and local numbers rackets, the loose individual, king of the "flip it" mentality whether on Wall Street or in executive suites and boardrooms across the land, has radically reconfigured the financial, governance and technical apparatus of the American economy.

Many factors have no doubt helped create and empower the loose individual—not least a lack of government regulatory restraint that encouraged imprudent risk taking, poorly designed compensation systems that motivated short-term thinking and behavior, and weak corporate governance and oversight that undermined internal control systems. One of the most important but least remarked sources of the loose individual, however, is a particular type of institution that has trained large numbers of our most elite business leaders: university-based business schools.

In the aftermath of our economic train wreck, many are beginning to question anew what business schools have been teaching their students in recent decades. A few of these questions have arisen from within business schools themselves. Joel Podolny, the former dean of the Yale School of Management, wrote in the June 2009 issue of the *Harvard Business Review*,

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<sup>1</sup>Nisbet, *The Present Age: Progress and Anarchy in Modern America* (Harper & Row, 1988).

<sup>2</sup>A similar analysis from left of center is Richard Sennett, *The Culture of the New Capitalism* (Yale University Press, 2006).

“So deep and widespread are the problems afflicting management education that people have come to believe that business schools are harmful to society, fostering self-interested, unethical and even illegal behavior by their graduates.” Indeed, these beliefs may be justified. To understand why, however, requires some historical reflection on one crucial question: Why do universities even have business schools?

## The Origins of Business Education

To those unfamiliar with the contemporary American business school, this question may seem akin to asking why universities have deans, dining halls or development offices. Business schools are now as solid and respectable a presence on their campuses as Gothic administration buildings or state-of-the-art sports complexes. One might as well wonder why the Taj Mahal has domes, or why someone hired a sculptor to paint the ceiling of the Sistine Chapel.

Indeed, by many measures the university-based business school is a colossal success. Upwards of 146,000 MBA degrees are now awarded annually in the United States, more than double the number in 1981, and up from just 3,200 in 1955. Once an almost exclusively American phenomenon, the MBA degree is now granted in more than a hundred countries and is becoming a globalized credential. The expansion of university business education has been driven to a great extent by the rewards to which it provides access. An MBA from an elite business school has become a golden passport to some of the most coveted and best-paid jobs in fields such as consulting, investment banking, private equity and hedge funds. Business school professors can now achieve the same level of public cachet enjoyed by top celebrity academics in more traditional disciplines. They write not only for respected academic journals but also sit on corporate boards, serve as well-paid consultants and dispense valued (if not always valuable) insights to the media. Their activities are increasingly underwritten by well-regarded philanthropists like Eli Broad and Michael Bloomberg, who give generously to business schools for facilities, endowed chairs and student scholarships.

It was not always this way. The role of higher education in American life had once been confined to preparing well-born young men for the traditional professions of law, medicine and divinity. But in the 18<sup>th</sup> and 19<sup>th</sup> centuries, a series of reforms extended the role of American universities into a broader range of professions. In 1787, the Northwest Ordinance expanded higher education by creating the state college and university system. The Morrill Act of 1862 sanctioned agriculture and the “mechanical arts” as fit subjects for study in the nation’s new land-grant universities. The movement to endow higher education with a more utilitarian cast picked up speed after the Civil War, when the German model of the research university was grafted on to the homegrown product in the 1870s and 1880s to create a uniquely American, and uniquely successful, hybrid institution.<sup>3</sup> Elite private schools such as Harvard and the University of Pennsylvania increasingly adopted the model of the new American research university, with its triple mission of teaching, research and public service. It was mostly at these schools that the potential for conflict between vocationalism and academic purism was greatest, and here that the idea of a university-based business school became a focal point of that conflict.

On the one side were advocates of legitimizing business as a subject worthy of a place in the university. Their advocacy arose, above all, from Progressive-era fears about the rise of the public corporation. A new vanguard of institutional entrepreneurs, both academics and enlightened business leaders, saw the growing power of unprecedentedly large corporations in the late 19<sup>th</sup> and early 20<sup>th</sup> century as a profound challenge to the existing social order. Rightly so: The sale of shares to the public resulted in a separation of ownership and control of the large corporation; boundaries between private ownership and public impact blurred, with the result that shareholders, labor and the state all claimed the right to direct this powerful new economic entity.

Smack in the middle of this dizzying scene was a new group known as managers. Managers worked for owners, but they interacted with

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<sup>3</sup>See Itamar Rabinovich, “The American Advantage”, *The American Interest* (May/June 2009).

laborers and shareholders, too. Proponents of the university-based business school thus focused on advancing management's claim to professional status within the university environment. To do so, the leaders of the business school movement allied themselves with three institutions viewed as pillars of the emergent social order in the Progressive Era: science, the professions and the new American research university. By means of this network of alliances, the university-based business school proposed to ensure that large corporations would be run in the interests of society by turning the occupation of management into a bona fide profession.

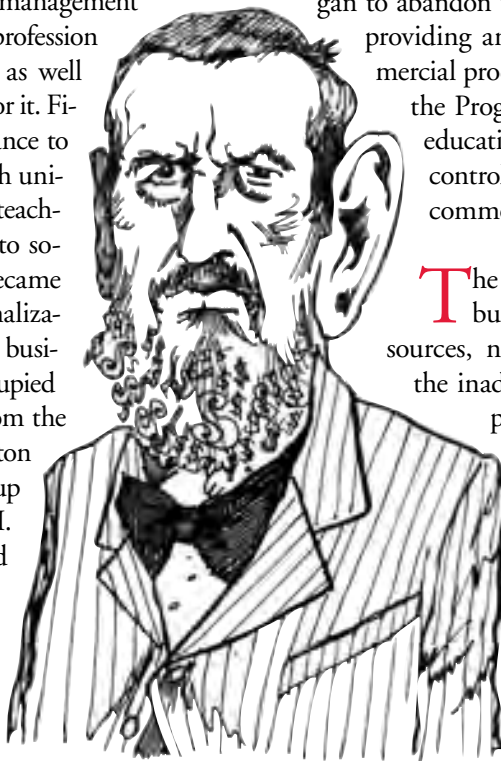
The notion that management should be made into an academic subject of study (in essence into a science and hence a value-neutral enterprise), as well as into a profession resembling the traditional ones of law and medicine, was controversial. Business schools had to earn their place within the university. They did so by following a three-pronged strategy flowing from their embrace of science, professionalism and the mission of the research university. First, they attempted to demonstrate that management was indeed a science whose conceptual roots lay in the traditional academic disciplines. Second, they proposed to elevate management to the level of a genuine profession by developing normative as well as cognitive foundations for it. Finally, they pledged allegiance to the new American research university's triple mission of teaching, research and service to society. These three goals became the basis of the "professionalization project" in American business education, which occupied business school leaders from the foundation of the Wharton School at Penn in 1881 up to the eve of World War II.

Not long after the end of the war, however, the professionalization project, which had never achieved more than partial success, began to unravel. A post-war boom in business

education spurred by the GI Bill witnessed the creation of dozens of new business schools, leading to a dilution of academic standards. The American Association of Collegiate Schools of Business (AACSB), which had been created by the founding deans of business schools at leading universities such as Harvard, Chicago and Dartmouth and had been the primary vehicle for the professionalization project, soon devolved into a mere accrediting agency.

The *coup de grâce* for the professionalization project came in the late 1980s, when *Business Week* published a cover story ranking U.S. MBA programs based mostly on the opinions of corporate recruiters and second-year students. Other publications soon followed suit with rankings emphasizing factors such as graduates' starting salaries, student satisfaction with the physical facilities and quality of services provided to recruiters—all measurements that have little to do with the quality of the education students receive, but that dramatically shape the perceptions of applicants, employers and alumni. Business school deans, mindful of the competitive landscape in which they operated, quickly submitted to the tyranny of the rankings, and many business educators began to abandon the pretense that they were providing anything other than a commercial product. This was the death of the Progressive concept of business education as a means to direct and control corporate power for the common welfare.

The de-professionalization of business schools had several sources, none more important than the inadvertent role played when a powerful but largely silent partner inserted itself into business education: the American philanthropic foundation. In the 1950s, the newly wealthy Ford Foundation, along with the Carnegie Corporation, took up the cause of reforming American business schools. Despite



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the best of intentions, the Ford Foundation's intervention in particular had dramatic consequences for the future of business schools—and catastrophic ones for the professionalization project.

To address the problem of uneven quality among business schools, the Ford Foundation centered its efforts to improve the intellectual caliber of business education on two major objectives: making business school research and curricula more “scientific” by grounding them in quantitative analysis; and making business school faculties more “professional” by recruiting them from the most relevant academic disciplines, primarily economics. Focusing on a small number of “centers of excellence”, Ford Foundation managers accurately foresaw that the means and methods it promoted in these elite business schools would trickle down to others. But they misunderstood what that trickling process would amount to.

In the business school classroom, new concepts from the discipline of economics, now methodologically “hardened” and broken away from the normative tradition of political economy, began to hold sway. Particularly influential were transaction-cost theory and agency theory. Rather than self-disciplined professionals using their expert knowledge for the greater good, managers were now seen in the light of economic theory as the corruptible agents of shareholders, to whose interests they must be bound by purely economic incentives. Thus taught to think of managers as mercenaries, graduates of the elite business schools increasingly opted for jobs not as managers but rather as management consultants, investment bankers and portfolio managers.

Eventually, the de-professionalization of business school education began to provoke a reaction. Respected business school faculty began in the 1990s to criticize the disciplinary orientation of business school scholarship and the relevance of both scholarship and teaching to the education of future managers. These criticisms centered mainly on faculty who pursue narrow research agendas on topics remote from the actual practice of business, the collateral result of which was to make business school pedagogy increasingly irrelevant to real business.<sup>4</sup> Henry Mintzberg, author of *Managers Not MBAs* (2004), has pointed out that

the typical full-time MBA student, with only one or two years of work experience, has little chance of making sense out of most of the concepts taught in business school courses.

## MBAs and the Economic Crisis

More important than the irrelevance of much MBA curricula, however, is the actual perniciousness of what is often taught to MBA students. The narrow, shareholder-value-maximization management model that has become a staple of MBA courses, argued the late Sumantra Ghoshal, has turned the pursuit of short-term shareholder interest, as well as naked self-interest on the part of managers, into managerial virtues. It is no surprise that “loose individuals” would be attracted to, or even arise from, this kind of education.

It is worth being specific here, so that we can better appreciate the links between MBA education and the current economic crisis. In the first place, as several scholars have pointed out, the dominant human behavior model taught to business school students—a model whose roots can be directly traced to neo-classical agency theory—is not only theoretically flawed but has contributed to the diffusion of practices that obliterate good management practices. The prescriptions that flow from the dominance of a narrowly conceived model of neo-classical economics have led MBA-credentialed corporate managers to favor extrinsic behavioral motivators, like pay and threats, over intrinsic motivators, like excellence or quality. Such choices consistently undermine long-term organizational performance.<sup>5</sup> Others like Robert Shiller have argued that current business school teachings socialize students into an ethic of selfishness and limited accountability. They legitimize the idea that managers should orient

<sup>4</sup>Warren Bennis and James O'Toole, “How Business Schools Lost Their Way”, *Harvard Business Review* (May 2005).

<sup>5</sup>See Fabrizio Ferraro, Jeffrey Pfeffer, and Robert Sutton, “Economics Language and Assumptions: How Theories Can Become Self-Fulfilling”, *Academy of Management Review* (January 2005).

their behavior solely around maximizing shareholder value and short-term profitability, without regard for the effects on other constituents like employees, customers or the community.<sup>6</sup> Ghoshal's criticisms are even more damning. He contended that the contemporary business school curriculum and business school professors have directly contributed to the institutionalization of many corrupt managerial practices, including excessive executive compensation and ethical shortcuts. Current theories, he argued, teach students that managers and employees cannot, and should not, trust one another, which in turn sets in motion a self-legitimizing, self-reinforcing cycle encouraging opportunism, lying and cheating.

One of the dominant theories to which Ghoshal is referring falls within the rubric of agency theory. Agency theory began as an economic model of the firm that offered a general conceptual framework for bringing together previously disparate fields such as accounting, strategy, finance and organizational behavior. This equivalent of a unified field theory for business, something business education had sorely been lacking and desperately wanted, was articulated in a series of papers by Michael Jensen and his colleagues. They proposed a theoretical roadmap asserting that the sole purpose of the corporation is to maximize shareholder value, and that since managers have self-regarding motives that differ from those of stockholders, monitoring these managers under conditions of wide stock dispersal is a major practical challenge.<sup>7</sup> The challenge is to create an "alignment of incentives" in which managers' personal financial interests will correspond with those of owners. Indeed, much discussion in these foundational papers emphasizes three mechanisms of interest alignment: monitoring managerial performance, providing comprehensive economic incentives and promoting an active market for corporate control.

Monitoring managerial behavior involves the deployment of complex accounting practices and the appointment of a professional board of directors whose members operate in the stockholders' interest by virtue of their need to maintain their personal reputations. Comprehensive economic incentives involves remunerating management in the form of company

stock and stock options, so that managers and owners possess exactly the same economic incentives. The market for corporate control leads to an emphasis not on long-term corporate growth or earnings-to-dividends ratios, but on stock prices. Agency theory taught that stock prices would faithfully reflect firm fundamentals and ensure that poorly performing "insiders" would be threatened and ultimately be replaced by efficient and profit-oriented "outsiders."

Agency theory quickly created a unified approach to organizations and corporate governance in American business schools, catalyzing academic revolutions in corporate finance, organizational behavior, accounting, corporate governance and the market for corporate control. Agency theory also spearheaded a new paradigm in management theory and research, but unlike most earlier business school scholarship it did not generate much empirical research. That is because the core ideas of agency theory did not emerge from inductive observation or practical experience but from the theoretical musings of a newly revitalized neoclassical economic theory.

In the early 1970s, agency theory bought into a highly abstract, deductive approach to business school research and then progressively applied this theory to a widening variety of corporate phenomena. Drawing on the growing legitimacy of macroeconomics, and spurred on by its apparent capacity to account for the economic stagnation of the 1970s, agency theory quickly reshaped the intellectual life of leading business schools. By the 1980s, this approach had gained the authority to classify and judge managerial behavior across the board.

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<sup>6</sup>Shiller, "How Wall Street Learns to Look the Other Way", *New York Times*, February 8, 2005.

<sup>7</sup>See Jensen and William H. Meckling, "Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure", *Journal of Financial Economics* (October 1976); Eugene F. Fama and Jensen, "Separation of Ownership and Control", *Journal of Law and Economics* (June 1983), and Jensen, *Foundations of Organizational Strategy* (Harvard University Press, 1998).

Agency theory has amounted to an attack on the legitimacy of managerial authority as university business schools traditionally understood it. It presumes that managers have no interest in serving the shareholders' interest beyond any formal contractual obligation to do so. But by reducing managers to minimally trustworthy agents of shareholders, the proponents of agency theory nullified the significance of factors like duty, loyalty or social conscience. This approach, of course, means that the only important way to make sense of the manager and the firm is through relentlessly commodified language and quantitative analysis.

This radical change in defining the relationship between managers and the firm has led to an overarching normative mutation. Once all notions of the broader human and social relationship between the manager and the firm—and between the firm and the larger society—began to disappear, the identity of management itself was transformed. MBA students are not taught that managerial professionalism is predicated on duties to the firm, its multiple constituents and the broader society. They are taught instead that managers matter solely because of their ability to keep the money flowing in and short-term stock prices up.

As was the case with all previous far-reaching materialist ideologies unleashed in the 20<sup>th</sup> century, the new ideology of management wanted nothing less than to create a new type of individual. But unlike the ideologies of socialism or fascism, which sought to appeal to individual prejudices or communal identities, the attraction of this ideology was its appeal to individual self-interest. In class after class, business school students were knocked into shape around a narrow focus on short-term self-interest—a bowdlerized version of Adam Smith. They were taught to conflate making money with creating wealth.

## Restoring the Mission

**M**ore than a hundred years after they first appeared, the university-based business school remains an unsettled, even inchoate institution. In light of the historical descent from the professionalizing aspirations of the founders to the nakedly commercial preoccupations of uni-

versity business schools today, the old question of why there are business schools in universities now takes on urgent contemporary relevance.

No university business school today would dare proclaim in its mission statement that it exists to “deliver superior return on investment for its students” or to “maximize shareholder value” (although many do in their marketing materials). In practice, however, this is about as high as contemporary MBA education aims. Virtually every university business school now proclaims its mission to be some variant on the theme of educating “leaders.” Yet given that “leadership” doesn't offer an even remotely adequate intellectual or normative foundation for a university professional school, one suspects that the “leadership” nostrum is an appeal to high-mindedness without the rigors and demands of educating actual professionals. Meanwhile, MBA students, understanding (not entirely unlike law school students) that the content of their business school education has little to do with the actual practice of business, have come to value their MBA experience largely for the networking access it provides.

They are correct to do so. The only things that really distinguish university business schools from the increasing numbers of for-profit competitors are the prestige and other forms of social capital accumulated by the university and generously shared by it with business schools. When the first university-based business schools were founded more than a century ago, universities were willing to share their social capital in order to bring business education into the academic fold and infuse it with the university's ideals. Why are they willing to continue sharing it now, when business schools have strayed so far from the university's academic and social mission?

One possibility is that, whereas a century ago business schools had to adopt the values of the university in order to establish themselves, the contemporary American university has increasingly adopted the values of a business. Indeed, so thorough has been the transvaluation of the past quarter century that one might as well debate not how much of their legitimacy business schools now owe to the university, but how much of their legitimacy universities (except for the most elite) owe to their business schools.

Alas, this is not a flippant suggestion. Business education has become so divorced from what is supposed to go on at a university that we ought to start giving it the same scrutiny that many are urging for mass-market college sports. Business schools need to revisit the guiding question of their founders: By what means, and for whose benefit, should large corporations be run?

In my book *From Higher Aims to Hired Hands* (2007), I describe how university-based business schools were humbled by the Great Depression. That crisis served as a rebuke to their teachings, forcing a deep re-examination of their missions, methods and indeed their very conception of management as a profession. Today, self-reflection does not necessarily mean that business schools should turn back the clock to the Progressive Era or the early New Deal, but it does mean they must revisit fundamental questions of purpose. What leadership models do business schools encourage, not just in glossy marketing brochures and fundraising letters, but at the deepest, structural level? What should business schools do to create responsible citizens in a democracy?

The answer should be about much more than adding an ethics course to the curriculum as a feel-good measure. I suggest the following:

*Recognize that continuous education must be a part of any MBA degree.* Doctors, lawyers and teachers need ongoing professional education; why not MBAs? Certainly corporate boards and executives should understand the complexities of the financial transactions they manage and the symptoms and dynamics of bubbles.

*Require certification.* An MBA degree today can mean virtually anything. It is time to begin a serious conversation about what graduates with the degree need to know. It is also time to create an opt-in system in which MBA students agree to abide by an oath of principles. We need a governance system that can certify *and decertify* their continuing abidance. If a lawyer can be disbarred for misconduct and a medical license revoked on evidence of abuse, why not an MBA degree?

*Create a new model of leadership* to form the core of the MBA curriculum, shifting the focus away from the maximization of shareholder value. Business schools must challenge any

expectations and assumptions about compensation that students carry over into the workplace. For example, the beliefs that there is a fair market for CEOs or that retention “bonuses” such as we saw at AIG should be written into a contract should be targeted for disabusement. Schools should also revisit the practice of institutionalizing relentless student networking. It would be better to expand social networks to include a wider range of experiences and potential leadership opportunities.

Society itself also has to be clear about what it expects from business schools. Left to their own devices, they would prefer to emulate giant corporations, satisfying critics by tinkering with perceptions rather than examining their own core operating systems. To date there has been little explicit discussion of the ethos that the current business education model has inculcated in students. We need to revive questions about why students want to go into business. Is it simply to get rich? That should not be an acceptable principal motive for inclusion in a business school program. At the same time, we educators must recognize that many of our theories have disenchanted our students about the possibilities of business and the meaningfulness of creating institutions that are built to last.

Economic crisis aside, business schools today, even despite their high seat in the ivory tower, know that “business as usual” must end. For the faculty, technological innovations such as open-access scholarly publications suggest that the glacial pace of peer-reviewed journals, the traditional outlet for research scholarship, must be radically accelerated, with implications for hiring and retention. And the student body is already changing. Given the ambient uncertainties with which we now live, MBA students now more than ever want work that is meaningful to society as well as personally fulfilling. Society’s loose individuals seem far less admirable these days.

The 125-year-plus history of the university business school has traced a dramatic rise and fall over the course of time. Our collective hope should be that future historians will call this not the end of an era, but a new beginning, a time when a new generation of institutional leaders seized the opportunity to become part of the solution to a critical problem instead of part of its cause. 🌐