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Throwing the Red Flag: Challenging the NFL's Lessons for American Business

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INTRODUCTION

The lovely double entendre in the title of Dean Roger L. Martin's book, *Fixing the Game: Bubbles, Crashes, and What Capitalism Can Learn from the NFL*,[1] encapsulates Martin's argument that the American system of business and capitalism is *rigged*, but can still be *repaired*.[2] Drawing on an unlikely source—an analogy to the National Football League (NFL)—Martin argues that business should shift its focus away from the "expectations market" (i.e., in football, the betting world, and in business, the stock market, where stock prices reflect investor expectations of future performance) and back to the "real market" (i.e., in football, the game on the field, and in business, the creation of products and services).[3]

Martin contends that the business world's overemphasis on the expectations market leads to the sacrifice of long-term business growth in favor of higher short-term stock

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1. ROGER L. MARTIN, FIXING THE GAME: BUBBLES, CRASHES, AND WHAT CAPITALISM CAN LEARN FROM THE NFL (Harvard Business Review Press 2011).

2. *See generally id.*

3. *Id.* at 37–38.

prices;[4] incentivizes inauthentic and amoral behavior by executives and other market players who withhold or manipulate information through earnings management, pumping of the stock price, and accounting fraud or otherwise;[5] entices market players to create economic volatility, which enables them to "tak[e] advantage of less-sophisticated investors while creating no net value for society;"[6] and creates a "downward spiral" in which market players try to increase their piece of a "finite pie" at the expense of other market players rather than trying to expand the size of the pie by creating societal goods.[7] That is, American capitalism's expectation-market orientation destroys shareholder value rather than increasing it. In contrast, Martin argues that reorienting business toward the real market could provide an "opportunity to build for the long run . . . and produce sustainability"; restore authenticity in our executives; reduce volatility and the influence of parasitic market players; and create more value for customers and society, making everyone (including shareholders) better off.[8] To accomplish this reorientation, Martin makes several specific recommendations,[9] the unstated upshot of which is to recommend that businesses remain private to the extent at all possible.

Fixing the Game makes powerful and persuasive arguments. Martin's analogy between business and the NFL is quite useful, and not solely for the substantive lessons Martin distills. In addition, the analogy makes the debate about corporate governance accessible to a wider audience,[10] gives this audience a more familiar lens through which it can understand the sometimes arcane aspects of business law and practice, and enables each member of this audience to draw on her sense of good sportsmanship in order to develop her own intuitions about what constitutes fair business practices. Moreover, the analogy can help even sophisticated businesspeople better appreciate some of the flaws of the system in which they operate.

However, the analogy between business and the NFL is far from perfect. Martin clearly acknowledges this,[11] but a more thorough exploration of the flaws of the analogy will help to refine the analysis. Thus, this Article challenges three[12] aspects of the analogy and discusses how these challenges ought to alter Martin's recommendations.

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4. *Id.* at 29.
5. *Id.* at 36.
6. MARTIN, *supra* note 1, at 36.
7. *Id.* at 32, 34.
8. *Id.* at 71, 80–81.
9. *Id.* at 37–41.
10. NFL football reaches an enormous market. Over 111 million viewers watched the NFL Super Bowl in 2012, and the 2010–12 Super Bowls are the "three most-watched programs in U.S. television history." Richard Deitsch, *Super Bowl XLVI Sets Viewership Records*, SPORTS ILLUSTRATED (Feb. 6, 2012, 3:33 PM), http://sportsillustrated.cnn.com/2012/football/nfl/02/06/tvratings.record/index.html.
11. MARTIN, *supra* note 1, at 14.
12. In the NFL, a coach throws a red flag in order to indicate that he wishes to challenge the referee's ruling on the field (e.g., as to whether a catch was completed in-bounds or as to whether the ball crossed the plane of the goal line for a touchdown). This use of the red flag in the NFL explains the title of this piece. Teams are generally allowed two challenges per game, but if a coach makes and wins both challenges, he becomes entitled to a third challenge, for a maximum of three challenges per team in a regulation game. *See* 2012 OFFICIAL PLAYING RULES OF THE NATIONAL FOOTBALL LEAGUE R. 15 § 9 (2012), *available at* http://static.nfl.com/static/content/public/image/rulebook/pdfs/18_Rule15_Officials_Jurisdictions_and_Duties.pdf (covering instant replays and coaches' challenges). Taking an optimistic view of the persuasiveness of my first two challenges, I make three challenges in this Article.

First, imperfection in the analogy between shareholders and sports bettors suggests a stronger condemnation of hedge funds and the derivatives market than of the traditional stock market. Second, the limitations of the analogy between business executives and NFL players weaken Martin's case against the use of stock compensation for executives. Third, the flaw in the analogy between business customers and NFL fans suggests that a reorientation of business toward the maximization of "customer delight" is unrealistic and perhaps unwise, particularly if the business needs capital. Ultimately, the intent of this Article is not to reject Martin's recommendations; rather, the goal of this Article is to help refine and further Martin's work as we face the daunting tasks of reforming corporate governance and growing the economy.

I. CHALLENGE #1: SHAREHOLDERS, SPORTS BETTORS, AND THE DANGERS OF THE EXPECTATIONS MARKET

Martin analogizes shareholders to sports bettors and capital markets brokers to bookies,[13] and he uses this analogy to argue that, just as the NFL's business decisions are not driven primarily by the expectation (sports betting) market, American business should not be driven primarily by the expectation (stock) market.[14] Instead, he argues that, in both cases, the real market should be the focus. This is the main theme of the book, and this view motivates Martin's specific recommendations discussed in Part II and Part III.

However, this argument suffers from a flaw in the analogy. There is an important difference between shareholders and sports bettors. Shareholders are owners of the underlying enterprise, while sports bettors are not. A sports bettor makes a naked wager, with no real stake in the enterprise, which makes a sports bettor more analogous to a trader in derivatives[15] than to someone who merely owns stock of a corporation. Thus, when Martin uses a sports betting analogy to argue that catering to the expectations market poses tremendous dangers, his argument resonates more strongly in the context of the derivatives market (particularly where the positions are used primarily for speculation rather than hedging)[16] than in the context of the traditional stock market.

A. Appreciating that the Starting Point Matters

While both a stock's price and a game's spread reflect projections about an outcome, the value of a stock is derived not only from the expectations of future earnings, but also from the value of the underlying assets.[17] That is, a sports bettor cares only about

13. MARTIN, *supra* note 1, at 16.

14. *Id.* at 17–26, 37–38.

15. For example, selling a company's stock short is effectively betting against the company. Very generally, someone who sells stock short borrows the stock, sells it to a third party (say, for $50 per share), and at some later date (say, Date *X*) must return the stock (with interest) to the party from whom it was borrowed. The short seller makes money if the stock declines in value in the interim; for example, if, as of Date *X*, the stock is trading at $30 per share, the individual can acquire the stock he needs (for purposes of returning the borrowed stock to the lender) for just $30 per share. In this example, the individual makes approximately $20 per share (less interest and fees) because the stock *declined* in value—that is, the investor won his bet against the company.

16. References herein to investors in derivatives generally assume that the investor is not using the derivative to hedge his position with respect to the underlying reference obligation, which he also owns.

17. A slightly different way of saying this is that stock price reflects expectations about a company's *total*

whether performance expectations are met (for example, did Team *X* beat the spread?), whereas a stockholder cares also about the starting point for setting those expectations (for example, is Team *X* a good team with a lot of wins or a bad team with no wins?). To illustrate, consider an example that Martin uses, comparing the 2007 New England Patriots and the 2007 Cleveland Browns.[18] The Patriots, who were unbeaten in the regular season, covered the spread on games only 10 out of 16 times, whereas the Browns, who had a 10-6 regular season record, covered the spread 12 times.[19] Martin argues that, if the expectations market mattered more than the real market, then the Browns would have been considered more successful and the Browns' quarterback would have out-earned the Patriots' record-setting quarterback.[20]

That discussion of performance relative to expectations disregards an important measure of each team's worth—its underlying value (that is, each team's starting point relative to which expectations are set). This can be illustrated by building on Martin's analogy: As of the start of the 2007 season, the Patriots averaged more than 11 wins per season since 2001, appearing in the playoffs five times and winning three Super Bowls.[21] In contrast, over the same time period, the Browns averaged fewer than six wins per season, and lost in their one and only playoff appearance.[22] Given these historical performances, the Patriots' pre-season odds for winning the year's Super Bowl (the futures odds)[23] were better than the Browns'.[24] Martin notes that the Browns performed better against the spread over the course of the season than the Patriots. As the Browns' over-performed (relative to expectations), the Browns' odds to win the Super Bowl improved.[25] Nevertheless, the futures odds for the Patriots to win the Super Bowl

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future performance—expectations about future earnings and expectations about the probability of liquidation (and what shareholders would receive if it occurs).

18. MARTIN, *supra* note 1, at 21–24.

19. *Id.* at 23.

20. *Id.* at 23–24.

21. *New England Patriots Franchise Encyclopedia*, PRO-FOOTBALL-REFERENCE.COM, http://www.pro-football-reference.com/teams/nwe/ (last visited Dec. 27, 2012).

22. *Cleveland Browns Franchise Encyclopedia*, PRO-FOOTBALL-REFERENCE.COM, http://www.pro-football-reference.com/teams/cle/ (last visited Dec. 27, 2012).

23. Futures odds in the NFL reflect long-term projections for each team, incorporating the cumulative expected performance over many games, rather than reflecting expected performance in just one game. This is similar to the way a company's stock price reflects the long-term projections for the company, which incorporate the cumulative expected performance of the company over many fiscal quarters, rather than over just one fiscal quarter. Of course, futures odds, despite having longer term horizons than individual game spreads, are for a particular term (they expire at the end of the relevant season), whereas stock prices do not reflect a term-limited projection.

24. *See Super Bowl XLII Odds (2007 season)*, SPORTSODDSHISTORY.COM, www.sportsoddshistory.com/aa_php/main.php?y=2007&s=nfl&a=sb&p=pre&o=r (last visited Dec. 27, 2012) (showing the betting lines for Super Bowl XLII); *Archived Super Bowl XLII NFL Futures Odds from Just Prior to Preseason, 2007 to Win Super Bowl 42*, FOOTBALL LOCK (Feb. 3, 2008), www.footballlocks.com/nfl_futures_odds_super_bowl_XLII.shtml (showing Super Bowl XLII historical futures odds); Stephen Rhodes, *Odds to Win 2008 Super Bowl XLII—Glendale AZ, February 3, 2008*, NFL GRIDIRON GAB (July 22, 2007), www.nflgridirongab.com/2007/07/22/odds-to-win-2008-super-bowl-xlii-glendale-az-february-3-2008/ (giving the odds for all 32 NFL franchises of winning Super Bowl XLII).

25. *Compare Super Bowl XLII*, OFFICIAL VEGAS TRAVEL SITE (Oct. 15, 2007), http://web.archive.org/web/20071018045820/http://www.vegas.com/gaming/futures/superbowl.html [hereinafter *Week Six Super Bowl XLII Odds*] (showing that, during week six of the season, the Browns had

remained better than the Browns' futures odds even as the season progressed.[26]

That is, a very bad team that outperforms expectations is likely to have its long-term odds improve, while a very good team that underperforms may have its long-term odds worsen,[27] but the odds of the underperforming very good team should still be better than the odds of the over-performing but very bad team. Similarly, a company's stock price, like a team's long-term odds of winning the Super Bowl, reflects more than just under- and over-performance relative to expectations in any particular period.

B. Understanding the Relationship Between the Bettor and the Organization that Is the Subject of the Bet

A shareholder's ultimate economic claim (i.e., upon liquidation and winding up of the investment) is against the company, whereas a sports bettor's economic claim is against the bookie, not the team. Thus, a shareholder should always prefer the value of the company to increase because the terminal value of stock upon liquidation depends upon the company having value available to distribute.[28] In contrast, a bettor is not necessarily interested in increasingly good performance of the team that is the subject of his bet; if he bets against the team, he prefers bad performance by the team. To him, it is perfectly fine if the team loses all of its value (or games) because he does not depend on the team for his economic entitlement—he depends on the creditworthiness of the counterparty to the bet (i.e., the bookie). So too with derivatives, an investor in a derivative generally does not depend on the company from whose securities the derivative is derived; that company could lose all of its value, and the investor could still reap rewards if he bet against the company's stock and the counterparty is creditworthy. Thus, shareholders should have an incentive to desire success of the underlying enterprise, whereas the sports bettors' and derivative investors' preferences about success or failure of the underlying enterprise should depend on the directionality of their bets.

Further, a sports bettor's wager does not provide resources to the team; rather, the wager merely facilitates the redistribution of existing funds among the actors in the betting market. In contrast, a shareholder (at least upon an initial stock issuance) transfers funds to the company; this investment is intended to provide capital that enables the business to grow and generate additional valuable goods and services. Of course, shareholders who acquire their stock in the secondary market do not contribute funds to

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250/1 odds for winning the Super Bowl), *with Super Bowl XLII*, OFFICIAL VEGAS TRAVEL SITE (Nov. 14, 2007), http://web.archive.org/web/20071117100256/http://www.vegas.com/gaming/futures/superbowl.html [hereinafter *Week Eleven Super Bowl XLII Odds*] (showing that, during week 11 of the season, the Browns had 125/1 odds for winning the Super Bowl).

26. *Compare Week Six Super Bowl XLII Odds*, *supra* note 25 (showing that during week six, the futures odds for the Patriots were 3/2 while the futures odds for the Browns were 250/1), *with Week Eleven Super Bowl XLII Odds*, *supra* note 25 (showing that during week 11, the futures odds for the Patriots were 1/3 while the futures odds for the Browns were 125/1).

27. Interestingly, the futures odds on the Patriots actually continued to improve as the season progressed. *See supra* text accompanying note 26 (discussing the futures odds for the Patriots).

28. Of course, most public shareholders monetize through sales to other shareholders rather than through redemptions upon liquidation. However, the value of a purchaser's long-term rights is reflected in the price at which the stock changes hands. That price incorporation may not be perfect, but as a corporation approaches liquidation or winding up, the stock price should increasingly reflect the value of the underlying assets available for distribution upon liquidation and should decreasingly reflect expectations about future earnings.

the company. However, any share purchased on the secondary market can be traced back to initial issuance, upon which the initial shareholder did contribute something to the business. Further, the existence of the secondary market arguably helps companies because the initial investors, knowing that the secondary market provides liquidity, were likely willing to pay more for their initial investment than they would have paid in the absence of the liquidity provided by the secondary market. Thus, even stock purchased on the secondary market reflects some contribution to the business. Sports bets never provide value directly to the team in order to help the team grow.[29]

Additionally, the timeframe for a sports bet and for a derivative contract is commonly finite and short.[30] As a result, the bettor/investor can benefit from short-term volatility and thus, may have an incentive to generate the volatility. In contrast, many shareholders invest for the long-term.[31] Of course, many shareholders invest for the short-term, but unlike a sports bet or many derivative contracts, an investment in stock is generally not time-limited by its own terms. Thus, the greater prevalence of long-term investing in stocks suggests that shareholders are less likely to benefit from the manufacture of volatility and may have more tolerance for business plans that produce long-term benefits.

C. Calibrating the Concerns to the Context

Ultimately, shareholder ownership of the underlying enterprise matters. Because the shareholders are bettors who also own a real stake in the underlying enterprise, some of the problems Martin identifies as products of expectation markets (such as volatility creation, the sacrifice of long-term growth for short-term benefits, and failure to contribute to the growth of the pie) may be less likely to be problematic in the traditional stock market than in sports betting or in derivatives trading. That is not to say the problems do not exist in the stock market—they do. This is, of course, because the price of any stock can be driven, to a significant extent, by the expectations about the business's future earnings. Martin notes that the S&P 500 has traded on an average price-to-earnings (P/E) ratio of 16:1, and he contends that this P/E ratio means that 94% of the price of the stock is for "what stock investors collectively expect the company to do in the future," whereas only six percent of the price of the stock is for "what is happening now."[32] But this is an average. Price-to-earnings ratios can vary widely from company to

29. Arguably, sports betting can provide value to teams indirectly if betting increases fan interest and viewership of the game, which in turn can increase advertising dollars and sponsorship fees received, but this is much more attenuated. *See generally* John A. Fortunato, *The Relationship of Fantasy Football Participation with NFL Television Ratings*, 3 J. SPORTS ADMIN. & SUPERVISION 74 (2011) (suggesting a positive correlation).

30. For example, I may bet that Team *X* will beat the spread in its game this weekend against Team *Y*. Once the game is over, the winner of the bet is determined, the loser pays the winner, and the transaction is over. Similarly, examples of derivatives include an option (for which the expiration date sets the date after which the option ceases to confer any rights) or a futures contract (which articulates the date on which the commodity subject to the contract is to be delivered, after which date, the contract is concluded).

31. *See* WORLD ECONOMIC FORUM, THE FUTURE OF LONG-TERM INVESTING 13–21 (2011), *available at* http://www3.weforum.org/docs/WEF_FutureLongTermInvesting_Report_2011.pdf (explaining who long-term investors are, discussing the magnitude of their long-term investments, and identifying stock in public and private companies as potential investments for long-term investors).

32. MARTIN, *supra* note 1, at 220.

company and industry to industry.[33] Employing Martin's use of P/E ratios as a proxy for the role of the expectations market,[34] the higher the P/E ratio, the greater the role of the expectations market in the pricing of the company's stock; conversely, where a company has a very low P/E ratio, the expectations market arguably plays a much less dominant role.

This suggests that perhaps Martin overstates the dangers of the expectation market in the context of the traditional stock market (or, at the very least, in the context of certain industries or particular companies), despite rightly emphasizing the severity of the problems in the context of derivatives and hedge funds (which are entirely expectations-market based).[35] When understanding and trying to respond to the adverse consequences of an expectations-market orientation, we should recognize that the prominence of the expectations market (and, thus, the problems it creates) varies by type of investment and type of industry. As a result, we should be careful to ensure that regulatory responses and private sector company-specific responses to the problems created by the expectations-market orientation are proportionate to the magnitude of the problem in the particular context.

Given that the critiques of the expectations market do resonate in the context of the traditional stock market (even if this resonance is weaker than it is in the context of derivatives), this Article's remaining two challenges address specific recommendations that Martin makes about how businesses can shift away from the expectations market and toward the real market.

II. CHALLENGE #2: BUSINESS EXECUTIVES, NFL PLAYERS, AND THE STRUCTURE OF INCENTIVE COMPENSATION

When criticizing the use of stock compensation for executives, Martin analogizes business executives to NFL players.[36] Using this analogy, he argues that, just as the NFL prohibits insider participation in sports betting, American businesses should eliminate (or at least reduce) the use of stock compensation for executives, thereby reducing insider betting on the future of the company.[37] Further, Martin argues that, to the extent that businesses use monetary incentives for executives, the metrics for the incentives should be grounded in the real market rather than in the expectations market, just as Tom Brady should be compensated for his on-field performance (yards, touchdowns, wins) rather than based on the number of times the Patriots beat the spread.[38] Moreover, Martin argues that non-monetary incentives—for NFL players, "the feeling of pride in helping his team win, in exciting the fans, and in being seen by his colleagues as working his hardest on the task," and for business executives, "the feeling of pride in contributing to a company's goal, in offering the best product or service to customers—should compete

33. *See* Aswath Pamodaran, *PE Ratio by Sector*, DAMODARAN ONLINE (Jan. 2012), http://pages.stern.nyu.edu/~adamodar/New_Home_Page/datafile/pedata.html (providing P/E ratios for a wide variety of industries).

34. P/E ratios may not, in fact, be good proxies for the role of the expectations market. For purposes of this Article, however, I set that concern aside and accept (and argue within) Martin's framing.

35. MARTIN, *supra* note 1, at 157–90 (dedicating an entire chapter to investment managers).

36. *Id.* at 17–19, 87–129.

37. *Id.*

38. *Id.* at 127–28.

closely [with monetary incentives]."[39] Martin asserts that these changes can restore authenticity to the lives of executives and can help executives focus on long-term business profitability and value creation.[40]

But, again, there are important differences between business executives and NFL players that suggest refinement of the analysis.

A. Valuing Efficient Markets

Despite the risks, the participation by executives in the stock market can reveal valuable information, thereby helping increase the efficiency of the public stock market,[41] which is beneficial to society.[42] In contrast, there is arguably little (if any) societal value in ensuring an efficient sports gambling market,[43] so player betting on sports primarily creates risks to the game, without also conferring benefits.[44] Thus, the case against stock compensation for executives seems weaker than the case against sports betting by NFL players.

However, the elimination of stock compensation, alone, would not prevent executives' market efficiency-increasing function because executives could still trade in the business's stock; the only difference would be that the executive would have to purchase the stock with his own money rather than receiving the stock as compensation.[45] Indeed, this could potentially be even *more* useful to the promotion of

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39. *Id.* at 127.

40. MARTIN, *supra* note 1, at 127–29.

41. *See generally* Ronald J. Gilson & Reinier H. Kraakman, *The Mechanisms of Market Efficiency*, 70 VA. L. REV. 549, 573–74 (1984) (discussing the decoding of trades by insiders as a way that markets can become more efficient). There is debate about how efficient the market is and about whether, and the extent to which, the information-revealing benefits of insider trading exceed the adverse consequences of such actions. Nevertheless, this discussion proceeds on the understanding that trading by insiders can reveal valuable information; similarly, this discussion treats as a separate issue the question of whether that information is sufficiently valuable to overcome adverse consequences of such actions.

42. Dennis W. Carlton & Daniel R. Fischel, *The Regulation of Insider Trading*, 35 STAN. L. REV. 857, 866 (1983) ("The social gains from efficient capital markets are well known. The more accurately prices reflect information, the better prices guide capital investment in the economy. From the perspective of an individual firm, . . . efficient capital markets are a public good . . . .").

43. *See* Philip K. Gray & Stephen F. Gray, *Testing Market Efficiency: Evidence from the NFL Sports Betting Market*, 52 J. FIN. 1725, 1729–31 (1997) (providing evidence of inefficiency in football betting). Further, in order for NFL player participation in the betting market to increase meaningfully the efficiency of that market, NFL player bets would have to be clearly and systematically disclosed to market participants, just as there is mandated disclosure of business insiders' material actions with respect to company stock.

44. It may be noteworthy that NFL players participate in another aspect of the sports expectations market—fantasy football. In fantasy football, participants set their "player rosters" based on their expectations about player performance in an effort to amass the greatest number of points (points are awarded based on in-game statistics, such as yards gained and touchdowns scored). Fantasy football participants win or lose in any given week depending on how the players on their roster perform. NFL players regularly participate in fantasy football, so their decision to draft themselves on to their team and to put themselves on their active roster for the week reflects their assessment about their likely performance. *See Fantasy Football Isn't Just for Fans—NFL Players Are Hooked*, NFL, http://www.nfl.com/news/story?template=with-video-with-comments&confirm=true&id=09000d5d8145ad3d (last visited Dec. 27, 2012) (discussing NFL players' participation in fantasy football).

45. This difference could be merely formal rather than substantive if executives understood that it was expected that they would own a certain number of shares and if the executives' cash compensation was

an efficient market because executives would signal information to the market upon purchase of the stock, and not solely upon sale of the stock. But Martin's recommendation that executives "should be prevented from selling any stock, for any reason, while serving in that capacity—and indeed for several years after leaving their posts,"[46] would inhibit the dissemination of information that can contribute to an efficient market.

Given the contribution to market efficiency served by insider participation in the market, perhaps it would be better just to limit the volume of stock an executive can sell during his tenure with the company, rather than to bar such sales entirely.[47] The difficulty would be setting the limit at an appropriate level—high enough so that meaningful information could be shared with the market, but low enough to ensure that the executives maintain a significant long-term stake in the company.

B. Designing Real-Market-Based Monetary Compensation

Despite his critique of stock compensation, Martin does admit that monetary incentives can serve a useful purpose in motivating individuals to achieve specific goals. However, he argues that, just as monetary incentives for NFL players are based on on-field performance and not with reference to the spread on the game, monetary incentives for business executives "should be grounded in the real market" and should not be based on stock price.[48] The importation of this real-market incentive approach into the business world presents challenges because, among other reasons, real-market performance in the NFL is much more easily measured—a player runs the ball a specific number of yards, a quarterback throws for a specific number of touchdowns, a defensive back has a specific number of interceptions, and a team has a specific number of wins. These measurements are more difficult in business because it is hard to determine which employee created a company's increased profitability, who increased a company's market share, and who reduced employee turnover. Changes to these real market business measures are products of many people working together, of the efforts from years ago by people who are no longer with the company, and of market events over which the company employees may have no control.[49] Of course, even NFL players do not accomplish their real-market achievements alone (e.g., even Tom Brady needs receivers to catch his passes). Yet, in the NFL, the accomplishments are more easily observable and objectively measurable—a touchdown is always worth six points, the player with possession of the ball in the end zone scores the touchdown, the team with more points at the end of the game is the winner, and the team that wins the Super Bowl is the top team of the season. What is equivalent in the business world where accounting practices change over time (or are fudged), where businesses can use many different metrics to evaluate their success, and

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increased by an amount sufficient to pay for the purchase of that number of shares on the open market.

46. MARTIN, *supra* note 1, at 121.

47. Current insider trading rules impose a variety of other limitations on the ability of executives to trade in the stock of the companies they serve, including limits on the time periods during which executives can trade. *See generally* DONALD C. LANGEVOORT, INSIDER TRADING REGULATION, ENFORCEMENT, AND PREVENTION §§ 1.12, 5.4 (Eric Smalley et al. eds., 2012).

48. MARTIN, *supra* note 1, at 127.

49. It is, of course, not a novel observation to note that designing incentive compensation can be quite difficult when trying to incentivize individuals to contribute to activities that are measured in the aggregate.

where there seems to be no consensus about what makes a company the victor over its competitors or about the time frame over which victory is measured?

Moreover, using real-market incentives does not avoid opportunities to manipulate the targets.[50] Real-market incentives are structured so that the player/executive receives additional compensation if he surpasses a particular threshold. But those thresholds are often set through negotiation based on expectations, and the player/executive has an incentive to try to lowball the expectation in order to make it easier to surpass, thereby increasing the odds that he will receive the bonus. Imagine, for example,[51] a team offering to pay a bonus to a running back (let's call him Willis McGahee) if he rushes for more yards in the coming year than he did in the previous year. The running back's agent might counter by arguing that the previous year was anomalous because the quarterback (let's call him Tim Tebow) was so inexperienced that the team relied heavily on the ground game, but that the team's acquisition of a great new quarterback (let's call him Peyton Manning) means that, in the coming year, there will be a more even split between the passing and running plays. Thus, the running back will argue that the previous year's yardage is not the appropriate threshold for a performance bonus this year, and rather the threshold should be much lower.[52] The same story can be told in the context of the business world. Imagine a business that offers to pay a bonus to an executive if the company increases its market share in the coming year more than it increased its market share in the previous year. The executive's lawyer might counter by arguing that the previous year's market share gains were anomalous because the company launched a new product, but that another new product launch that could lead to a similar market share increase is not planned for the coming year; thus, the executive could argue (rightly or wrongly) that last year's rate of market share increase is not the appropriate threshold for a performance bonus in the coming year, and rather the threshold should be much lower. These games sound awfully similar to the earnings management[53] game that Martin condemns for its inauthenticity[54] and for its short-term outlook.

Incentive *targets* are not the only things that can be manipulated. Similarly, real-market-based incentives, like expectation-market-based incentives, are also susceptible to the manipulation of the *outputs*.[55] For example, in the NFL, Michael Strahan became the all-time sack leader not when he made a great play, but rather when Brett Favre basically

50. *See generally* HOWARD M. SCHILIT, FINANCIAL SHENANIGANS: HOW TO DETECT ACCOUNTING GIMMICKS & FRAUD IN FINANCIAL REPORTS (2d ed. 2002) (discussing the manipulability of a variety of real-market business metrics).

51. I have no information to suggest that the negotiation described in the following example actually occurred. Rather, I am posing a hypothetical situation, and I provide some context by illustrating the hypothetical with real players.

52. Query how justifiable this argument is given that McGahee did not begin the prior year as the team's starting running back, but he began the current year as the starter.

53. Perhaps the game is less likely to be successful in the bonus-threshold setting context because there are fewer players involved and the players are likely to be repeat players who may be more effective at reigning in this inauthentic activity.

54. As an aside, the NFL is hardly a bastion of authenticity when it comes to compensation. Just look at the announcement of the worth of any player contract. For example, the $100 million contract that Michael Vick signed in 2011 is virtually guaranteed not to pay Vick $100 million.

55. For example, a running back who is very close to his bonus threshold for yards gained might lobby the coach for more carries even in a game that is a blowout.

fell down to give Strahan the record.[56] And in business, executives could try to reach targets for increased market share by diverting money from research and development to advertising, even though this move could harm the business's long term prospects. Again, these opportunities for manipulation of real-market metrics sound remarkably akin to the opportunities for manipulation of expectation-market metrics that Martin criticizes.[57]

Further, with any monetary incentive, it is critical to design the incentive so that the individual's economic interests are as aligned as possible with the organization's interests, such that opportunities for an individual to maximize his personal financial gain at the expense of the organization are as infrequent as possible, and so that the individual is not encouraged to take illegal or unethical actions in furtherance of his financial gain. The New Orleans Saints bounty scandal is a recent illustration of how a financial incentive can encourage improper behavior (i.e., deliberate efforts to physically harm members of the opposing team) and can ultimately cause long-term harm to the organization the incentive was designed to help (i.e., resulting in suspensions of coaches and players, and harming the reputation of a beloved organization).[58] Martin rightly recognizes that these dangers of monetary incentives are present whether the incentive is based on the expectations market or on the real market.[59]

The challenges of measurability, manipulability, and alignment of individual and organizational incentives do not mean that we should abandon the idea of using real-market-based monetary incentives for executives. I agree with Martin that this idea ought to be pursued. However, design will be difficult. Martin does not claim that real-market-based incentives are a panacea, but he is quite optimistic that, with "creativity" in design, real-market-based monetary incentives can be employed to foster "more authentic executives" and to encourage and reward long-term business growth.[60] I am less sanguine. Either way, I think we would be wise to appreciate the challenges of designing effective real-market-based monetary incentives and to accept that the use of monetary incentives that are based on the real market does not solve all of the problems created by use of monetary incentives that are based on the expectations market.

C. Employing Non-Monetary Incentives

Martin also argues that businesses should move beyond monetary incentives and incorporate non-monetary psychological compensation in order to "focus executives on

56. Mike Freeman, *On Pro Football; Cheap Sack Will Cost Favre and Strahan*, N.Y. TIMES, Jan. 7, 2002, http://www.nytimes.com/2002/01/07/sports/on-pro-football-cheap-sack-will-cost-favre-and-strahan.html.

57. Indeed, depending on the individual case, expectations-market players may have more difficulty discovering manipulation of real-market metrics than expectations-market metrics.

58. *See Saints Bounty Scandal*, ESPN (Dec. 5, 2012), http://espn.go.com/nfl/topics/_/page/new-orleans-saints-bounty-scandal (discussing the scandal and its sanctions). Even monetary incentives that generally align individual and organizational interests can present opportunities for individuals to sacrifice organizational goals for individual benefits. *See* Michael Conlin & Patrick M. Emerson, *Multidimensional Separating Equilibria and Moral Hazard: An Empirical Study of National Football League Contract Negotiations*, 85 REV. ECON. & STAT. 760, 763 (2003) (finding that players exert more effort in the last year of their contracts than during the regular term of the contracts).

59. *See, e.g.*, MARTIN, *supra* note 1, at 125 (using an incident with Sears as an illustration of the potential for misdeeds).

60. *Id.* at 128–29.

real and meaningful goals."[61] In the NFL, such non-monetary incentives include a player's desire to help his team win, "to excite fans, and to be seen by his colleagues as working his hardest on the task."[62] Additionally, these incentives can include a player's desire to be valued by his community (as the Saints value Drew Brees) and to be an integral part of a community that is valued by him and others (as the people of New Orleans value the Saints).[63] In business, non-monetary incentives could include "pride in doing a great job for . . . his city, [and] his customers,"[64] and "pride in contributing to [his] company's goal [and] in offering the best product or service to customers."[65]

Admittedly, these feelings can be incredibly powerful and can spur an individual to do everything he can for his organization. But these attitudes are more intrinsic to certain people and less to others, and these values are more inherent in some organizational cultures but less in others.[66] Examples of the power of non-monetary incentives are easy to find in the NFL.[67] In important games for their teams, Brian Westbrook and Maurice Jones-Drew each knelt down shortly before the goal line to help secure a team win, rather than score, pad personal statistics, and risk the chance that the other team might score in the game's waning seconds.[68] Players regularly put their personal health and safety at risk to help their teams win; this is true even though players know that the long-term health repercussions of playing football can be quite serious.[69] And big name players such as Tom Brady and Peyton Manning have agreed to restructure their contracts in order to help their teams put together rosters that are more likely to win.[70] The NFL is a culture that values camaraderie and winning, so an opportunity to make an important contribution to a team's success can be a powerful non-monetary incentive for players.

Similarly, the organization and executives must value customer delight in order for the opportunity to contribute to the company's creation of customer delight to provide a powerful non-monetary incentive for business executives. Martin gives examples of companies, such as Johnson & Johnson and Apple, which place a very high value on the

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61. *Id.* at 39.

62. *Id.* at 127.

63. *Id.* at 101–03.

64. MARTIN, *supra* note 1, at 106.

65. *Id.* at 127.

66. *Cf.* Patricia Casey Douglas et al., *The Effect of Organizational Culture and Ethical Orientation on Accountants' Ethical Judgments*, 34 J. BUS. ETHICS 101, 103–05 (2001) (discussing how differences in organizational culture can affect individual decision making).

67. The military is another organization where individuals regularly subordinate individualism in favor of organizational success.

68. Michael C. Wright, *Competitive Jones-Drew Unaccustomed to Not Scoring*, FLA. TIMES UNION, Nov. 15, 2009, http://jacksonville.com/sports/football/jaguars/2009-11-15/story/competitive_jones_drew_unaccustomed_to_not_scoring; *Eagles RB Westbrook Credits Runyan for His Stop Inside 1-Yard Line*, CBS SPORTS (Dec. 17, 2007), http://www.cbssports.com/nfl/story/10534431.

69. *See* Ben McGrath, *Does Football Have a Future? The NFL and the Concussion Crisis*, NEW YORKER (Jan. 31, 2011), www.newyorker.com/reporting/2011/01/31/110131fa_fact_mcgrath (discussing the impact of serious head injuries incurred by individuals playing professional football).

70. Erik Frenz, *Tom Brady Restructures Contract, How Can New England Patriots Use Extra Money?*, BLEACHER REPORT (Mar. 22, 2012), http://bleacherreport.com/articles/1115180-tom-brady-restructures-contract-how-can-new-england-patriots-use-extra-money; *Manning Restructures Contract to Save Colts Cap Room*, ESPN (Feb. 21, 2007, 5:39 PM), http://sports.espn.go.com/nfl/news/story?id=2773817.

customer experience and subordinate the goal of maximizing shareholder value.[71] But for companies where customer delight, production of social goods, and/or community pride are not already part of the organizational ethic, how can a business use these non-monetary incentives to "focus executives on real and meaningful goals"?[72] To overcome this "chicken and egg" problem, business must transition, and that transition requires, at least in part, convincing executives to value these non-monetary rewards.[73]

Martin rightly notes that business culture can change, as it did after the Jensen and Meckling article that reoriented business to focus on shareholder value maximization.[74] I submit that a shift in the other direction will be more difficult in part because it is much harder to measure these non-monetary benefits than it is to measure stock price. Moreover, even if a business's executives all value these non-monetary benefits, the executives likely value the benefits differently, meaning that it may be difficult to design a comprehensive incentive plan tailored to each executive. Ultimately, efforts to redesign executive compensation packages (so that they include less stock compensation, rely more on real-market-based monetary incentives, and make greater use of non-monetary incentives) in order to increase authenticity and facilitate long-term value creation may be desirable, but they are likely more difficult than Martin acknowledges.

III. CHALLENGE #3: BUSINESS CUSTOMERS, NFL FANS, AND THE MAXIMIZATION OF CUSTOMER DELIGHT

When criticizing business for its focus on shareholder value maximization rather than on the maximization of customer delight, Martin analogizes business customers to NFL fans,[75] arguing that, just as the NFL focuses on fans rather than owners, American business should focus on customers rather than shareholders. He explains that, "[w]ith fans and the real game as the focus [of the NFL], owners have indeed done just fine."[76] Similarly, Martin contends that, in business, "customer delight is a more powerful objective than shareholder value . . . [and] if you take care of customers, shareholders will be drawn along for a very nice ride."[77]

But, once more, there is a critical weakness in the analogy: NFL owners are generally also NFL fans,[78] but company shareholders may or may not be company

71. MARTIN, *supra* note 1, at 44–50, 65–66.

72. *Id.* at 39.

73. Alternatively, a business could fire its executives and just hire new people who do value these things. Either way, the executives' values matter because they can permeate throughout an organization. *See* Yair Berson et al., *CEO Values, Organizational Culture & Firm Outcomes*, 29 J. ORG. BEHAV. 615, 619 (2008) (contending that "organizational culture" is a predictor of organizational outcomes).

74. MARTIN, *supra* note 1, at 10–14 (citing Michael C. Jensen & William H. Meckling, *Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure*, 3 J. FIN. ECON. 305 (1976)).

75. MARTIN, *supra* note 1, at 37–38, 79–80.

76. *Id.* at 80.

77. *Id.* at 85.

78. For example, Robert Kraft, owner of the New England Patriots since 1994, has been a fan of the team since the early 1960s. *Robert Kraft: Chairman and CEO*, NEW ENG. PATRIOTS, http://www.patriots.com/team/staff/robert-kraft/e4af13f7-fe19-430c-9485-e3fe17042ca6 (last visited Dec. 27, 2012). The biographies of many other team owners similarly indicate that the owner is also a fan. Moreover, owners' reactions to watching their teams play and owners' reactions to lifting the Lombardi Trophy at the end of a Super Bowl-winning season easily demonstrate that owners are also fans of the game. However, the interests of NFL owners

customers. Thus, NFL owners likely get utility out of the fan experience,[79] but shareholders may not get utility out of the customer experience.

Generally, if an investor gets utility out of something (e.g., environmentally sustainable practices of a business) other than a monetary return on his investment, the investor's total return on investment includes both the monetary return and the value of that additional item. Thus, as the corporate social responsibility literature discusses,[80] such an investor may be willing to accept a lower monetary return on his investment than he would in the absence of the non-monetary item. The Green Bay Packers provide a stark example of this phenomenon in the NFL. The Packers recently completed its fifth public offering of stock, offering shares of Packer stock at $250 per share and adding more than 250,000 new shareholders.[81] The offering documents stated that investors should not expect any monetary return on this investment; the Packers do not pay dividends, and if an owner wishes to sell his stock, he must offer it for sale first to the Packer organization for just pennies.[82] Given these terms, each person who subscribes for Packer stock must believe that the non-monetary return (e.g., the pride of being a fan–owner) is sufficiently valuable to justify investing in the team, even without the prospect of receiving any financial return on the investment.[83] Profits and on-field performance are often at odds in professional sports,[84] and thus, an owner's willingness to sacrifice the profits in favor of the on-field performance must mean that the owner gets value not just

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and NFL fans are not entirely aligned. There is ample evidence to the contrary. *See, e.g.*, Sean Leahy, *Roger Goodell Pens Letter to Fans About NFL CBA Talks*, USA TODAY, Jan. 3, 2011, http://content.usatoday.com/communities/thehuddle/post/2011/01/roger-goodell-pens-letter-to-fans-about-nfl-cba-talks/1 (discussing the NFL commissioner's efforts to persuade fans of the merit in the NFL's and owners' position on the collective bargaining agreement negotiations with the players' union); Phil Gentile, *Why the NFL Desperately Needs to Address Preseason Ticket Prices*, BLEACHER REPORT (Aug. 25, 2012), http://bleacherreport.com/articles/1311081-why-the-nfl-desperately-needs-to-address-preseason-ticket-prices (noting that fans complain about being charged full-ticket prices for preseason games when stars rarely play).

79. Similarly, when NFL owners sacrifice profits for victory, they may also get utility out of their ability to help create what is essentially a public good (i.e., enjoyment of wins from which individuals cannot be effectively excluded and use of which by one individual does not reduce the availability of this good to others) for the team's fan base. Thanks to John Crawford for this (and other) insights. Query how commonly businesses create a similar public good and how commonly shareholders in such businesses may value the creation of such public goods.

80. *See, e.g.*, Einer Elhauge, *Sacrificing Corporate Profits in the Public Interest*, 80 N.Y.U. L. REV. 733, 783–96 (2005) (contending that the maximization of total shareholder welfare requires the consideration of both financial and non-financial utility derived by shareholders from corporate action).

81. *Shareholders*, GREEN BAY PACKERS, www.packers.com/community/shareholders.html (last visited Dec. 27, 2012); *Packers Stock Sale Underway: $250 Shares to Support Lambeau Field Expansion*, GREEN BAY PACKERS (Dec. 6, 2011), http://www.packers.com/news-and-events/article-1/Packers-stock-sale-underway-250-shares-to-support-Lambeau-Field-expansion/17178be6-6fdc-49a2-bffe-d650bda38ef5.

82. *See* Rich Smith, *Green Bay Packers Stock Offering: Packers 12, Shareholders 0*, DAILY FIN. (Dec. 7, 2011), http://www.dailyfinance.com/2011/12/07/green-bay-packers-stock-offering-packers-12-shareholders-0/ (summarizing the terms of the offering).

83. *Id.* (arguing that Packers fans are "chumps" to invest in Packers stock). A rational investor would not invest unless he received some utility out of the investment. Given that the offering was quickly subscribed, many investors clearly found value in the opportunity to be a fan–owner.

84. A team owner may try to increase the chances of winning by adding increasingly talented (and thus increasingly expensive) players to the roster. With its revenue sharing and salary cap rules, I think the NFL balances tension between profits and performance better than most other professional sports leagues, but the tension still remains.

from the former but from the latter as well.

Similarly, if a corporation's owner is also a customer or otherwise gets significant utility out of customer delight, he may be willing to accept a lower financial return than he would otherwise be able to achieve from a comparable investment. In this case, the corporation should likely, as Martin advocates, focus its efforts on maximizing the quality of the customer experience. If, however, a corporation needs additional capital, a focus on maximizing customer delight rather than share value may cause the corporation to have trouble selling additional stock[85] unless: (1) the additional equity investors are also willing to accept reduced returns because they already value customer delight,[86] (2) the additional equity investors can be convinced to value customer delight so that they become willing to accept lower financial returns,[87] or (3) the additional equity investors believe that maximizing customer delight will ultimately maximize share value (i.e., that they lose nothing, and may actually gain, if the business focuses on the customer experience).[88]

The first seems unlikely in today's public companies, in general. Given the widely dispersed ownership of public corporations in the United States, it is unlikely that all (or even a majority) of shareholders find utility in the customer experience of the companies in which they own stock, assuming that each shareholder even knows whether he is a customer of each of the companies he owns.[89] Surely, it is reasonable to assume that the percentage of NFL owners that value the fan experience (likely the vast majority) is higher than the percentage of shareholders in public companies that value the customer experience those companies provide. There may be some companies in which investors are willing to accept lower returns because the investors value the customer delight that the companies provide, but it is difficult to find evidence that investors are flocking to

85. Such a corporation should have less trouble borrowing money because lenders receive a fixed, not residual, return and because the corporation must pay lenders before stockholders.

86. *Cf.* David Millon, *Two Models of Corporate Social Responsibility*, 46 WAKE FOREST L. REV. 523, 525–30 (2011) (discussing the "constituency model of corporate social responsibility" in which shareholder returns may be reduced in order to benefit another constituency); Hoje Jo et al., *Socially Responsible Investing vs. Vice Investing* 2 (Acad. & Bus. Res. Inst., Working Paper No. LV10107, 2010), *available at* www.aabri.com/LV2010Manuscripts/LV10107.pdf (explaining that the "value-discounting hypothesis" of socially responsible investing means that "investors who care about ethical aspects of investing may derive non-financial utility by holding assets consistent with SRI criteria and are willing to forego return to avoid holding unethical assets thus bringing down the rate of return").

87. This is just a variant on the constituency model of corporate social responsibility. *See* Millon, *supra* note 86, at 525–30 (discussing the constituency model).

88. *Id.* at 530–39 (discussing the "sustainability model of corporate social responsibility," in which advancing the interests of non-shareholder constituencies ultimately inures to the benefit of all constituencies); Jo et al., *supra* note 86, at 3 (explaining that the "value-enhancing hypothesis" of socially responsible investing means that "SRI portfolios can outperform conventional counterparts" if, for example, "socially responsible corporate policies are considered of value to consumers and employees, [such that] sales will increase and employee relations will improve, [thereby] translat[ing] into a higher firm value").

89. Given the prevalence of mutual fund investing (meaning that a shareholder may not know exactly which stocks he effectively owns at any given time) and given corporate conglomerate structures (meaning that a shareholder might not realize that a particular product is produced by a particular corporation in which she owns stock), shareholder–customers might not even be able to identify the companies in which they are both owners and customers. If an individual cannot correlate a particular customer experience with a particular stock, it is hard for that individual to include the value of the customer experience when calculating his total return on investment.

invest in such companies.

The second is a possibility but may be a long shot. Social movements and priorities change over time and can be reflected in investing decisions. Recall that as the public increasingly rallied against South African apartheid, shareholders (in particular, states and localities) increasingly divested themselves of South African companies, choosing to invest elsewhere.[90] However, changing attitudes and perceptions takes time, and investors must find the cause to be sufficiently compelling. Increasing customer delight may not resonate as powerfully with investors as did opposing the human rights violations of apartheid.

The third is Martin's view—that a corporation that focuses on its customers will ultimately do right by its shareholders.[91] He argues that the NFL is an example of the success of this approach, and he gives examples of corporations, such as Johnson & Johnson and Apple, that have grown to great prominence and value by employing a customer-first approach.[92] Martin may be correct that the best way to maximize shareholder value is to focus on maximizing customer delight, but I do not think that the book makes a conclusive case that this is so.[93] I do, however, think the book makes a very strong case that the customer-focused approach is worthwhile for businesses to try if they believe the strategy might work in their particular contexts. Even assuming that Martin is correct about customer focus leading to the maximization of shareholder value, it may take a long time for a company's customer-focused approach to result in a significant increase in shareholder value. Thus, the company would need shareholders with sufficiently long time horizons and investors who are also customers or who have enough confidence in the customer-focused approach that they are willing to support the company and ensure its financial viability until the value increase is realized. Not every company has the luxury of having these types of shareholders. Indeed, private companies are much more likely than public companies to be in this position, meaning that Martin's analysis suggests that companies ought to stay private to the extent it is at all possible.

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90. *See generally* Jennifer Frankel, *The Legal and Regulatory Climate for Investment in Post-Apartheid South Africa: An Historical Overview*, 6 CARDOZO J. INT'L & COMP. L. 183, 191–94 (1998) (providing an overview of the anti-apartheid divestment by states, localities, and businesses).

91. Some of what Martin states in his book could be read to support the first alternative—that shareholders may be willing to accept a slightly lower return because they value customer delight. For example, Martin refers to owners being "just fine" and going for a "very nice ride," and he refers to Johnson & Johnson's philosophy of providing a "fair return" (not a maximum return) to shareholders. MARTIN, *supra* note 1, at 47, 80, 85. However, I had the opportunity to listen to Martin speak about his book at the Commonwealth Club in San Francisco, and I asked him about this directly. In a very brief conversation, he confirmed that he is not advocating that investors should accept lower returns so that businesses can delight customers; rather, he confirmed that his position is that customer focus ultimately leads to maximum value creation for shareholders. Conversation with Roger Martin, Dean, University of Toronto's Rotman School of Management, in S.F., Cal. (June 21, 2012).

92. MARTIN, *supra* note 1, at 63–66.

93. The customer-focused approach may work in some situations, but there is no assurance. Some companies thrive despite poor customer experiences. For example, Walmart, which is among the world's largest companies (as measured by market capitalization), recently ranked "dead last" among department and discount stores in customer satisfaction according to the American Customer Satisfaction Index. Press Release, Am. Customer Satisfaction Index, Tepid Rise in Customer Satisfaction Mimics Pace of Economic Recovery (Feb. 2012), *available at* http://www.theacsi.org/index.php?option=com_content&view=article&id=275&Itemid=349.

CONCLUSION

Martin's creative analogy between American business and the NFL facilitates our ability to reflect on the current state of business and helps us to devise ideas about how to improve business laws and strategies. Yet, the analogy's fit is far from perfect. Thus, the challenges levied in this Article seek to advance the analysis by identifying the weaknesses in the analogy and explaining their implications. Ultimately, it is only with this nuanced understanding that we can determine how to successfully import the lessons from the NFL into the context of American business.

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