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Chapter 2

Managing Fundamentals: Benching a Hall of Fame Pitcher

It may be that you will need a great length of time to have it become automatic to you, and not be confused by the mechanics of the game

Branch Rickey, former Baseball Executive

Now the fundamentals have got to be more education. More information of knowledge, faster speed, more technology across the board

Jack Welch, former General Electric CEO

Most of the attention and adulation regarding sports flows toward the most visible participants – players and coaches. Few "executives" have extensive histories written about their exploits or philosophies. An exception to this rule is Branch Rickey, who helped to build the St. Louis Cardinals during the 1920s and 1930s and later the Brooklyn Dodgers during the 1940s into consistent winners as their general manager. Rickey has been called part entrepreneur, part scout, part philosopher, part preacher, and part snake-oil salesman for his wide-ranging activities and thoughts regarding baseball and business. These have been well-documented in anecdotes, biographies, and personal notes.

In both his basic outlook on players as well as within the organizational frameworks that

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he established for the Cardinals and Dodgers, Rickey stressed the importance of fundamentals. By fundamentals or synonymous terms, he was talking about the skills or characteristics from which the basic elements of performance could be built. Rather than just looking at a young player's hitting statistics, Rickey looked at the components of the young players swing to see if he thought the mechanics present would lead to future success with development or whether the player, even with impressive statistics might use unsound elements in their swing. He had made detailed notes on pitching and base running stealing along with coaching and drills.[1] He viewed the foundational principles of the game as so important that he institutionalized the instruction of them in the minor league systems of each team he supervised so that players coming up to the major league team would already be well-schooled in them. Because of Rickey's influence, the Cardinals and the Dodger minor league systems became innovators in developing elemental skills such as situational hitting, base running, sliding, defense situations, and others. The stress on these fundamentals came to be so institutionalized that they came to be known as the "Dodger system."

Fundamentals are not just important for players. For managers inside and outside of, laying out and understanding the basic components of effective management are also important. Yet, because they are basic, many would-be managers and MBA students skirt right past them in their haste to get on to the sexier and contemporary topics. Just as a few players may ignore the basics and still excel because of innate abilities, the same holds true for managers. For the masses, though, skipping over the essential elements of decision making or playing a game

because it seem obvious or boring invites a lot of hard knocks if not out and out disaster. Many of the biggest errors made by managers in sports and business grow out of their failure to appreciate fully the subtlety and scope of basic decision concepts. This chapter presents a few of the most basic but most important ideas behind successful management regardless of whether the manager is leading the Yankees or running an automobile dealership. In discussing "fundamentals," it should be stressed that these are elemental or building block level components of sound decision making. Other ideas that utilize these will be developed in later chapters.

HUMAN MOTIVATION 101

During his tenure as head coach of the Packers, Vince Lombardi made a ritual of handing out five and ten dollar bills at weekly "award sessions" on Thursdays. Former Packer Gary Knofelc observed, "It was amazing how prideful you would become" in receiving these nominal sums of money.[2] Lombardi's policies fit in with what Green Bay assistant coach and Lombardi successor Phil Bengston noted as a key feature of Lombardi's understanding of player motivation "the player produces for himself and the team as an extension of himself ... basic appeal to individual pride and performance."[3] He balanced the need for individuals to subjugate themselves to the needs of the team while continuing to recognize the importance of individual.

The divergence between team goals and personal objectives is an example of what has been labeled as the principal-agency problem or just the agency problem – any situation where

the principal's interests differ from the agent's interests. The agency problem may involve a divergence between ownership and management, between general management and divisional managers, between owners or managers and other employees, or between a player and his agent. The problem arises because the objectives of the two parties do not coincide perfectly or maybe very little. For instance, the owner is concerned about profits while the manager is concerned about his own compensation. General management may be concerned with overall company performance while a divisional manager may be interested primarily in the performance of his division. The agency problem is fundamental because it draws its source from the universal fact that people are different and pursue their own agendas. As a result, finding ways to solve or at least reduce the agency problem is one of a manager's most basic and critical functions.

One expression of the agency problem, whether in business or athletics, is the fact that the divergence in objectives within a team or organization can lead to problems of effort or of misdirected effort. Without some kind of monitoring or incentive system, many "agents" such players or employees will not provide full effort. Some may back off only a bit while others may shirk to the fullest possible extent. Or, if they do work very hard, it may be directed in a way that generates greater personal statistics but not necessarily improving overall team performance. The basketball player who hogs the ball and shoots constantly may is one example. One job of coaches and managers is to do things that make the interests of team members, and thereby their activities, more closely coincide with those beneficial to the team as a whole.

An intriguing point about Lombardi is not merely his recognition of the need for

motivation but the depth of his understanding of the fundamental problems involved. Some coaches and business leaders hope to reduce the agency problem solely by preaching lofty platitudes about "team first" and through verbal harassment. Coaches invented and have long have moralized with slogans such as "There's no 'I' in team" and "We not me." These kinds of attempts at instilling a sense of individual responsibility to the group have a place (as discussed later). It does supply a kind of incentive and may change preferences of individuals and their interests slightly, but really proficient managers understand that all of the slogans in the world do not change people into robots who think only of the greater good for the team. "Group-think" babble will not make a player or employee who sees his own personal interest as standing far apart from the team's interest subjugate his own interest without some accompanying incentive.

People are people – not angels and not demons (for the most part). They are concerned primarily with their own personal goals and comforts and those of the closest family members. As longtime Princeton basketball coach, Pete Carill, put it, "Start with the premise that, in general, people would rather do something less difficult than something difficult...People resist giving that high level of effort. There is a tendency to settle for less and then have to overcome it." When it comes to subjugating their own goals and comforts to those of a group, a small percentage may wholly conform to some group-directed goals even without any special monitoring or motivations. A greater percentage will conform to some degree to group-directed goals while pursuing their own agendas to some extent. Finally, a small percentage will exploit any opportunity to pursue a personal objective to the fullest. Sloganeering may tweak these

percentages a bit, but it will not change basic character dramatically.

For all of his loud preaching, Lombardi appeared to comprehend the need to attend to the needs of the individual, at least to some extent. In his view, if a coach failed to account for the personal goals, he would likely fall short of motivating people to their best performance. Although he used speeches, harassment, and intimidation extensively, he went far beyond these methods and explicitly factored in personal goals and satisfaction. An army of coaches and managers observed the louder aspects of Lombardi's style without sharing his depth of understanding of the balancing of personal and team objectives motivation, but some do.

At the University of Kentucky, Rick Pitino assembled highly touted high school basketball stars, many of whom had professional basketball aspirations and skills. Pitino, like Lombardi and many coaches possessed plenty of ego and frequently used verbal assaults to try to root out lack of effort and other personal agendas. Yet, he did not rely solely on these methods. He understood that getting the players to merge their objectives with those of the team required some attention to their personal goals. So, he would encourage the team members to see their own personal rewards and attention as being increased if the team did well. By contrast, if the team performed poorly, much less attention would be directed toward them individually.

This is not to say that the "no 'I' in team" kind of talk has no place in motivating people. As noted above, the majority of employees want the team or company to succeed, but usually the team's success is secondary or at least only equal to the interest in their own personal welfare and that of their family. The sloganeering and preaching about the importance of the team goals

along with the fact that the players go through common experiences together may build a sense of comradery and brotherhood among team members. To some extent, the team may become extension of the player's family. Most players who have been part of athletic teams, especially involving extensive teamwork and physical effort, do build emotional attachments to other players and sometimes coaches, leading the player to expend effort "for the team" that they likely would not without such emotional attachment.

Some coaches and managers go beyond just slogans and throwing the word "family" around to try spend an unusual amount of effort trying to build this sense of team or company as an extended family. George Allen coached the Washington Redskins during the 1970s and Joe Gibbs led them during the 1980s and early 1990s. Both of these coaches took the route of sticking by veteran players and tending to prefer veterans over young players. This kind of loyalty to players comes with a price – it may diminish the athleticism of players and slow the infusion of younger players. Yet, it also tends to build a much greater bond between these players and the team. Their attention to team-oriented goals and objectives are likely to be greater than on a team where the coach throws around the phrases like "were a family" but treats veteran players like little more than nuts and bolts to be plucked off the assembly line.[4]

Yet, astute coaches and managers will realize that there is a limit to the team-as-family concept. For all of the rhetoric, teams and families are quite different. Even the most loyal coach is not going to treat the veteran player like his son or daughter who have lifetime membership in his family. By contrast, every player knows that some day, unless the player

retires first, the playing relationship with the team is going to end. Young family members share the same loyalty from parents as old family members. Coaches who try to build bonds with veteran players frequently do so by treating younger players without the same loyalty or respect. Such a policy can have short run benefits but entail long run costs as younger players are not mixed well into the organization. Chapter 4 digs deeper into the discussion of motivating people and its ramifications for managing.

TRADEOFFS & HIDDEN COSTS

From 1915 to 1919, Babe Ruth regularly pitched for the Boston Red Sox, throwing over 300 innings in both 1916 and 1917. Ruth not only pitched – he excelled at it as Table 2.1 indicates, leading the American League with the lowest Earned Run Average (1.75) and most shut outs (9) in 1916. His career Earned Run Average (2.28) would place him tenth and his career winning percentage (0.671) would place him fifth on the all-time list if he had pitched enough innings to qualify for the list. For further evaluation of his pitching prowess, his ERA falls just a shade behind legendary pitchers Christy Mathewson (2.13) and Walter Johnson (2.17). As is normal in baseball, a pitcher of such talents played sparingly at other positions, so Ruth almost exclusively as a pitcher at least until 1918. Because of his hitting abilities, a new manager of the Red Sox, Ed Barrow, began to split Ruth's time between pitching and playing other positions. In 1918, his innings pitched dropped to 166 innings while he batted over 300

times, up from only about 100 times the year before. In his last year with the Red Sox, 1919, Ruth pitched only 133 innings – equivalent to a widely used reliever or an occasional starter in more recent times – while he batted over 400 times. Even with his part-time role as a hitter, Ruth led the league in home runs in 1918 and in home runs, runs, and runs batted in during the 1919 season.

After being traded to the New York Yankees for the 1920 season, Miller Huggins, his Yankee manager, took a much more drastic step. Ruth pitched only four innings during the 1920 season and merely thirty one more innings the rest of his career that ended in 1935. Of course, his hitting exploits over the rest of his career made him the most recognizable figure in American sports for decades to come. These figures are also provided in Table 2.1. He led the American League in homers twelve times, in slugging percentage thirteen times, in walks eleven times, in runs scored eight times, in runs batted in six times, and in batting average one time. He ranks first all-time in slugging percentage, home run percentage, and walks and second all-time in runs scored, runs batted in, and home runs – a record he held until Hank Aaron broke it in 1974. Had he spent his entire career as playing in the field and hitting, he would have likely approached 800 career home runs.

[INSERT TABLE 2.1 HERE]

Table 2.1 Babe Ruth as a Hitter and Pitcher

Year	At-Bats	Home Runs	Runs	RBI	Innings Pitched	W-L	ERA	League ERA
1914	10	0	0	0	23	2-1	3.91	2.90
1915	92	4	16	21	217	18-8	2.44	2.80
1916	136	3	18	16	323	23-12	1.75	2.70
1917	123	2	14	12	326	24-13	2.01	
1918	317	11	50	66	166	13-7	2.22	
1919	432	29	103	104	133	9-5	2.97	3.20
1920-1930	475	44	131	139	2	-	-	-
Career Totals	8339	714	2174	2211	1221	94-46	2.28	
Career Rank		2nd	2nd	2nd	-	5th	10th	

Ruth's mammoth career hitting statistics made his switch from full time pitcher to full time position player part of baseball lore. It also makes the wisdom of the switch obvious. Yet, many managers outside of sports frequently choose to do what Ruth's Red Sox managers attempted – striking a balance in the utilization of a multi-skilled person. After all, even if Ruth led the league in homers in 1918 and 1919, the wisdom in removing a league-leading pitcher from the mound altogether only appears obvious with the advantage of hindsight in view of Ruth's enormous hitting exploits. In 1918 or 1920, the wisdom of such a move was not nearly so transparent.[5]

The decision faced by Ruth's managers in Boston and New York graphically illustrates a fundamental and critical aspect of managing in or out of sports and in business or personal affairs – a sound manager must be on the look-out for key tradeoffs, be able to gauge the costs and benefits embedded in these tradeoffs, and make correct decisions in view of them. These instructions may appear intuitive, even obvious, but observation of mangers reveals that the ability to grasp their full importance and the implications extending from them are far from obvious for many. Both sports and business managers frequently fail to grasp the importance of implicit tradeoffs where the costs or benefits may be enormous but hard to detect. They may only see the most obvious costs and benefits while overlooking those that are much larger but more subtle. In other settings, a seemingly successful status quo may freeze managers into complacent inaction, thinking that some success equals optimal management policy.

Possibly the most common mistake made by managers across all kinds of settings is fixating only on the most transparent consequences of decisions. Usually, the most obvious consequences attracting the attention of nearly any manager involve a direct outlay of cash. For instance, the decision to pay a free agent player such as Alex Rodriguez $20 million per year for seven years or financing a new plant worth $100 million will not be overlooked or taken lightly by most managers. The size of the expenditure coupled with its means of payment steers attention toward it. One can be sure that it will be carefully scrutinized by the media or by other decision makers in executive meetings or board meetings. In the end, disagreements may arise as to the wisdom of undertaking such large expenses, but they will not be decided without careful thought.

However, many decisions that make or break a team or company do not stand out so clearly in front of the decision makers. For instance, when viewed from a 1915 or 1918 perspective, the Babe Ruth story highlights the difficulty in accurately assessing the relevant tradeoffs. For Ruth's first two managers in Boston, Bill Carrigan and Ed Barry, the most obvious cost boiled down to reducing the time Ruth spent using his established pitching. Later Ed Barrow factored Ruth's hitting in more heavily and struck a balance between his pitching and hitting time. Viewed in 1918, Barrow's decision reflects a common managerial decision whether in or out of sports. It's easy to float through management life thinking that the idea of striking a balance in the use of a valuable person or other resource is prudent. A balanced approach holds the appeal as apparently avoiding extremes. The fallacy in this kind of thinking is that it ignores

the “hidden costs” associated with striking a balance.

In Ruth’s case, the hidden costs amounted to all the hits, homers, runs, and runs batted in that the Red Sox missed out on by having him split his time and that the Yankees would have missed out on by the hundreds if his Yankee manager had followed the course of his Red Sox managers. In retrospect, this likely added up to around 100 home runs and 300 to 400 runs and runs batted in over the four seasons that he either mostly pitched or split time. The problem for his early managers was that they could easily and fairly accurately estimate the costs associated with him pitching less because he already had a sizable track record in pitching. These costs were, in essence, the “cash outlay.” In fact, the reluctance of the Red Sox to move him away from pitching stemmed from the fixation on this cost. Ed Barrow stated that fans would “string him up” if he quit using the best pitcher in baseball.

The more obvious and measurable costs frequently lure managers into the trap of placing more weight on them for the very fact that they are obvious and measurable. Sitting in 1916, his manager could only guess at the costs of Ruth missing batting opportunities. Writing down a firm figure for these costs – the home runs, runs, and runs batted in given up – for the next ten years would have been difficult. As a result, his manager that year and even later managers with some record of his hitting discounted the hidden costs of Ruth’s future hitting and weighed heavily the more directly measurable cost of reducing his pitching time. Miller Huggins displayed genuine insight, decision making skill, and courage to remove Ruth from the pitching rotation altogether.

To correctly assess the relevant tradeoffs in using Babe Ruth, the critical comparison was his productivity as a hitter relative to his productivity as a pitcher. Ruth was, indeed, more productive than almost all major league players as either a pitcher or a hitter. Looking solely at this fact in isolation could easily lead a manager to switch him back and forth between the two positions. After all, moving Ruth exclusively to the outfield almost certainly meant that the pitcher replacing him would not be as effect as Ruth. Yet, these facts were really irrelevant to sound decision making. The fact that as a pitcher he could outperform most others only muddled the picture. The relevant comparison was his hitting productivity relative to his pitching productivity. Ruth's value to his team as a hitter dwarfed even his impressive contributions to the team as a pitcher. He held a relative or comparative advantage versus other players in hitting as opposed to pitching. To use Ruth to his fullest advantage meant taking one of the best pitchers in the league off the mound for good. To do that took a manager with a keen grasp of comparative advantage and the subtle costs embedded in the pitch versus not pitch decision.

Another example of a coach grasping subtle aspects of tradeoffs is John Wooden. While many coaches scream about minimizing turnovers and yank players who commit them out of the game, Wooden's outlook differed by 180 degrees. He thought the team making the most mistakes (measured by turnovers) would win because that was the team that took the initiative and forced the action.[6] Obviously, Wooden did not encourage his team to maximize their turnovers. Instead, he recognized the tradeoff between cautious play that minimizes turnovers and aggressive play that yields more turnovers but also yields better scoring opportunities.

Moreover, he not only recognized this tradeoff but openly attempted to manage his players in such a way so that they did not steer too far toward caution and lose out on many scoring opportunities. Many other coaches may have recognized the tradeoff to some extent, but very few showed the insight or courage to push their team to be more aggressive.

Effective managers share this ability with John Wooden to grasp the fact that there is an inherent optimal amount of just about everything – whether good or bad. Too great of an effort can be made to completely eliminate negative outcomes, such as a turnover in basketball over employee loafing, when the effort to eliminate these negative involve costs themselves. As one NFL coach put it when asked about contact in practice, he responded by saying his teams would have enough contact in practice but "not too much," they would run "but not too much," and so forth. His comments implied that he clearly understood these practice regimens to be useful but too much of them imposed a too high of a cost. Many coaches, even at the NFL level, do not seem to understand that the NFL season is more like a marathon than a sprint. Physical and mental preparation is essential but the season does not end after the first game. The price of too much hitting and strenuous activity in August – injuries, dehydration, lack of mental sharpness – may reduce performance in November and December just as a marathon running would experience a decline in performance by trying to run the first mile of the race at full tilt.

COORDINATED DECISIONS

During the late 1990s, the New York Yankees dominated Major League Baseball in a way that they had not been able to replicated since the 1950s and early 1960s, winning championships in 1996, 1998, 1999, and 2000 along with a narrow miss in 2001 World Series. Based on regular season and post season dominance as well as in the opinion of expert observers, their 1999 team ranked among the best baseball teams of all time. Some rival owners as well as media writers attributed the Yankees' success to the power of the dollar in the era of free agency in baseball. Indeed, the Yankees' revenue from their local market media rights considerably exceeds those obtained even by other large market teams such as the Dodgers and Mets and rise head and shoulder above the revenues of typical MLB teams.

Yet, the deep pocket-free agent explanation offers only a superficial analysis of reemergence of the Yankee dynasty and does not hold up to close scrutiny. The team enjoyed the same kind of financial advantage over the rest of MLB teams ever since the inception of free agency in the mid 1970s. Yet, after winning championships in 1977 and 1978, the Yankees did not win another one until 1996. Even more telling, they stunk over many of these years, at least relative to their own historical standards, appearing in the American League playoffs only twice between 1978 and 1996. In 1981, the Yankees reached the World Series but lost to the Los Angeles Dodgers by four games to two. In 1995 the Seattle Mariners eliminated them in the first round American League Divisional Series. For nearly twenty years, the financial advantage enjoyed by the Yankees translated into mediocrity in spite of ownership by a man, George Steinbrenner, who was obsessed with winning by all appearances and accounts.

What converted mediocrity into dominance for the Yankees over the mid to late 1990s? Their success came largely by the insight of their general managers in developing three young "position" players and two pitchers from within their minor league system. These three players became cornerstones of their team. The three young players assumed arguably the three most important positions on the field other than pitcher-- Bernie Williams at centerfield, Derek Jeter at shortstop, and Jorge Posada at catcher. About the same time, the team developed two key pitchers within their minor league system -- Andy Pettitte, a starting pitcher, and Mariano Rivera, a relief pitcher. Beyond these players, they used their financial leverage to add several good but not star-level complimentary players including Chuck Knoblauch (second base), Tino Martinez (first base), Scott Brosius (third base), Jeff Nelson (relief pitcher) and acquiring starting pitcher Orlando Hernandez as a unique free agent -- a refugee from Cuba.

Another feature of their renaissance contradicts the usual winning-with-money story. They achieved their success without a bona fide superstar. In manager Joe Torre's own words, "talentwise, there are no obvious superstars on the Yankees."[7] While the claim might be argued, none of the Yankees players over their late 1990s streak would qualify as the best at his position in the American League much less in MLB. Williams and Jeter were certainly very good, All-Star caliber players, but if either were playing in smaller media markets, their statistics would not be attention grabbing to average fans in other cities. The Yankees' only high profile, expensive additions over this time frame were pitchers David Cone and Roger Clemens both of whom were attained via trade. Although both players contributed, neither could be viewed as the keys to the

success of the Yankees at least through the 2000 season. Cone never attained superstar performances with the Yankees and faded badly during the 2000 season. Clemens pitched with only modest success in 1999 and half of 2000, improving markedly late in the 2000 season but regaining superstar form only during the 2001 regular season. Neither keyed the Yankees' post-season heroics in any of the years.

The lack of "the best" individual talents also stands out relative to the past Yankee dynasties. Their great teams of the 1920s and 1930s boasted legends such as Babe Ruth and Lou Gehrig. During the 1940s, Joe DiMaggio and Yogi Berra led the way. By the 1950s, Mickey Mantle replaced DiMaggio as the team's marquee player along with pitcher Whitey Ford. All of these players were not only the best at their positions during their playing eras but stand out with the best players across any era. Among these all-time greats were peppered highly skilled players of the caliber of Williams, Jeter, and Posada.

What lessons does the Yankees success during the late 1990s illustrate? No doubt, luck accounts for a part of their success. Coaches, along with many successful entrepreneurs, disdain references to luck, somehow thinking it diminishes appreciation of hard work and sound decisions. Coach-speak notwithstanding, at the very least the development of young players from teenage draftee to major league contributor can be a shot in the dark even with good scouting and minor league coaching. For every major hit from the draft, a big bust can usually be found. The Yankees' early picks in the 1991 and 1992 amateur drafts showcase this fact. They selected Derek Jeter as the sixth overall pick in 1992, and he has developed into one of the

game's leading shortstop. In 1991, they picked Brien Taylor who never developed into a major leaguer. In fact, out of the yearly top ten picks for all of MLB between 1975 and 1989, more than one-fifth never rose above the minor leagues.

Beyond luck, the Yankee story epitomizes a basic canon of sound management, that is, decisions are inter-related and not independent of each other. For twenty years the Yankees attempted to regain their form largely by using their financial clout to woo one highly publicized free agent superstar after another. This list includes high profile hitters such as Dave Winfield, Rickey Henderson, Jack Clark, Danny Tartabull, Jesse Barfield, and Wade Boggs along with "name brand" pitchers such as Jimmy Key, Andy Hawkins, Tim Leary, Jim Abbott, and Steve Howe among others. Some of these players, such as Winfield and Henderson performed well. Others such as Barfield, Clark, and Tartabull struggled. Overall, these lacked cohesion. When the Yankees started making sound decisions that dovetailed with each other, their fortunes improved dramatically.

In their book *Managerial Economics and Organizational Architecture*, a set of Rochester University business school professors describe management decisions as three legs of a stool.[8] For them, the these three legs are the allocation of decision responsibilities within the firm, the evaluation of individual and unit performance, and the set of incentives provided to hire, retain, and motivate managers and other workers. While various academics, business people, or coaches might disagree as to how many legs support the stool, the analogy makes an important fundamental point. Making adjustments to one leg of the stool alters the support provided by the

other two legs. The idea closely parallels the age-old proverb, “a chain is only as strong as its weakest link.”

From the late 1970s through the early 1990s, Yankee management made decisions that not only did not fit together but negatively effected the organization in other ways. Like most businesses, the Yankees’ faced key decisions about using their funds in selecting and attracting members of their workforce as well as keeping their workforce motivated, making appropriate evaluations of people within their organization, making adjustments to the environment dictated by the enforcement of rules like strike zones and rivals’ capabilities and strategies.

Then, during the 1990s, the Yankees began making decisions that were not only sound individually but well-coordinated well with each other. Much of the credit goes to their General Managers – Gene Michael and Bob Watson. Rather than blowing huge amounts of money on the biggest name free agents, the team built their nucleus around relatively young players. This had a number of benefits beyond providing them solid players at key positions. The youth of these players meant that they came with relatively small price tags for several years. The Yankees then used the money left over to plug in the holes with a very good set of complimentary players. To the whole mix, they ultimately added a manager, Joe Torre, who excelled in effectively integrating the full set of players into the team’s overall effort. In particular, he not only mentored younger players, integrated veterans, and made solid use of his pitching assets, but he excelled in recognizing the difference in personal statistics of players versus evaluating how well players contributed to the ultimate goal of winning. Additionally, he

related well to his players, and by most reports, they enjoyed playing for him.

As a principle on paper, the idea of managing so that decisions are not only sound in isolation from each other but coordinate well together seems simple enough. In reality, recognizing and effectively juggling inter-connections of decisions presents one of the toughest problems faced by managers. By its very nature, handling these interconnections involves complex interactions not always easy to see or predict. Whether in MLB or other management settings, too many managers read a book, gain a few years of experience, or observe a role model or a rival that convinces them that successful management is all about one or two things in isolation from nearly everything else. The manager then pursues this myopic view of the world, possibly even experiencing some success that only reinforces their narrow and piecemeal view of managing. Sooner or later, though, the imbalanced stool becomes unsteady and crashes to the floor.

Were the opportunities to make similar decisions open only to teams with the big bucks like the Yankees? Obviously, in sports leagues not everyone can excel simultaneously. One team's success must come at the expense of one or more other teams. Nevertheless, most of the moves made by the Yankees were open to others even though their pocketbooks may not have been as deep.

Over part of the same time frame, the Seattle Mariners exhibited the same kind of grasp of the inner-connectedness of decisions. Furthermore, Seattle performed well without the extra money of a mega-TV market like the Yankees. Even more enlightening, they even accomplished

the feat while losing three future Hall-of-Fame caliber players -- pitching ace, Randy Johnson, centerfielder, Ken Griffey, Jr., and shortstop Alex Rodriguez. The magnitude of these losses is hard to overstate. Each of these three players were or were very close to being the best player at his position in all of MLB. Moreover, their positions, along with catcher, are typically viewed as the most important positions on any team. *Wall Street Journal* columnist, Allen Berra, likened their exodus to one team losing Hall-of Fame, legendary players Willie Mays, Mike Schmidt, and Steve Carlton in the course of two seasons. In the case of Rodriguez, a free agent, the Mariners received no players in exchange. They did receive players for Johnson, but because he would become a free agent at the end of the year, his trade value drastically diminished. In Griffey's case, they obtained players who would be important to their future success, but players not nearly as heralded as Griffey. In addition to these losses, injuries sidelined one of their most accomplished remaining sluggers, Jay Buhner. In spite of these obstacles and without the New York media revenues, the Mariners advanced to the playoffs in 2000. In 2001 they tied the major league record for the most wins in a regular season (116).

How did the Mariners cope with these losses without the money-to-burn of the Yankees? In short, they employed the same kind of managerial skill as the Yankees -- making sound decisions that were exceptionally well connected with each other. Seattle did not panic and attempt sign the highest priced players available as replicas of the players they had lost. They did not set up a plan to fix everything within a month, then stop that plan when it failed and start another. Instead, the Mariners front office made a sequence of reasonable acquisitions of less

heralded, less expensive players but valuable players who fit together to fill the voids they experienced. These players included obtaining starting pitcher Aaron Sele and reliever Jeff Nelson via free agency, neither of whom came with the price tags of the exiting players. They also used innovative approaches by signing two premier Japanese players without prior MLB experience and by obtaining a young and developing centerfielder in exchange for Griffey.[9]

As with the Yankees, an element of luck surfaced in how quickly the team responded from losing its key stars. Likely, even the Mariners themselves did not expect to reach the performance levels they obtained during the 2001 season. Still, their story fits right in with the Yankees story – making sound and well coordinated decisions on developing young talent, taking the plunge on foreign players, prudent use of dollars to bring in players needed to plug holes, and staying the course without hitting any panic buttons. Without getting as much attention, the Houston Astros accomplished the same kind of feat over the late 1990s, continuing to excel, at least in the regular season, while suffering the departure of several successful pitchers.

One of the most interesting sports cases illustrating the importance of coordinated decisions is one that turned out well in the end but nearly got sidetracked along the way. It is the case of the Los Angeles Lakers in recent years. It is an especially interesting case because it involves one of the most highly acclaimed general managers in all of sports, Jerry West -- known in particular for his ability to judge talent.

Although the Lakers had experienced some moderate success during the 1990s based on

West's drafting of unrecognized players such as Nick Van Exel, Eddie Jones, and Eldon Campbell, they did not appear to be very close to reaching the championship level. West made the decision to go after Shaquille O'Neil, a player with tremendous physical skills but whose basketball skills and savvy were still doubted by many. In addition to O'Neil, West shocked the basketball world by drafting a 6'6" high schooler named Kobe Bryant. Up to this point, the few high school players drafted had tended to be those much closer to 7'.

After making these monumental decisions about the players on whom he would try to bring another championship to L.A., West then set out to fill in the complimentary pieces -- a journey that nearly proved to be the undoing of West as GM. West traded Van Exel whose considerable talents were sometimes overshadowed by his temperament. Then, West sent Jones and Campbell packing to Charlotte for Glenn Rice with the intention of securing better perimeter shooting to go with the inside play of O'Neil and the slashing of Bryant. However, in trading Jones, West took a considerable risk. Jones and Bryant were of similar size, yet Jones was noted as a much better defender and team player than they still developing Bryant. For two seasons, the team appeared stuck -- possessing tremendous talent but bowing out in the playoffs to teams of seeming lesser talent. Finally, West added the piece that balanced the legs of the stool when he attracted Phil Jackson to be the coach. Jackson's forte' during his six championships as coach of the Bulls had been finding the right team chemistry.

In contrast to these examples of sports managers who have grasped the importance of coordinated decisions, many other sports franchises illustrate just how costly making

disconnected decisions can be. The Texas Rangers present a premier example of disconnected decision making over roughly the same time frame as the Yankees and Mariners built their success. The Rangers, who moved to Arlington from Washington D.C. at the end of the 1971 season, experienced some good, some bad, and many mediocre seasons during their Texas tenure but had never visited the playoffs until 1996. With relatively young talent developed within their minor league system, including American League MVP Juan Gonzalez and All-Star catcher Ivan Rodriguez, the team began to improve under the ownership of Tom Hicks. After making the playoffs in 1996, they returned again in 1998 and 1999. Their team emphasized slugging with only average pitching and defensive abilities. However, in each of these playoff appearances, the Yankees humbled them with the Rangers winning only a single game over the three years. These disappointments set in motion a sequence of decisions by Ranger management reminiscent of the futile efforts of the Yankees during the 1980s and early 1990s. More than any single errant decision, the sequence illustrated poorly connected decisions.

First, the Rangers seemed to pursue a path of trying to imitate the Yankees since it had been the Yankees who had demolished them. At the end of the 1999 season, the Rangers' Yankee-aping started by adding left-handed pitching and better defense – two features associated with the Yankees success in the 1990s. They traded their most marketable player, two time American League Most Valuable Player Juan Gonzalez, to Detroit for three untested position players, a young left-handed starting pitcher who was experiencing arm problems, and a minor league relief pitcher. In separate deals, the club added two other veteran left-handed

pitchers.

Even with the young left-handed pitcher obtained from Detroit still injured, the 2000 season started out alright for the Rangers. They entered June with a winning record and near the top of their division. Then, their prized young centerfielder, Ruben Mateo, broke his leg and the team's fortunes began to slide as their hitting fell off. Later in the summer, their perennial All-Star catcher, Ivan Rodriguez, was also lost for the remainder of the season to injury. After these two key players were lost, the remainder of the season flopped. The team's pitching rated dead last in the league.

Rather than stay on course, attribute some of the losses to injury, and try to obtain improved pitching or more hitting depth, the Rangers appeared to scrap completely their original plan to remake themselves in the Yankees image. During the 2000-2001 offseason, they went after and caught the biggest fish in the free agent market -- former Seattle Mariner shortstop, Alex Rodriguez, for a record $250 million, ten-year contract. The size of the contract drew much criticism from the baseball press not only for its magnitude but also for the fact that it diminished the Ranger's ability to go after and sign pitching, which was universally recognized as their biggest weakness. Owner Hicks and General Manager Doug Melvin felt that the opportunity to obtain a player at such a key position at shortstop who had demonstrated outlandish hitting feats for a shortstop was too good to pass.

However, instead of using Rodriguez as the basis for a new long term plan for success by plugging in young players in the field and acquiring better pitching with whatever dollars were

left, the team made an effort to jump from last to best in one season. The dollars that could have gone for pitching help went toward signing several late-thirty-something players in the free agent market -- third baseman Ken Caminiti, second baseman Randy Velarde, and designated hitter Andres Galaraga. All of these had been very successful players over their careers, but Caminiti and Galaraga had both begin to show decline in their output. As a result of the influx of veteran sluggers, when wunderkind Mateo returned from his injury, he was pushed down low in the batting order.

By mid-May of the 2001 season, the push from worst to first became a disastrous slide from bad to even worse. In view of the abysmal start to the season, the "win now" philosophy became moot, and the Rangers implemented a two or three year plan for long term improvement. They released Caminiti and traded Galaraga as well as Mateo, who had struggled to regain his form after the injury and his relegation to platoon player rather than superstar in waiting. In the end, through all of this, the Rangers had traded two of their three most marketable players, Gonzalez and Mateo, without improving their woeful pitching and by sliding from a divisional winner to being out of the pennant race by June. But, this is exactly what managers and general managers in sports or other business should expect when decisions over time reflect a hodgepodge of benchmarking, shifting of strategies, and short term focus.

Before the 2002 season began, owner Tom Hicks replaced Doug Melvin with John Hart at General Manager. Hart had built highly successful teams with the Cleveland Indians during the 1990s. From the outset, the clear intent in bringing in Hart was an emphasis on the "win

now" philosophy. Hart signed free agent Chan Ho Park who had fallen out of favor in Los Angeles, resigned Juan Gonzalez as a free agent, added veteran players with recent problems, Carl Everett and John Rocker, and added a few additional veterans. Several injuries and mediocre performances by the acquired players sent the Rangers into a "building for the future" mode that should have started with the signing of Rodriguez two years prior. By this time, Rodriguez had tired of the losing and pushed for a trade but only to World Series contenders such as the Red Sox or Yankees. The Rangers made a deal with the Yankees before the 2004 season. The Rangers received a budding hitter in Alfonso Soriano in return but had to pay all but about $5 million of Rodriguez's salary to make the deal. Ironically, the deal finally put them squarely on the path of relying on their talented young players, who responded with a unexpectedly strong 2004 season.

The complexity of managing means that few if any managers in any kind of operation will make all of the right decisions. Mistakes will be made. Luck – both good and bad plays a role. Over the long haul, though, those managers who key in on the important decisions and link them together will stand the best opportunities for success. The ones who manage only from problem to problem, day to day with no sense of how things work together must hope that good luck overwhelms their managerial weaknesses.

ELEMENTS OF UNCERTAINTY & RISK

When the NCAA adopted the three-point shot in 1987, the most obvious effect was to

benefit teams with excellent outside shooters or those who developed good shooters. In bare statistical terms, these teams stood to increase their point production relative to other teams. By comparison, a team with only average outside shooting would likely stay at about the same place they started. No doubt, the success enjoyed by several teams mentioned in the preceding section with the advent of the three-point shot came about because of this effect.

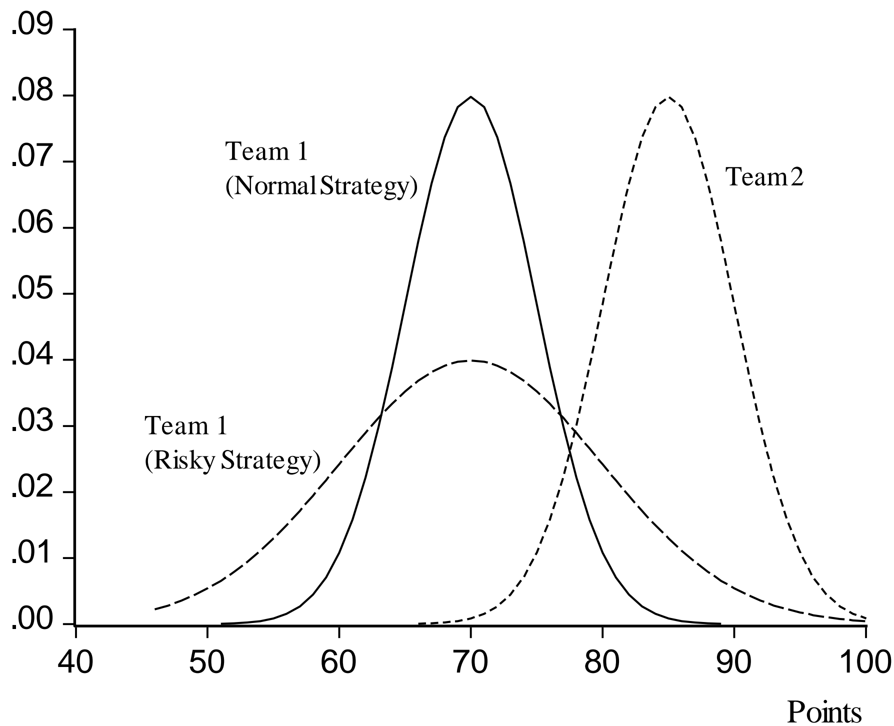
However, several coaches such as Paul Westhead at Loyola Marymount and Rick Pitino at Providence displayed a more subtle understanding of the effect of the rule change. The rule change permitted teams the option of not only changing their average outcome but also changing the range or variability of their outcomes. This option arose because the rule change allowed teams to adopt a riskier strategy – taking a large number of three point shots. Because these shots had a lower probability of going in the basket than closer shots, teams choosing to shoot a large number of them risked the possibility of enduring woeful nights with terrible offensive performances. On the other hand, the increased risk also raised the specter of nights where many of the shots went in and the teams were able to challenge seemingly more talented opposing teams. In fact, Westhead openly remarked that his team's style of play opened up the possibility for big upsets but that fans had to realize that it also meant that some nights the results would look disastrous.

Figure 2.1 strips the logic of the strategy down to its bare statistical essence. Here, the range of likely point outcomes for a team with a lower average scoring ability (Team 1) is compared with the range of likely outcomes for a team with a higher scoring ability (Team 2).

The likelihood of the underdog team beating the favorite is equal to the area of overlap of the two ranges. By adopting the strategy of shooting a lot of three-point shots, the underdog (Team 1) can "stretch out" its range of likely outcomes. In other words, the variability of its point outcomes increases. This implies that some nights the team will score fewer points than if it stuck to a more conventional shooting strategy but some nights they will score more points, increasing the area of overlap between their point distribution and the favorites, meaning a higher chance of winning.

Figure 2.1

Increasing Chances of Winning by "Stretching" the Possible Outcomes



To Westhead, the ultimate object was trying to win more games rather than concern about point differential, and this higher risk strategy raised the chances of winning. Teams such as Loyola or Providence could have played a traditional style of basketball, likely only to lose against taller teams more talented at playing those styles. By going to the unconventional, more-frenetic style, these teams not only tried to influence the average outcome, but played on the greater variability of outcome such a style generated. In essence, they intentionally adopted a riskier style. They might lose by bigger margins some nights, but would also give themselves a chance to win on other nights. Playing a more traditional, "safer" style would reduce the sizes of some losses but would also likely eliminate a chance to win against some very talented teams. It should be noted that the increased chance of winning arises even if the underdog does not improve its average point level.

Many coaches and successful business managers disdain the mention of luck – either good or bad. To them, references to bad luck seem to be a way of providing illegitimate excuses for bad outcomes while references to good luck seem to be a way of diminishing the importance of hard work and smart decisions. In spite of such contempt for these ideas, citing good or bad luck only give expression to a basic fact of decision making – that is, decisions are constantly made without knowing the exact state of events in the future. Practically all real world events play out in ways that cannot be fully anticipated. The same shot taken by the same player under

nearly identical circumstances sometimes falls in the bucket and sometimes rims out. The ball that flies out of the park for a game winning home run one night is caught on the warning track another night because the wind is blowing in or because the field has larger outfield fence dimensions. No one knows the future with complete predictability, yet decisions must be forward looking because decisions ultimately relate to events and consequences ahead rather than behind. This places every decision maker, whether in personal or management settings, at risk that things will not play out as expected.

A critical part of successfully managing tradeoffs is the ability to recognize and use risk to one's advantage or minimize the disadvantage. Of course, the idea of managing risk is not novel to this book. In recent years "risk management" has become an industry in itself. Such usage of the term, however, usually refers only to part of what is at issue in this chapter – diminishing the financial risks to a company of potential future hazards such as fire, theft, lawsuits, injuries, health care and so on. More broadly considered, risk management involves the ability to evaluate and make sound decisions that involve risks. The subject has become course material for economists, business professors, psychologists, and statisticians at many leading universities such as Chicago, Harvard, Duke, and UC Berkeley.[10] For example, widely acclaimed economist, Richard Thaler, from the University of Chicago has students evaluate critical decisions from sports settings such as the World Series in class.

While no one can grasp the future with certainty, all future states of the world are not equally likely and current decisions usually will have an influence on these future states.

Whenever possible, establishing the boundaries and detailing some of the characteristics of what these potential outcomes can be can pair the uncertainty down into chunks that can be analyzed and managed. For example, one characteristic than can often be determined is where are the typical outcomes centered or bunched. What are "average" outcomes? Through past experiences on his own team or other teams, a coach might be able to get a handle on the likely point differential if they play a particular against this team or the average rate of success that a batter is likely to have against a particular pitcher. Likewise, almost any manager can benefit from gaining a perspective on average outcomes whether they be about the number of sick days, health care claims, productivity, interest rates, or other items of interest.

Determining the most likely outcomes are a first step toward dealing with uncertainty and risk, but it is only a first step. In many circumstances, the greatest risks are faced because of atypical outcomes. To really get a handle on what is typical or atypical, a manager must collect data or get a feel for how the full variety of possible outcomes and, at a minimum, establish a general idea of their likelihood as well as the consequences if they come about. This is the very heart of dealing with risk. Westhead and Pitino might not have ever used graphs such as those in the figures above that depict "probability distributions," but they did realize that using a strategy that increased the variability of outcomes provided their undermanned Loyola and Providence teams a chance to win that pursuing a strategy that narrowed the possible outcomes would not. They put a bridle on risk and used it to their advantage rather than just seeing risk as something to be minimized.[11]

One difficulty in correctly assessing risks is that the same decision can imply a different tradeoff and cost depending on the situation. For instance, if a team is favored using a less risky strategy, then increasing the variance by taking on a riskier style would be detrimental to the team. On the contrary, a style that reduced risk would provide benefits. In addition, the manager must give attention to the effects of the style not only on the variance of outcomes but the average outcome. The up-tempo, three-point shooting style of play was not only an innovation that increased risk and volatility of outcomes but also increased average performance for their teams, at least for a time.

Baseball also illustrates how decisions regarding risk can change depending on the specific situation under consideration. Managers and their assistants determining whether to position players closer to the third and first base foul lines exemplifies this principle. For typical hitters during the course of a game, the first and third basemen play several steps away from the foul lines. However, when leading late in games, baseball managers often choose to position players much closer to the foul lines to reduce the likelihood of a batter hitting a double or triple. The wisdom of this approach, even when leading late in a game, depends on the score. Although sometimes used, the strategy does not make sense when a team leads only by a single run. The logic is this: if playing the third and first basemen in their normal positions limits opponents to the fewest runs, on average, when tied or behind, then it will continue to be the best run-limiting defensive strategy when leading only by one run. However, if the team leads by two or more runs late in the game, then “guarding the line” may be optimal because using this technique may

in fact reduce the likelihood of multiple run innings even though it increases the likelihood of giving up a single run.

Golf also provides fertile ground for the examination of risk management. Whether high-handicap amateur or highly skilled professional golfer, all golfers frequently find themselves asking questions such as "Can I carry that water hazard? Should I hit my driver or another club off the tee? Should I aim away from trouble or toward the center of the green?" Couched within each of these questions is a risk-reward tradeoff. Unlike settings where the uncertainties are so great as to make decision making solely guesswork or impulse, the nature of the uncertainties involved in golf permit genuine "analysis" of the risks. For one thing, the decisions come in discrete bites with plenty of time for thinking and planning. Also, each decision involves a combination of certain known features of the course, playing ability, and position along with uncertain aspects such as the specifics of the way the ball will be struck and the influence of external influences such as wind.

One common risk management setting facing golfers of all abilities involves recovering from trouble. All golfers from Tiger Woods to "Joe Duffer" sooner or later find themselves behind a tree, in long grass, on unstable footing, and other hindrances. The decision at hand usually involves how best to recover from the trouble – "how much should I go try to get back with this shot?" The ability to deal with these situations is one of the main characteristics separating golfers on the PGA Tour from those who may be relatively good golfers on their home course. Professional golfers are uncanny in their ability to turn seeming bogeys into pars

or double-bogeys into bogeys, although even they make some widely publicized mistakes especially when facing the extra pressure of a "major" tournament. The key to the decision is recognizing that there exists an optimal amount of risk to endure – going for enough but not too much. Many amateur golfers swing between the extremes. On one shot, the amateur will go for a "circus shot" that might be successful in 1 out of 100 attempts. After attempting such a shot a time or two and seeing the dire consequences, the player is apt to take a complete risk minimization approach and just punch out. Unless the shot takes place near the very end of a tournament, professional golfers are much more likely to stay away from these extremes. Tiger Woods will play a shot that has a high likelihood of success but involves some risk. Inherent in this successful management of risk in this situation by a Tiger Woods or Jack Nicklaus in the prior generation is honest assessment of one's own abilities.

Another common problem facing people making decisions with risk is illustrated by what happened when the American League adopted the Designated Hitter rule in 1972. With this new rule in place, the American League pitchers no longer faced the direct consequences of throwing at hitters from the opposing team. As a result, the number of batters hit by American League pitchers went up relative to their National League counterparts.[12] In economics and insurance this is called a "moral hazard" problem – the circumstance where decision makers do not bear the full risks associated with their decisions, and as a result, take on more risk and exposes others to additional risk. Insurance settings provide fertile ground because individual policy holders pay premiums based on the average risk of their group. This drives a wedge between their

individual risk based on their decisions and the consequences of their actions. Individual policy holders end up engaging in riskier behavior, driving up claims and premiums for the group as a whole.

The problem is not limited to insurance settings. Any kind of business setting where an employee or manager does not bear the full consequence of risky activity poses the same dilemma. For example, the compensation for a CEO or CFO, although linked to changes in firm's net worth, may not be perfectly linked. In some cases, the CEO or CFO may not bear the full consequences of risky decisions. Especially in situations where company earnings are declining and the corporate officers begin to seek means to boost them in order to maintain their own employment, they may engage in activities that expose the company's shareholders to risks that they may not face themselves. Just as in the insurance case, a tradeoff exists between the benefits from limiting the exposure of policyholders or corporate executives to risk and the increase in the potential for moral hazard problems. Pooling risk in the form of insurance groups helps individuals to lower the likelihood of the inability of meeting large but infrequent expenses. All changes in stock value are not due to decisions of corporate officers. Providing some compensation to these executives that does not go up and down with the stock price is a way of the company reducing some of the risk of employment with the executives just as firms do with other employees. However, these policies also create the potential for the moral hazard outcomes.

Usually mentioned in the same context as moral hazard is the problem of adverse

selection. When people or projects must be chosen with limited information, it is possible that the process of sorting through the alternatives tends to weed out the most desirable ones and leave-in the least desirable ones. The essence of the problem is that the people making the selection decisions have less information than the people applying. For example, the work environment for assistant coaches is sometimes barely above indentured servitude. Assistant coaches often work extremely long hours and are compensated very little, at least in lower level positions. While such a setting may weed out individuals who have little passion for coaching, it also tends to weed out individuals who have alluring employment alternatives. At the end of the day, the coaches who stick around long enough to land top-level assistant and head coaching positions may be people who have a passion for coaching but who also had few good alternatives.

The classic example in business of adverse selection involves bank loans. Typically, individuals or business who are deemed significant risks are charged higher interest rates to obtain loans. The trouble is that at some point, the only people who are willing to pay very high interest rates may be those who face dire financial straits. In the end, if the bank does not set some upper-end limit on rates or have some other kind of sorting mechanisms other than the price of the loan, it will end up attracting a bad pool of loans with almost certain likelihood of default.

A final foundational aspect of risk and uncertainty is the ability to assess honestly and accurately one’s own attitude toward risk as well as the attitudes of others. Most people prefer to

take on less risk than more given an equal payoff, especially when substantial sums of money or risk of personal injury are at stake. This aversion to risk is much keener in some individuals than others. Because most people, including managers, are risk averse when faced with important decisions, it's easy to see why managers sometimes bias their thinking about tradeoffs in favor of the costs more easily measured or estimated.

Outside of sports, these same ways of thinking can help managers. For banks, knowing exactly what will happen to interest rates or checking balances held by customers is impossible, yet movements in these kinds of things can have important effects on the bottom line. In spite of the uncertainty, past experience and current condition do permit an evaluation of likely changes on average, an idea of a range for typical changes, possible but unlikely changes, and changes that whose likelihood is only slightly above zero. They also permit the assessment of the symmetry or asymmetry of these likely changes. In laying out the possibilities in this kind of analytical way and incorporating them with simulation software, the bank's decision makers can steer clear extreme policies that either place the bank at far too great a risk or that steer such a safe course as to significantly reduce earnings in almost any possible future state of the world.

SPILLED MILK

A final fundamental aspect of management considered here is an understanding of sunk costs. A basic tenet of managerial economics stresses an age-old proverb, "there is no use crying

over spilled milk." Put simply, sunk costs should not influence current decisions. The logic is simple. Bygones should be treated as bygones. Costs and problems of the past that have no bearing on the present should be ignored when determining the best course of action for the future. While on its face, this idea seems so simple as to hardly warrant discussion, astute management of sunk costs is a subtle matter for two reasons. First, the seemingly transparent principle of looking to the costs ahead rather than those already sunk is not always so transparent in application. Second, beyond the problem of properly recognizing costs that are in fact sunk are the personal and organizational recriminations that may go with those sunk costs.

On the problem of recognizing sunk costs as sunk, an episode with Western Kentucky University football in the late 1980s and early 1990s illustrates the confusions that can occur. The athletic department made the decision to play only ten football games even though the NCAA permitted an eleven game schedule. The thinking was that the revenues from an additional game at home could not cover the cost of an additional game. The flaw in the thinking was that the decision makers were including costs that were already sunk into their decision calculus. Rather than looking ahead to include only the additional costs that would be incurred from playing another game – stadium preparation and cleaning, security, electricity, athletic tape, and a few other minor expenses – the athletic director included sunk costs into his estimate. His means of doing so was not obvious to him or others. He estimated the cost of a future game by taking the average cost over all games. The trouble is that the average cost across all games included expenses that were already sunk such as coaches' salaries, equipment,

and so on. As it turned out, this inflated the average cost of future games substantially because most of the costs incurred by the program were sunk while the additional expenses of another game were only a small fraction of the average cost per game.

An important distinction for the consideration of costs is the difference between sunk and fixed costs. Sunk costs are gone forever. Fixed costs, on the other hand, may be unavoidable for a given time period, but avoidable when a longer period is considered. For example, when a team decides to sign a player to a long term contract, those monies are fixed for the length of the contract or until another team is willing to make a trade and relieve the original club of the liability. Barring a trade, the player's salary represents an unavoidable cost to the team for the length of the contract. Decisions about other players signed over this same time frame must be made with regard to the budget, expense, or benefits of those players for this time frame.

While managers make mistakes with regard to thinking about sunk and fixed costs, there is a more complicated side than is indicated by the "don't cry over spilled milk" proverb.[13] In a cool, dispassionate world where all people look ahead in making decisions, the proverb would be sufficient. However, that is not the world of real management. Sunk costs may represent bygone decisions but these decisions live on in the minds of people. Regret, embarrassment, or fear of a bad evaluation over bygone decisions frequently permit sunk costs to influence thinking about current decisions. Rather than "cutting bait" with the past decision and moving on to the decisions at hand, attempts may be made to justify the past expenditures by continuing or even increasing expenditures on those projects. At the extreme, attempts may be made to cover up the

very existence of the past expenditures and decisions.

In sports, these kind of scenarios have played out many times with regard to personnel decisions. A coach positions a player at a key position or a general manager brings in a coach in whom he has supreme confidence. The player or coach fails miserably. Rather than treating the past decision as a poor one and trying to make decisions based on current and future circumstances, the coach or GM continues to try to justify the prior decision and may even become belligerent when questioned on the matter. In the end, the team suffers and the coach or GM may suffer personal consequences for the inability to deal dispassionately with the past decision. The dilemma is that the coach, GM, or any manager is always going to be evaluated on the basis of past performance. This creates an incentive to make past decisions look better and the avenue for the past decisions to influence future decisions. Beyond the organizational incentives that may lead to sunk costs leaking into future thinking, some people place great pressure on themselves over past decisions.

Another element that complicates the matter of sunk costs are expenditures on long-lived assets versus short-lived assets or perishable goods and services. A past expenditure on a long-lived asset represents an investment. While the expense may never be recovered in dollar terms, the asset provides a stream of service to the organization. This is what makes personnel decisions difficult for athletic teams. Players' skills develop over time and as they do, the team can reap long-term benefits by sticking with a player. In contrast, a sunk expenditure on a short-lived or perishable item yields no such long-term benefits and should have no bearing on

decisions about the future. While this is clear enough, knowing when an expenditure on an investment has been a bad one that will not likely be recovered through the lifetime of the asset is not very clear. It leads to guesswork – sometimes sending players off too soon only to see them succeed on another team and sometimes sticking with players too long. That is the nature of investing in uncertain assets. The problem centered on here is the tendency on the part of decision makers to treat expenditures on clearly short-lived assets or perishable goods or services as investments. "How can I not go on that cruise, I've already paid for it." Ultimately, dealing with sunk costs is not merely about juggling around numbers and parts, but it is also about dealing with people – a topic explored more in Chapter 4.

REPLAY

1. Key elements of managing teams and organizations often involve basic tasks such as motivation, assessing costs and risks, or coordinating activities. Failure to grasp the subtleties of these basic tasks have been the downfall of many intelligent managers inside and outside of sports.

2. The goals of organizations and teams do not perfectly coincide with the goals of the individuals within them. Successful coaches and managers recognize this and even coaches such as Vince Lombardi used a variety of tools to align individual goals with

team goals more closely.

3. Every decision entails costs beyond those on the income statement. Assessing these "hidden" costs accurately may make or brake a manager as the Babe Ruth history illustrates.

4. Key components of management policy must be integrated with each other. Otherwise, the result is much like the Reds or Rangers who acquired baseball's best centerfielder or shortstop only to flounder in league standings.

5. The uncertainty of the future along with its risks associated does not mean that all future states of the world are equally likely. Establishing the characteristics of uncertain outcomes and making risk a tool to be manipulated as Paul Westhead's Loyola team showed.

Notes

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1. Many of these have been collected from Rickey's own writings. See *Branch Rickey's Little Blue Book* (New York: Macmillan, 1995). Chapter 3 deals extensively with his view of baseball's "fundamentals."

2. See David Maraniss. *When Pride Still Mattered: A Life of Vince Lombardi* (New York: Simon and Schuster, 1999), p. 376.

3. Maraniss, *When Pride Still Mattered*, p. 377.

4. James Brickley, Clifford Smith, and Jerold Zimmerman, *Managerial Economics and Organizational Architecture* (Chicago: Irwin, 1997), Chapter 2, provide an excellent discussion on individual motivation in managerial and organizational contexts.

5. A detailed discussion of the choice of Ruth as a hitter versus pitcher appears in Edward Scahill, "Did Babe Ruth Have a Comparative Advantage as a Pitcher?" *Journal of Economic Education*, 21 (Fall 1990), pp. 402-410.

6. Jim Savage, *The Encyclopedia of the NCAA Basketball Tournament*, New York: Dell Publishing, 1990), pp. 709-10.

7. Joe Torre (with Henry Dreher), *Ground Rules for Winners* (New York, Hyperion, 1999), p. 129.

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8. See Brickley, Smith, and Zimmerman. *Managerial Economics,* Chapter 1 and Preface.

9. See Allen Barra, "Seattle's Defying Reason," *Wall Street Journal*, July 27, 2001, for further discussion of how Seattle thrived after losing star players.

10. The example here is from David Lionhardt, "Caution is Costly," at www.nytimes.com, July 30, 2003. The article includes additional examples.

11. See Frederick Mosteller, "Lessons from Sports Statistics," *The American Statistician*, 51 (November 1997), pp. 305-10, for a good introduction to a variety of distributions from sports including baseball, football, and golf.

12. The evidence is presented in Brian L. Goff, William F. Shughart, and Robert D. Tollison, "Batter Up! Moral Hazard and the Effects of the Designated Hitter Rule on Hit Batsmen,"*Economic Inquiry* 35 (July 1997), pp. 555-61.

13. Economist Richard Thaler has written on this and related topics where economics and psychology meet. See Richard Thaler, *Quasi-Rational Economics* (New York: Russell Sage Foundation, 1991).