Introduction: Sports Leagues and Organizations

Module 1, Chapter 3

Chapter 3: Sports Leagues and Organizations

Objectives:

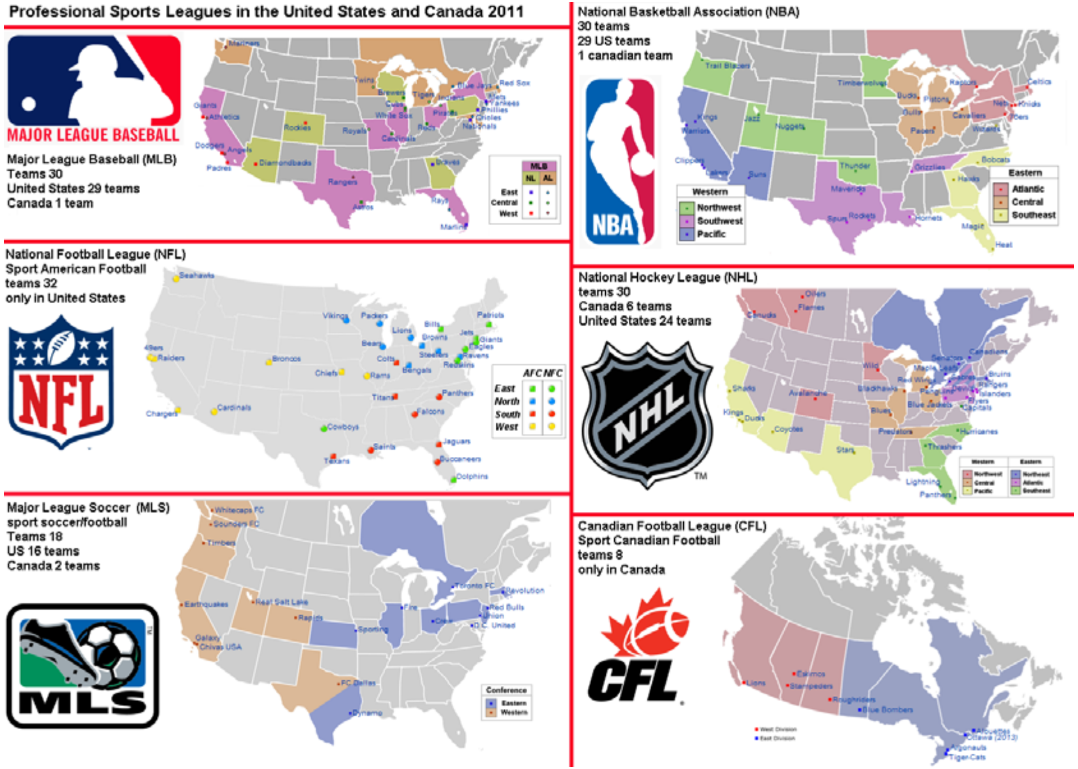
- ❑ Explain how leagues facilitate play and maintain structure
- ❑ Justify territorial exclusivity for teams
- ❑ Understand the financial & strategic components of expansion & relocation
- ❑ Outline joint venture acts that owners perform
- ❑ Describe the two-team model of a sports league
- ❑ Distinguish between league actions that affect competitive balance

Lesson Direction

Scarcity

Rationing

Competition



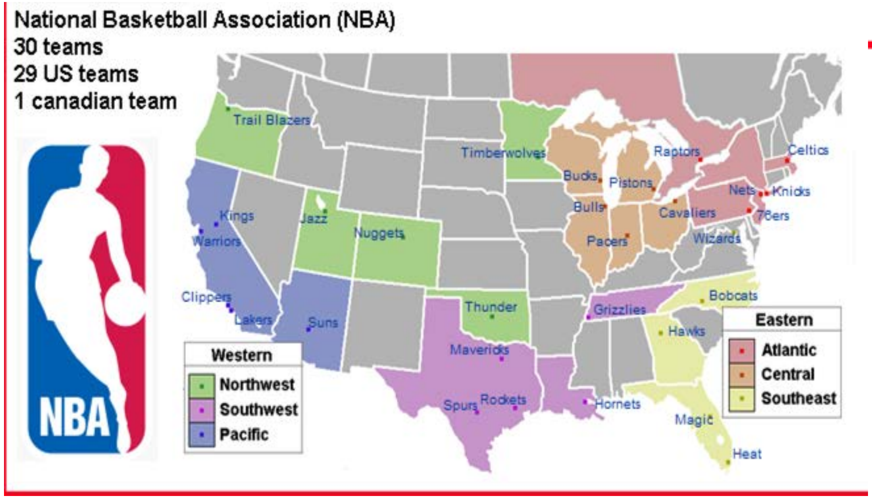
Major Professional Leagues

- The Big 4:
  - MLB
  - NFL
  - NBA
  - NHL

- Other professional leagues
  - MLS
  - CFL

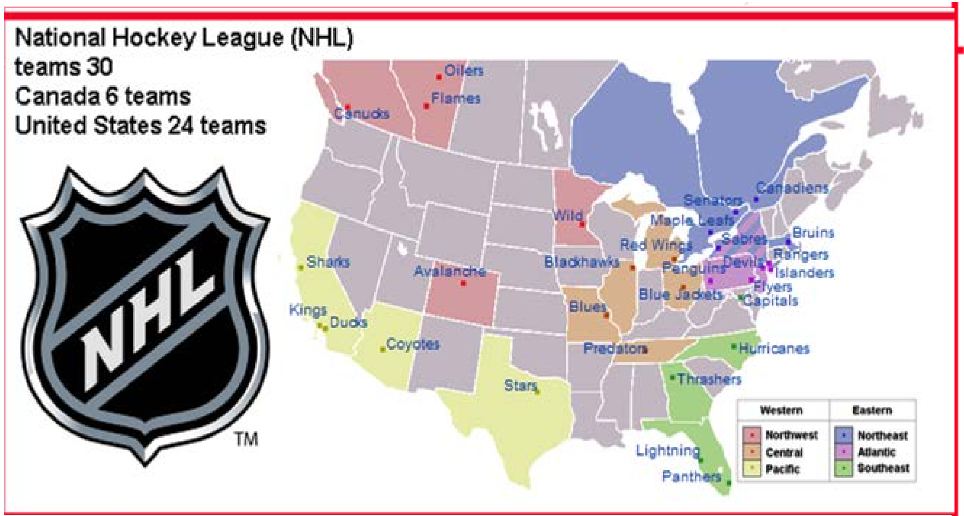
Professional Sports Leagues

- Major League Baseball (MLB)
  - Includes National League (1876) and American League (1901)
  - 30 member teams
- National Football League (NFL)
  - Founded in 1920
- National Basketball Association (NBA)
  - Founded in 1946. 1976: ABA united with NBA
  - 30 teams



Professional Sports Leagues

- Major League Soccer
  - Top men’s soccer league US and Canada (20 US teams, 3 Canadian teams)
  - Began in 1996 as a requirement by FIFA 1994 World Cup
- National Hockey League
  - Founded in Canada, 1917, after Canadian NHL absorbed its rival World Hockey Association.
  - Includes Eastern Conference & Western Conference
  - 23 US teams, 7 Canadian teams



Children’s Sports Leagues:

- Little League Baseball
- Pop Warner Youth Football
- High school leagues

College-level Sports Conferences:

- Called “Conferences”, not “Leagues”
- However, many conferences are similar to sports leagues in many respects

- Pacific-12 (PAC-12)
- Big Ten
- Southeastern Conference (SEC)
- Atlantic Coast Conference (ACC)

Individual Sports Organizations

- The Professional Golf Association (PGA)
- Ladies PGA
- The Association of Tennis Professionals (ATP)
- Women’s Tennis Association (WTA)
- The Professional Bowling Association (PBA)
- Others

Why do the Leagues / Organizations exist?

Roles of a League

These are activities that MUST be done together by all teams in a league to establish a viable sports product:

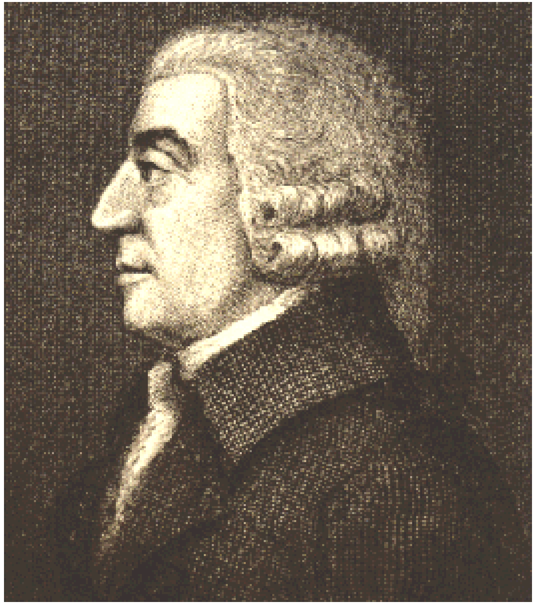
1. Setting the Schedule

2. Setting the Rules

3. Organizing Championships

Joint Venture Cooperation

Adam Smith says: “People of the same trade seldom meet together… but the conversation ends in… some contrivance to raise prices.” (Wealth of Nations, Book I, Chapter X)



Joint venture – a business enterprise in which two or more independent entities collaborate to achieve a commercial goal

Joint Venture Cooperation

Some activities can be done by either the league OR the individual teams.

- What would be some advantages to teams setting out on their own?
- What are the advantages of working together as a league?

Joint Venture Cooperation

A joint venture allows businesses to pool their complementary assets and capabilities for a specific purpose without the need for complete integration (Competition + Cooperation)

- E.g. in MLB:

Each club files its own tax return, finds its investors. Clubs cooperate on advertising, broadcasting rights, negotiating with the players union

Are Leagues Cartels?

A cartel – a group of independent firms that agree not to compete with each other to earn supra-competitive profits. Cartels may fix prices, rig bids, divide markets, or refuse to deal with others.

Like cartels:

- Leagues divide markets on a geographical basis
- Leagues restrict team mobility to maintain league stability
- Leagues pool their broadcast rights to prevent the clubs from competing with one another
- Extensive Revenue sharing within leagues

Leagues and Profit Maximization

- A league is comprised of the clubs
- Clubs are separately owned, independent businesses

- By forming a league, clubs increase the demand for their product (and, as a result, increase the profit)

  - How?
  - By providing predictable schedules, forming traditional rivalries, championships, performance records

  - Result: fans are willing to pay more for tickets, parking, concessions. More popular games means: sponsors pay more for naming rights; network and cable providers pay more for broadcast rights

Rules & Procedures of Leagues

League Membership

- League founders decide who will be a member, number of franchises, and their locations
- A league's image affects its popularity and fan support
    - MLB & NFL will not permit a casino owner to own an MLB club (exception: Michael Ilitch owns the Detroit Tigers (MLB) and the Detroit Red Wings (NHL))
- Location

Rules & Procedures of Leagues

League Governance

- Major sports leagues are governed by the members
- Commissioner – a league employee that makes decisions on behalf of the league.
  - These decisions can adversely affect the owners
  - Roger Goodell, (NFL commissioner) introduced a tougher policy about off-field behavior by players. Suspended Pacman Jones (Tennessee Titans).
  - Fined the Patriots $25 mln for spying on the NY Jets, and took away their first-round choice in the 2008 NFL draft.

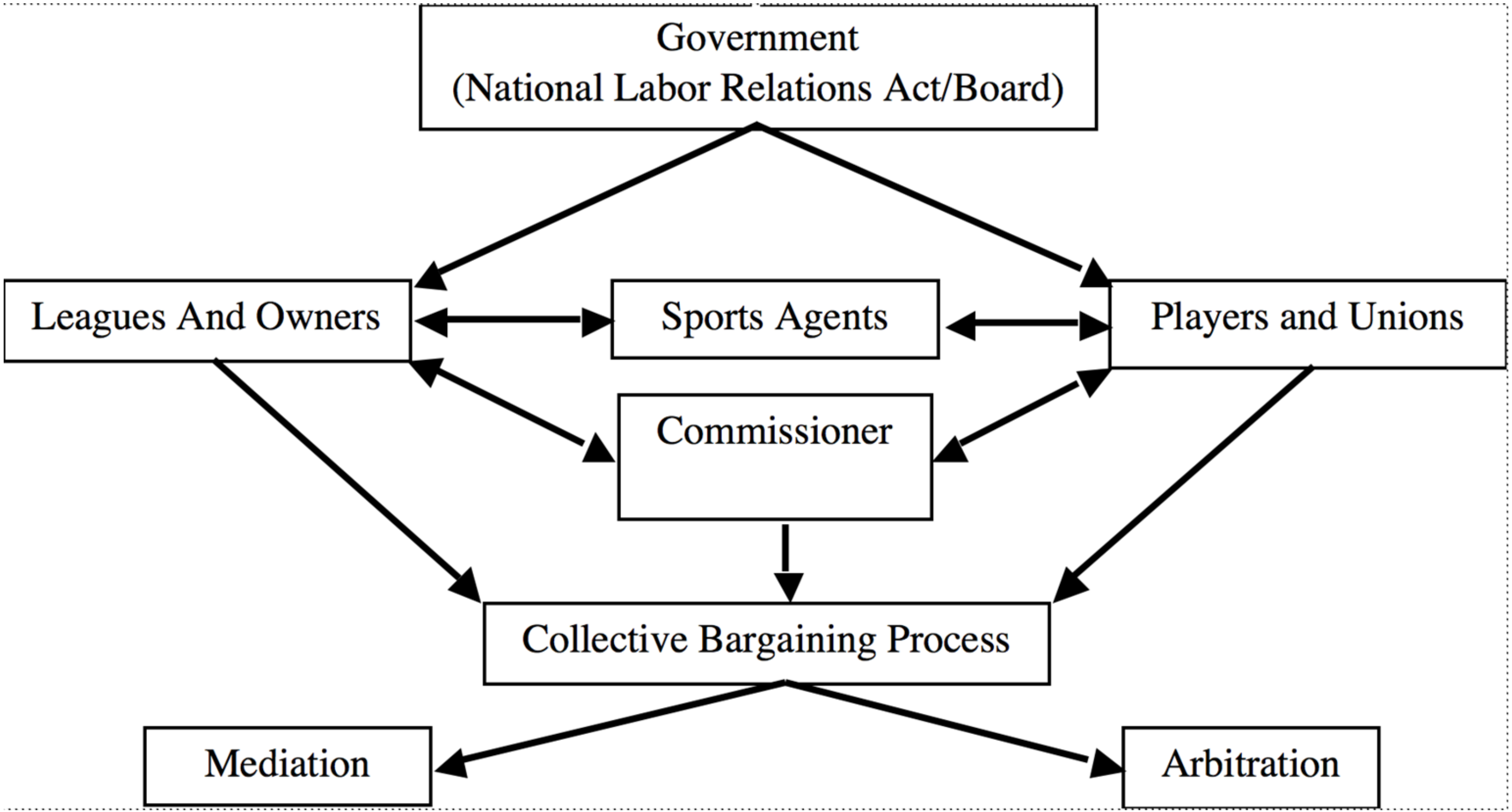


Figure 9.1, Rodney Fort *Sports Econ 3rd Ed.*

Rules & Procedures of Leagues

Setting the Schedule

- NFL

  Each spring, 4 NFL executives create a 256-game schedule that spans the 17 weeks of the NFL season: 16 games per team

- MLB

  schedule released around September. 162 games for each of the 30 teams in the American League (AL) and National League (NL), played over approximately six months— a total of 2,430 games, plus the postseason

- NBA

  schedule released in August, each team plays around 82 games in a season –a total of 1230 games, plus pre- and post-season

Rules & Procedures of Leagues

Production of Athletic Competition

- Set of uniform rules governing play
  - “three strikes and you’re out” in MLB
  - field goals are worth 3 points in NFL
  - the three-point line is the same in NBA courts
- League members must agree to the dates and locations of the games
- League members must agree to the procedure for determining the league champion, eligibility for postseason play, and structure of the playoffs

Rules & Procedures of Leagues

Marketing

- The league decides on broadcasting rights and marketing strategies

Players' Market

The league decides on:

- eligibility requirements (age, gender)
- draft time/location
- mobility restrictions, compensation limits, salry caps, penalties for off-field behavior

Revenue Sharing

Clubs may share revenue:

- national broadcast rights are shared equally among teams
- trademark licenses generate shared revenue
- gate receipts: shared in the NFL & MLB (not NBA)

    60 – 40 split in the NFL (between home team & visitor)

    85 – 15 split in the MLB

- Why share revenue?

    To support financially weak teams

Revenue Sharing Effects

Sharing varies among leagues

- •NFL shares the most
- MLB and NHL have recently increased sharing
- NBA will start to share more in new agreement

Some perverse results of revenue sharing

- Weak teams might have higher profits
  - If revenues are shared – just hold down costs
  - The 5 most profitable NFL teams in 2011-12: Cowboys, Redskins, Cardinals, Buccaneers, and Bengals
  - They had a combined record of 31-49 and did not make the playoffs
- Some call revenue sharing a “tax on quality”

Revenue Sharing: Example

Suppose there is a team in a strong market and a team in a weak market.

- A team in the strong market has $160 mln in revenues and $100 mln in payroll costs → Profit = 160 – 100 = 60 mln
- A team in the weak market has $80 mln in revenues and $80 mln in payroll costs → Profit = 80 – 80 = 0 mln
- This profit may be used to cover other costs, but the weaker-market team may run a negative profit.

- Revenue sharing: Suppose there is a 75-25 revenue split.
- Then the strong team gets 0.75*(160)+0.25*(80)=$140 mln in revenue
- The weak team gets 0.75*(80)+0.25*(160) = $100 mln in revenue
- Now the weak team has the Profit of 100 – 80 = 20 that may be used to cover other costs.

Revenue Sharing: Example

We see that revenue sharing clearly helps the weaker-market team.
But **will revenue sharing always help the club improve their roster?**

- **Not necessarily!** Here's why:

- Suppose Total Revenue (TR_1) is a function of the number of wins (W_1)

- Team 1 will want the number of wins that maximizes profit.
- Without revenue sharing, this profit is:
- Profit = $TR_1(W_1) - TC(W_1)$ $\rightarrow$ max Profit: $MR_1(W_1) - MC(W_1) = 0$

Revenue Sharing: Example

- With revenue sharing, Team 1 gives up a share (s) of their revenue, and receives a share (1-s) of the Team 2's revenue. Then, Team 1 again will choose the number of wins that maximizes profit:

- Profit = $s*TR_1(W_1) + (1- s)*TR_2(W_2) – TC(W_1)$ $\rightarrow$
- max Profit: $s*MR_1(W_1) + (1- s)* MR_2(W_2) – MC(W_1) = 0$

- If Team 1 wins, their revenue increases (add $s*MR_1$). But because Team 2 lost, Team 1 gets a share of that reduced revenue (subtract $(1-s) * MR_2$).
- The net effect of another win is much lower with revenue sharing. **Thus the incentive to improve team quality to win more games is reduced for all teams.**

Expansion

- Leagues are not static – they expand over time by adding new franchises

    An “Expansion” team – team in its first/second season (except in MLB, where a team may be regarded an “expansion team” indefinitely)

- Leagues can contract too, but that happens rarely.

    2001 – MLB commissioner announced that MLB would shrink by 2 teams (prime candidates were Minnesota Twins & the Montreal Expos)

Trivia:

- Who were the most recent expansion teams in the NFL?
- How much did other teams make off of their expansion fees?
  - Cleveland in 1999, expansion fee of $16,788,696 per team, for ~$537 Million total.
  - Houston in 2002, expansion fees of $5M in 2000, 2001, 2002, and 2003, and $3.3M in 2004, for a total of $23.3M per team, or $745M total (ignoring NPV).

Expansion Procedures

- Expansion in MLB

Prospective owner of an expansion franchise must have a management structure intact and submit to league officials a 5-year projection of the financial statements of the club’s operations
At the new site, he ballpark must have a seating capacity of nearly 40 thousand, and the parking facilities must accommodate at least 25% of the ballpark’s capacity
A receptive local government + local demographic data
To gain ownership, 75% of the team’s league + 50% in the other league must approve the deal
1997 Expansion draft: Arizona Diamondbacks & Tampa Bay Devil Rays: Each team selected 35 players (over 3 rounds) – each round they could pick a player not on the protected list of the 28 other teams.

Expansion

- What do leagues require in order to allow expansion?
    - What goes into the expansion fee for a new franchise in a professional league?
        - Net Present Value of the new team
        - What’s the effect on other teams’ profit?
        - Are they expanding into the cities of other teams?

Negotiations

- Leagues cooperate on a very large scale in the US with respect to negotiations:
  - With Media Providers
  - With Players
  - With Host Cities
- Why?

How do teams relocate?

- Imagine that teams can relocate as they please.
  - What do you think league structure would look like?
  - How would it affect team and league profits?
- What changes when teams have to get league approval to relocate?
  - http://profootballtalk.nbcsports.com/2015/02/13/st-louis-could-become-the-nfls-new-los-angeles/

Exclusive Territories/Market Power

Like fast food chains, sports leagues typically use franchising to establish teams in different cities. Franchising itself does not necessarily reduce competition.

- How competitive do you think the market is for fast food franchises? Do they have a lot of market power?
- So maybe sports franchises are a little different...

Exclusive Territories/Market Power

Sports franchises have the following characteristics:

- Managed absence of substitutes
- Season length
- Expansion
- Rival Leagues