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The growth and financial status of professional sports in North America: insights for English soccer leagues?

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An overview of the financial status of professional sports leagues in North America is provided. It reveals that they face similar challenges to those confronting professional soccer teams in England: most teams report annual operating losses; costs, primarily attributed to players' salaries, are accelerating at a level which outstrips the large growth in revenues that is also occurring; and the wealthiest teams tend to dominate competitions on the playing field. The North American leagues' problems of falling attendance, declining ratings, and an economic disconnect with their fan base all contribute to the leagues' declining financial health. Strategies used by leagues to control player costs are described.

INTRODUCTION

The Deloitte and Touche Annual Review of Football Finance (2001) for the 1999/2000 season concluded that the aggregate pre-tax losses of Premier and Football League clubs totalled £145 million. Only 15 of the 92 clubs reported an operating profit. Among the elite Premier clubs, nine of the 20 teams showed an operating profit. These losses occurred at a time when English football has never been richer. In the nine-year period from 1990/91 to 1999/2000, Deloitte and Touche report that aggregate income for the 92 teams increased by an extraordinary £823 million to its 1999/2000, total of £1.078 million. This increase in revenues is projected to continue to reach £1.5 billion in the 2002/03 season. Part of this projected increase is attributable to the substantially larger television fees which will grow to £100 million over this period.

The substantial losses that have accrued while revenues have escalated reflect the clubs' inability to control costs. Thus, while revenues increased by £128 million in 1999/2000, costs escalated by £188 million,

and £127 million of the additional costs were attributable to increases in wages and salaries. The deteriorating status of football clubs was reflected in the changing fortunes of the Singer and Friedlander Football Fund. The Fund invested exclusively in football clubs and businesses associated with them. In 1997, when it was launched, it raised approximately £30 million and attracted nearly 20,000 members (Miles, 2002). There was much excitement and optimism about the investment potential of football. In the previous year, the share prices of several clubs had more than trebled. Manchester United briefly achieved a market capitalization of £1 billion.

The game appeared to be in a financially strong position since attendances have risen consistently each year since 1986. Prior to that time, they had declined for much of the post-war period. Since the turnaround in 1986, attendances have increased from 16 million to around 30 million. However, much of the momentum for investing in clubs arose from the anticipation of quantum increases in income from the sale of media rights. The

television companies competed vigorously for those rights. The revenue potential from this source was realized, but it was accompanied by the spiralling costs associated with the purchase of players and paying them exponentially higher wages. As a result, the value of football stocks has plummeted so the Singer and Friedlander Fund was valued at only £7.4 million in March 2000.

Television rights across the five leading European football leagues of England, Spain, Italy, Germany and France rose 993% in value in the 10 years from 1991, but are projected to increase by only 8% in the 3 years after the 2002/03 season (*The Sunday Times*, 2002). The likelihood of future reductions in media rights income was exacerbated by the demise of ITV digital whose 2002 bankruptcy will be prominent in the minds of the media representatives charged with renegotiating television rights. This has reinforced the sense of urgency to address football's financial crisis. The Deloitte and Touche (2001) report shows a convincing high correlation ($r^2 = 0.89$) between clubs' wage bills for players and their league standings on the playing field. Over the previous five-year period, the four Premier League clubs with the average highest salary bills were Manchester United, Liverpool, Chelsea and Arsenal, and all of these teams are consistently at the forefront of the Premier League. In short, the evidence is strong that money brings success.

These challenges of rapidly accelerating revenues being outstripped by even greater increases in salaries; substantial operating losses at a time when revenues are at an all time high level; and the wealthiest teams dominating the major competitions are also characteristic of the challenges confronted by professional sports leagues in the United States. The review of these leagues' financial challenges in this paper suggests that the problems of the English soccer leagues are not unique. The discussions in the paper of how some of the major leagues have resolved

these problems while others have failed to do so, may offer insights that are useful in addressing the problems of the English leagues.

THE GROWTH IN US PROFESSIONAL SPORTS

Professional sports was a major beneficiary of the longest sustained period of growth in United States' history. In the 1990s, almost 180 new professional sports teams came into existence, so the total inventory of professional teams at all levels now exceeds 800. Most of these teams were associated with the 13 new leagues which were launched in that decade (e.g. the Xtreme Football League, National Rookie League, West Coast Hockey League). Two trends that were unanticipated by analysts at the beginning of the 1990s were the spectacular expansion of major and minor league hockey in the Sun Belt states, and the emergence of women's sports leagues (e.g. Women's National Basketball Association and the Women's United Soccer Association).

There are four so-called major leagues in the United States: the National Football League (NFL), Major League Baseball (MLB), National Basketball Association (NBA) and National Hockey League (NHL). The number of teams in these four leagues increased from 103 franchises in 1989 to 123 by 2001. During that time, the NHL added eight expansion teams, MLB added four, the NFL added three and the NBA added five new teams. The most spectacular growth in professional team sports, however, occurred at the secondary level, where the so-called minor league teams, particularly in hockey and basketball, have expanded in numbers substantially. By 2000, over 140 minor league hockey teams were playing in arenas throughout the US and Canada. Only baseball, with a total of 188 franchises, has more minor league teams. Four new basketball leagues were launched in 2000 alone, includ-

ing the International Basketball League, the National Rookie League, the College Pro League, and the ABA 2000. And, what is probably surprising even to the most ardent football fans in the US is that, by 2001 over 60 professional football teams in addition to the 32 NFL franchises, operated in cities throughout the US and Canada.

The Arena Football League (AFL) may be the single most successful league property launched in the last 15 years. The AFL has expanded from eight teams at its inception in 1987 to 19 teams in 2001. In fact, it has grown from one to two separate leagues with the creation of its own minor league, called AF2 in 2000. In 2001, there were 47 indoor football teams playing under the Arena Football League banner. Arena football is a hybrid version of the outdoor game with similar scoring, rules and the basics of blocking and tackling. The one major difference is that it is played indoors, on a surface half the size of a regulation football field, surrounded by padded dasher boards, similar to hockey. The result is a game called the '50-yard indoor war' or the 'brawl inside the wall' (Fitzgerald, 2000). The league's model has proven immensely successful. In 1999, the NFL acquired an exclusive option to purchase 49.9% of the league by 2002. It seems likely that arena football will become NFL-indoor or NFL-arena within the near future.

Women's sports finally emerged as a part of the professional sports landscape in North America over the last half of the 1990s. The talent pool produced by the achievements of title IX, which is a federal law requiring women be given equal sporting opportunities to men in high schools and colleges; the resultant success of women's national teams on the world stage at the summer and winter Olympics; and the 1999 women's soccer world cup provided the impetus for the launch of several women's sports leagues. The seminal event in the history of women's sports in the United States was probably the national team's dramatic penalty kick-shoot-

out victory over China in the women's world cup final in 1999. With an estimated 40 million US viewers, the cup final was the most watched soccer match in the history of US network television, and the crowd of 90,185 at the Rose Bowl was the largest ever for a women's sporting event.

In the late 1990s, new women's leagues were established in basketball (WNBA and the now defunct American Basketball League), soccer (WUSA), softball (WPSL) and plans for a professional hockey league in the US and Canada are under serious consideration. Women's sports properties accounted for \$600 million of the \$4.5 billion that corporations spent on sports in 1999. A crucial factor in both the development and sustainability of these new properties has been corporate support. Corporations began to realize that women's sports could provide a highly effective platform for reaching women, who make 80% of a household's purchase decisions in the US. As the executive director of the Women's Sports Foundation asserted, women are now serious consumers of sport, who are 'no longer watching soap operas and talk shows from 10am to 2pm' (Reynolds, 1999, p. 5). Indeed, in the US more than half of women now engage in some form of regular exercise, and one third of all high school girls participate in one or more varsity sports.

One sports property which has flourished as a result of corporate America's growing interest in aligning with women's sports, has been the Ladies' Professional Golf Association (LPGA). The women's golf tour experienced a remarkable increase in corporate support over the last decade, with sponsor-supported prize money more than doubling from \$17.1 million in 1990 to \$36.2 million for the 2000 season (Williams, 2000). While the LPGA continues to grow, the recent experience of the WNBA and the WPSL indicates that women's sports leagues will continue to struggle to find a secure niche in a cluttered sports marketplace. After a successful debut

season in 1997, the NBA owned WNBA found it difficult to maintain its initial momentum. During the 2000 season, league-wide attendance slipped 11% and the league reportedly continued to lose money (Mullen, 2001). On the plus side however, television ratings, while modest, grew 5% during the league's fourth season and the WNBA was able to add six new corporate sponsors. Since its inception, the league has steadily expanded from its original eight teams to 16 teams in 2001.

Analysts are less sanguine about the WPSL's future. The league, launched in 1997, as Women's Pro Fastpitch, has struggled to find its niche in the competitive sports market. Instead of achieving its initial goal of expanding to at least 12 markets to establish a national presence, the WPSL declined from the six original teams to just four franchises by the end of its fourth season. Given its severely contracted state, the league faced major challenges in sustaining sufficient fan and corporate support to ensure its future. Another sports property that has become a big financial success in recent years is the US open tennis championships which is arguably the single most profitable sporting event in North America. Total revenues grew to \$135 million in 2000, with corporate sponsorship support almost doubling from 1995 to \$27 million. The United States Tennis Association reported an income of \$90.29 million after expenses, so the net operating profit represented 69% of total revenues (Kaplan, 2000). The profit margin is remarkable when compared to most major league teams which operate at a loss.

Finally, the late 1990s and early 2000s saw the growth of many new, 'niche sports', like billiards, lacrosse and pro rodeo. These sports attract a small but avid following, and their appeal is often confined to a particular region. Lacrosse, a game historically confined to the east coast and pockets of interest in the midwest, has established two professional leagues; the indoor National Lacrosse League (NLL) and the more recently

established outdoor Major League Lacrosse (MLL). Again, as with any new sports venture, an essential ingredient for success is corporate sponsor support. With the niche sports, the property's ability to tap the intensity of the sports fan base is the key to generating sponsor involvement. As one analyst suggests, 'The intensity of the fan base is often far more important than its actual size' (Cawley, 2000, p. 25). The MLL was able to leverage the league's natural appeal to lacrosse enthusiasts in signing its first three major sponsorship deals with Sports Helmets, Great Atlantic (a lacrosse catalogue), and stick maker Warrior Lacrosse, for reportedly more than 1 million dollars (Bernstein, 1999).

Complementing the extensive involvement of corporations has been the evolution of cable television as the second key element in the growth of niche sports. Cable channels such as ESPN, ESPN2 and the 13 Regional Sports Networks around the country are in constant need of new programming to fill their 24-hour schedules. For example, it was anticipation of the expansion of professional rodeo into network television that persuaded the owner of the MLB Texas Rangers and NHL Dallas Stars to buy the Mesquite rodeo in 1999 (Mesquite is a suburb of Dallas). His instincts were verified in 2001 when the professional bull riders' world challenge event graduated from ESPN2 to NBC in the fall of 2001 (Shropshire, 2001). The demand to fill cable programming has created attractive exposure opportunities for other niche sports like track and field, bowling and bass fishing on a national level, and for lacrosse and roller hockey on a local or regional level.

THE ECONOMIC REALITY OF PROFESSIONAL SPORTS

In 2001, the estimated total market value of the 123 franchises across the four major leagues in the US and Canada had grown to



• **Major League Baseball**

*Founded: National League in 1876, American League in 1901,
Teams: 30, Commissioner: Bud Selig, Gross Revenues: \$2.79 billion,
Net Worth: \$6.55 billion*



• **National Hockey League**

*Founded: 1917, Teams: 32, Commissioner: Gary Bettman,
Gross Revenues: \$1.82 billion, Net Worth: \$3.75 billion.*



• **National Football League**

*Founded: 1920, Teams: 32, Commissioner: Paul Tagliabue,
Gross Revenues: \$3.51 billion, Net Worth: \$12.80 billion*



• **National Basketball Association**

*Founded: 1946, Teams: 29, Commissioner: David Stern,
Gross Revenues: \$2.1 billion, Net Worth: \$6.01 billion*

Fig 1. Economic value of the major leagues

about \$30 billion, more than doubling their market value in 1990. The relative economic valuation of each league is shown in Figure 1. The cumulative revenues generated by the teams in the Big Four Leagues in 2001 edged over \$10 billion.

Despite their value and the magnitude of their financial resources, a majority of teams in some leagues, are losing money on an annual basis. Consider the following data:

- Since 1993, net income has steadily declined across all leagues except for the NFL; the average net earnings in 1999–2000 was just 4%.
- 75% of the teams in the NHL and 70% of the teams in Major League Baseball, finished in the red in 1999–2000.
- Since 1994, Major League Baseball has

lost money each year, usually between \$200 to \$300 million each year. During the 2000 season, the NHL lost \$150 million.

Professional sport executives attribute the failure of franchises to make a profit to their inability to generate sufficient revenues to meet the acceleration in operating costs which has occurred in the past decade. However, some analysts claim their purported losses are the result of creative accounting and are paper rather than real losses. All agree that irrespective of how the operational financial status of the franchises is viewed, their owners enjoy substantial capital appreciation of their assets. These issues are reviewed in the following sub-sections.

Revenues cannot keep pace with expenses

The fundamental problem for many teams is that although revenues are rising, costs are increasing at a more accelerated rate. The profit and loss reports of professional sports at the individual team level show that a number of teams are facing serious financial problems. The Anaheim Angels reported more than \$42 million in operating losses during the first three seasons of the Walt Disney Company's ownership of the MLB team (Shaiken, 1999). Over the same time-frame, from 1997 through 1999, the NHL's Vancouver Canucks reported losses of C\$91 million (Kerr, 2000). Surprisingly, many of the teams at the top of their respective leagues are reporting serious losses. One year after winning the NBA championship, the San Antonio Spurs claimed that the team lost \$6 million to \$7 million in 1999, and projected losses of \$30 million by 2002. Even the venerable NFL team, the Green Bay Packers, reported an operating loss of nearly \$500,000 in 2000. During the 2000 season, the Packers' expenses, primarily players' salaries, increased at a rate three times greater than team revenues. The Arizona Diamondbacks reported an operational loss of \$15.8 million in 2000. In an effort to bring a winning ball club to Phoenix in just its second year of operation, the MLB expansion team doubled its payroll to \$70 million in 1999. Despite the team's excellent performance on the field, attendance declined, as did revenues. As a result, the team had to make a cash call of \$24 million to its owners/investors in order to meet the Diamondbacks large payroll (Gilbertson, 2000).

The Cleveland Indians MLB team are a troubling example of how hard it is even for the most successful teams to make money in the current economic environment. After the opening of Jacobs Field in 1996, the Cleveland Indians were one of the most successful teams in all of professional sports.

They pre-sold over 3 million tickets every year. Yet the team claimed, in a Securities Exchange Commission (SEC) filing, that only their successful appearance in post-season playoffs allowed them to turn a modest profit. Excerpts from a prospectus filed by the Cleveland Indians with the SEC to offer \$73.6 million public stock sale, stated:

Management believes that the Indians' local revenue potential has already been realized, and that future increases in net income, are likely to be substantially less than in the past 5 years. Without the contribution of post-season playoff revenues, the team would not have produced a profit in 1997.

Creative accounting

While league officials and team owners consistently report that their franchises are losing lots of money, the actual extent and magnitude of these claims are difficult to substantiate. Very few professional sport teams are publicly held corporations. Ownership in most cases is mainly in the hands of private individuals, families or closely held corporations, all of which are under no legal obligation to disclose detailed financial information about their team's operations. Financial experts and players' association representatives have repeatedly challenged the authenticity of the owners' claims of financial distress, claiming that 'creative accounting' procedures used by the owners made the teams' financial positions look much worse than they really were. A former president of the Toronto Blue Jays reputedly stated:

Under generally accepted accounting principles, I can turn a \$4 million profit into a \$2 million loss, and I can get every national accounting firm to agree with me. (Zimbalist, 1992, p. 62)

This was a reference to the roster depreciation allowance provided to the owners of professional sports teams. Under a special provision, called the 'Veeck tax shelter convention', (after Bill Veeck, a legendary figure

among the owners of MLB teams), the IRS allows owners to claim half of what they paid to purchase a team as depreciation on player contracts. Specifically, the owner can assign 50% of the franchises purchase price to player contracts. And then, for tax purposes the roster can be treated as a declining or ‘wasting’ asset, depreciating the value of the contract over a five-year period.

The following illustration clarifies how an owner can take advantage of this tax sheltering provision (Quirk and Fort, 1999, p. 105):

Suppose someone buys an NFL team for \$200 million. The new owner assigns 50% of the purchase price to player contracts, (the maximum allowed under the law), that is, \$100 million, and then depreciates the contracts over five years at \$20 million per year. Suppose that revenue is \$100 million per year, and that costs, exclusive of player contract depreciation, are \$90 million. Then, for the first five years of operation of the team, the books of the team will look like this:

Revenue	\$100 million
Less costs	\$ 90 million
Less depreciation	<u>\$ 20 million</u>
Pre-tax profits	-\$ 10 million

Depreciation is simply a bookkeeping entry with no actual cash expended to cover this expense, so a \$10 million profit is transformed by legitimate accounting procedures to a \$10 million pre-tax loss. Some analysts believe that this tax shelter enhances the after tax return to an owner to such an extent that it increases the value of a team by as much as 40%

Capital appreciation

In addition to the special tax benefits they receive, owners of sports teams have been able to count on steep increases in the market value of their teams. Historical records of franchise sales indicate that team sales prices have increased at double digit rates over the past 30 years. In 1920, George Halas paid \$100 for the NFL Chicago Bears. In a more contemporary context, in 1984 the owner of the NFL Denver Broncos paid \$70 million to purchase the team. A decade later, the NFL Tampa Bay Buccaneers were sold for \$197 million. By 2001, according to Forbes magazine, all three of these NFL franchises were estimated to be worth around \$500 million. As Table 1 indicates, huge capital gains are not confined to NFL teams. From 1995 to 2000, the average value of MLB teams increased by \$126 million, at an annual rate of appreciation of around 17%. Both the NBA and NHL also demonstrated impressive double digit gains.

Table 1 indicates that profit taking is best understood from a franchise appreciation perspective. Given the considerable cost of buying a team, return on investment is difficult to justify on the basis of annual operating income performance. Many teams are struggling to break even from one season to the next, and the average net profit generated by major sport franchises of around 6% is well below market rates of return for investments of comparable risk. However, when ownership investment is considered on the basis of asset appreciation,

Table 1 Average value of league teams from 1995–2000 (in millions)

League	1995	1996	1997	1998	1999	2000	\$ Diff	%Annual increase
NFL	\$160	\$177	\$202	\$285	\$380	\$423	+\$263	24.2%
NBA	\$113	\$127	\$150	\$170	\$183	\$207	+\$94	12.9%
MLB	\$107	\$111	\$115	\$134	\$194	\$233	+\$126	17.2%
NHL	\$71	\$74	\$90	\$125	\$135	\$148	+\$77	16.5%

Sources: Financial World and Forbes

the financial rewards of team ownership are evident.

While the cost of ownership continues to rise at unprecedented levels, it appears that there are still more wealthy individuals interested in buying teams than there are available franchises. As long as demand exceeds supply, the value of professional sport franchises will continue to climb. While so called, 'psychic income' benefits (e.g. prestige, status, fame, fun) remain as compelling motives for team ownership, contemporary owners of professional sport franchises also recognize that well managed sport properties afford them abundant tax sheltering benefits during their initial years of ownership and the prospect of an attractive return on investment over the long haul.

THE LEAGUES' DECLINING HEALTH

The four major leagues are confronted with four major problems: falling attendance, declining ratings, a saturated marketplace and an economic disconnect with their fan base. Each of these issues is discussed in the following sub-sections.

Falling attendance

A majority of teams in the four biggest leagues, reported flat or declining attendances in 1999–2000. During the 2000 MLB campaign, more than one third of the league's total seating inventory went unsold. Even the stirring home-run duel between Mark McGuire and Sammy Sosa during the summer of 1998, which many pundits called baseball's 'comeback season', was not able to reinvigorate major league attendance. In fact, the overall increase in MLB attendance of four per cent in 2000 was attributable entirely to just one team, the San Francisco Giants, who experienced a 67% jump in attendance when they moved into their new Pac Bell Park. Without the Giants' extraordinary attendance spike, overall major league gate figures would have been down 2%. Over the

last five years, the NBA's average attendance has fallen by about 2%. During the 1999–2000 season, 11 of the NBA's 29 teams showed substantial declines, with four reporting double digit gate losses from the previous season. On the ice, only nine of the 27 teams comprising the NHL reported increased attendance in 1999–2000, while half the teams suffered moderate to severe losses. The NHL declines are particularly troubling for a league that depends on gate receipts for 60% of its total revenues. Attendance eroded steadily over the last four years of the 1990s, with league-wide percentage of capacity figures falling from 93% in 1996–97 to 88.9% during the 1999–2000 campaign.

Even the venerable NFL, with its limited inventory of just eight home games per season, has reason to be concerned. During the 2000 season, 16 of the league's 31 teams showed no growth. What may be more troubling is the rising report of 'no shows' (no longer reported by the league) in many NFL stadiums. An example is the Carolina Panthers, who, in only the third year of operation, saw an average of more than 7,000 no shows per game. That was a 317% increase in empty seats compared to their inaugural 1996 season (Swift, 2000).

Declining ratings

Most league executives, particularly in the NFL and NBA, profess relatively little concern about stagnant or sagging attendance, proclaiming that the typical fan is now a television fan. Certainly, more sports programming is available on free or cable television than ever before. And, with the emergence of regional sports networks to compete with ESPN's delivery of around the clock broadcasting, fans have unprecedented opportunities to watch their favourite teams. Although the four major networks now devote an increased portion of their programming to sports – which in aggregate exceeds 2000 hours each year – unfortunately, fewer viewers appear to be watching games involv-

ing teams from the NBA, NHL, MLB, or the NFL. Ratings for all four leagues have been sinking for the past decade (McGraw, 1998). Between 1987 and 2000, ratings for MLB were down 30%, for the NBA 14% and for the NFL 22%. Some, like the President of the NFL, believe that the glut of sports entertainment options increasingly available to fans has diluted network numbers. There are more people watching sports on television, but they are watching it on a lot more channels (McGraw, 1998).

Saturated marketplace

Ironically, the prosperity that undergirded the unprecedented growth of the sports industry over the past decade has been a major contributor to one of the most serious challenges confronting sport teams – a saturated marketplace. Consumers now have more entertainment options available than ever before. Indeed, a respected national business publication proclaimed that the long-term robust economy which characterized the 1990s had stimulated the creation of so many new sport and entertainment alternatives that the US now faced an ‘entertainment glut’ (Stevens and Grover, 1998).

Although new sports teams and properties expanded substantially, so did other entertainment options. Major entertainment and media companies like Disney, Time-Warner and Viacom invested heavily in movie studios, broadcast and cable networks, online ventures, new record labels and theme parks. It is projected that the total number of channels available to television viewers will increase from about 75 in 2000 (mostly cable channels) to 1000 by 2010, ‘when digital compression of television signals makes room for hundreds of channels, and the linkage of televisions and computers becomes a reality’ (Stevens and Grover, 1998, p. 90). At the same time, the exponential growth of web sites is creating further choices for consumers. Some industry analysts are worried that there may already be

too many choices and consumers may be overwhelmed. As *Business Week* proclaimed, ‘It’s a brutal battle, especially as audiences fragment amid the flurry of competing choices’ (Stevens and Grover, 1998, p. 89). As entertainment providers, sports teams are part of this highly competitive environment. They are competing for the scarce time and disposable dollars of the same consumers that all other entertainment companies are seeking to attract. The challenge of competing in such a cluttered marketplace is exacerbated because consumer spending on entertainment in 2001 declined dramatically as the economy entered a recession.

Economic disconnect

A more ominous explanation for the various league rating declines is that working and middle class families, the traditional bedrock fans of professional sports, are gradually losing interest in watching major league games because they can no longer afford to attend them. There is ample evidence of a growing economic disconnect between professional sports and most Americans. Table 2 shows the steady and substantial increase in the cost of attending games across all four leagues. Using the Fan Cost Index (FCI) created by *Team Marketing Report*, which estimates the average cost for a hypothetical family of four to attend a professional team sports event, comparisons are provided for the major leagues over a 10-year period.

The results show the price of attendance rising four to six times greater than the rate of inflation. The NBA and NHL lead the way, with more than 100% price increases over the decade. In 2001, at an average of \$53.14, the cost of a ticket to attend an NFL game had eclipsed all of the other leagues. But, the NBA and NHL were not too far behind, with ticket prices averaging \$51.34 and \$47.70, respectively. For a family of four to attend an NHL (\$264.11) or NFL (\$303.33) game during the 2000 season, amounted to about 30% of an average household’s weekly earnings. Even

Table 2 The rising cost of attending major league sports

League	1990-91	2000-01	% Change	Proj. 2006
MLB	\$77.41	\$145.83	+88%	\$221
NBA	\$138.82	\$282.72	+104%	\$462
NFL	\$152.55	\$303.33	+99%	\$493
NHL	\$132.62	\$264.11	+131%	\$461
From 1991-2000 CPI rose 21.4% in US				

*Based on Fan Cost Index (FCI) calculated by TMR to represent average cost for family of four attending a major league game (two adult and two child's tickets, four sodas, four hot dogs, two beers, two programs, two caps).

Sources: *Team Marketing Report* (April 2000, October 2000, November 2000, and September 2001) and *USA Today*, January 22, 1998, p. 3.

MLB, which takes pride in being pro sports' biggest bargain, raised its cost of attendance by 88%. It is clear that attending a live major league sport event is now beyond the reach of most of the population. Indeed, nine out of ten Americans say ticket prices are so high that it is difficult for them to attend a professional sporting event (Howard, 1999).

Data confirm the increasingly narrow demographics of those attending big league games. They indicate that more affluent spectators have replaced middle class and blue-collar fans. A columnist proclaimed, 'going to ball games is becoming a perk of the new rich' (Angell, 1998, p. 9). His proclamation is given credence by a report indicating that the household income of Washington DC area residents attending Baltimore Orioles games averaged \$87,500, whereas the average household income of those residing in the Baltimore DC area is around \$53,000 (Fehr, 1997). Other compelling evidence indicating the gentrification of big league appeared in *American Demographics* (Dortch, 1996). The analysis found that adults with household incomes of \$75,000 and above were 72% more likely to attend major league baseball games than households with aggregate incomes of less than \$35,000. When only such a narrow segment of the market (13.6% of US households have incomes in excess of \$75,000) can afford to attend

professional sporting events on a regular basis, it is not surprising to find consumer interest dissipating for both live and televised offerings of major league sports. It has been suggested that the greatest danger facing professional sports is fan 'apathy.' For example, a 1998 *Los Angeles Times* poll reported that almost two thirds of respondents did not consider an NFL team in the Los Angeles area to be of any importance to them (McGraw, 1998). A similar situation appears to have emerged among top teams in the English premier league. Roy Keane, the Manchester United captain, famously bemoaned the replacement of the hard-core, enthusiastic, loud, genuinely loyal supporters by relatively wealthy season ticket holders who watched the game quietly while eating their prawn sandwiches!

With ticket prices displacing all but the most affluent consumers, teams – particularly in the NBA and NHL – have devoted an increasing proportion of their seating inventory to corporate ticket buyers. A survey conducted by the NBA's Minnesota Timberwolves found that 62% of season tickets sold in the lower bowl of their arena were owned by corporations (Swift, 2000). While teams may be able to sell an increasing share of their most expensive tickets to businesses, the trend leads to other problems. It has been pointed out that:

Sports Illustrated commissioned the Peter Harris Research Group to conduct a scientific national survey of sports fans on issues related to attendance at MLB, NBA, NFL and NHL games. The 874 fans polled attended an average of 10.3 pro or college basketball or football games in the past year and 39.5 games in the past five years. The top 10 reasons, with percentages of fans citing them, that made respondents less likely to fill a seat at a sporting event were:

Total cost to attend	57%
Comfort of watching games at home.....	41%
Player's behaviour during games.....	41%
Traffic and Parking.....	38%
Increase in sports on TV.....	35%
Lateness of games.....	26%
TV replay and analysis.....	22%
Unlikelihood of getting good seats.....	19%
Change in how local team is doing.....	14%
Change in family's interest in game.....	13%

Fig 2. Reasons why fans stay home

the corporate fan, who has replaced the core fan, is a fickle beast, choosy about which game he'll use his precious free time to attend. Mid-week against the Milwaukee Bucks, or the Nashville Predators? That's a pass. If the suit bothers to give the tickets away, he's likely to hand them over at the last minute to some secretary in personnel, who might prefer to be home watching *Regis* [a popular television game show] make people sweat. (Swift, 2000, p. 75)

It is no wonder, then, that no shows are a growing concern to the major leagues. Some teams, like the NBA's Charlotte Hornets, were filling less than half the number of seats that were actually sold late in the 2000 season. Sold but unfilled or unused tickets can have serious financial repercussions because, 'When no one is in that seat, not only do we lose the value of the ticket, we lose concession money, merchandise money and program money' (Swift, 2000, p. 76).

While pricing is a serious issue facing the managers of professional sports teams, a poll commissioned by *Sports Illustrated*, indicates there are a number of other serious issues that managers must address (Figure 2).

CONTROLLING PLAYER COSTS: A PRESCRIPTION FOR RECOVERY

The single greatest operational expense for major league teams is player costs. It is a conundrum familiar to English soccer clubs, recently highlighted by David Beckham's new contract with Manchester United raising his guaranteed salary for the next four years from £40,000 to £90,000 per week. Even before the Beckham contract, Manchester United's salary bill was £1.3 million per week (Cave and Millard, 2002). According to estimates provided by various industry sources, player payroll costs in the American leagues represent about two-thirds of the total operational expenses incurred by teams. Salary increases during the 1990s in every major sports league were extraordinary. As Table 3 illustrates, the NBA led the way. In 1991, the average NBA player was a millionaire. Ten years later, the average had more than trebled to \$3.93 million. From 1990 through 2001, player salaries increased more than two and half times in all four major professional leagues.

The deputy commissioner of the NBA declared, 'we have an economic system that

Table 3 League salary increases from 1990-91 to 2000-01

Year	MLB	NFL	NBA	NHL
2001-01	\$2,217,887	\$1,320,000	\$3,930,000	\$1,385,000
1999-00	\$1,938,849	\$996,000	\$3,170,000	\$1,350,000
1997-98	\$1,341,000	\$751,000	\$2,600,000	\$1,200,000
1993-94	\$1,012,424	\$645,000	\$1,350,000	\$430,000
1990-91	\$597,537	\$351,800	\$990,000	\$320,000
Increase	271%	275%	297%	333%

Sources: National Football League Players Association, National Basketball Players Association.

we think is out of whack’ (Howard, 1999, p. 81). But, this declaration was not a revelation to most of those who owned or operated those franchises. The owners are ultimately responsible for paying the players’ salaries, but the chairman of the MLB Chicago White Sox and NFL Bulls, expressed frustration at the lack of constraint demonstrated by fellow owners by commenting ‘in paying ball-players, we are at the mercy of our dumbest competitor’ (Howard, 1999, p. 81). Each league has attempted, with varying degrees of success, to bring spiralling salaries under some form of control. The varying systems involving ‘hard’ and ‘soft’ salary caps, free agency constraints, and luxury taxes have all been intended to act as a ‘drag’ on the rapid inflation of player salaries. In every instance, however, owners’ efforts to impose a constraint on roster costs have met with fierce resistance from the collective bargaining unit or players association representing the interests of players in each of the leagues. Every league endured at least one labour conflict over the past decade. Major League Baseball has led the way with six lockouts or strikes since 1972. The following sub-sections provide an overview of the current state of each of the major leagues with respect to their ability to control or constrain player salaries.

National Football League

In 1993, the NFL owners signed a collective bargaining agreement (CBA) with the NFL

Players Association ending a five-year labour dispute. Under the agreement, for the first time, players whose contracts had expired were allowed the right as ‘free agents’ to move to a team willing to make the best offer. In exchange for free agency, the players and owners agreed to a salary cap under which teams were restricted to spending not more than 64% of the league’s ‘designated gross revenues’ on player salaries (in effect, this pool of money included the combined gate receipts of NFL teams and the monies from the league’s national television contract). The CBA also established a minimum, guaranteeing players no less than 58% of the designated revenues. The salary cap or payroll maximum in 1994 was \$34.6 million. As league revenues have grown, so has the amount teams can pay their players. By the 2001 season, the salary cap had reached \$67.4 million, up from \$64.5 million in 2000.

Players, however, or more accurately the agents representing players in contract negotiations, were able to circumvent the imposed salary ceiling shortly after the CBA agreement went into effect. They negotiated a loophole, sometimes referred to as the ‘Sanders Provision’ after Deion Sanders, the first player to secure the arrangement. It allows teams to pay players substantial up front signing bonuses, but count only a small portion of the bonus payment toward their cap. Teams are allowed to pro-rate the amount of the bonus over the length of the player’s contract. So hypothetically, let’s

say Deion Sanders signed a \$50 million deal with the Washington Redskins for five years, including a \$10 million signing bonus. For cap purposes, even though the Redskins could have paid Sanders as much as \$18 million in year one of the agreement: \$10 million up front bonus and \$8 million in salary (assuming a salary payment schedule of \$8 million per year for five years for a total of \$40 million), the team would only have to count \$10 million against their cap (\$8 million in first-year salary and \$2 million as a pro rata share of the signing bonus). Although the team actually paid out \$18 million, due to the signing bonus loophole it only had to charge \$10 million toward the team's salary cap. This is why the Washington Redskins team payroll in 2000 was \$88 million, as much as \$25 million above the NFL's cap. According to the NFL Players Association (NFLPA), the team had a total base salary expenditure of \$31 million, and signing bonus payments of around \$56 million (Lombardo, 2000). While the Redskins had the highest ever payroll, the NFLPA estimated the average NFL team spent \$65 million on player salaries for the 2000 season. What allows some teams the ability to maintain salary expenditures well above the cap is that some NFL owners have been able to generate significant additional income that does not have to be shared as a part of league wide revenues, such as income from luxury suites, concessions, naming rights deals, and in stadium signage. So, for example, because the Redskins play in a stadium owned by the team that generates close to \$100 million in annual revenues, most of which is exempt from the league's shared designated gross revenue system, the team is capable of paying huge bonuses that don't count entirely against the cap (Lombardo, 2000).

Although teams that play in lucrative stadiums have an economic advantage, the league's underlying economic structure has created substantial financial parity among NFL franchises. The NFL has the greatest

amount of revenue sharing among its owners, since as much as 77% of the total revenues generated by the league is shared among its 32 teams. Revenues from the national television broadcast contract, which escalate from \$2 billion in 2000 to \$2.8 billion in 2005, are shared equally among teams, amounting to team shares of \$60 million to \$70 million annually. The result is that the NFL is clearly the healthiest of any of the major sports leagues in North America. Not only does it enjoy the greatest financial parity, it also benefits from the greatest competitive parity. During the 1999 season, 13 of the league's then 31 teams finished with records between seven wins and nine losses and nine wins and seven losses. The NFL has the highest and most consistent team valuations, the strongest television ratings, and the most ardent fan following.

In contrast to the NFL's focus on revenue sharing, English football clubs have moved in the opposite direction. Before 1984, clubs equally shared the admission revenues from every match. Today the home clubs keep all the revenues. Thus, the large well-supported clubs accrue much more income, and any expectation of parity of competition has disappeared. If no revenue sharing is introduced, then the emergence of an elite half dozen clubs, analogous to the 'old firm' situation of Rangers and Celtic in Scotland, appears inevitable.

Major League Baseball

Unfortunately MLB, which often is characterized as 'America's pastime', from a financial perspective pales in comparison to the NFL. Major League Baseball has no salary cap. Indeed, the league has no real mechanism in place to constrain salary inflation. Under the collective bargaining agreement which expired at the end of the 2001 season, players with six years of 'big league' experience were eligible to become free agents. When their contracts expired, these players

could offer their services to the highest bidder.

Compounding the problem further from a cost control perspective is that owners do not have the ability to control payroll expenses when negotiating with players who have three to six years of experience. Players in this category, while not eligible for free agency, are allowed by a clause in the bargaining agreement to go to binding arbitration in the event of a salary dispute with the team. Final resolution of the dispute is made by an independent arbitrator who is required to choose between the salary demand made by the player and the salary offer made by the team. In this process, the player and management each submit a figure, and the arbitrator selects one or the other; no compromise is allowed. Over the years, the owners have won more than half the decisions. However, owners would suggest that most of their victories have been pyrrhic in that even when they win, players are still rewarded with considerably higher salaries than they received the previous season. For example, in a typical year, the three players who lost their cases received average salary increases of 20% (*USA Today*, 1996). Thus, there is 'little downside risk' for players because the salary figures owners present in arbitration are invariably higher than their current levels of compensation. In the first 18 years of arbitration only 20 players emerged with pay cuts (Zimbalist, 1992). The result has been an extraordinary increase in overall MLB salaries of 705% in the 20-year period from 1982 to 2001.

Many teams have not been able to keep up with the relentless escalation in player salaries. Nowhere is the gap between the 'haves' and 'have nots' more evident than in baseball. Over the last decade, the revenue disparity between large and small market teams has grown dramatically. In 1999, the New York Yankees generated a total of \$179 million in gross revenues, compared to the Minnesota Twins \$52 million – a \$127 million

disparity (Rofe, 2000). And, the disparity may widen as the Yankees are currently considering a new local television deal which would give them \$838 million over the next 10 years. In contrast, in 2000 the Twins received \$5 million from the sale of their local television broadcast rights.

The significant revenue disparity in major league baseball has translated into a serious competitive disadvantage for have not teams. The Blue Ribbon Panel commissioned by MLB to evaluate the economic conditions and prospects for major league baseball revealed that teams with the highest payrolls had won virtually all of the post season playoff games since the settlement of the 1994 strike. The study found that no team which was not in the top tier or upper 25% of payroll spending, won a single World Series game over the previous five seasons. During the 2000 season, the defending world champion New York Yankees became the first major professional league team in North America with a payroll in excess of \$100 million. The last place Minnesota Twins salary bill that season was \$17 million. Thus, 'the single biggest indicator of a team's opportunity for success from one year to the next is whether the team's payroll is among the top few teams in the league. Period' (Costas, 2000, p. 58).

The competitive imbalance prevailing in MLB is the league's most pressing challenge. A leading national publication declared that 'as many as two thirds of the teams in major league baseball have no chance of contending for the World Series – now, or anytime soon' (Bodley and Brady, 1999, p. C10). The league has attempted to address the serious disparity but has not been successful. The owners' thwarted attempt to institute a salary cap precipitated a damaging players strike, which led to the cancellation of the World Series in 1994 and a shortened 1995 season. While the owners were unsuccessful in imposing a cap, the 1996 agreement with

the MLB Players Association did establish a 'luxury tax' on the five teams with the highest payrolls. In 1999, the luxury tax provision required the teams with the five highest salaries to pay a 34% tax on every payroll dollar spent above \$70.5 million. The tax bill that year for the Yankees came to \$4.8 million. Given the limited scope (just five teams) and impact (the team with the fifth highest payroll in 1999, the Boston Red Sox, paid a tax of just \$21,000) the luxury tax has proven to be an ineffective deterrent to salary inflation in baseball.

Perhaps, the single best hope for establishing an economic system that allows all 30 MLB's teams to compete, depends on whether the recommendations of the Commissioner's Blue Ribbon Panel ever come to fruition. The 87-page report issued in 2000, urged MLB to:

- institute a 'competitive-balance tax' of 50% on all club payrolls in excess of \$84 million;
- create a revenue sharing mechanism in which teams would contribute at least 40%, and as much as 50% of all their local net revenues from gate receipts and television contracts.

These recommendations and others would increase the percentage of revenues shared among the league's 30 teams from the present 35% to roughly 60% (Ozanian and Badehausen, 2000). The proposal would reduce the revenue gap between the league's richest and poorest teams, promising at least the potential of greater competitive parity. The challenge facing MLB is to convince the owners of those teams with the highest payrolls and greatest revenues that it is in their best interest to share 'their wealth' with their less fortunate league brethren. In addition, the league must win the approval of the players union in order to adopt additional revenue sharing.

National Basketball Association

After remarkable growth through most of the 1990s, the NBA faded over the last few years. With the retirement of mega star Michael Jordan and his magical championship run with the Chicago Bulls in 1998 and the labour dispute that led to the cancellation of 464 league games in 1999, league attendance steadily declined, television ratings sunk to the lowest in years, and merchandise sales plummeted (Tagliabue, 2000). After negotiations over a new collective bargaining agreement (CBA) collapsed in June 1998, the NBA owners locked out the players for the third time since 1995. The struggle occurred over how much of the league's \$2 billion in gross revenues would be shared with the players. The NBA claimed that the league operated at a deficit during the 1997–98 season for the first time in almost 20 years. League officials attributed the steady decline in the league's operating profits to rapidly escalating player salaries, which in 1997–98 amounted to 57.2% of the league's total revenues. Under the existing labour contract, the players' share was projected to reach 61% during the 1998–99 season. Negotiations stalemated when the owners wanted to impose a fixed limit on salaries at 48% of the total NBA revenues. The NBA Players Association held out for a 60% share.

After a 190-day lockout, resulting in an abbreviated 50-game season (regularly 82 games), the NBA and its players reached a settlement in January 1999. The new six-year CBA ensured players would receive no less than 48% and no more than 55% of the league's pooled revenues, referred to as 'Basketball Related Income' (BRI). Most importantly to the owners, the new agreement afforded teams much greater financial stability by setting caps for maximums on the salaries players can earn based on the number of years of service a player has had in the league. Under the new agreement, players with zero to five years of NBA service are

capped at \$9 million per season; players with six to nine years of league experience are capped at \$11 million; and veterans with 10 or more years of service can earn a maximum of \$14 million per season. The new CBA also built in some long-term cost control by setting a fixed or maximum limit on salary increases at 10%. In an effort, however, to promote roster stability, the agreement stipulated that a player re-signing with his existing team could receive a pay raise of 12.5% per year over the length of his contract. The new agreement, while costly, provides the NBA with one clear advantage over all the other leagues, the ability to control and anticipate its greatest expense, player salaries.

National Hockey League

The National Hockey League is in the most precarious financial position of any of the major leagues. Like MLB, it has minimal revenue sharing and no real mechanism in place to control salary growth. Unfortunately, the league is locked into its collective bargaining agreement until 2004. This agreement established a cap only on rookie salaries, set at a maximum of \$975,000 per season. The agreement provides few restrictions on free agency. The result is that player salaries are growing at a much faster rate than team revenues. The league's economic troubles have been exacerbated by several other problems. With a relatively small national television contract (teams received \$4.3 million per year at the end of the 1990s, compared to NFL teams' \$60–70 million) NHL teams depended on gate receipts on average for 60% of their overall revenues. This situation made it particularly difficult for the 14 or 15 teams that experienced attendance declines in recent years. With no provision for sharing gate revenues – home teams keep 100% of the ticket sale income – the revenue imbalance has widened among NHL teams.

The financial stress has been particularly acute for the NHL's Canadian franchises. The six Canadian hockey teams have been bur-

dened by a weak Canadian dollar and high Canadian taxes. The purchasing power of the Canadian dollar has slipped 30% in value compared to the US dollar over the last decade. The declining value of Canadian currency has created an increasingly stressful dilemma for Canadian teams. Although the franchises collect revenue in their native currency, in order to stay competitive with American-based teams they have to pay salaries in US dollars. In early 1999, the currency exchange difference on a \$50 million payroll would have been about \$20 million. The Montreal Canadians pay property taxes on their arena of around \$10 million per year which is triple the combined taxes paid by all the US based NHL teams. There appears to be no relief in sight for the Canadian franchises. In 2000, the Canadian Federal Government withdrew a tax credit plan which would have provided teams C\$2 million a year, claiming there was no public support for the plan.

One bright note for the NHL is the television deal the league signed with ABC/ESPN in 2000. The five-year broadcast contract through the 2005–06 season, pays the league \$600 million, a significant increase over its previous contract with Fox that paid the league \$200 million. However, with no meaningful revenue sharing proposal in sight, and the likelihood of uncontrolled salary growth through at least 2004, the short-term financial prospects for many NHL teams looks grim. In 1999, it was estimated that 20 of the NHL's then 28 teams were losing money. It will be interesting to see whether the NHL commissioner's prescription for a 'prosperous NHL future' will ever be realized. In his state of the NHL address in 2000, the commissioner offered the following plan:

- Continue to increase revenues by moving into even more new money generating arenas and stimulating interest in hockey internationally.
- Slow skyrocketing salaries with judi-

cious personnel decisions and, ultimately, through a new collective bargaining agreeing.

- Promote, promote, promote, to build a younger and broader fan base (Robinson, 2000).

CONCLUDING COMMENTS

The urgency to control costs in the English and European soccer leagues is exemplified by the actions of the 'G14' group of leading European clubs, which includes Manchester United and Liverpool. They have proposed a salary cap in a bid to ease the sport's economic problems. At a meeting at the 2002 European cup final, they also agreed to reduce their playing staffs and to introduce a code of conduct to contain spiralling costs (*The Times*, 2002). The details remain elusive but the thinking has changed from 'should there be a cost control mechanism?' to 'what form should it take, and how quickly can it be implemented?'

There are fundamental differences between English football and the American leagues in that European laws differ from American laws; the English leagues have to contend with promotion and relegation; and the American leagues have a draft system for recruiting new players into the leagues which contributes to parity. Nevertheless, it is likely that the analyses of approaches to resolving the problem adopted by the American leagues offer useful insights to the conundrum in English soccer. Professional sports leagues in North America and professional soccer leagues in England enjoyed unprecedented levels of revenues in the 1990s, but in both cases it is likely that profitable operation will be more difficult to achieve in the first decade of the new millennium. There are similarities in the difficulties they face even though each of the four North American major leagues generate more annual revenue than the English soccer leagues, and their aggregate annual revenues of over \$10 billion

dwarf the \$1.6 billion generated by the English leagues. In the English leagues, costs associated with players' salaries have escalated at a rate substantially greater than that of revenues, and there is nothing to suggest that this trend will change in the foreseeable future. In addition, English soccer leagues are confronted with many of the challenges faced by the North American leagues especially a growing economic disconnect with their traditional fan base, and competition from other sources of entertainment. However, there is an important difference between financial prospects of the English and North American leagues in that the long-term prospects for financial gain in the North American context are excellent, while the financial long-term outlook for the owners of English soccer teams is less sanguine. The Deloitte and Touche (2001) review asks the question 'is football an investment?' And succinctly answers it by concluding, 'Emotionally – yes. Financially – in rare cases' (p. 43).

There are three main reasons why the long-term financial prospects of North American teams are stronger. First, the value of professional sports franchises has been appreciating at double digit rates annually for the past 30 years, providing owners with substantial capital gains which more than compensate them for relatively small operational losses. This occurs because each of the four major leagues acts as an independent cartel restricting the number of teams allowed to enter the league, so the demand from cities seeking to host a team always exceeds the supply of teams. This favourable demand-supply position ensures the value of existing teams remains high. It enables team owners to exact substantial subsidies – typically in the \$10 million to \$20 million per year range – from the public funds of host cities. If host cities refuse to pay such subsidies, the team owners then transfer the teams to other cities that will provide them because they are anxious to achieve the 'big city' status which

they perceive to accrue from hosting major league teams.

The second factor contributing to the long-term financial strength of North American teams is their favourable treatment by the tax laws. The most prominent of these tax breaks is the special roster depreciation allowance that saves the teams tens of millions of dollars over the first five years of team ownership. The final factor is the leagues' abilities to control the escalating costs of players' wages. Their experiences may inform discussions of the English soccer leagues on this issue. North American leagues have responded to it differently and, consequently, their long-term future financial prospects are different. The financially strongest league is the NFL even though its teams play fewer than 20 games a year. The league's salary cap limits players' wages to a minimum of 58% and a maximum of 64% of the league's revenues. Even though there are a couple of loopholes in this cap, it does exercise control on players' salaries. In addition, the NFL team owners share 77% of the total revenues generated by the league. This ensures a large degree of financial parity among the teams, which permits competitive parity. Thus, 'dynasties' among NFL teams tend to last no longer than two or three years. There is no small cadre of teams who always dominate, so fans feel that their team has as good a chance to win the Superbowl as any other team, if not this year then in the near future. A similar salary cap exists in the NBA where players receive a minimum of 48% and a maximum of 55% of the league's pooled revenues. Again, there are loopholes, but the existence of this cap goes a long way to ensuring the league remains viable and that there is some semblance of financial parity.

In contrast to the NFL and NBA, Major League Baseball has no salary cap. The owners did agree to a 'luxury tax' by which the five teams with the highest profits would share those profits with the rest of the league's teams, but this has proved to be

ineffective. NHL lacks either a salary cap or a meaningful revenue sharing arrangement, resulting in a wide disparity of revenue and ability to be competitive among its teams. The situation in the English soccer leagues resembles that of MLB and the NHL, but without the promise of capital gains these leagues create by curtailing the supply of teams. If teams cannot be competitive, it seems likely then their fan base will erode. Most fans are likely to want to see some potential for success in order to sustain their enthusiasm over the long term. The NFL and NBA have produced mechanisms to control costs and share revenues that ensure long-term operating viability of their leagues. Their experiences may prove useful to the English soccer leagues.

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