

Chapter 2

Some Conceptual Foundations: A Primer on the Economic Structure of Professional Sport

2.1 Sports Leagues as Monopolies

The notion of competition is fundamentally at the core of a capitalist society. When firms actively compete against each other in a market, several social benefits are generated. In general, competition tends to lower costs, reduces production inefficiency, and leads to a more efficient allocation of societal resources. In other words, resources flow to their most productive uses. Competition is a dynamic process in that it is inherently forward looking, leading to innovation and creativity amongst producers. These benefits ultimately flow through to consumers, who enjoy a more wide range of product choices, higher-quality products, and lower prices. In general, the lower the degree of competition in a given market, the less present are these array of benefits—all else equal, less competitive markets can result in greater production inefficiencies, reduced innovation, fewer product choices, and higher prices for consumers, with the latter directly resulting in higher profits for producers.

Competition is revered in American society, not only as an economic concept but also as a social and cultural foundation and perhaps even as a moral ideal. Politically, the federal government has long taken an active role in promoting competition through the use of antitrust laws. Antitrust policy has generally been concerned about the dominance of firms in a market. Where there has been a tendency for this domination—either due to natural monopoly causes or anticompetitive actions—policymakers have used a variety of remedies, including the forced breakup of monopolies, monetary fines, and price and output regulation.

Compared to many other countries, the United States has a history of taking a particularly interventionist approach to competition policy. The Sherman Antitrust Act of 1890 attempted to control the trusts that had dominated American business during the latter part of the nineteenth century; antitrust policy was further refined and extended with the Clayton Antitrust Act of 1914. There have been several notable instances of activist antitrust policy. It began with the Supreme Court's 1911 decision, pursuant to the Sherman Act, to force the breakup of the Standard Oil monopoly. More recently, the federal government reached an agreement with AT&T

in 1984 that broke the telephone monopoly into several smaller competing firms. In 1998, Microsoft met the wrath of the Department of Justice's antitrust unit, and the subsequent (lower) court decision ruled that Microsoft be broken into two separate units; however, the breakup ruling was later overturned on appeal.

There are many markets in the United States that are oligopolistic in nature, i.e., they are dominated by a small number of large firms; for example, Coke and Pepsi in the cola market and McDonalds, Burger King, and Wendy's in the fast-food hamburger market. However, much rarer is the situation where there is only one firm in the market. These markets where there is a complete absence of competition are termed monopolies.

Under almost any definition of the term, the four major professional sports leagues in the United States—the NFL, NBA, NHL, and MLB—currently operate as monopolists in their respective industries. As mentioned in Chapter 1, while all of these leagues that comprise the “Big Four” have faced competitor leagues at some point in their histories, no rival leagues have emerged to challenge one of the Big Four in over 30 years. Even more importantly, unlike some instances of monopoly where the monopolist has faced price and output regulation by government—for example, as in the electric utility industry—the professional sport industry has operated largely immune from government oversight. While numerous congressional investigations into the professional sport industry have occurred over the decades, these investigations have generally not resulted in any meaningful or significant policy initiatives. Zimbalist (2006) refers to baseball, with its antitrust exemption dating back to 1922, as “the only unregulated, legal monopoly we have in this country” (p. 174).

The monopoly position of sports leagues potentially allows them to gain leverage over a variety of other stakeholders—suppliers, employees, third-party partners, governments, etc. For example, the lack of alternative leagues can reduce labor market competition for players and, all else equal, may result in a wealth transfer from players to owners. The monopoly power of leagues also gives them increased bargaining power over TV networks and sponsors, allowing leagues to capture higher prices for league broadcast deals and for sponsorships. Monopoly leagues also gain political power within the host cities, and threats by its teams to relocate—with no competitor league to fill the void—can lever large-scale public subsidies for arenas and stadiums.

2.2 The Core Foundations of the Spectator Sport Business

Within this context, the purpose of this book is to explore the nature of competition within professional team sports. An examination of competition and competitiveness must begin with an understanding of the unique structure of the pro sport industry and, correspondingly, an examination as to whether this unique structure fundamentally changes how one must view the nature of competition.

The spectator sport industry is in the business of selling entertainment. At its most basic level, the business premise of the spectator sport business is quite simple—consumers will pay to watch two teams competing in a sporting contest. This is broadly similar, to say, the live theater business, where consumers will pay to watch a Broadway show.

Not all sporting contests are of equal entertainment value, just as not all theater productions are equal. First, the absolute quality of the event and its “performers” matters. For example, most individuals would pay more to see a Broadway show than a production from a local community theater—with the Broadway show, the actors are more well known and accomplished, and the quality of acting and directing is higher. Furthermore, the Broadway show is a more polished event, with a more appealing physical theater and with more history and reputation. Analogously with sports, watching a high-school football game is very different than watching an NFL game. With the latter, the players are more talented and are able to athletically perform at a much higher level than high-school players, and the stadium is more conducive to a higher-quality experience—it is often indoors and immune from weather vagaries, the seating is more comfortable, the concessions offer a wider range of choices, etc.

At the same time, there are also elements to spectator sport that are quite different than other forms of entertainment like Broadway shows. In sport, what is being sold is the opportunity to view a contest between two teams in which the outcome is uncertain. This uncertainty is really what defines and separates the spectator sport business from other forms of entertainment. Unlike a Broadway show or a Hollywood movie, the outcome of a sporting event is not scripted—no one, including those staging the event, knows beforehand what the outcome of the event will be. Sport events unfold in real time.

Economists have extensively studied this issue and have categorized this notion of “uncertainty of outcome” into three dimensions.¹ First, fans want individual games to be closely contested, with outcomes not determined until near the end. Extending this to the season, fans want teams to be closely grouped during a season—if some teams are far in front of the standings, or far in back, fan interest may drop. Finally, balance is also important across seasons—fans do not want the same teams to be successful (or unsuccessful) each year and prefer some turnover in the standings from year to year. In general, then, fans value the notion of competition and competitiveness, and predictability lessens fan interest.

However, added to this desire for uncertainty and competitiveness is a further complicating factor associated with the sport industry; specifically, spectator sports tends to engender partisan behavior on the part of the fan, whereby some fans may strongly identify with one of the participating teams and may thus have a strong

¹See Humphreys and Watanabe (2012) for a comprehensive review of the competitive balance literature.

personal stake in the outcome. Thus, spectators are often not simply detached observers of an event played by others—the team essentially becomes an extension of the person, where it is not uncommon to hear fans referring to their favorite team as “we.” One of the arguments later in the book is that this intense fan loyalty to a particular club—beyond any type of loyalty consumers may show to brands or firms in other industries—is a key factor in reducing the viability of potential rival leagues.

Given consumers’ desire to view sporting contests, and their propensity to identify with specific teams, entrepreneurs have a business opportunity by organizing and staging such contests. However, by necessity, the staging of such games obviously requires two teams, not one. Thus, the sport entrepreneur needs to find at least one other entrepreneur willing to establish a team.

Assuming the two teams are at arm’s length from each other, the teams have an interesting and complex relationship with each other. While they may be competitors *on* the field, they have an off-field dependency. Assume, for the moment, that only two teams exist and that they repeatedly play each other. If both teams build a separate and distinct fan base, each team has a financial interest in defeating the other team—each team is more popular with its own fans when that team wins, rather than loses, and hence winning teams generate more revenue than losing teams. However, if one team starts winning too often, the opposing team may lose fan interest, eventually threatening the existence of that team but also threatening the existence of the winning team, since the winning team would have no one left to play. Thus, the relationship between the two teams is not, for example, like the relationship between McDonalds and Burger King—with the hamburger chains, the demise of one of the firms would unequivocally benefit the other, since they are competing for the same consumer dollar and hence are substitutes.

Since fans would inevitably lose interest in seeing the same two teams playing each other repeatedly, sport entrepreneurs may have incentives to expand the number of teams against whom they can compete. One possibility is that the network of teams is loosely organized—for example, in the early days of sport competitions in America, “barnstorming” teams were popular. These teams travelled across the country playing local teams. Eventually, however, more formal leagues began to develop. Leagues offered a number of advantages over loose affiliations. First, they allowed for a formal schedule to be developed—the competition would become not just about a single game in isolation, but about a season-long series of contests, where an eventual champion would be declared. Leagues also had the advantage of providing consistency and standardization across teams, thus increasing the “fairness” aspect of on-field competitions—the rules of the game can be standardized, player conduct can be monitored and regulated, both on and off the field, etc.

Relatively early on, team owners in major professional leagues began to see governance as critical and saw that a central entity needed to be created to oversee operations of the various league members. The first commissioner appointed in major professional sports—Kenesaw Mountain Landis in 1920—was the result of the “Black Sox” gambling scandal of the previous year. Baseball owners saw that their interests were interlinked and that problems with one franchise could affect other franchises, and ultimately affect the league’s continued existence.

As leagues became stronger and more developed, their power and influence as entities increased. Leagues are the adjudicating mechanism to deal with competing and contradictory economic incentive structures facing individual owners. On one hand, individual owners are business partners with other franchise owners in the league; there is a certain amount of common interest amongst owners, and the financial success of one franchise is at least partially dependent on the success and popularity of other franchises in the league. These common interests are both direct and indirect. Indirectly, the revenues of any given franchise are impacted by the overall popularity of the league—i.e., of the popularity of the other franchises collectively. However, the links are also direct—in the current era of league governance, each of the four major leagues has some degree of revenue sharing amongst franchises. Thus, increased revenues from one franchise can have direct and positive effects on all franchises.

Further to this notion of collective dependence, one could consider, for example, a franchise like the Dallas Cowboys of the NFL. While they operate in a lucrative local market where football is extremely popular, the value of this franchise is still heavily influenced by the fact the Cowboys are members of the NFL and are partners with the other 31 franchise owners in the NFL. The Cowboys' brand without the NFL, even if such a scenario were possible, would be much less valuable. In effect, as leagues have developed and become more prominent over time, the value of an individual team in a league was as much driven by the league to which the team belonged—i.e., its partner franchises in other cities—as it was by the characteristics of the individual team itself.

However, counter to this notion is the fact that, in the short run at least, each team also has an incentive to improve performance, even if it means, by necessity, that other teams would be harmed. Sport competitions are a zero-sum game—if one team wins, the other team must lose. Thus, similar to a classic cartel scenario, each benefits from colluding with other teams, but some teams simultaneously have incentives to “cheat” on specific aspects of the collusive agreement. Thus, sports leagues have a collective incentive to regulate the behavior of individual franchises and to ensure that the actions of one franchise do not damage the league as a whole. As we will see later, one manifestation of this could be salary caps, where individual clubs are limited as to what they can spend on payroll. However, as we will also see later, such mechanisms can only be successful if the league is a monopoly.

2.3 The Appropriate Unit of Analysis: Leagues or Teams?

When evaluating the nature of competition and competitiveness in professional sport, a question arises as to whether it should be (1) leagues or (2) individual teams that are the appropriate level of analysis.

To answer this question, one must consider that modern North American sports leagues are “closed,” in that the existing collection of individual owners in the league maintains strict and complete control over all aspects of franchise location

decisions. New franchises are only admitted with the collective approval of the other franchise owners. As well, all existing franchises in a league are granted geographic “territorial rights” by the league that prevents any other franchise in the league from relocating into their territory. Thus, an entrepreneurial owner cannot independently start a franchise in a city and gain entry into the league. The territorial rights ensure that each franchise owner is granted a local monopoly.

This is quite different than the “open” leagues found, for example, in European domestic soccer leagues, where teams enter and exit leagues through promotion and relegation systems. In these open leagues, a club could form at a lower-level league and then eventually get promoted to the higher tier league. Entry into the top tier league in each country is *earned* by club performance and is not *granted* by existing clubs currently in the league. In the 20-team English Premier League (EPL), for example, 6 of these teams during the 2012–2013 season were London based, and as many as 9 London teams have participated in the EPL, at one time or another, over the league’s 20-year existence. Such a concentration of teams in one location, even in a city the size of London, would be unheard of in North American sport, simply because existing North American franchise owners have their geographic territory protected by the league to which they belong.

Nor can competition occur in the form of “franchise free agency,” a situation where a franchise in an established league voluntarily left that league to join a competitor league. While such a possibility would seem unlikely in the current era, given the huge values of the brands of the established leagues, franchise movement between leagues has actually occurred in past eras and has sometimes helped rival leagues compete with the established leagues.

For example, as will be discussed later in the book, the Brooklyn Tigers of the NFL left that league in 1946 to join the rival All-America Football Conference (AAFC) and helped to quickly establish the upstart league as a viable threat. The owner of the Tigers—Dan Topping—also co-owned the New York Yankees baseball club. When Topping bought the Tigers in 1945, his intent was to relocate the team from Brooklyn to Yankee Stadium in the Bronx. However, the NFL disallowed the move, since the Tigers would have been within the territory of the NFL’s New York Giants, who played their games just across the East River in Manhattan’s Polo Grounds. Unhappy with this decision, Topping pulled his franchise out of the NFL to become a founding member of the AAFC. In basketball, similar types of interleague franchise shifts also occurred during the late 1940s. In 1948, four teams from the established league, the National Basketball League (NBL), left that league to join the upstart Basketball Association of America (BAA), the latter being the forerunner to what would become known as the NBA. In 1949, six more teams abandoned the NBL for the BAA, thus causing the NBL to fold.

Since that era, all leagues have introduced greater legal protections that contractually bind the franchise to the league. In economic terms, such league protections could be quite rational, in the sense that individual franchises gain a considerable portion of their value by simply being members of the league. In other words, and as discussed earlier, the Dallas Cowboys are a valuable franchise today, in part,

because they are members of the NFL, and benefit from all of the externality effects that membership in the NFL provides. Thus, the Cowboys' value is embedded not just in the fact that they play high-level football in a city and a state where the game is extremely popular, but because they do so as members of the NFL. An illustration of this is that the Dallas Texans franchise of the upstart American Football League (AFL), which began play in 1960—the same year the Cowboys' NFL expansion franchise began play—was never able to compete with the Cowboys' NFL affiliation. After 3 years of attempting to compete, and despite much greater on-field success than the Cowboys, the Texans moved to Kansas City in 1963 to become the Chiefs.

Thus, individual franchises are inextricably tied to the league to which they are members—an individual franchise would have little or no value as a stand-alone entity. Nor, in today's world, would an individual franchise likely even desire to leave the league. Each of the Big Four has developed such high brand recognition that franchises would lose considerable value if they left. However, one could perhaps envision a scenario where a group of franchises left an established league to form an offshoot rival league. This could be analogous to what occurred in England in 1992, where a group of leading soccer clubs separated from the Football Association (FA) to form the Premier League, where they were able to keep all of the revenues they generated, rather than share them with small-market clubs. In US sports, it is not entirely beyond the realm of possibility that something similar could occur, if a group of clubs felt that they could collectively be more profitable outside the league than inside. The relatively high level of revenue sharing that now occurs in many leagues may actually increase the incentive for some of the wealthier clubs to consider forming their own league. For example, in the NFL, large-market teams such as Dallas, New England, Philadelphia, Washington, and the New York Giants receive the exact same share of the national television contract as do small-market teams like Buffalo, Jacksonville, and Kansas City. In effect, the large-market teams are cross subsidizing the small-market teams, and, at least in the short run, the large-market teams would be more profitable without providing such transfers.

However, a renegade group of NFL owners forming their own league would only gain if two conditions were satisfied. First, the teams would have to be able to keep their names and logos in order to ensure fan acceptance and identification with the new league. However, such a possibility is precluded by league contracts that ensure the league owns the rights to its franchise's names and logos.² Second, any renegade franchise would have to believe that the gains from not having to cross subsidize smaller-market franchises would be greater than the losses from losing the NFL brand and its commensurate revenue potential.

²For example, in 1994, the NFL filed suit to prevent a Canadian Football League franchise in Baltimore from using the name "Colts," even though the NFL's Baltimore Colts had left for Indianapolis 10 years earlier.

In essence, then, established leagues have gone to great lengths to insulate themselves from competitive threats. Thus, while the monopoly profits in established leagues are earned at the local (i.e., franchise) level, they are a direct result of the protections granted at the league level. League policies ensure these local profits cannot be threatened from within—i.e., from a new franchise being granted entry into the market or from an existing franchise moving into the market. It is only through the formation of an entire rival league that individual clubs in the established league can face competition. This is the essence of the foundation of this book—i.e., that it is *leagues*, and not individual *teams*, that are the critical entity in the North American sport business, and that it is leagues upon which one must focus in order to better understand the nature of business competition in the industry.

2.4 Defining Competition

An argument sometimes heard is that, while teams and leagues face no direct competition from a rival league, they still face competition in the broader sport and entertainment market. For example, one could argue that while the NBA faces no direct competition from a competitor league, it does compete for the broader consumer entertainment dollar with the other major pro leagues, with college basketball (and/or football), and with a host of other entertainment options. Viewed even more broadly, one could even say the NBA competes with several non-sport options, such as amusement parks, concerts, and theaters.

While there is some validity to these notions, they can be overstated and have the potential to mislead. Certainly at one level, teams and leagues *do* compete with teams and leagues in other sports for the consumer entertainment dollar. For example, teams like the Philadelphia Flyers of the NHL and the Philadelphia 76ers of the NBA do, to a certain degree, compete for season ticket holders—some fans may choose to attend either Flyers games or 76ers games, but not both. These fans may make choices based on the relative success of each of the clubs, on the entertainment value of the product, on ticket prices, etc. Similarly, these teams would also compete in the Philadelphia market for sponsorship dollars and local TV packages. Rascher et al. (2009), for example, found that during the 2004–2005 season-long lockout in the NHL, the NBA increased its revenues by an average of over \$1 million per team, revealing some level of cross-substitutability between the NHL and NBA product.

However, the extent of this type of competition can be overstated. First, the 76ers and Flyers, as entertainment products, are not perfect substitutes for some fans. In fact, there would be a significant group of Flyers fans that would have little or no interest in basketball or the 76ers and vice versa. Economists formally measure this concept by calculating the degree of cross-price elasticity, which, in essence, measures the degree to which consumers see two products as substitutable.

Thus, by any reasonable definition of the term, the Flyers operate in a monopoly environment, even though they face competition from non-sport entities. More generally, if one defines the unit of analysis broadly enough, then, in the extreme, almost any business competes with all others in the economy. For example, a

fashion retailer competes with a concert promoter, in the sense that a consumer could spend his/her disposable income on buying a new suit or on attending a concert of his/her favorite band. At some level, such comparisons border on the absurd and move well away from the notion of competition and competitive markets as we typically define them.

What about the more specific case of leagues within the same sport as the established league—for example, the Extreme Football League (XFL) of the early 2000s or the United Football League (UFL) that existed from 2009 to 2012? Can't these leagues be considered competition? They *are* competition, but in the same broad sense that McDonalds competes with a movie theater for the consumer dollar, not in the more important sense of McDonalds competing with, say, Burger King, in the specific space of fast-food hamburger restaurants. McDonalds and Burger King compete for "market share"—McDonalds and movie theaters do not.

Using this analogy helps to define which professional leagues over time could be considered true rival leagues and which are not. While the exact definition is open to interpretation and debate, it is the argument of this book that, to be considered a rival league, the league must be competing in the same competitive space as the established league—in other words, it must be directly targeting some of the revenues, and monopoly profits, of the established league. Correspondingly, then, it must be selling the same, or a very similar, product as the established league. In sports, this product-quality notion translates into the level of *on-field* playing quality—i.e., what differentiates the four established leagues from other (minor) leagues in the same sport is that the established league employs all of the best players in the game. Other leagues, like the XFL or UFL, never competed with the NFL for players, but instead employed those players that were unable to earn spots on NFL rosters. Thus, one should not mistake "minor leagues" as competitors—minor leagues serve an entirely different market segment and have no intention of inflicting harm on the established league.

Thus, some type of head-to-head competition between the leagues for players is generally seen as a prerequisite for a league to be considered a rival. Rival leagues, if they are to have any chance of capturing some of the monopoly profits of the established leagues, must lure at least some players away from the established league—this is the only means by which the rival league can show fans that it is competing in the same quality space as the established league.

2.5 The Current State of the Monopoly Leagues: Structure, Conduct, and Policies

If one takes a current snapshot of the Big Four sport monopolies, there is a remarkable similarity across the leagues, not only in terms of their structure but also in terms of their conduct and policies. Presumably this similarity is not by coincidence, but is a function of the monopoly power of these leagues. The absence of competition allows monopoly leagues to explicitly *choose* a structure and set of policies that maximize expected profits; this is different than competitive markets,

Table 2.1 Number of franchises, established leagues: by decade

	NFL	MLB	NBA	NHL
1950	13	16	11	6
1960	13	16	8	6
1970	26	24	17	14
1980	28	26	23	21
1990	28	26	27	21
2000	31	30	30	30
2010	32	30	30	30

Table 2.2 Franchise locations, by Nielsen TV markets: 2013

	NFL	MLB	NBA	NHL
Number of top-10 markets served	9	10	10	8
Number of top-20 markets served	17	18	18	14
Number of top-30 markets served	24	22	21	18

where individual firms must constantly *respond* to market forces. The current states of the Big Four can be examined along several dimensions: output market and franchise locations, revenue sources and allocations, input costs and player relations, and profitability.

In terms of output market decisions, a defining characteristic of North American sports leagues is that they operate as “closed” leagues. Each league—or, more correctly, the existing franchise owners in a league at any given time—makes unilateral decisions regarding league membership; this is in contrast to the “open” leagues found in much of the rest of the world, where clubs enter and exit leagues based on a promotion and relegation system. Economists have long argued that monopolists have a profit incentive to restrict output to a level below the competitive outcome—by restricting output, monopolists are able to increase price above its competitive level. Monopolists will continue to restrict output until the effects of increased price are more than offset by the effects of decreased output/sales. Applied to professional sports, this would suggest that the monopoly leagues in North America have an incentive to grant fewer franchises than what could be profitably supported—in other words, there will be cities that could support a franchise, but who are unable to gain entry into the league. This undersupply of franchises also gives leagues considerable leverage in dealing with cities, particularly as it relates to the public funding of arenas and stadiums. By leagues leaving viable markets unserved, existing franchises are able to present credible threats to relocate if sufficient public funding is not secured from the current host city.

These issues would seem to underlie the fact that all four leagues have made very similar franchise location decisions. In terms of the number of franchises, there is a high congruence across leagues. Three of the leagues—the NBA, the NHL, and MLB—have the exact same number of franchises (30), while the NFL has slightly more at 32. Not only are these current franchise numbers very similar, each league has shown similar growth patterns over the last several decades. Table 2.1 shows the number of franchises in each league, decade by decade, over the past half century.

As well, the location of current franchises shows remarkable similarity across the four leagues. Table 2.2 shows the number of top-10, top-20, and top-30 markets

in the United States that is served by each league. The table shows a definite pattern. Each league has a strong presence across the major markets in the United States, but this presence is far from complete. For example, of the country's top-30 markets, the NFL is in 24 of these, MLB in 22, the NBA in 21, and the NHL in only 18. Perhaps most stark is the NFL's lack of presence in Los Angeles, despite that market being the second largest in the country. There has not been an NFL team in Los Angeles since the Rams left for St. Louis in 1995 and the Raiders left for Oakland that same year. The NFL is presumably not returning to Los Angeles until a new stadium is built, but that position would undoubtedly change if a competitor league existed, since a competitor league would almost assuredly move into the unserved Los Angeles market.

In terms of the financial performance of sports leagues, this is somewhat more difficult to accurately discern, since leagues and their member teams do not publicly release financial data. The media often attempt to estimate such performance, with *Forbes* magazine's analyses being the most comprehensive. *Forbes'* tracking of pro sport finances now goes back over 15 years and includes estimates of both league and team performance. In terms of absolutes, the NFL is the largest of the four leagues, generating approximately \$9 billion in annual revenues, followed by MLB at \$7 billion, the NBA at \$5 billion, and the NHL at \$3 billion. For all four leagues, gate receipts and media rights fees are the dominant source of revenues, with merchandise sales and sponsorship revenues also contributing significant amounts. In the early eras of professional sports, gate receipts were the dominant source of revenues, but media rights fees have now become equally important for most leagues, if not more important in some leagues. For example, about 70 % of all NFL revenues come from the league's network TV contract.

What is also important about league revenues is not just their absolute levels, but also their distribution amongst franchises. Different leagues have somewhat different levels of revenue sharing amongst their franchises, although there are some common principles and themes. First, all four leagues share national TV contracts equally amongst their member franchises. However, the impacts of this equal sharing vary substantially across leagues, based on the relative importance of the national TV revenues as a percentage of league total revenues. In the NFL, all regular season and playoff TV rights for all teams are sold as part of the national contract—individual franchises cannot sell their TV rights in their local markets (except for preseason games). Thus, in effect, all TV revenues in the NFL are *national* revenues and hence are equally distributed. Contrast this with the other three leagues, where franchises are allowed to sell media rights in their local markets. While these other three leagues all do have national TV contracts, and the revenue generated from these contracts is distributed equally, as in the NFL, the value of these contracts is much smaller than in the NFL. The value of the local rights for any given franchise will depend on the market size of that franchise—in general, franchises in larger markets will have greater local media revenues than those in smaller markets. For example, in baseball, the annual value of the New York Yankees local TV contract is more than ten times what the Kansas City Royals generate from their local TV deal. The same is also true, on a smaller scale, for gate receipts—larger markets will have an inherent revenue advantage over smaller markets.

These issues directly relate to the monopoly power possessed by leagues—the local monopolies that each franchise possesses through territorial rights mean that large markets are protected from intrusions into their territory by other league members; the result is that revenues across a league's franchises can be quite widely varying. If left uncorrected, this uneven distribution of revenues can cause competitive balance problems for a league—in essence, large-market teams have a greater revenue payoff from winning than do smaller-market teams and hence have an incentive to buy greater amounts of talent in the players' market. Long-term imbalance problems may decrease fan interest in the game and may ultimately threaten the viability of small-market franchises.

As a means to address these imbalance issues, leagues have adopted various measures to level outcomes. First, all leagues have some type of internal revenue sharing arrangements. Second, three of the four leagues have adopted some type of a salary cap. A salary cap is really somewhat of a misnomer, since it is not a cap on individual player salaries, but rather a cap on a team's payroll. Only MLB operates without any type of cap. The NFL and NHL both have a hard cap—where the upper (and lower) bounds of team payroll are absolute and cannot be violated—while the NBA has long operated with a “soft” version of the cap, whereby teams can exceed the cap under certain provisions. As well, both MLB and the NBA have a luxury tax, whereby teams whose payroll exceeds a certain threshold are required to pay a “tax” on the excess amount. The thought is that such a tax will slow down the spending on payroll of large-market teams, since it increases the marginal cost of signing players if the team is at or near the threshold.

Redistributional mechanisms like salary caps are, themselves, only possible in leagues that are monopolies. Restrictions on the amount that individual teams can spend on players can only be successful if all teams abide by these rules. In a closed, monopoly, league, such rules can be easily enforced. However, if a competitor league exists, competitors will have no requirement, or desire, to abide by the restrictions. In fact, salary caps would not continue to exist in the established league, simply because it would limit the established leagues' ability to retain players in the face of potentially higher salary offers from the rival league. Witness that in European soccer, where domestic leagues operate independently from one another, no country's domestic league has implemented salary caps. If the English Premier League, for example, introduced a salary cap on its teams, many players would simply defect from that league and go to leagues where there was no cap, say Germany or Spain.

In the three leagues that have some form of a salary cap—the NFL, NHL, and NBA—players' associations in these leagues have only agreed to these caps in return for a guarantee that players receive a certain predefined percentage of league revenues. These provisions are set out in each league's CBA. The exact percentage going to players varies across leagues and with each new CBA, but, in general, players have tended to receive about 50 % of league revenues. Again, as with salary caps, this guaranteed distribution to players could only occur in a monopoly league. If a competitor league were to exist, established leagues would not be willing to introduce a salary cap, and without a salary cap, they would not be willing to provide revenue guarantees to players. With interleague competition, the competitive

dynamics of the marketplace determines allocations to owners and players, not predetermined contractual agreements.

Another key aspect of leagues' relationship with their players pertains to player mobility rights. At one time, players in all four leagues were bound to the teams that had originally signed them—under the so-called reserve clause, teams had the right to perpetually renew players' contracts, effectively prohibiting any voluntary player mobility between teams. While leagues argued that this was needed to preserve competitive balance—i.e., to prevent large-market teams from buying up all the talent—it really was more about suppressing player salaries by denying them any opportunity to sell their services on the open market. Players in all four leagues now have free agency rights, whereby they are able to sign with any other team in the league upon expiration of their contract. Baseball players were the first players to win unrestricted free agency rights, in 1975, and as a result of an arbitrator's decision; over the next 20 years, players in the other three leagues gradually won such rights, although the specific provisions of such free agency rights vary by league and by CBA.

While the monopoly power of sports leagues can manifest itself in many forms, its ultimate effect is to generate abnormal (excess) returns for owners—i.e., returns above a risk-adjusted market rate. As discussed earlier, one problem in identifying this effect is that the financial statements of the major North American professional sport teams are generally not public information. Almost all teams are privately held and hence have no obligation to publicly reveal their financial performance. Nor do these teams generally have any incentive to voluntarily release this information. Teams often have an incentive to “plead poverty” to their stakeholders, i.e., fans, players' associations, and cities regarding stadium funding, in the hope that this will increase their bargaining power with these groups. In addition, liberal tax rules that have existed for over half a century allow pro sport teams to depreciate player contracts, thus making their reported “net income” figures well below their actual cash flows. In other words, the financial statements of teams, if taken at face value, significantly underestimate the true returns to owning the team.

However, information on profitability can be gleaned in other, more indirect, ways. For example, Quirk and Fort (1992) examine the growth rates in franchise values over the entire history of professional sports to the time of their writing. Franchise values are a type of summary statistic, in that they represent the discounted value of all expected future cash flows. Quirk and Fort find that, using these franchise values, the professional sport industry enjoyed a long period of above-normal returns. In a more recent study, Fort (2006) specifically focuses on MLB franchises during the modern era and finds that the sale prices of franchises have grown at twice the economy-wide benchmark rate, although these franchise growth rates have fluctuated considerably from era to era. Humphreys and Mondello (2008), using data on franchise sales over the 1969–2006 period, find average annual price increases of over 15 %. Using, then, the conceptual foundations of this chapter as a framework, the next two chapters examine the actual case histories of the various rival leagues that have existed since World War II.

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