# Defining the Market Conditions for Success

by Glen Hodgson and Mario Lefebvre | March 2011

Fan passion is critical to the success of a pro sports franchise. The fans faithfully buy the tickets and the souvenirs, and watch the television coverage that brings in the ad revenues. But on its own, passion is not enough. In the pro sports business, success or failure also rides on the existence—or lack of—some key market conditions.

Every local or regional market has fundamental characteristics that can be assessed to determine whether a pro sports franchise can succeed in that particular market. When assessing such a market, we want to know whether it has what we call the "market conditions for success."

Of course, the local population's love or passion for the game has to be a part of the equation. That's a given. No matter how populous or fortunate a region is, if fan passion for the game does not exist, the team will fail.

Our assumption is that individuals and/or corporations that try to bring professional teams to their communities have already satisfied themselves that there is a love for the game there. (We will look at the issue of fan passion—and what happens when the passion is gone—in later briefings.)

Aside from passion, therefore, the success of a professional sports organization in any given market relies on four pillars of support. They are:

- market size;
- income levels;
- a strong corporate presence; and
- a level playing field.

***Pillar One: Market Size***

Every professional team requires strong fan support to be financially sustainable. Empty seats in the stands mean fewer tickets sold and lower revenues from souvenir and concession stand sales and parking. In addition to fan support, a successful pro sports franchise will generally need strong corporate or business support and healthy broadcasting revenues in order to survive.

What size population base is needed for a city or region to support a professional team? We believe that the following rule of thumb is reasonable: The population of a market must be at least equal to the potential total number of tickets sold in a season.

No matter how populous or fortunate a region is, if fan passion for the game does not exist, the team will fail. According to this hypothesis, the minimum market size needed to support a Canadian Football League team is about 250,000 (one pre-season game plus nine regular season home games, multiplied by 25,000 fans per game). A National Hockey League team in Canada needs a little over 800,000 potential fans (4 pre−season games plus 41 regular season games, multiplied by 18,000 fans per game), and a Major League Baseball team needs a home−market population of almost 2,500,000 (81 home games times 30,000 fans per game). Thus, based on this first pillar, Regina can support a CFL team, but it doesn't come close to being able to support an NHL team.

***Population in the Market Must Be Rising***

Another element—sound population growth—must be added to this first pillar. It is one thing to have the fan base required right now, but it is just as important that the fan base be there in the future. A market not only needs a large enough population today, it also needs a population that is growing. The need for growth stems mainly from the phenomenon of aging. The population in Canada is aging at a rapid pace, and we can assume that as citizens age

they become less likely to attend professional sports events, due to income restraints and fading interest. It is therefore imperative for the success of a pro sports franchise that the community posts solid population growth, thereby ensuring that it will possess the required fan base for years to come.

Let's use a few numbers to illustrate this need for a growing population. Our rule of thumb for pillar one suggests that the fan base required to support an NHL team is about 800,000. On average, people aged 65 and over made up about 15 per cent of Canada's population in 2010. So, on average, a community of 800,000 last year had a total of 680,000 people aged 64 or younger. With no growth in the population, and based on current demographic trends in Canada, by 2025 that same community of 800,000 would have 600,000 citizens aged 64 or younger. That's a drop of about 12 per cent over 15 years in the population aged 64 or younger—a drop that would be detrimental to, for example, the health of a local NHL franchise. To maintain a population of 680,000 aged 64 or younger, the overall head count would need to increase to 910,000, a rise of 0.9 per cent per year (and a rate that is very much in line with the pace at which Canada's population is rising).

The rapid rise in immigration is another reason why growth in the population is required. While this is hard to quantify, foreign-born Canadians are less likely to have grown up with hockey, football, or baseball, and are therefore less likely to be as passionate about these sports as Canadian-born citizens. The steady rise in the ratio of foreign-born to total population in Canada's urban areas is yet another reason why population growth is required in order to provide a sufficiently large and ongoing fan base.

There is a limit to how far any one market can be stretched by adding additional pro sports teams to the mix. Market saturation will occur at some point.

A word of caution—there is a limit to the number of different sports franchises any market can absorb. Since there are sports fans who have both the interest and the income to support teams in multiple sports, the fan base required for an additional franchise is additive; that is, the required fan base per franchise is not mutually exclusive.

Nonetheless, there is a limit to how far any one market can be stretched by adding additional pro sports teams to the mix. Market saturation will occur at some point. (We will explore this issue in greater depth in future briefings.)

***Pillar Two: Income Levels***

For a market to be able to support a professional sports team today, it must have a relatively high−income population. Attending a professional sports event can be expensive. Is there a minimum per capita income needed to support a professional sports franchise? Again, there are no formal rules, and the Conference Board has not conducted specific data−driven research.

However, to see whether there is an observed relationship between income level and possible franchise success, let's compare the level of disposable income per capita in cities that do have National Hockey League franchises with that of cities that have the right market size (our first pillar) but do not have NHL franchises.

As shown in Table 1, the level of disposable income per capita in the three metropolitan areas that have sufficient populations but do not have NHL teams (Winnipeg, Hamilton, and Québec City) are not the lowest among the nine metropolitan areas listed. In fact, Montréal—home to one of the NHL's most successful franchises—has the lowest level of disposable income per capita. But with a population and fan base of nearly 4,000,000, Greater Montréal's absolute size more than compensates for its slightly lower average disposable income. (It is also worth noting that the per capita income rankings of Québec City and Winnipeg have improved since those cities lost their NHL franchises in the mid−1990s.)

Other Canadian census metropolitan areas (CMAs)—Regina, Saskatoon, and Kitchener-Waterloo-Cambridge (KWC), for example—have levels of personal disposable income that are very much comparable to those that appear in Table 1. While these three CMAs do not have sufficient market size (our first pillar) to support an NHL franchise,

Saskatoon and KWC may have large enough populations to support a Canadian Football League (CFL) franchise. (We will devote an entire later briefing to the CFL and the potential for other CFL franchises in Canada.)

Table 1
**Major League Canadian Professional Sports Franchises by City and League**

| | National Hockey League | Canadian Football League | Major League Baseball | National Basketball Association | Major League Soccer | National Lacrosse League |
|---|---|---|---|---|---|---|
| Calgary | Flames | Stampeders | | | | Roughnecks |
| Edmonton | Oilers | Eskimos | | | | Rush |
| Hamilton | | Tiger-Cats | | | | |
| Montréal | Canadiens | Alouettes | Expos (1969–2004) | | Impact (2012–) | |
| Ottawa–Gatineau | Senators | Rough Riders (1876–1996) Renegades (2001–06) | | | | |
| Québec City | Nordiques (1979–95) | | | | | |
| Regina | | Saskatchewan Roughriders | | | | |
| Toronto | Maple Leafs | Argonauts | Blue Jays | Raptors | Toronto FC | Rock |
| Vancouver | Canucks | B.C. Lions | | Grizzlies (1995–2001) | Whitecaps (2011–) | |
| Winnipeg | Jets (1979–96) | Blue Bombers | | | | |

Source: The Conference Board of Canada.

***Pillar Three: A Strong Corporate Presence***

The third pillar required to support a pro sports franchise is the presence in the region of corporate head offices. Filling your arena or stadium every night is good, but filling dozens of corporate boxes every night is even better. The rental rate for corporate boxes is high relative to the rates for other seats in the stadium. The same holds true for the price of food and drinks served in the boxes. Plus, boxes can generate sponsorship and other revenues. And even if a stadium does not have corporate boxes, the relatively higher income of employees in head offices will help to support the fan base.

Table 2 provides the number of corporate head offices per metropolitan area for selected Canadian cities.
Undeniably, Toronto, Calgary, Montréal, and Vancouver are in a league of their own on this criterion. In fact, Toronto is well ahead of everyone else; the head offices of 286 of Canada's 800 largest corporations—36 per cent—are located in the Toronto metropolitan area. Calgary (119), Montréal (98), and Vancouver (79) are relatively close to each other in terms of head office numbers. After that, the numbers drop off sharply. Fifth−place Winnipeg is home to 30 of Canada's 800 largest corporations, trailing far behind fourth−place Vancouver. However, Winnipeg finds itself ahead of Edmonton and Ottawa–Gatineau, both of which are home to NHL franchises. Québec City is in eighth place, not far behind Ottawa–Gatineau.1 Given the relatively low presence of large corporations in the cities that would like to attract or bring back an NHL franchise, a smart move would be to secure corporate engagement beforehand.

Table 2
**Estimated Canadian NHL, MLB, and NBA Franchise Revenues and Operating Income, 2010**
($ millions)

| Franchise | Revenues | Operating Income |
|---|---|---|
| Toronto Maple Leafs | 187 | 85.7 |
| Montreal Canadiens | 163 | 53.1 |
| Vancouver Canucks | 119 | 17.6 |
| Calgary Flames | 98 | 4.6 |
| Ottawa Senators | 96 | −3.8 |
| Edmonton Oilers | 87 | 8.2 |
| Toronto Raptors | 133 | 18.0 |
| Toronto Blue Jays | 163 | 13.1 |

Source: Forbes.

Table 3
**Canadian NHL Teams—Average Attendance**
(per game, after 20 home games, 2010–11 season)

| Rank | Franchise | Attendance |
|---|---|---|
| 1 | Montreal Canadiens | 21,273 |
| 4 | Toronto Maple Leafs | 19,308 |
| 5 | Calgary Flames | 19,289 |
| 8 | Vancouver Canucks | 18,860 |
| 14 | Ottawa Senators | 17,914 |
| 18 | Edmonton Oilers | 16,839 |

Source: National Hockey League; My NHL Trade Rumours. com.

Québec City has already done just that, lining up a relatively firm list of would–be corporate sponsors behind its bid to bring an NHL franchise back to replace the Nordiques (who moved to Colorado in 1995).

### *Pillar Four: A Level Playing Field*

If a metropolitan area has the fan base, both in size and in relative income, and the necessary corporate presence, does that guarantee success? Not quite. Our fourth macroeconomic pillar for success is a level playing field. Two items in particular are part of this pillar: the exchange rate and the tax burden. In the case of a league—such as the CFL—that has all of its operations in one country, the exchange rate does not play a significant role. Nearly all of the CFL's revenues are denominated in Canadian dollars, as are its costs. Neither does the tax burden play a significant role. True, the overall tax burden for businesses and individuals is heavier in Quebec than it is in Alberta. But we have yet to hear a CFL player say he'd rather play in Calgary or Edmonton than in Montréal because he will pay less tax playing for a team located in Alberta. (Maybe the nightlife in Montréal provides a balancing influence.)
If a metropolitan area has the fan base, both in size and in relative income, and the necessary corporate presence, does that guarantee success? Not quite.

However, when the league operates in more than one country—as is the case for the National Hockey League, Major League Baseball, Major League Soccer, and even pro lacrosse—the exchange rate and the tax burden can become significant barriers to the success of a franchise. Imagine when both of these factors are working against a market, as was the case in the mid–1990s for the Winnipeg Jets (who moved to Phoenix in 1996) and the Quebec Nordiques. Back then, Québec City and Winnipeg residents faced much higher marginal income tax rates than did their U.S. counterparts. That was a major strike against these teams at the time, and it remains a concern for Canadian teams to this day. And, of course, while fans with higher incomes are more likely to buy tickets, they are also burdened with the highest marginal tax rates—which diminishes their capacity to buy tickets.

On top of this heavier tax burden, Canadian franchises in the mid–1990s were being squeezed by the weakness of the Canadian dollar. At the time, the Canadian currency was worth about US$0.75. (And it would continue to lose ground, dropping below US$0.62 in January 2002!) This negative exchange rate effect was devastating for Canadian NHL teams, since they are required to pay their players in U.S. dollars. The same was true for baseball's Toronto Blue Jays and Montreal Expos. For example, a player who was paid a salary of US$2.5 million in the mid–1990s would cost his Canadian team almost C$3.5 million. On a payroll of US$25 million, this negative exchange rate effect would add almost C$10 million to the cost base of Canadian teams compared with their U.S.–based rivals. This painful exchange rate situation led to a sharp rise in revenue requirements to cover player salaries and became a serious financial issue for numerous Canadian NHL franchises and both of Canada's Major League Baseball teams. It may not have been the only factor that compelled the Jets and Nordiques to leave for greener pastures (as the Expos would also do in 2004), but it certainly was a major contributing factor.

### *What About the Economic Outlook?*

Should the economic outlook for a given market be considered a pillar for success? We are reluctant to do so, since economic fluctuations occur everywhere. Even Calgary, a city some thought immune to economic downturns not so long ago, was hit hard by the 2008–09 recession. There will always be economic fluctuations, and there is little reason to believe that one city will be hit more frequently or harder than any other city. Therefore, while recognizing that the economic outlook is important, we do not include it as a market pillar for success.

### *Conclusion*

Basic economics matter fundamentally to the financial success of a professional sports franchise in a given market. There are four market pillars:

Market size—Having a large enough population is key to ensuring that seats will be filled every night. Moreover, faced with changing demographics and an aging population, communities with a growing population will be better positioned to offer continuing support to their professional sports franchise.

Income levels—Relatively high income levels are required, since attending a professional sports event is expensive. A sound corporate presence—Sufficient corporate support is a must. Filling the stands with fans is great, but corporate sponsorship and full corporate boxes are critical additional sources of revenue.

A level playing field—Teams have a tough time succeeding if they are not able to compete on a level playing field. The weak exchange rate of the 1990s and early 2000s (which hurt Canadian NHL franchises in particular) and the sharp differences between Canadian and U.S. taxation levels tilted the field against Canadian franchises. A level field is needed.

If these four market−based pillars exist, they provide a strong foundation for a professional sports franchise's financial success over the long run.

There are, and probably always will be, some wealthy owners for whom money is no object and for whom the possibility of losing a few million dollars a year on their sports franchises is no cause for concern. But for the others—and they make up the majority of franchise owners—the market fundamentals matter.