The Case of the Quebec Nordiques and the Winnipeg Jets

by Glen Hodgson and Mario Lefebvre | May 2011

TweetSome people are saying it is time to bring NHL hockey back to Québec City and Winnipeg. In this third briefing in our series, we look at the four market pillars of success—and how they apply to the loss and possible return of the Nordiques and the Jets.

In the mid-1990s, battered by a weak Canadian dollar and struggling to compete financially with bigger-market teams, two Canadian NHL franchises packed up and headed south. In the second briefing in this series, we argued that 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.

In this third briefing, we put our four market pillars to the test by using two former Canadian-based National Hockey League franchises—the Quebec Nordiques and the Winnipeg Jets—as concrete examples. Were the departures of these two teams from Canada in the mid-1990s the result of weakness in these pillars? And have things changed enough to allow these teams to successfully return to Canada?

The Departures of the Winnipeg Jets and Quebec Nordiques

The Winnipeg Jets and Quebec Nordiques were both based in smaller cities, and both enjoyed passionate fan bases. Although neither team was able to bring home hockey's ultimate prize—the Stanley Cup—they were much beloved by their communities. In 1995, the Quebec Nordiques left for Denver, Colorado, while the Winnipeg Jets moved to Phoenix, Arizona, the following year. A lot of tears flowed when the franchises packed up and left town. Clearly, the decision to leave could not be blamed on any lack of fan support. So what exactly did happen? Let's look at the state of the four market pillars at that time.

Market Size

In our second briefing, we hypothesized and estimated that the fan base required to support an NHL franchise is about 800,000. Interestingly, in the mid-1990s, the populations of both the Québec City and Winnipeg census metropolitan areas (CMAs) were below that threshold. Both stood at around 685,000. Moreover, Winnipeg was (and still is) home to a Canadian Football League (CFL) team, which required a market size of its own of at least 250,000. So in both cases, but particularly in the case of Winnipeg, the markets were being squeezed by the lack of a sufficiently large population base.

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In fact, the Winnipeg market was facing saturation in terms of pro sports franchises. That's because the fan base required for each franchise is at least partly additive. While some fans will buy tickets to see more than one team, some won't, and others will divide their sports entertainment budgets between the teams. Let's consider a simple numerical example. A family devotes $1,000 per year to recreational activities, such as restaurant meals, movies, hockey games, football games, etc. If a family spends $350 to go to watch an NHL game, it will only have $650 left for the rest of the year. Will the family be able to afford to go to a CFL game in that same year? That would cost the family about $250, leaving only $400 for all other recreational activities in the year.

This simple example demonstrates why we believe the fan base requirement for additional professional sport franchises is at least partly additive. Some families will have the budget to attend games for multiple teams, but some others won't. In the case of Winnipeg, this principle means that the population required to support sustainable CFL and NHL franchises would well be as high as 1 million (since a population of 800,000 is needed for a successful NHL

franchise and 250,000 for a CFL franchise). With a population of 685,000 in the mid-1990s, the Winnipeg area fell well below this threshold.

Income Levels

Our second pillar, the per capita income level of the market, was not an issue in the case of either Winnipeg or Québec City. As described in our previous briefing in this series, Winnipeg posted the sixth-highest level of per capita disposable income among Canada's nine largest cities in 1995. At that time, Winnipeg was ahead of Edmonton (seventh), Québec City (eighth), and Montréal (ninth). Moreover, Québec City had a higher level of per capita disposable income than Montréal. That suggests that income levels were not a factor in the Jets or the Nordiques leaving.

Corporate Presence

Our third pillar, a sound corporate presence, may have come into play, particularly for the Québec City market. There is no definite minimum number of corporations required in a community for a professional sports franchise to be viable. But in 2009, only 17 of Canada's 800 largest corporations were headquartered in Québec City, while Winnipeg was home to 30. Are those numbers too low? Well, they are certainly a far cry from the 286 corporations headquartered in Toronto, 119 in Calgary, 98 in Montréal, and 79 in Vancouver. However, Winnipeg has more corporate headquarters than Edmonton and Ottawa, both of which are home to NHL franchises. Indeed, only 19 of Canada's 800 largest corporations had their headquarters in Ottawa in 2009, just two more than Québec City. Based on the evidence, it is difficult to conclude that a relatively low corporate presence was (or is today) an issue for the Québec City or Winnipeg markets.

A Level Playing Field

The variable that played the biggest role in the departures of the Nordiques and the Jets was our fourth pillar—a level playing field. In particular, the Winnipeg Jets and Quebec Nordiques had to contend with a combination of higher income tax rates than U.S.-based teams and a plummeting Canadian dollar.

In 1979, when the Winnipeg Jets and Quebec Nordiques entered the NHL (moving over from the defunct World Hockey Association, or WHA), the average player salary was around US$100,000. When the teams left their Canadian homes in the mid-1990s, the average player salary had reached US$750,000. That works out to a 750 per cent rise in about 15 years, or a 55 per cent increase per year, compounded. Also adding to the problem is the fact that a player on a Canadian-based team pays a marginal income tax rate that is at least 10 percentage points higher than that of a player for a team located in the United States. Using this "10 per cent" rule of thumb, the average player on a Canadian-based team in 1979 was losing about US$10,000 in additional taxes by playing in Canada. By the mid-1990s, that same player was pulling in something like $75,000 less in after-tax income by playing in Canada. And those numbers were for the average player. A player making $3 million a year was losing US$300,000 in after-tax income if he was playing for a Canadian-based team. By the mid-1990s, this tax gap had become a serious challenge for Canadian NHL franchises as they struggled to attract and retain player talent—and this was particularly true for the two smallest market franchises.

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On top of the tax-related challenge, the exchange rate between the Canadian and U.S. dollars was becoming an increasingly important factor. From 1979 (when the Jets and the Nordiques entered the NHL) to the mid-1990s, the Canadian dollar progressively depreciated vis-à-vis its U.S. counterpart. In 1979, the Canadian dollar was worth more than 85 cents U.S. By the mid-1990s, it had declined to around 70 cents. This depreciation had a strong impact on the financial health of Canadian NHL franchises, which generate revenues in Canadian dollars but have to remain competitive with teams generating revenues in U.S. dollars. While not all NHL players were paid in U.S. dollars in the mid-1990s (unlike today), players' contract negotiations were still based on what players of "equal talent" playing for U.S.-based teams were getting in terms of spending power.1

To illustrate the impact of the exchange rate on team finances, consider the following example. In the mid–1990s, the Quebec Nordiques and Winnipeg Jets were carrying payrolls of about US$20 million. In Canadian dollar terms, this would have meant a payroll of C$23.5 million if the 1979 exchange rate had still been in effect. Instead, the actual cost was about C$28.5 million. By the time the franchises were deciding to move to the United States, the depreciation of the Canadian dollar alone was costing the Nordiques and the Jets about C$5 million a year. If we assume the average price of a ticket was about C$50 at the time, both teams needed to sell 100,000 more tickets over a season to absorb the impact of the exchange rate. That is equivalent to increasing the average attendance by more than 2,000 people per game—a pretty tall order, particularly for the two franchises based in the Canada's smallest NHL markets, and with two of the smaller rinks in the league. Even if rink capacity had not been an issue, getting that many extra people into the stands every single night would be an extremely demanding feat.

The exchange rate continued to depreciate and the negative impact of the income tax rate differential grew as salaries rose. The business conditions became increasingly difficult for most Canadian teams and players became less enthusiastic about playing for a team based in Canada. While the other Canadian teams did not fold despite facing the same set of circumstances, they struggled financially. And the Nordiques and Jets were particularly squeezed by the smaller size of their markets, and by the relatively weak corporate presence in their cities. The final decision to move both these franchises south to U.S. cities was a rational business response to the deteriorating overall market conditions.

Could Québec City or Winnipeg Support an NHL Franchise Today?

That was then, but what about today? Has the situation changed enough so that Québec City or Winnipeg could now support an NHL franchise? Once again, a look at our four market pillars helps provide an answer to that question.

Market Size

As noted earlier, Québec City and (particularly) Winnipeg were stretched markets for the NHL back in the mid-1990s. Much has changed since then. Both CMAs have posted robust population growth since the mid-1990s. By 2010, the Québec City and Winnipeg CMAs both had populations over 750,000—well above the 685,000 levels of the mid-1990s. Since we believe that a market size of 800,000 is needed to support a successful NHL franchise, both markets are clearly in a much better position to do so than they were 15 years ago. Both would remain small markets, but both are at least very close to the 800,000 threshold.

Income Levels

There is also good news for Québec City and Winnipeg when it comes to our second pillar, per capita income. Income levels have improved in both cities since the mid-1990s. Winnipeg ranked sixth among Canada's nine largest cities in terms of per capita income levels back then, but had climbed to fifth spot by 2009. In the case of Québec City, the per capita income ranking has also improved since the Nordiques moved to Denver, going from eighth to seventh place over that time.

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Given that the NHL operates in both Canada and the United States, and that the NHL is free to choose cities in either country when it considers new markets, should we be comparing Winnipeg's and Québec City's income levels to those of U.S. cities as well? Perhaps, but our point here is that the income levels of Québec City and Winnipeg are in line with other Canadian cities that are currently home to financially stable NHL teams.

Corporate Presence

Our analysis concerning our third pillar—corporate presence—was done using 2009 data, which means that it reflects today's reality. Neither Winnipeg nor Québec City can compete with Toronto, Calgary, Montréal, or Vancouver

when it comes to their number of corporate head offices. And it could be argued that this pillar is even more important now than it was in the mid-1990s, since growth in ticket prices has generally outpaced growth in per capita income. This means that fewer people are able to afford the cost of going to a hockey game today than was the case in the mid-1990s. Thus, professional sports teams need corporations to buy boxes even more today.2 Therefore, it is critical that any group hoping to bring a franchise to Winnipeg or Québec City ensures that the corporations that are based in these markets are on board prior to securing a franchise, rather than waiting until after a franchise is secured before lining up corporate support in the form of box and season ticket sales and advertising.

A Level Playing Field

The biggest change in favour of a potential return of NHL franchises to Québec City and Winnipeg is the evolution of our fourth pillar—the level playing field. Two significant changes have occurred that have levelled the playing field considerably:

- The Canadian dollar is now hovering around parity with its U.S. counterpart.
- A player salary cap has been established.

We mentioned the significant costs that NHL teams in Canada were forced to bear due to the depreciation of the Canadian dollar. When the Nordiques and the Jets entered the NHL, the dollar was worth 85 cents (U.S.). By the time they moved south of the border in the mid-90s, the dollar had fallen to around 70 cents (and it would continue falling until bottoming out around 62 cents in early 2002). But this depreciation has been more than reversed. The Canadian dollar is now trading above parity with its U.S. counterpart, and The Conference Board of Canada expects the loonie to remain near of above parity for the foreseeable future.3

The rebound of the loonie drastically improves the playing field for all Canadian NHL franchises—and indeed all pro sports franchises in Canada that have significant portions of their operating costs denominated in U.S. dollars. These franchises no longer have to find an extra 20, 30, or even 40 per cent in revenues in Canadian dollars, compared with their U.S.-based counterparts, in order to pay player salaries denominated in U.S. dollars. Canadian teams are now able to pay their players their market value without an exchange rate premium, which is a huge gain, although the income tax differential remains and works against Canadian teams.

Last but not least, the NHL has made an effort (in contrast to Major League Baseball) to ensure that teams located in smaller markets are able to compete. It did so by introducing a salary cap.4 While we recognize that the NHL salary cap might not be perfect and that the league could do more when it comes to revenue sharing, the NHL has gone a long way to helping its smaller-market franchises. Under these conditions, Québec City and Winnipeg could compete with larger markets on an ongoing basis.

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The Winnipeg market, however, still faces one further potential obstacle to success—saturation. Winnipeg might be challenged to support both a CFL and an NHL franchise. Winnipeg's population did grow by over 10 per cent in the last 15 years, bringing it to a little over 750,000. But the city is home to a long-time CFL franchise—the Blue Bombers. According to our analysis, a CFL franchise requires a potential fan base of at least 250,000. And for both a CFL and an NHL franchise to be successful in the same market, we estimate the required population of that market at as high as 1 million. There may be other circumstances that would allow Winnipeg to host both a CFL and NHL franchise successfully, but the basic market condition of population size indicates that it could be a challenge.

Conclusion

A look at our four market pillars helps to explain why the Quebec Nordiques and Winnipeg Jets had to leave Canada in the mid-1990s. In both these markets, however, things have improved since then. Their populations are higher, per capita disposable income has increased, the dollar is at parity with its U.S. counterpart, and the NHL has established a player salary cap that gives smaller markets a chance to be more competitive. However, the corporate presence in

both markets remains relatively low. This is particularly true for Québec City. Nonetheless, we believe that Québec City and Winnipeg have the right market conditions for another shot at NHL hockey—but not at any price.

Other factors will need to be examined to determine whether Québec City and Winnipeg have the sufficient overall conditions for success. Both would remain small markets. Therefore, any franchise that is brought to Québec City or Winnipeg must be in strong financial condition to start. Should the franchise be an existing team? Or would an expansion team be a better fit? Ownership is an issue for all professional sport franchises—and a committed, caring, and deep-pocketed owner is a prerequisite for both of these markets.

There is also the issue of the venue where the teams would play. Québec City would need a new arena. Winnipeg already has a new arena that seats just over 15,000, but it would likely need to be expanded to include more boxes and up to 3,000 more seats. In both cases, who would pay?

Winnipeg faces an additional challenge. Is the fan base strong enough to support both an NHL and a CFL franchise?

Or would the existence of two pro sports franchises stretch the market beyond what it could support?

So while our four market pillars indicate that Québec City and Winnipeg could support NHL teams, bringing a franchise back to either city would require deeper analysis and a lot of work and dedication from all stakeholders.