Why Are Toronto Teams Financial Successes, but Competitive Flops?

by Glen Hodgson and Mario Lefebvre | November 2011

In pro sports, competitive and financial success tend to go together. A team that struggles on the field for an extended period of time is likely to struggle at the box office, as well. But that hasn't been the story in Canada's largest city. In recent years, most of Toronto's pro sports franchises have been financial successes, but consistent underachievers on the ice or field of play. What's going on? Is there something special about Toronto that turns its sports franchises into balance-sheet dynasties but competitive underperformers?

Using the analytical framework developed throughout this briefing series, we conclude that strong market fundamentals for pro sports in the greater Toronto region mean that many Toronto teams can succeed financially without having to succeed competitively. A team's competitive results are ultimately determined by the selection and performance of its players and coaches, which is the responsibility of the franchise owners and the management they hire to run the team. But the market fundamentals suggest that Toronto's teams don't have to win to be financially successful, unlike teams in many smaller Canadian markets, where winning is often a prerequisite for financial success.

The Context

In recent years, most Toronto teams have fallen well short of the mark in terms of competitive success. The Leafs last won the Stanley Cup in 1967 and haven't made it back to the National Hockey League finals since. Major League Baseball's Blue Jays won back-to-back World Series in 1992 and 1993, but have not made the playoffs since then. (Being stuck in baseball's toughest division doesn't help.) The Raptors have made the National Basketball Association playoffs three times in their 16-year existence but have advanced beyond the first round only once, a decade ago. Major League Soccer's Toronto FC is in its fifth season and still searching for its first playoff berth. And while the Canadian Football League's Toronto Argonauts did win the Grey Cup in 2004 and have appeared in three Eastern Conference finals since then, they won't be going to the finals this season, as they are once again dead last in the four-team Eastern Conference and out of the playoffs.

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There is one shining exception in the Toronto sports world. The National Lacrosse League's Toronto Rock is arguably the model franchise in pro lacrosse and has won six NLL championships since 1999, most recently last spring. Still, despite the Rock's success, the common perception of Toronto today is that the city is not a pro sports powerhouse. In his column in The Globe and Mail last year, Jeffrey Simpson reached the conclusion that "Toronto indisputably remains the city of sports losers."1 This past June, the U.S. sports network ESPN provided no less harsh a review when, in its survey of pro sports cities, it rated Toronto as the worst city for professional sports in North America. The ESPN survey ostensibly assessed how much a city's franchises in pro baseball, football, hockey, and basketball give back to the fans in exchange for the money and emotion the fans provide to their teams. The Leafs were ranked last among NHL franchises, and the Raptors were third-worst in the NBA. The Blue Jays scored the best ranking among Toronto teams—18th out of 30 MLB franchises.2 (The Argonauts, Toronto FC, and the Rock were not included in the evaluation.)

The ESPN survey methodology is highly suspect. The survey relies on online voting by fans for a team or city—it is not random. And it measures fans' attitudes or perceptions, not the hard facts. It is more a popularity contest that an objective survey. Since it is conducted by a U.S. media firm, it may also have an implicit bias in favour of U.S.-based teams. And given the methodological weaknesses as well as the outcome, it is not surprising that members of Toronto's pro sports management cadre—including Leafs general manager Brian Burke—flatly rejected the results.

But even if the ESPN survey isn't the most reliable source, it reflects the view that Toronto's pro sports teams are financial successes but competitive underperformers. Table 1 shows the profitability of some Toronto sports franchises (owned by major corporate entities), as estimated by Forbes. Each of these franchises produces handsome profits that seemingly have little to do with the team's performance on the field or ice.

Expert observers of the Toronto pro sports market suggest that net operating income for the Leafs may be even higher than the Forbes estimates (thanks to stronger overall revenues), and that of the Blue Jays lower (due to higher player salaries). Unfortunately, there are no financial data publicly available for the Argonauts, Rock, or Toronto FC, which are privately held and are not covered by the Forbes survey. Still, we know that the Argos have been through some financially trying times, although new owner David Braley is deeply committed to the success of the CFL. And we know that Toronto FC is owned by the same corporate entity that owns the Leafs and Raptors (Maple Leaf Sports and Entertainment, or MLSE), has very strong fan support at its games, and maintains firm control over its player payroll, so is likely to have positive financial results. And the Rock continues to be a cornerstone franchise for the NLL, which would not be possible if the team was continually bleeding red ink.

The Analysis

At the core of our analysis are the four market pillars for franchise success, which were introduced in the second briefing (Defining the Market Conditions for Success) in this series. They are:

- population size;
- incomes;
- corporate presence; and
- a level playing field.

The Market Pillars

Toronto's potential fan base is very large. The Greater Toronto Area (GTA) has a population of more than 6.5 million when the census metropolitan areas of Toronto, Hamilton, and Oshawa are included. The population and employment base is also growing by more than 2 per cent annually and could approach 8 million by 2020 if the region's population grows as expected. The GTA fan base is hungry for sports entertainment, and there is unfulfilled demand for some pro sports (particularly hockey).

Toronto is fourth among Canadian cities in terms of per capita income—more than $30,000 in 2009. The large fan base, therefore, has the purchasing power necessary to support pro sports. In terms of head office presence, Toronto had 236 (or 36 per cent) of Canada's 800 largest corporate head offices in 2009. When these two factors are combined, it is clear that individuals and companies in the GTA have the requisite cash flow to purchase tickets, suites, advertising space, and merchandise for all of Toronto's pro sports franchises.

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We called the fourth market pillar "a level playing field," which specifically means the exchange rate and tax rates in the market. The Canadian dollar is now trading more or less at parity with its U.S. counterpart, and The Conference Board of Canada expects the loonie to remain in that range for the foreseeable future. The strengthening of the loonie levels the playing field for all Canadian pro sports franchises that have significant portions of their operating costs (notably, player salaries) denominated in U.S. dollars. Toronto's NHL, MLB, and NBA teams are now able to pay their players without an added exchange rate premium—a huge financial gain amounting to millions of dollars annually. And most players like being in Toronto.

In addition, in recent years, Canada and Ontario have undertaken far-reaching business tax reform aimed at boosting business competitiveness. Capital taxes have been eliminated, corporate income tax rates are being reduced, and Ontario has harmonized its provincial sales tax with the federal goods and services tax. These reforms all provide positive financial benefits to Toronto-based sports franchises.

Therefore, Toronto has the right market conditions in place for the financial success of most, or all, of its pro sports franchises. The region is home to a large and growing population with high average incomes. There is a strong corporate presence. And the playing field for pro sports franchises within North America is more level than it was a decade ago.

League Competitive Conditions

The next stage is to assess the league-specific factors that affect each team. As described in the fifth briefing (Pro League Competitive Conditions and How the NHL Stacks Up) in this series, among the four major North American leagues, MLB makes the least effort to create a level playing field among franchises. With its soft salary-cap system and limited revenue-sharing, Major League Baseball's operating rules allow a few high-revenue teams to try to buy championships year after year. Unfortunately for the Blue Jays, they play in the division with the two biggest spenders—the New York Yankees and the Boston Red Sox—making it harder for the Jays to compete on the field while still generating positive financial results. This is one factor behind the Jays' limited competitive success since the mid-1990s.3

The NHL and NBA provide a more level playing field among their franchises than does MLB. The NHL and NBA have a common player entry draft, salary cap, and free agency, but only limited direct revenue sharing among franchises. Thanks to these operating rules and a strong regional market, the Maple Leafs are one of the richest franchises in the NHL. The Raptors are also profitable, and could become more so in future. In an effort to make the NBA salary cap more binding and thereby improve the financial conditions of its franchises (and, hopefully, level the competitive playing field), the NBA has demanded more contract concessions from its players.4

We did not examine the CFL, MLS, or NLL operating conditions in detail in earlier briefings, but each of these leagues has a salary cap or other limits on player salary costs. By constraining a key cost factor, leagues' competitive conditions help to support franchise financial success.

Overall, Toronto has the right market conditions in place for the financial success of its pro sports franchises—but there are major differences in how their respective leagues operate.

Franchise-Specific Factors and Toronto's Teams

In the eighth briefing (Why Pro Sports Franchises Succeed … and Fail) in this series, we looked at three factors that determine why some franchises succeed, while others don't. The three are:

- ownership and management;
- access to quality facilities; and
- fan support.

The first franchise-specific reason why Toronto's teams succeed financially, but often come up short competitively, is related to the nature of franchise ownership. We have not done a detailed analysis of each franchise's business and competitive strategy and resulting decisions. However, it is striking that the three highly profitable Toronto franchises covered in the Forbes survey (the Leafs, Jays, and Raptors), as well as Toronto FC, are today owned by corporate entities. For these corporations, competitive results need to be good enough to maintain a minimum level of fan support, but the overall success of the franchise is measured in dollars.

Corporate-owned franchises that can generate significant profits in the large Toronto market may simply not be on the same "burning platform" as teams in other markets where financial results depend more on the team's competitive results. The financial performance of most Toronto franchises is not contingent on winning.5

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There are, of course, differences among the franchises. Today's hard salary cap in the NHL means that a club like the Leafs can no longer try to "buy" competitive success by having payrolls that are much higher than those of other teams. A soft salary cap in MLB presents a different kind of challenge to the Blue Jays. Either they try to compete with the Yankees and Red Sox in terms of player payroll (a risky and possibly very costly proposition), or they seek positive financial performance by fielding a less-expensive team that is still good enough to sustain interest among the fan base.

As a counterpoint, the two Toronto pro sports franchises that have achieved the best competitive success in recent years—the Argos and the Rock—have been, and continue to be, owned by individuals, not corporate entities. These individuals are likely to try to balance their franchises' competitive and financial outcomes, and they make decisions on team management and player personnel accordingly. They don't want to lose money, but the results on the playing field often matter just as much as the financial performance. Of course, the balancing act can be hard to achieve. Some franchises owned by individuals experience financial losses even as the teams achieve winning records.

In all cases, franchise owners in Toronto and elsewhere cannot afford to simply ignore the feelings and commitment of their fan base—to do so would risk alienating those loyal fans. Therefore, ongoing changes in team management continue to be made in a bid to offer some hope for future competitive success. Each Toronto franchise has made changes in ownership and team management in recent years. Three years ago, the Maple Leafs hired a general manager, Brian Burke, with a proven track record of success with other NHL franchises. In 2009, the Blue Jays hired Alex Anthopolous as their GM, and he has been busy making significant changes aimed at turning the Jays back into legitimate contenders. And the Raptors have opted for continuity at the general manager's position as a means of improving their results on the court—Bryan Colangelo has held the job since February 2006. All these changes (or in the case of the Raptors, lack of change) to ownership and management are aimed at trying to change the pattern of performance and offer Toronto's loyal sports fans some hope of competitive success … eventually.

Ultimately, a team's competitive success or failure is determined by skilful management. That means acquiring the right players through draft choices, trades, and free agent signings, with the goal of building a critical mass of talent. With or without a hard salary cap, the selection and performance of player talent is what determines a team's competitive record. Coaching matters, too. But without the right mix of players, competitive success won't happen.

Even if a corporate-owned team hires a quality general manager, the GM still has to make the right player and coaching personnel decisions. The fans have every right to question a GM's ability to lead a team to victory if that GM signs the wrong free agents or trades away fan favourites or multiple draft picks for a player that never becomes a superstar.

The overall lesson is that, while ownership can indeed be a factor in the business and competitive results of Toronto franchises, it is sheer market size, combined with specific league competitive conditions and management capacity, that are more significant in explaining why most Toronto-based franchises are able to achieve financial success without necessarily having success on the ice or field.

The second factor for franchise success is the playing facility—and Toronto has quality pro sports facilities, all of which are attractive places to attend a game.

Lastly, all pro sports franchises need to grow and nurture a strong fan base to succeed. They need to be aware of how consumer tastes are evolving and of the changing demographics of their market. Over 40 per cent of the population in Toronto was not born in Canada, and its professional sports franchises must adjust to this new reality. The financial success of the Raptors and Toronto FC may well reflect the changes in consumer tastes and Toronto's demographics.

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But why do fans in the Toronto region seem so willing to tolerate mediocrity? Maybe it's just a matter of simple economics. Combine strong consumer demand (a large population, with considerable individual and corporate purchasing power, fed by strong media interest) with a limited supply of available tickets for most pro sports events (especially NHL hockey), and you get sustaining fan support. Toronto is the media centre of English-speaking Canada. Sports coverage in the Toronto area is extensive, aggressive, and has fed the ongoing development of a fan base in the GTA, despite the often-mediocre athletic performance of the teams. Not all Toronto teams have the same intense fan support, of course. The Argos have been suffering at the box office as well as on the field of late. But Toronto fans have a history of tolerating competitive mediocrity to a degree that fans in Montreal, Ottawa, and many other Canadian cities will not.

Conclusion

So why are most of Toronto's pro sports teams financial successes but competitive flops? By using the analytical structure developed in this briefing series, we can see that the financial success of Toronto franchises is supported by local market-based factors such as population size, income levels, and head office presence. League competitive conditions are particularly important to the Blue Jays, who play in the same division as the two biggest spenders in baseball—the Yankees and the Red Sox—and therefore do not compete on a level playing field.

However, ownership and management matter critically to franchise success, and Toronto's franchises are no exception. Four Toronto franchises that are owned by corporate entities (the Leafs, Jays, Raptors, and Toronto FC) are financially successful, but have produced mediocre results on the field or ice in recent years. Corporations are expected by their shareholders to achieve an adequate financial return. While competitive results need to be good enough to maintain a minimum level of fan support and profitability, success is measured in dollars—not just in wins. In contrast, the Argos and the Rock have achieved competitive success in recent years and are owned by individuals. These individuals may place a different importance on their franchises' competitive and financial outcomes than would corporate owners of a team—and they would make decisions on team management and player personnel accordingly.

In short, a strong local market means there is less urgency for many Toronto teams to achieve the same success competitively as they are having financially. And unlike in smaller markets where teams may need to win in order to be financially successful, teams in Toronto can struggle on the field or ice but still be financial success stories.

1 Jeffrey Simpson, "When it Comes to Sports, Toronto Is a City of Losers," The Globe and Mail, April 10, 2010.
2 ESPN, "The Mag: Ultimate Standings 2011."
3 However, the Tampa Bay Rays face similar circumstances but have, nevertheless, succeeded in fielding highly competitive teams in recent years. So that explanation only goes so far.
4 When the players refused to budge further, the league locked them out. So far, there is no end to the lockout in sight.
5 That said, the highly profitable Leafs franchise has been owned in past decades by private individuals—with the same mediocre results on the ice. Harold Ballard's Leafs were certainly entertaining, and they no doubt made money. But they didn't have much competitive success … and perhaps that was the plan.