In Team Pro Sports, NFL “Socialism” is the Big Winner for Owners and Fans—Part 1 of 2

by Glen Hodgson and Mario Lefebvre | June 2012

If pro sports leagues are evaluated as economic systems, which ones are the most “capitalist”? That is, which are the ones where individual interests are paramount? On the other side of the coin, which are the most “socialist” ones, where the emphasis is on shared economic interests? And which produce the strongest performances? The results may surprise you.

Over the past year, we have produced a series of briefings on the economics of pro sports, with a focus on Canada (available at www.conferenceboard.ca).1 In this briefing, we take a system-wide look at pro sports leagues and teams. We consider what economic system—from highly socialist to purely capitalist—best describes their operations; and we identify the top performers.

The “Socialist” NFL

Capitalist America’s most popular pro sports league—The National Football League (NFL)—is also by far the most “socialist” of the major pro sports leagues in North America today. More than 80 per cent of league and club revenues are shared among the franchises. TV broadcast revenues, currently worth more than $20 billion (or about $4 billion annually) under contracts that run to 2013, are shared equally among the franchises, as are merchandising revenues. Even gate revenues are shared between the home and visiting teams, with 40 per cent of the ticket revenues for each game going to the visiting team. The NFL also has a “hard” salary cap. A firm upper limit on annual player salaries is set at between 47 and 48 per cent of league revenues, using a complex formula that takes into account all revenue sources . For 2012, the salary cap is just above $120 million, essentially unchanged from 2011.

NFL owners understand that they have a common interest in maximizing total revenue, sharing it widely, and controlling costs. Franchise values have risen significantly over the decades. Most franchises now exceed $1 billion in value, with a few (such as the Dallas Cowboys) approaching $2 billion. And they all make lots of money.

The NFL’s operating rules achieve both financial success for its franchises and balanced competitive conditions for its fans.

Overall, the resulting on-field competitive conditions in the NFL are exceptionally balanced. The combination of a hard salary cap and significant revenue-sharing means that every NFL team has a reasonable expectation of making the playoffs each year. Teams’ qualification and positioning for the playoffs are often determined on the final weekend(s) of the season, keeping fan interest high. As a result, management quality and player performance have become the dominant factors that determine team performance.

In short, the NFL’s operating rules achieve both financial success for its franchises and balanced competitive conditions for its fans. The Super Bowl provides an annual marquee event to showcase the game, but the underlying business model determines the league’s ongoing success.

There is one obvious major exception to all this socialism in the NFL—the treatment of individual players, which is distinctly market-driven. Under the defined salary cap, teams are ready to pay massive salaries to attract stars, and few superstars ever actually hit the open market. But teams are equally ready to discard players when they are no longer useful or are deemed too expensive for their current level of play. Thus, the NFL has a very capitalist attitude toward its players.

Major League Soccer: In Transition

A rising star among North America's pro sports leagues is Major League Soccer, or MLS. The original business model was decidedly collectivist, based on cost control and steady growth. Rather than a league based on individual franchises, MLS was founded in 1993 as a single entity that controlled all player contracts and costs under a tight salary cap and shared the profits or, until recently, the losses. Three entrepreneurial sports businessmen—Lamar Hunt, Phil Anschutz, and Robert Craft—kept the league afloat through its early days and de facto controlled many of the early franchises.

After some growing pains, MLS is catching on with sports fans across North America. The MLS model, which has taken a great leap forward in recent years, is based on attracting new owners with significant financial capacity, adding franchises in soccer-friendly markets, creating soccer-specific stadiums, and attracting some high-profile European stars, including David Beckham and Thierry Henry. A 2012 salary cap of approximately $2.8 million in aggregate and $335,000 per player (and lower for players early in their careers) is in place, but teams are able to sign and compensate designated star players at a market-determined rate, with a hit to the salary cap that is limited to the defined per player maximum. The step-by-step addition of three strong Canadian franchises (Toronto FC, Vancouver Whitecaps, and Montréal Impact) with already-developed fan support has been a significant boost to the league, as has adding teams in the soccer-friendly markets of Seattle, Portland, and Philadelphia.

Where the MLS goes next is open to debate, but the league is clearly in transition—from a cost-controlling single entity that shared the start-up losses to a league driven by star players, strong owners, and the maximizing of revenues from growing media exposure and ticket sales.

The NHL: A Mixed Economy

Moving from left to right along the economic spectrum, the National Hockey League (NHL) is next. Like the NFL, the NHL has a hard salary cap to control overall player salary costs, currently set at 57 per cent of league revenues as based on the previous season. (There is also a player salary floor, which obliges all teams to spend enough to ensure they are able to put a competitive team on the ice. The floor was originally set at 55 per cent of revenues but is now defined as $16 million below the cap.) The dollar amount of the NHL salary cap will be renegotiated later this year, and the owners are aiming to reduce the players' share of revenues. Hopefully, both management and the players have learned from their experience in 2004–05 when a full season was lost due to a dispute over the creation of the salary cap, and they will not risk losing another season.

The NHL has a complex revenue-sharing system that is also part of the collective bargaining agreement with the players. The system is based on team attendance and local market size, so that only teams in the smaller markets (defined as fewer than 2.5 million TV households) with adequate (at least 14,000 per game) but below-average attendance qualify for payments under the system. National TV revenues for the NHL are a fraction of what the NFL gets from its TV contracts, so there is not much TV money to share—less than $350 million annually from national broadcast rights in the U.S. and Canada. This means that most revenue-sharing comes directly out of the pockets of the richer teams.

In the NHL, management quality and player performance play a central role in deciding who succeeds and who fails. The NHL is willing to provide subsidies to its weaker franchises in order to protect the current and future value of the stronger franchises, since the bankruptcy of any franchise is not a good signal to prospective investors. The NHL will also move to recover its paid-out subsidies if a subsidized franchise changes ownership. In the case of the franchise move from Atlanta to Winnipeg last May, for example, around $60 million of the $170 million purchase price reportedly went back to the NHL.

Overall, the on-ice competitive conditions in the NHL are good—financially weak franchises such as Phoenix and Florida made the playoffs this year, while financially strong franchises such as the Leafs and the Habs did not. Hockey is a game that requires a full team effort to achieve success. Having and making money is no guarantee of victory, and the salary cap and salary floor create a similar operating space for each team. Management quality and player performance play a central role in deciding who succeeds and who fails.

The Modern Capitalism of the NBA and Major League Baseball

The NBA

So far, the National Basketball Association (NBA) has been less market-interventionist than the NHL. It has a "soft" salary cap that sets a limit on a team's player compensation, but the NBA salary cap system also includes an array of significant and arcane exemptions that allow teams to exceed the defined salary cap. The NBA does not share locally generated revenue among teams (at least not yet), but it does share the proceeds of a luxury tax on teams that exceed the salary cap, and it shares the revenues from national TV broadcasting rights.

A third of NBA teams made money in 2010–11. Teams in major markets such as Los Angeles, Chicago, and New York can sustain high ticket prices and pull in significant regional TV earnings, so they are profitable. The remaining two-thirds—which includes teams in smaller markets, such as Memphis and New Orleans—collectively lost a reported $400 million in 2010–11.

To begin addressing this financial imbalance among franchises, the NBA decided in 2011 to take on its players and cut operating costs. The result was a lockout that saw the first 20 per cent of the 2011–12 season cancelled. An agreement on a new salary cap level was eventually reached with the players' association in December 2011, reducing the players' share of league revenues from 57 to 51 per cent. As a transition measure, the dollar amount of the salary cap will be kept at $58 million through 2012 and may be extended to 2013, and salaries will be pro-rated for the 2011–12 season. A higher luxury tax will also be levied on teams that exceed the salary cap.

On-floor competitive conditions in the NBA today are not as strong as those in the NFL or NHL, due to league operating rules and to the nature of the game, where a few stars can dominate.

Media reports indicate that NBA owners are now engaged in serious discussions about revenue-sharing. The proposal being discussed would see the richest teams—the Los Angeles Lakers, Chicago Bulls, New York Knicks, Boston Celtics, and Orlando Magic—share up to 50 per cent of their profits (i.e., net earnings after core operating costs are covered) with the poorest franchises, including the Sacramento Kings, Memphis Grizzlies, and Charlotte Bobcats (a franchise that, somewhat ironically, is owned by Michael Jordan, one of the wealthiest former players of all time). The suggested time frame for the introduction of a NBA revenue-sharing system is 2013–14. If implemented, this system would be an important step toward improving the competitive balance within the league. Overall, the on-floor competitive conditions in the NBA today are not as strong as those in the NFL or NHL. This is due in part to league operating rules, but also to the nature of the game, where a few stars working together can dominate. The championship game invariably includes a team from one of the traditionally strong markets. While the Lakers, Celtics, and Bulls have been in the final many times, the competitive success of the small-market San Antonio Spurs over the past decade is the exception that proves the rule. The Miami Heat are the latest NBA team to make use of a soft salary cap system to stack a team with superstars in the hope that winning will generate enough revenue to operate in the black even with an elevated players payroll.

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Major League Baseball

Arguably the most “capitalist” pro sports league in North America is Major League Baseball. MLB has a much freer market for player talent than the other leagues, which drives up player costs and makes the smaller market teams largely uncompetitive on the field. Rising TV revenues for the large markets is the key source of revenue, and MLB shares enough of these revenues among its teams to ensure that it has adequate competition on the field to maintain fan interest in the game—but not enough to create the kind of level playing field we see in the NFL.

Under MLB’s “soft” salary cap system, a progressive “luxury tax” is paid by a team when its player payroll exceeds the league’s annual defined maximum. In 2011, the cap was set at $178 million, which is actually far beyond the revenue-generating capacity and the total player compensation of nearly every team in MLB. The New York Yankees have paid 95 per cent of the luxury tax collected to date. The actual luxury tax paid is reportedly quite small—around $25 million annually. This sum represents a small fraction of the revenues available to the Yankees, who reportedly include luxury tax payments in their spending budget for each season, as do their bitter rivals, the Boston Red Sox.

No wonder that in November 2011, the MLB Players Association quietly signed an agreement with the owners extending their collective bargaining agreement to 2016!

In the MLB, the playing field is not level, but modest revenue-sharing allows smaller market teams to make money if they keep their player costs under control.

The absence of a hard salary cap as a share of expected revenues has led to enormous differences in MLB’s team payrolls, severely limiting the ability of the low-payroll teams to compete on the field on a regular basis with the league’s big spenders. In 2011, 12 teams had payrolls that exceeded $100 million. (See Table 1.) The Yankees’ exceptional revenue-generating capacity (over $450 million annually, and growing) allows them to compete aggressively in the free agent market each off-season, but other teams are also in the race for talent.

Table 1
2011 MLB Team Payrolls Exceeding $100 Million
($ millions)

1	New York Yankees	201.6
2	Philadelphia Phillies	172.6
3	Boston Red Sox	161.4
4	Los Angeles Angels	140.0
5	Chicago White Sox	129.2
6	Chicago Cubs	125.4
7	New York Mets	120.1
8	San Francisco Giants	118.2
9	Minnesota Twins	112.7
10	Detroit Tigers	105.7
11	St. Louis Cardinals	105.4
12	Los Angeles Dodgers	103.7

Source: CBS Sports.

At the opposite end of the scale, the Kansas City Royals spent $36 million on player compensation in 2011. The Toronto Blue Jays spent $62 million on players, ranking them 23rd in MLB. (Not surprisingly, the Jays finished fourth once again in the toughest division in baseball.)

On the other side of the ledger, there are huge differences among teams in terms of their capacity to generate revenue. Since they are private businesses, few MLB teams ever reveal their financial performance. But when the information does leak out, there are some remarkable revelations. For example, the 2008 and 2009 financial statements for the Florida Marlins revealed profits of $39.2 million and $12.6 million, even though home game ticket sales were only around $21 million annually.2 Similar results have been revealed for another smaller-market team, the Pittsburgh Pirates. So it is fair to surmise that even the poorest MLB teams can make money most seasons. And if local authorities can be convinced to build a new baseball-only stadium to keep a team in their city, that usually leads to an increase in the number of paying fans at games, at least until the novelty of the new stadium wears off.

How is this possible? It's because MLB has a revenue-sharing agreement in place (albeit a modest one), under which teams share 31 per cent of their local revenues. The Marlins received over $81 million in revenue via transfers from MLB in 2009, and other smaller-market teams likely received comparable amounts. By keeping their payrolls under control, the Marlins and other small-market teams have been able to operate profitably. Overall, some analysts estimate that MLB shares about 20 per cent of its overall revenues, compared with the 80 per cent shared by the NFL.

The key revenue differentiator among MLB teams is the richness of their local TV contracts. We have already noted the significant and growing revenues generated by the Yankees. But a number of other MLB teams are also signing very lucrative long-term TV deals, which in turn are driving up franchise values in those top-tier TV markets. For example, the Los Angeles Angels signed a $3-billion, 20-year TV contract (or $150 million in revenue annually), and used some of the money to sign free agent Albert Pujols at $25 million per year. Teams like the Texas Rangers and San Diego Padres have signed TV deals exceeding $1 billion, which allow them to become bigger players in the free-agent market. And at the end of March 2012, the Los Angeles Dodgers were sold to an ownership group that includes former Laker superstar Magic Johnson for the incredible sum of $2 billion, presumably because the new owners see massive untapped revenue potential in the Southern California market.

In this world, the logic of the Blue Jays being owned by Rogers, which also owns the stadium in which they play, is pretty obvious. The Jays provide their owner with guaranteed multimedia content, and the owner can transfer as much revenue to the team as is required to field a more-or-less competitive and interesting product. And in baseball, hope does indeed spring eternal.

MLB operates much like a modern capitalist economy. The playing field is not level, but modest revenue-sharing within MLB allows smaller market teams to make money if they keep their player costs under control. Many teams are unlikely to ever win the World Series, and just making the playoffs is a struggle for them. In short, income transfers are used to soften the hard edges of the MLB free market for talent.

Robber Barons: European Football as Unconstrained 19th-Century Capitalism

The last pro sports economic model examined here is European football (or soccer), where almost anything goes. European football is comparable to the unconstrained capitalism of the 19th century, when enormous market power and wealth could be accumulated by a few wealthy individuals, sometimes called "robber barons," and everyone else was left to fend for themselves. Here's how it works.

First, European football has a long history, with each country having many clubs that are grouped into multiple divisions. Based on their play each season, the bottom two or three teams in each division are relegated (or sent down a division), and the top two or three teams in the lower divisions are promoted to replace them. The top few teams in the top division of each country are invited to play in annual pan-European tournaments, called the Champions League and the UEFA Europa League. Each country also has one or more single knockout tournaments (such as the FA Cup in England, which involves every team in the English football association). As a result, all teams have multiple opportunities each year to win one or more championships.

Second, European football has access to a free and global market for player talent. Players are drawn from anywhere in the world. They sign contracts with individual clubs depending on what the market will bear, and their contract can be bought from or sold to other clubs. Players can also be lent to another club for a period of time. This free market for player talent drives up both player salaries and the cost of contract transfers for top players, and makes smaller and less-wealthy teams largely uncompetitive on the field. Upsets do happen on occasion, but the major tournaments and divisions are almost invariably won by a rich team with skilled and expensive players. European football has a long history, with each country having many clubs that are grouped into multiple divisions.

Third, there is limited revenue-sharing within countries and across divisions. The operating conditions for revenue-sharing vary by country. In England, teams in the top division, called the Premier League, generate and share more than a billion pounds of annual broadcast revenue. The estimated revenue gap between the richest and poorest clubs in the Premier League is about 1.7 times, which is smaller than the comparable gap in MLB (where it is at least

4 times). Staying in the top league is critically important for clubs—relegation means losing their access to the rich TV dollars. In contrast, the two biggest clubs in Spain—Barcelona and Real Madrid—currently take half of the annual €600 million in football TV revenue in Spain, leaving the balance to be split among the remaining 18 clubs in the Spanish top division.3 It is no surprise that Barcelona and Real Madrid invariably lead the way in Spain and in Europe, since they have the means to buy the very best players.

And fourth, some very rich individuals from around the world have been lured by the prestige of owning a European football club—as a very expensive “plaything” or because of the potential to achieve capital gains if the club’s value rises. Football clubs in England have been particularly subject to purchase by rich foreigners—sometimes with success, but sometimes with disastrous results.

The result of this free market system? There are a few very rich football clubs—such as Manchester United and Chelsea FC in England, Barcelona and Real Madrid in Spain, and Bayern Munich in Germany—that are almost always competitive. Supporters of these clubs can reasonably expect their team to win championships each year. And there are upstart clubs where new owners come in with lots of money—clubs like Manchester City, which has bought some of the best players available and pushed into the top tier of European football, supported by a billionaire owner who is prepared to sustain massive financial losses (£197 million in 2011, or around C$350 million) in order to achieve competitive success.

In the next tier, there are many good—but not top-level—clubs (such as Everton and West Ham in England), which can move up and down between divisions depending on their results over the season. Their fans have to be satisfied with doing well in national tournaments such as the FA Cup, and moving up a division if possible, or at least avoiding relegation.

European football is a modern-day example of 19th century capitalism, where the strong thrive and become ever more powerful, the majority manage to just get by, and the weak are left behind.

Below these clubs are many others that simply do not have the financial means to buy better players and compete at higher levels. They have to be content with developing the occasional star player that can later be sold, and with competing a division or two below the top clubs.

And then there are the outright financial disasters—clubs that have tried to compete with the big clubs, only to blow their budget and end up in financial turmoil. Storied British clubs such as Leeds United, Portsmouth FC, and Glasgow Rangers have all ended up in what is called “administration.” Unable to pay their bills, they get taken over by a court-appointed administrator, are forced to sell star players to cover costs, and are usually docked points in the divisional standings as punishment for their financial mismanagement, which leads to their being relegated to a lower division.

In 2009, UEFA (Union of European Football Associations) moved to stem the mounting losses of some clubs. That year, the Financial Fair Play (FFP) regulations, which essentially amount to a flexible spending cap for clubs, were approved. Under FFP (which took effect in 2011), clubs can spend as much as they want, but revenues must cover their spending. If a club can generate more revenue, it can spend more on players. Teams must abide by FFP if they are to take part in European competitions, and violators face exclusion beginning in 2014–15. FFP should make European football more business-sustainable. But since there is no effort to level the playing field in terms of revenue-sharing or controlling player costs, it will have only a limited impact on the competitiveness on the pitch.

In short, European football today is a modern-day example of 19th century capitalism, where the strong thrive and become ever more powerful, the majority manage to just get by, and the weak are left behind. Just as it is somewhat of a contradiction that the “socialist” NFL is the top sport in the firmly capitalist U.S., it is ironic to find the unconstrained capitalism of European football on a continent with such a highly developed social welfare system.

Team Sports at Major U.S. Universities—“Voluntary Servitude”

The team sports system at major U.S. universities is designed to ensure that everyone makes money—everyone, that is, except the athletes. Thanks to extensive TV coverage and related contracts for college football and basketball

in particular, the top sports universities, their athletic departments, and the superstar coaches receive significant compensation. Annual salaries for U.S. college football and basketball coaches can reach into the millions of dollars. But what about the athletes? The top ones usually receive an athletic scholarship, and a growing number are completing their degrees (although this is less common among the top basketball and football players). Moreover, the athletes are punished severely if they accept the smallest gift from an agent or supporter. Such a system has enormous potential for abuse and is in many ways little more than a form of voluntary servitude in which the uncompensated efforts of many young athletes generate significant incomes and wealth for a few.

Conclusion

Looking at pro sports leagues and teams as economic systems, it is the NFL that is the most collectivist, sharing 80 per cent of league revenues and having a player salary cap firmly in place. It has the most level playing field for its teams and fans when it comes to competitive conditions. And it is also the league with the most sustained financial success. The NHL is a mixed economy, with a salary cap to limit player costs and some sharing of revenues among franchises if and when required to protect franchise values. Competitive conditions are better in the NHL than in the NBA. The NBA is a more capitalist economy. It has a soft salary cap, no revenue-sharing, some regular winners, but significant financial losses for many teams. MLB’s system is consistent with modern capitalism, with enough income transfers to allow most teams to make money and thus soften the hard edges of the free market, but with many teams unable to seriously contend for a World Series championship. And European football is the pro sport that operates like old-fashioned capitalism—with the robber barons firmly in charge.