Pro League Competitive Conditions and How the NHL Stacks Up

by Glen Hodgson and Mario Lefebvre | June 2011

All the major pro sports leagues pay lip service to the concept of ensuring a “level playing field.” But while all “talk the talk,” there is a wide disparity among the leagues when it comes to walking the walk. In this fifth briefing, we look at what the NHL and its rivals have done to make their leagues more competitive.

In the fourth briefing in this series, we looked at the tools that leagues use to create a “level playing field” among their teams. Clearly, the more level the playing field, the more competitive—and compelling—the league is for its fans. In this fifth briefing, we look at the competitive conditions among the National Hockey League’s biggest North American competitors—Major League Baseball (MLB), the National Football League (NFL), and the National Basketball Association (NBA). And we look at how the NHL compares with its rivals.

Salary Cap and Player Salaries

Most professional sports leagues today have some form of a salary cap. Caps are designed to allow all franchises to operate profitably. In an era of free agency, a cap constrains the ability of players (or more specifically, their agents) to bid up salaries to levels at which only a handful of clubs can afford to sign the top players. Since no team can grossly outspend its competitors when it comes to player payrolls, a salary cap also helps to level the competitive playing field among teams, which appeals to the fan base. All four of the top North American leagues have caps based on a division of revenues between the teams and the players, and all regularly face the risk that their players will strike to back their demands for a great share of those revenues.

The NFL and NHL both have “hard” salary caps, with a firm upper limit on annual player salaries. The other two—Major League Baseball and the NBA—do not have hard salary caps. Both leagues do, however, have “soft” salary caps. In the case of the NBA, there is a defined cap, but the system includes an array of significant and arcane exemptions that allow teams to exceed the defined salary cap.

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We will examine the NHL salary cap system in detail in a later briefing. In this briefing, we focus on Major League Baseball’s soft cap system. Under that system, a progressive “luxury tax” is paid by a team when its player payroll exceeds the league’s annual maximum. That limit is set each season. For 2011, the cap was set at $178 million. This amount is, in fact, far beyond the revenue-generating capacity of nearly all the teams in MLB—in 2010, only eight of the 30 teams had a payroll above $100 million. The setting of the luxury tax limit at $178 million is testament to the negotiating skills of the players association and to the high level of influence possessed by a few powerful franchise owners. Only a handful of rich teams pay the luxury tax, with the New York Yankees paying 95 per cent of the luxury tax collected to date. But those payments represent only a fraction of the revenues available to the Yankees. The club’s exceptional revenue-generating capacity (over $440 million annually) allows it to compete aggressively in the free agent market each off-season. The Yankees—as well their bitter rivals, the Boston Red Sox—now reportedly include luxury tax payments in their spending budgets for each season.

The absence of a hard salary cap as a share of expected revenues in MLB has led to enormous differences in team payrolls, allowing historical trends to continue and severely limiting the ability of a team with a low payroll to compete on the field on a regular basis with the league’s big spenders. True, through brilliant draft picks and clever management of personnel, a team can develop up-and-coming young stars and become a contender. The Tampa Bay Rays are a clear example of that practice, having made it to the World Series in 2008 and finishing first in the American League East last season. However, unless the Rays find a way to increase their payroll tremendously over the next few years (they were 21st out of 30 teams in terms of payroll last year), they are unlikely to remain contenders over the longer term. The young stars that have been leading the way in Tampa Bay are starting to

become eligible for free agency, and they are likely to be lost to the New York Yankees, Boston Red Sox, or other teams with much deeper pockets. If Tampa Bay does not increase its payroll significantly, it will have to hope that it can continue to hit home runs in the draft by identifying exceptional young players that the other teams miss. Clearly, over the longer term, a strategy of acquiring the best talent available will beat out a strategy that depends on smart drafting and clever management of personnel.

But simply outspending other teams does not guarantee success, at least not on a regular basis. (See Table 1.) The San Francisco Giants won the World Series in 2010 but were only 10th in terms of payroll. The Chicago Cubs (who last won the World Series in 1908) and New York Mets definitely provide evidence that money does not buy success every year. They featured the third and fifth highest payrolls in 2010, while ranking 23rd and 20th in wins among the 30 MLB teams that season. However, their deep pockets give these teams the ability to bounce back into contention rapidly by buying top talent on the free agent market—an advantage enjoyed by only a few teams.

Table 1
Major League Baseball, 2010 Payrolls

Team	Total 2010 payroll (US$ millions)	2010 wins ranking
1. New York Yankees	206.4	3
2. Boston Red Sox	162.7	10
3. Chicago Cubs	146.9	23
4. Philadelphia Phillies	141.9	1
5. New York Mets	132.7	20
6. Detroit Tigers	122.9	16
7. Chicago White Sox	108.3	11
8. Los Angeles Angels	105.0	18
9. Seattle Mariners	98.4	29
10. San Francisco Giants	97.8	5
11. Minnesota Twins	97.6	4
12. Los Angeles Dodgers	94.9	19
13. St. Louis Cardinals	93.5	12
14. Houston Astros	92.4	22
15. Atlanta Braves	84.4	7
16. Colorado Rockies	84.2	14
17. Baltimore Orioles	81.6	27
18. Milwaukee Brewers	81.1	21
19. Cincinnati Reds	72.4	6
20. Kansas City Royals	72.3	26
21. Tampa Bay Devil Rays	71.9	2
22. Toronto Blue Jays	**62.9**	**13**
23. Washington Nationals	61.4	25
24. Cleveland Indians	61.2	24
25. Arizona Diamondbacks	60.7	28
26. Florida Marlins	55.6	17
27. Texas Rangers	55.3	8
28. Oakland Athletics	51.7	15
29. San Diego Padres	37.8	9
30. Pittsburgh Pirates	34.9	30

Source: Major League Baseball.

For Canadian baseball fans, the reality of life in a non-binding salary cap world is that the country's only MLB team will have to rely on superior management capacity and talent selection—not on payroll—to make the playoffs, let alone win another World Series.1 The Toronto Blue Jays have the added misfortune of playing in the same division as the two richest teams in baseball (the Yankees and the Red Sox) and one of the rare winning small-market teams (Tampa Bay). After a "successful" season (22nd in payroll but 13th in wins) in 2010, hopes are still high for the Blue Jays this year. But with the playing field tilted significantly against them, the Blue Jays would appear to have at best an outside chance of getting a wildcard berth in the playoffs this season. And their fans should not be surprised if the Jays once again struggle to compete for third place in their division.

Revenue Sharing

If a league is truly interested in creating a level playing field among its franchises, one of the fundamental steps it can take is to share a significant portion of revenue among the teams.

The NFL has set the standard when it comes to revenue sharing. During the early 1960s, Wellington Mara and his brother Jack owned the NY Giants, and thereby controlled the NFL's largest market. But they agreed on a plan to share television revenue on a league-wide basis. That meant that the money generated from TV rights in the larger cities, such as New York, flowed equally to small-market teams, such as the Green Bay Packers. Perhaps because the money involved was small at that time, the richest NFL owners accepted the principle of revenue sharing—a key factor that has allowed the NFL to grow and prosper ever since.

Today, the NFL and its franchises share more than 80 per cent of league and club revenues. TV broadcast revenues, currently worth more than $20 billion annually, 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 (and the remaining 60 per cent going to the home team). NFL franchises recognize that they have a shared interest in maximizing total revenue. The league has prospered under these "all for one and one for all" arrangements. (The on-again, off-again, on-again lockout of the players in the spring of 2011 does, however, raise some interesting questions about the league's evolving attitude toward the share of revenue that goes to the players.)

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Now compare the NFL approach to the NHL's revenue-sharing system. To start, national TV revenues for the NHL are low compared with what the other leagues get from their TV contracts. Although the numbers have not yet been officially announced, a new, 10-year contract with NBC and Versus will boost the league's U.S. national TV revenues to $200 million annually in the 2011–12 season—up from $75 million last season. In Canada, the CBC pays the NHL about $100 million in broadcast fees annually, and TSN reportedly pays about $40 million a year in broadcast fees. With total national TV revenues of less than $350 million, the bulk of the revenue shared among NHL teams comes directly out of the wealthier teams' pockets—a key difference.

The NHL's complex revenue-sharing system is part of the collective bargaining agreement reached with the players. Under that system, a team is eligible for what the league calls "revenue-sharing subsidies" if its attendance is in the bottom half of the league and if its demographic market area has fewer than 2.5 million TV households. A team must also have average paid attendance of at least 14,000 per game to fully qualify for the revenue-sharing subsidies. In practice, the NHL's revenue-sharing system means that most—if not all—of the six Canadian NHL franchises, plus the richer U.S. franchises, are subsidizing weaker franchises in places like Phoenix and Florida. (Some franchises have reportedly been buying up their own tickets in order to get to the minimum attendance level and thereby qualify for the subsidies.)

Why would the NHL provide subsidies to it weaker franchises? Protecting the current and future value of the stronger franchises is the principal reason. The bankruptcy of any franchise is not a good signal to send to prospective investors in other NHL franchises, and simply moving franchises between cities means there are no franchise expansion fees to share. (While the deal to move the Atlanta Thrashers to Winnipeg does include a $60-million relocation fee, that amount is far less than what the league would receive from the owners of a new franchise. Only when the ongoing costs of subsidizing a struggling franchise become uncomfortably large does the relocation of a weak franchise become an attractive idea to the other franchise owners.) A secondary reason for the NHL to provide occasional subsidies to weaker franchises is to maintain its profile in prime television markets—a key to winning larger U.S. national TV contracts in future.

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Access to Player Talent

All the major pro sports leagues have now adopted the same operating model for player talent—an entry draft and free agency at some point in a player's tenure with the league. The specific details of the entry draft and free agency, however, vary considerably among the leagues.

In the case of the NHL, the league introduced its amateur entry draft in 1963 to give all teams a relatively equal chance to sign young talent.2 Today, players who will be at least 18 years old on September 15, but will be no older than 20 on December 31, are eligible for selection in the June draft. The order is based on where the teams finished during the past season, with the lowest-placed teams picking first. (However, there is also a lottery designed to discourage those teams from deliberately weakening their rosters in the final weeks of a season in order to improve their draft position.)

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Globalization has also become a factor of growing importance in pro sports that have international appeal. Forty years ago, more than 90 per cent of the players in the NHL were Canadian. Today, that share has fallen to about 50 per cent. The U.S. share of the NHL talent pool has grown to about 20 per cent, and Europeans now account for about 30 per cent (although this share is being challenged by the three-year-old Kontinental Hockey League in

Russia). Baseball first looked to the Caribbean and Latin America to its expand its existing American player base, and has more recently spread its talent search to the Asia-Pacific region and Canada. The NBA has the most diversified talent pool. It draws players from around the globe. More than 30 countries are represented in the NBA, with foreign-born players accounting for about 20 per cent of NBA rosters. Expanding the pro sports talent pool has been key to maintaining a high standard of play at a time of steady expansion in all the North American leagues in recent decades. At the same time, international expansion of the talent pool has helped to grow the popularity of these sports in international markets.

Changes in Competitive Conditions

On occasion, a league will recognize that a franchise or group of franchises is facing particular challenges and will take special steps to make the financial and competitive playing field more level. A decade ago, for example, the NHL agreed to help struggling Canadian franchises that had been battered by the effects of a weak Canadian dollar. (Today, the Canadian dollar is trading above par with the U.S. greenback, which radically changes the circumstances of Canadian teams playing in North American sports leagues.)

And as discussed earlier, the NHL today provides operating subsidies for teams in smaller markets that are struggling with low attendance. The NHL thus appears to face chronic challenges with respect to competitive conditions among its franchises.

Conclusion

Whether a league implements a level playing field among its franchises, and how it does so, says a great deal about its business philosophy and the distribution of economic power within the league. The business model of the NFL and its franchises, which share more than 80 per cent of league and club revenues, is vastly different from that of Major League Baseball, whose operating rules allow a few high-revenue teams to try to buy championships year after year. A level playing field—financially and in the win-loss column—is, therefore, far more likely in the NFL than it ever will be for Major League Baseball.

Not surprisingly, the level playing field concept is applied mostly to issues that directly affect the players—issues such as the creation of a hard or soft salary cap, the establishing of comparable access to player talent through a league entry draft, or the drawing up of free agency rights and rules.

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The NHL and NBA fall somewhere between the NFL and Major League Baseball in establishing a level playing field among franchises. The NHL has a player entry draft, salary cap, and free agency, but only limited direct revenue sharing among franchises. The NHL compensates for the absence of aggressive revenue sharing by introducing targeted subsidy schemes when and where required. These selective schemes help to ensure that franchises survive as long as possible in a specific location, and thus do not drag down franchise values elsewhere or eliminate the potential value of shared expansion fees. Among the four major North American leagues, MLB makes the least effort to create a level playing field.

The NHL faces the most chronic challenges, in terms of keeping its weaker franchises afloat. A decade ago, the NHL was struggling to deal with the structural issue of a weak exchange rate for Canadian teams. Today, there are a number of weak franchises in the U.S.—particularly in southern markets, where there is no tradition of passion for hockey. When it comes to these struggling U.S. franchises, there are no easy solutions. The other franchise owners will eventually tire of propping up the weakest organizations—such as Florida and Phoenix—and allow them to be moved to cities that truly value NHL hockey. We’ve already seen this happen with the move of the Atlanta Thrashers to Winnipeg this coming season. Others could follow.