

Sports

Where have you gone Joe DiMaggio

Perfect Competition?

- ◆ Professional Sports Poses a Few Interesting Problems
 - Are the Teams in the League a Single Entity, or Are They Competitors, or Some Combination?
 - What Is the Relation of Professional Sports to the Rest of the Entertainment Industries?
 - What Is the Source of the Value Creation in Professional Sports?

- ◆ Use Baseball As the Paradigm

Single Entity?

- ◆ Clearly There Are Aspects of Both

- ◆ One Way to Think About It Is to Look at the Incentives of Any Owner to Field the Best Possible Team
 - And Consider How the Motives of a Single Owner Interact With Those of Other Owners

- ◆ A Specific Example Is Brought About by the Advent of Free-agency in Major League Baseball

First of All, I'd Like to Talk to You About Starting Salaries in the Major Leagues



Are Teams of Equal Quality?

- ◆ No
- ◆ Actual Winning Percentages Are More Disperse Than They Would Be If Teams Were of Equal Quality
 - Either Lifetime or Season-by-season
- ◆ But There Is a Clear Aversion to Having Teams Be Too Bad or Too Good for Too Long
 - Reserve Clause
 - Revenue Sharing
 - Salary Caps

Owner Arguments for Restrictions on Salaries

- ◆ Same Arguments for Reserve Clause or Salary Caps
- ◆ Need to Maintain Competitive Balance
- ◆ Affect on Ticket Prices

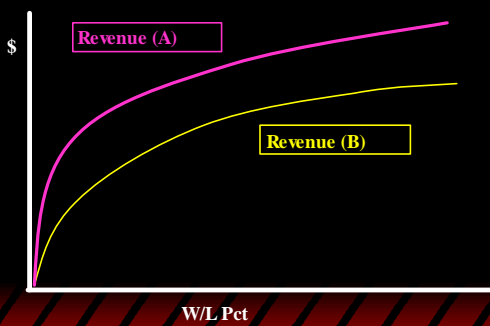
So What Is the Effect of Free Agency on Competition?

- ◆ No Detectable Effect on Competitive Balance in Baseball
 - Standard Deviation of W/L % Is the Same

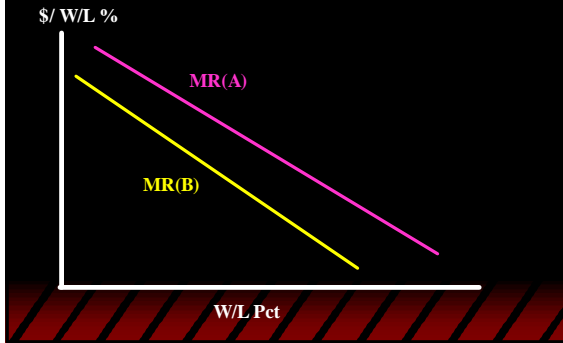
Is this a surprise?

- ◆ We Need an Economic Theory of Salaries

First Consider Two Teams



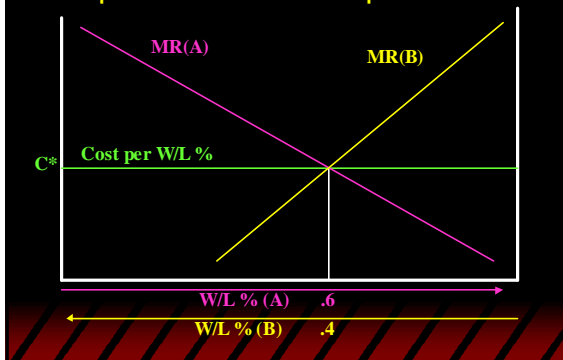
Now Look at Marginal Revenue

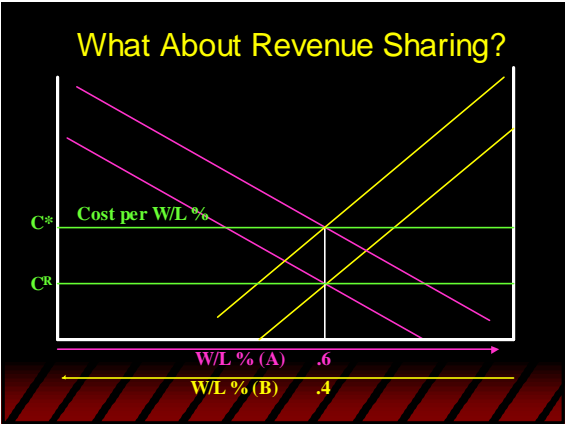


Now What Happens in Competition

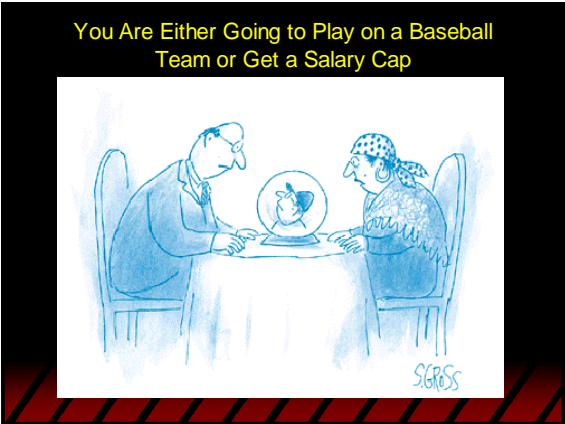
- ◆ The Competitive Equilibrium Must Be One in Which Price Is Equated to Marginal Revenue for Each Team
 - both teams face same marginal cost of a victory
 - old $MR=MC$
- ◆ Graph Shows This, Note That for Team A the W/L % Goes up As We Move to the Right, While for Team B the W/L % Goes up As We Move to the Left

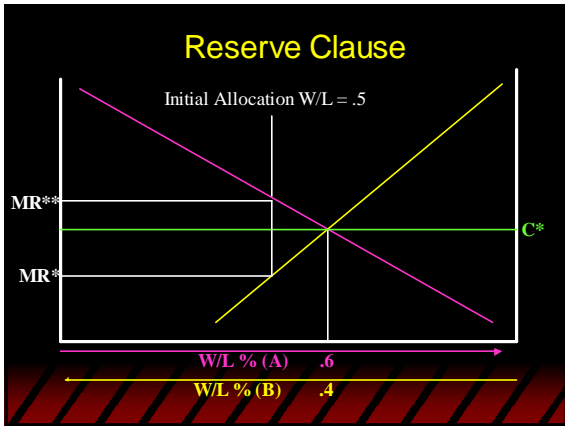
Equilibrium With Competitive Mkt





- ### Revenue Sharing Has No Effect on W/L %
- ◆ As Long As Teams Take Into Account the Effect of an Added Victory on Not Only Their Home, but Also Their Road Income, Revenue Sharing Will Not Increase Competitive Balance
 - ◆ But, Since a Given Victory Is Now Worth Less to a Team (As Long As the Revenue Sharing % Is Less Than .5), Salaries Will Fall
 - ◆ Revenue Sharing Doesn't Lead to Balance, It Leads to Lower Player Wages As Long As Teams Remain Viable
 - ◆ It Will Transfer Wealth From Big-city Clubs to Small-city Clubs





- ### Effect of Reserve Clause
- ◆ Initial 50-50 Allocation Is Not an Equilibrium Because MR(A) [Big Market] Is Higher Than MR(B) Small Market
 - ◆ If Cash Sales Are Possible, Will Move to Competitive Allocation by Player Sales
 - ◆ Relative Wealth of Teams Will Be Affected
 - ◆ Players Get No Benefit

- ### Conclusion
- ◆ Neither Revenue Sharing, nor the Reserve Clause, Can Be Expected to Maintain Competitive Balance
 - ◆ They Can Be Expected to Increase Owner's Wealth

But We Have to Protect the Poor Fan?

- ◆ Owner's Argue That High Salaries Must Lead to High Ticket Prices So They Are Harmful to Fans
- ◆ But That Hard to Believe Because It Is Inconsistent With Profit Maximization by Owners
 - Once the Mets Sign Piazza His Salary Is Fixed, but Fixed Costs Don't Affect Prices--Remember Your Economics, Firms Equate *Marginal Revenue* With *Marginal Cost*
 - True As Long As the Mets Stay in Business

So, Will All the Best Players End up on the Yankees?

- ◆ I Hope Not!
- ◆ Two Views
 - Even Without Free Agency, As Long As Cash Sales of Players Are Permitted the Best Players Will All Go to the Teams With the Biggest Payoff to Winning
 - ◆ So Free Agency Doesn't Really Change Things
 - ◆ It Does Affect Who Get the Money - the Owners or the Players
 - Others, George Daly for Example, Argue That Owners Will Not Let This Happen Because Fans Like Competition
 - ◆ Old Boston and Baltimore

Important Caveat

- ◆ This Assumes Owners Are Value Maximizing and Won't Overpay to Win
- ◆ There Are Numerous Examples Where This Appears to Miss Something

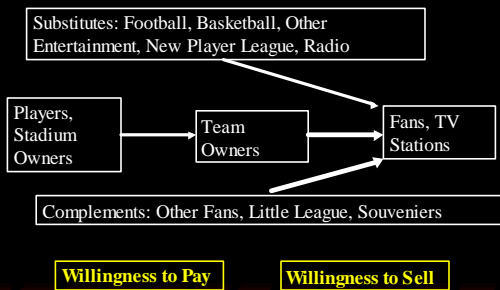
So What Is the Effect of Free Agency?

- ◆ Strong Evidence That Player Salaries Are Higher
 - Except in Years When Owners Collude
- ◆ No Evidence of Any Effect on Competition

Why Couldn't the Players and the Owners Cut a Deal in 1994?

- ◆ I.E., Why Was I, a Loyal White Sox Fan, Unable to See the Sox in the Series?
 - Jerry Reinsdorf
- ◆ In Order to Understand the Bargaining Game You Have to Look at the Underlying Economics of Bargaining Power

Need to Get Some Idea of How Value Is Created in Baseball



WTP, WTS

- ◆ These Are Simply the Old Economic Notion of the Opportunity Cost
- ◆ The Willingness to Pay for a Fan or a TV Station Depends on Her (or Its) Next Best Alternatives
- ◆ Willingness to Sell for an Owner or a Player Depends on Their Next Best Alternatives
 - Clipping Coupons
 - Retirement
 - Soccer
 - Broadcasting

Prior to Strike Baseball Creates Value

- ◆ Prices Going up 10% Per Year and Fans Still Pay
- ◆ Big TV Contracts
- ◆ But Some Signs of Trouble
- ◆ Still WTP Looks Strong

- ◆ \$1.8 Billion Dollar Industry With Only 700 People
 - Plus a Lot of O' Malleys
- ◆ Why?

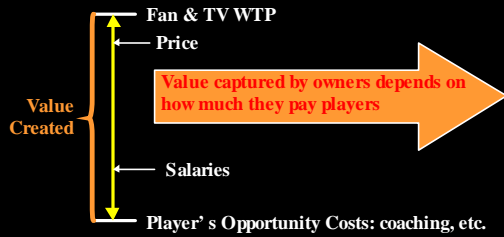
What Is Going on?

Up to the time of the strike, baseball created value



What Is Going on?

It looks like owners have been setting prices near WTP



Problem: Can't Separate Value Provided by Current Owners From Value Provided by Players

- ◆ Players and Owners Already Have Made Big Commitments to the Game
 - Players Train for Years
 - Owners Invest in Training Facilities, Stadiums
- ◆ The Commitments Preserve Value Creation Relative to Alternatives
- ◆ If Either Refuses to Participate Other Is Left Holding the Bag

What Does Free Agency Do?

- ◆ Changes the Nature of the Bargaining Between Owners and Players
- ◆ Clearly Owners Will Be Getting Less of the Value
 - Free Agency Forces Owners to Compete With Each Other
 - Players Have Always Been Competing With Each Other
- ◆ Free Agency Exacerbates Small Vs. Large Market Problems

Alternatives

- ◆ Vertical Integration
- ◆ Build New Stadiums
- ◆ Find Different Owners

Vertical Integration

- ◆ Similar to Problems in Other Areas
- ◆ Let Players Own the Clubs
- ◆ But This Turns Out Not to Work
 - Problems With Personnel Decisions

Build New Stadiums

- ◆ Luxury Boxes Are an Untaxed (by Revenue Sharing) Source of Income
- ◆ Can Get the Municipality to Finance It
- ◆ Box Income Not Tightly Tied to Quality of the Team
 - Require Multi-year Deal

Find New Owners

- ◆ Owners Who Only Bring Money to the Table Will Not Make Money
 - Lots of People With Money Want to Own a Ballclub, Too Much Competition
- ◆ Need Owners With Special Skill
 - Give Me a Break
- ◆ Owners Who Bring Something Unique to the Table
 - Entertainment Companies

Owners

- ◆ 1950's Owners Either Started or Inherited Clubs or Made Money in an Unrelated Business
- ◆ Now We Have a Number of Teams Owned by Entertainment Companies
 - Dodgers, Cubs, Braves, Angels
- ◆ Why?

Vertical Integration

- ◆ Sports Is Important Content
- ◆ Why Will Murdoch Pay More Than Anyone Else for the Dodgers?
 - JSkyb
 - Will This Affect the Team on the Field?
- ◆ For News Corp, and Somewhat for Disney, Sports Is Central

Murdoch and Sports

- ◆ Premier League (UK Football)
- ◆ Use of Local Sports Team Loyalty
- ◆ Different Strategy From Disney Re Sports Network
- ◆ Key Point Is That Value of Sports Depends on Decisions Made There
 - This Is Just Like Other Places Where Vertical Integration Makes Sense

New Stadiums

- ◆ These Virtually Never Generate Public Benefits That Exceed Public Costs
- ◆ Benefits Flow Entirely to Owners
