

MIDCONTINENT PERSPECTIVES

[Midwest Research Institute](#)

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The Economics Of Baseball

First of all, let me tell you what an honor it is to be part of your program. In reviewing a few of the other speeches in this series, I've learned that the topics ranged from inflation and banking to solar energy, from the role of government and industry to communications and computers. There can be no doubt that these are valid subjects which all impact our future. As important as these subjects are, I suspect that if you were to discuss them in your home, most family members would be reluctant to voice an opinion on them. Certainly no one would claim to be an expert. That is not the case, however, with my subject. In homes from coast to coast, you can find experts by the hundreds, because the subject I am going to talk about is baseball.

Now sit back, relax, and come with me to the ballpark. To understand baseball you have to get into the mental set of what is going on. Just think of that warm breeze, the kids laughing, and the vendors screaming.

Today I want you to imagine yourself one of the participants in baseball be it fan, owner, or player. Now some of you may choose the role of the fan to sit out there, drink a beer, have a hot dog, perhaps arrive a little early to hear the sounds in the batting cage, and perhaps keep score.

If you prefer the role of a player, you will find that when you get to the ballpark, you have big decisions to make. The first one is whether you are going to wear fast socks. Fast socks, I've learned from some of the ballplayers, are those socks that you pull up real tight to create a racing stripe up your leg. Those are fast socks! Then you have the old traditional socks like those worn by Darrell Porter, George Brett, and John Wathan. Your second big decision is, should you put a chew in your mouth or a dip of snuff? After that you've got to go out onto the field and look around to see if there are any interesting young women. If there are, you can shag balls in their direction. Aren't those some of the big decisions ballplayers have to make, George [referring to George Brett in the audience]?

There are, of course, some serious aspects, too. Most people don't realize that in Kansas City ballplayers get to the park around four o'clock, which means that they leave their homes around three, and don't return until midnight. As players you can count on putting in a full day even without traveling. Players warm up, take their fielding and batting practice, and then look forward to the tension of 36,000 to 40,000 people screaming at them, telling them how to play the game.

Or then, maybe you would like to be the owner. Now, if you were the owner, would you want to be sitting in your box behind the dugout, or would you be up in your suite? Maybe you would prefer to be home like Mr. Wrigley, watching the game on television. If you are like Charles Finley, you will be telephoning in.

Whatever role you prefer – fan, player or owner – you will be concerned with our subject today, the economics of baseball. In my role today I'm going to talk to you as your advisor. I have the opportunity through my involvement with the Kansas City Royals and the Major League Baseball Players Relations Committee to consult with players and owners and, as a result, have a good nonbiased data base. The data we will review have been pulled together by an associate of mine, Carl Mitchell, from both public and audited sources.

Let's talk generally about baseball because we all are fantasizing about our roles as either fans, players, or owners. I think you'll agree that we all are the community. Who stands to get ahead? Who's going to gain or lose? What's going to happen in the eighties?

To give perspective we should remember that baseball is a relatively small industry, about 650 players in both leagues. That's not a heck of a lot of employees. Any good size plant here in Kansas City probably has more employees than that. The total revenue for all of baseball is only \$260 million, which is about the same size as a medium-sized food chain like Milgram's. Any one team has about \$5 to \$10 million in revenues, and that's not much bigger than your local grocery store.

Yet baseball gets a tremendous amount of press, and it's an incredibly complex business to understand. You have legal problems, labor problems, antitrust problems, tax problems, and public relations problems.

We in the community feel that we own the club. Sometimes the owners have a different opinion on that, and that can cause problems. We citizens feel that the community should be able to tell the owner what to do with his assets. Sometimes, at least in Kansas City, the owner agrees. Then again, sometimes he doesn't. In other cities – Oakland, for example – the community doesn't always agree with the owner.

The economics of baseball are relatively unattractive for the owners, and this is different from what it was in the "old days." Right now the attendance needed to break even is rapidly increasing. Later, we will show you that the average club is losing money; that a club has less control over its income than it once did; that we could be approaching a media market saturation; that there has been and will continue to be fan resistance to increases in prices; and that the reserve clause, which has been struck down, has become a major economic issue.

Let's talk about the major determinants. First of all, for you who want to be owners, is it a good investment? What about taxes, inflation, players' salaries, and revenues? We'll also need to talk about attendance (that it's dictated by the population in your geographic area) and its relation to television and radio revenues.

First of all, is baseball a good investment for you? When you bought your team you received some assets. You acquired a franchise, some players' contracts, equipment, and television and radio rights. When you purchased your franchise, your tax advisor said you should try to allocate as much as possible of the purchase price to those assets that have what is called a determinable life, because the IRS allows you to write off or depreciate such assets. It is no different from buying an office building, which has a determinable life. Unfortunately, the

franchise, according to the IRS, does not have a determinable life. Its life is indefinite, so you do not want to allocate a large portion of your purchase price to it. You can and will want to put some of your purchase price on your players' contracts because the IRS has agreed that a player has a determinable life. It might be five to seven years. This recognizes that as the ballplayer gets older, his fastball may lose its zip and his knees may get weak. So you are allowed to depreciate the players' contracts.

Equipment? Yes, it has a determinable life. No problem there. If you buy fixtures, such as the owners who bought the Red Sox did when they bought the ballpark with the team, you can depreciate a piece of that. The television rights you cannot depreciate because the IRS says that television rights have an indeterminate life. The big argument that has been going on for the last seven years revolves around how much of your purchase price can be allocated to the players' contracts and how much should be allocated to the franchise and television rights.

Let's review an example of how, as an owner and depending on how the IRS allows allocation of the purchase price, you can determine whether baseball has been a good investment from a tax viewpoint.

We're going to have to make two simple assumptions. First of all, in both cases, let's assume you paid \$6 million for the franchise. By the way, that's about the price paid for the Seattle franchise, which moved to Milwaukee, and it's in line with the price paid for the Kansas City franchise.

For the same purposes you ascribed, in both cases, \$500,000 for your television rights and \$50,000 for equipment. No problem. Here comes the big difference. In Case A you attributed the remainder of that purchase price, \$5.25 million, to the players' contracts because you are claiming that's what they are worth. Case B is, on the other hand, more in line with where the IRS is now. They say you cannot allocate more than 50 percent of your purchase price to the players' contracts. So the only difference between Case A and Case B is that you imputed only \$2,625,000 to the players' contracts and a larger portion has to go to goodwill. In the old days you were able to relate much of your purchase price to the players' contracts. Today, in our example, you are still paying the same \$6 million for the purchase price, but the IRS says all you can assign to the players' contracts is \$2,625,000.

The last assumption is that, because you are the owner, we figure that you must have some outside income, so all of you people who want to be owners can go to Bryant's tonight and have a good time – we're giving you \$600,000 of outside income.

In both cases you had income from the ball club (\$500,000) before player amortization. In Case A, where you had more of the purchase price ascribed to the players' contracts, you received amortization of \$1 million. In Case B, where you ascribed a smaller amount to the players' contracts, you have \$500,000 in amortization. Case A shows, for tax purposes, a \$500,000 loss while Case B shows you broke even. As a result, in Case B you did not have taxes to pay. When you, the owner, filed your personal tax return, you found that even though you had \$600,000 in income from your outside source, when your baseball losses were included, you had to pay taxes on \$100,000 of income versus \$600,000 in Case B. In the 70 percent tax bracket you must pay \$530,000 in Case A versus \$180,000 in Case B.

The big difference in your tax obligation resulted from what the players' contracts were assumed to be worth. The difference in cash flow between the examples (\$350,000) is simply the

difference in income (\$500,000) times your tax rate, 70 percent. This is the only tax shelter that there is in baseball – the amortization of the players’ contracts. This is no different from what you are allowed on a piece of real estate you might purchase for investment and subsequently depreciate. Of course, after so many years your investment becomes fully depreciated and the tax benefit disappears. The same thing happens to owners of ball teams. After five years the owner has no more tax breaks. The truth is, he never really had one to start with. It’s a simple matter of how you are allowed to allocate your assets.

EXHIBIT 1

IMPACT OF ALLOCATION OF TEAM PURCHASE PRICE ON OWNER’S CASH FLOW

CASE A -- ASSUMPTIONS

- TOTAL PURCHASE PRICE = \$6 MILLION OF WHICH:
 - \$ 500,000 FOR T.V. RIGHTS
 - 50,000 FOR EQUIPMENT
 - 200,000 FOR FRANCHISE ACQUISITION (GOODWILL)
 - 5,250,000 FOR PLAYERS CONTRACTS
- USEFUL LIFE OF PLAYERS CONTRACTS - 5.25 YEARS
- NET INCOME BEFORE AMORTIZATION OF CONTRACTS - \$500,000
- OWNER’S OUTSIDE INCOME - \$600,000

CASE B -- ASSUMPTIONS

- SAME AS A; I.E., TOTAL PURCHASE PRICE \$6 MILLION OF WHICH:
 - \$ 500,000 FOR T.V. RIGHTS
 - 50,000 FOR EQUIPMENT
 - 2,825,000 FOR FRANCHISE ACQUISITION (GOODWILL)
 - 2,625,000 FOR PLAYERS CONTRACTS

	(\$000’s)	
TEAM’S CASH FLOW:	Case A	Case B
INCOME FROM OPERATIONS EXCLUDING AMORTIZATION	500	500
AMORTIZATION	<u>1,000</u>	<u>500</u>
TAXABLE INCOME (LOSS)	(500)	-0-
TAXES PAYABLE	-0-	-0-
AMORTIZATION ADD-BACK	<u>1,000</u>	<u>500</u>
CASH FLOW (A)	500	500
 OWNER’S CASH FLOW:		
TAXABLE INCOME	600	600
TAXABLE LOSS ABOVE	<u>(500)</u>	<u>-0-</u>
ADJUSTED TAXABLE INCOME	100	600
TAX LIABILITY (70%)	<u>70</u>	<u>420</u>
CASH FLOW (B)	530	180
 TOTAL CASH FLOW (A + B)	1,030	680
 DIFFERENCE		350

THIS IS A “ONE TIME” BENEFIT FOR EACH OWNER!!
 GENERALLY, FOR TEAMS OVER FIVE YEARS OLD,
 CASH FLOW = EARNINGS

After your first five years you usually do not have any more depreciation on the original purchase of the franchise. At that time whatever losses you incur become real losses or cash, and

whatever losses you are able to deduct from taxes are actual cash losses. At that point I, as your advisor, would tell you that you are losing money. At that point you must make a decision. Would you rather own a ball club or give your money to charity? There are no more tax breaks after the first five years and if you are losing money at that point, you are simply giving it away.

Let's talk about the issue of amortization of the players' contracts. Is it necessary? The owners have argued successfully to the IRS that the players are a real cost and players must eventually be replaced. So, like any assets, owners should be allowed to depreciate them.

Let's look at what we call player development. Last year the major league teams spent about \$29 million on just their minor leagues, or about 11 percent of revenue. We consider player development to be like R & D. Now if you add player acquisition, training, scouting, etc., it costs about \$2.5 million a team. If you are only getting, on the average, one new player to the majors per year, you as owners have about \$2.5 million sunk in each one of those players who make it to your major league club.

If the amortization of the players, which now can be no more than 50 percent of the purchase price, is eliminated, the owners receive no tax relief. We think that this will discourage them from taking the risk associated with player development and, as a result, they will not invest as much in their minor league franchises. That hurts baseball. In 1974 teams were spending 14 percent of revenues on player development. I believe it was because the tax treatment prevented them from drilling for dry holes, so to speak. This percentage has gone down to 11 percent. You've noticed, no doubt, that whenever the government changes tax laws, it affects investment decisions, whether it's oil, gas, or baseball. With the change in tax laws, owners are no longer spending as much money, as a percentage of the total gross revenue, on the development of the players as they used to. To you owners, my conclusion is that baseball is a less attractive investment than it used to be.

Let's look at what inflation has done to baseball. Shown on Exhibit 2 are some statistics for the period 1970 to 1978. Please note that broadcast revenues have grown at 7.5 percent a year, gate revenues have grown at 7.7 percent, ticket prices have increased only 4.3 percent, and attendance has grown by 4.4 percent. During the same period of time inflation has far exceeded 7 percent. As owners you would conclude that attendance has not kept up with inflation, which shows me that there is some fan resistance to increasing the ticket prices. Your total revenues, if you are an owner, are growing just about in line with inflation.

Yet look what has happened to expenses. Team expenses are primarily salaries. Salaries have been growing at 20 percent a year. Player development, which includes minor leagues and player acquisition, has grown at 8 percent a year, and stadium expenses at 14 percent a year. Let's examine this phenomenon. The average player salary has increased from \$19,000 in 1967 to \$100,000 in 1978. Remember, the average 1980 salary is much higher. So average salaries have increased at 12 percent. The truly excellent players are getting very, very high salaries and are experiencing faster salary growth than are the medium and minimum paid players. The skew is in favor of the higher paid ballplayers.

The owners are caught between a rock and a hard place. Their expenses are soaring and yet they will probably have a hard time raising ticket prices. Their expenses are moving up and are difficult to control. Their television revenues are becoming saturated because they are not growing in real terms. In fact, there is not much an owner can control. The stadium costs are fixed and owners must plow money back into the minor leagues to develop new players. Can

you control these team expenses? That is a big issue. This is why there was almost a strike this year.

EXHIBIT 2

INFLATION IN BASEBALL			
(\$MM)			
AVERAGE TEAM:	1970	1978	ANNUAL INCREASE
			E
BROADCAST REVENUES	1.5 (1974)	2.0	7.5%
GATE REVENUES	3.5	6.3	7.7%
TICKET PRICES	2.9	4.1	4.3%
ATTENDANCE (LEAGUE)	28.7	40.6 (1)	4.4%
EXPENSES (1974-1978)			
TEAM			20.0%
PLAYER DEVELOPMENT			8.0%
STADIUM			14.0%
TOTAL			13.6%
SALARIES (\$000)			
	1967	1976	
AVERAGE	19	100	16%
MEDIUM	17	68	13%
MINIMUM	6	21	12%

(1) includes 2 new teams; i.e., Seattle and Toronto – growth only 3.5% without these teams 1970-78 inflation average 7%.

Source: *Barrons, New York Times*

Let's now talk about the free agency issue in lay terms. Free agency in baseball means that after you have played in the major league six years, you are free to move and play for whatever team you want to play for. Therefore, you can negotiate your salary as an independent agent with any team after six years. Since the inception of free agency 50 percent of the free agents have actually changed teams. The large majority of the free agents go to large metropolitan areas and not to the Midwest. They have been going primarily to teams on either coast, and a few have gone to Texas. Fifty-three percent of the free agents have gone to only five clubs. The reason for this is that the large metropolitan centers can afford to pay more. They are more profitable because they receive higher television revenues. The coast cities are attractive to the ballplayer because they usually offer more money from product endorsements. Believe it or not, there are certain players who like having their name on a "Reggie Bar" and, as a result, end up playing in New York. We would say this was definitely a factor in the Royals' negotiations with Tommy John. The economic package offered to him by the Royals was equal to or better than the Yankees' package, but Tommy chose to go to New York.

Many people do not realize that a player can go to arbitration on his salary at any time. If during the six-year period that a player is bound to a club he cannot reach salary agreement, he can go to arbitration. Therefore, a player would not be a "salary slave" of the team even if free agency were eliminated. I would not call the free agency issue "slavery." Rather, I would call it a dispute between an investor who is trying to recoup his investment and a two-legged asset who is trying to maximize his wealth.

Let's look at Exhibit 3, which shows the correlation between winning percentage and salary. The top paying team in 1975 was the Oakland Athletics at \$66,000 per player for that year. Then came Los Angeles, Pittsburgh, and New York. The bottom paying team was the California Angels. Kansas City was paying \$47,000 for the average player at that time. By 1978, which is the last year we have this data for, look what happened: New York was paying \$189,000; California jumped from \$32,000 to \$142,000; and Oakland was the lowest paying team. The Kansas City number that I recently saw for 1979 was up to about \$140,000. So Kansas City pays competitive salaries, making it probably the sixth highest paying team. Surprisingly – or maybe it is not so surprising – there is a high correlation between what you pay and what you do on the field. Based on the statistics, I would say that those who pay, win! With the free agency system and an eye for talent, one can buy the better players and ensure that your team will have a better winning record.

EXHIBIT 3

FREE AGENCY

- **CAUSING MORE TEAM SALARY IMBALANCE**

1975 AVERAGE PLAYER SALARY (\$000)

<u>TOP 5 PAYING TEAMS</u>		<u>BOTTOM 5 PAYING TEAMS</u>	
Oakland	\$66.5	California	\$32.5
Los Angeles (NL)	62.5	Chicago (AL)	33.0
Pittsburgh	61.0	Montreal	35.0
New York (AL)	56.0	Minnesota	36.0
St. Louis	56.4	San Francisco	36.0
	Kansas City		\$47.5

1979 AVERAGE PLAYER SALARY (\$000)

<u>TOP 5 PAYING TEAMS</u>		<u>BOTTOM 5 PAYING TEAMS</u>	
New York (AL)	\$169	Oakland	\$49
Philadelphia	159	Minnesota	51
Boston	146	Seattle	56
California	142	Detroit	61
Los Angeles (NL)	136	Toronto	64
	Kansas City		\$107

- **CAUSING GREATER PERFORMANCE IMBALANCE**

	WINNING PERCENTAGE	
	<u>1975</u>	<u>1979</u>
TOP 5 PAYING TEAMS	.551	.560
BOTTOM 6 PAYING TEAMS	.465	.456

THOSE THAT PAY – WIN!!

Source: *Professional Sports Journal*

Well, who is getting ahead? That is what all three groups want to know. Are the owners getting ahead? The average players? The stars? Or is it the public?

I asked this question last night of a major league player and he said, "It's obvious. The stars are the big winners." For example, I think the best player in the major league happens to be

in the audience and that is George Brett. He's the best hitter since Ted Williams. If George wants, he has a choice. When he plays out his contract, he can go to New York or Los Angeles to play and demand top dollar. If the Royals want to keep George, they will have to pay him as much as he can get by going to another team. If not, they will lose him. That is just the economics of baseball. The free agency system allows the star either to get more money by leaving the team or force his existing team to pay more to keep him in place. It is a zero sum game, however, in that there is less money left for the other players. That is the issue we are starting to see in the newspapers now.

In 1976 the free agent got an average of \$260,000 a year. In 1979 the free agent got an average of \$366,000. That amounted to a 41 percent increase, even though most would agree that the quality of players that came with the 1979 draft was inferior to that available in the 1976 draft. Unlike the players who went in the 1976 draft, we are now seeing many marginal players getting very high salaries.

No matter what happens to baseball, and you can look back to the 1920's, the stars will not lose. The stars will always win. People paid a lot of money to watch Babe Ruth and he made more money than the President of the United States did in those years. Baseball will continue to pay the stars. We think that's part of our American ethic. As a result, we will say the stars are probably the ones who are going to win.

How about the owner? Does he have a good investment? In Exhibit 4 we see that even though the cash flow in this sport does tend to be marginal to negative, the resale value does appreciate. Many people make money in professional sports when they sell their team.

We should consider when these teams were bought and sold, and if the sale price was realistic. In the case of the Mets, they sold for \$21 million. Yet in speaking to Joe Burke, General Manager for the Kansas City Royals, and Gabe Paul, President of the Cleveland Indians, they did not think the franchise was worth more than about \$12 to \$13 million. But, as in selling your house, if someone offers a higher price, take it.

The Red Sox, a team in a very large metropolitan area, went for about \$13 million. The Red Sox have very good television revenues. Baltimore, which had won its division three out of four years, went for \$10 million. Oakland went for \$12 million. So a typical price for a baseball franchise would be in the area of \$12 to \$13 million, unless there are some unique assets such as a stadium, lucrative television contracts, or large season ticket sales commitments.

Let's look a little further into this issue of whether a team is a good investment even after considering the appreciation. If you were one of the owners of Milwaukee and you sold the ball club for, let's say, between \$10 and \$15 million, you'd be making between 3 and 6 percent pretax return on your investment. That means that if you bought Milwaukee in 1967 or if you bought the Royals in 1968 and you sold the team for those types of prices, that would be your return on your initial investment.

Is that a worthwhile return considering the risk you took? You could have put your money in farm real estate and made 9.5 percent; a new home and received 7.5 percent; Triple A bonds in this bad bond market returned 6 percent. The owner must determine whether that is a good enough return for the risk he is taking. First, you will have to find a buyer who will pay that price. Baseball teams are not exactly liquid investments. Secondly, you will have to consider the

operating risk and the fact that your cash flow is at best marginal. Lastly, there are also a lot of future obligations associated with owning a team.

EXHIBIT 4

IS TEAM A GOOD INVESTMENT FOR OWNER?

- **CASH FLOWS TEND TO BE MARGINAL OR NEGATIVE**
- **RESALE VALUE APPRECIATES BUT NOT SPECTACULARLY**

	<u>Purchased Price</u>	<u>Estimated Value 1978</u>	<u>Annual Appreciation (PreTax)</u>
Los Angeles Kings (Hockey)	\$ 2.0MM (1966)	\$ 8MM	12%
Seattle Supersonics (Basketball)	1.7MM (1967)	12MM	17%
New York Mets (Baseball)	1.6MM	21MM*(1980)	13%
Philadelphia Eagles (Football)	16.2MM (1969)	25MM	5%

- **THIS ASSUMES ESTIMATED VALUES ARE ACCURATE (??)
...COMPARE THEM TO ACTUALS**

1979 METS	\$21MM (UNIQUE)
1979 RED SOX**	13MM (IN A LARGE METRO AREA)
1979 BALTIMORE	IOMM

*ACTUAL

**PLUS \$5MM FOR STADIUM

EXHIBIT 5

GOOD INVESTMENT

- ◆ **MILWAUKEE (THEN SEATTLE) COST APPROXIMATELY ...**
\$6.5MM (1967)
- ◆ **IF SOLD TODAY FOR ...**
\$10MM THEN ROI WOULD BE 3.4%
\$15MM (??) THEN ROI WOULD BE 6.6%
\$20MM (???) THEN ROI WOULD BE 9.0%
... PRE-TAX
- COMPARE TO ...
 - FARM REAL ESTATE (9.5%, 1968 - 1978)
 - AVERAGE NEW HOME PRICE (7.50/o, 1968 - 78)
 - AAA BOND (6% IN 1967)
 - COMMERCIAL PAPER (7%, 1967 - 80)
- ◆ **IS THE RETURN FOR TEAM OWNERSHIP ADEQUATE GIVEN ...**
 - RISK
 - CASH FLOWS THAT ARE MARGINAL AT BEST
 - FUTURE OBLIGATIONS

There are, for example, considerable deferred salary obligations. The total team payroll in baseball in 1978 was \$65 million. But as of that date, those same teams had guaranteed an excess of \$250 million worth of future salary and deferred payments. That means that when we show you that the average team is breaking even or losing a little money, that does not include any amortization of this quarter of a billion dollars of deferred liabilities that are on their books. We

do not know how the clubs are going to fund those future liabilities. When I have advised some of the players, I've told them to figure out the financial health of the club because the club's guarantees are only as good as its ability to pay. We think you will see many ballplayers in the future taking cash and not deferring unless they are dealing with a strong financial organization like Los Angeles, New York, St. Louis, or the Royals – the type of operation that is not going to go under financially.

Exhibit 6 details the profit and loss statement for various teams. The average team in 1978 had attendance of 1.6 million. Gate and concession revenues were \$7.3 million. Advertising and "other" were \$2.7 million for a total of \$10 million. These are all the expenses. You can see that the average team lost a little money. The chart consists of two public clubs, Baltimore and the Chicago Cubs. Team C is private, and Teams E and F are private but are located in large coastal metropolitan areas. Please note the advertising and radio revenues of Team E. In 1976 they had \$2.6 million in television revenues compared to the average team in 1978 having \$1.1 million. Yet this team had only \$500,000 in earnings. The team was covering its higher team salaries and other expenses with its television revenues. Had they only had the television revenues of an average team, the club would have lost \$1 million.

EXHIBIT 6

MAJOR LEAGUE BASEBALL PROFIT AND LOSS COMPARISON (\$MM's)						
	Baltimo re 1978	Cubs 1978	Team C 1978	Team E 1978	Team F 1976	Major League Average 1978
Attendance	1.0	1.5	2.0	1.1	1.7	1.6
REVENUE:						
Gate/Concessions	\$5.0	\$7.3	\$10.5	\$5.3	\$7.7	\$7.3
Advertising/TV & Radio	1.4	1.3	.5		2.6	1.1
Other	.7		3.3	3.0	.7	1.6
Total Revenue (1)	7.0	9.1	14.3	8.3	11.0	10.0
EXPENSES						
Team Salary	3.6	3.7	3.3	2.8	3.4	3.8
Player Development	1.9	2.4	2.2	1.6	1.8	2.5
G & A/Other	1.9	3.1	6.3	6.2	5.2	3.8
Total	7.4	9.2	11.9	10.6	10.6	10.0
Income(Loss) Before Tax	(.4)	(.1)	2.4	(2.3)	.5	(.05)

(1) Includes play-off, Series, All Star revenue: actual numbers – some detail is estimated based on actuals.

SOURCE: Baltimore & Cubs from public/published annuals.

Perhaps you are starting to realize what the economics are. When your attendance goes up (look at the Cubs, Team C and Team F), most of the gate and concession numbers go up. That makes sense. Team salaries are fixed during the year so they will not go up if attendance increases. You have to pay the players what they can receive from other teams; otherwise, they will leave. Team E had a very low salary base – no superstars, in other words. Even with that low base, they lost \$2.3 million.

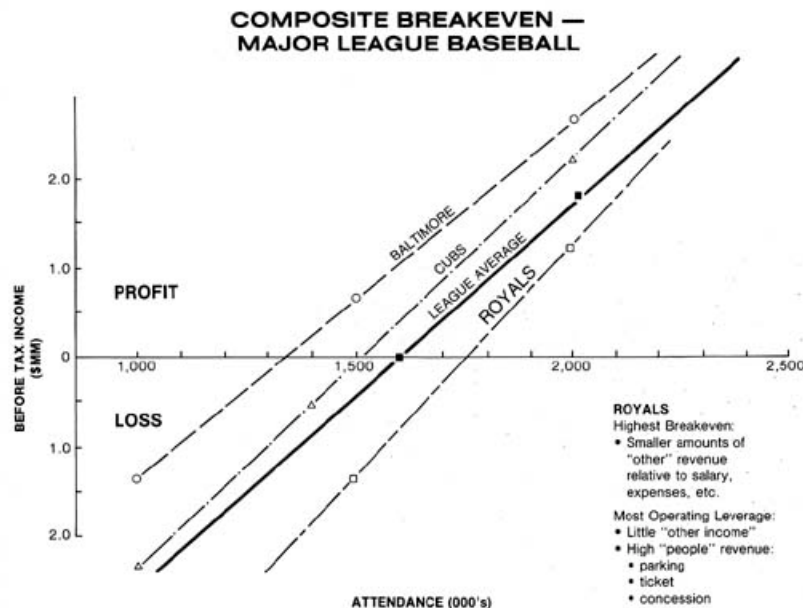
Some of the other things that are very unusual and that we think you should be aware of are: Team C drew 2 million attendance from a population of about 1.3 million. Team F drew 1.7 million attendance from a population of 6 million. Baltimore drew 1.2 million attendance last

year, although in 1978 they only drew 1 million and that was from a population of 4 million. And the Cubs, with a population of 7 million, only drew 1.5 million people. So it is quite unusual to see certain teams with very low population centers drawing as many people to the ball park as the higher population centers do. I'd say they are probably providing good entertainment to attract the number they do from the relatively small population centers.

For those of you who run companies, you will recognize Exhibit 7 as a breakeven analysis. It shows how much attendance is needed to break even. These are 1978 figures. The average team had to draw about 1.6 million fans in order to break even. A team with higher broadcasting revenues, like Baltimore, as shown in the previous slide, only needed about 1.3 million at the gate because they relied more on non-attendance related revenue, such as television revenue. The Royals, because we do not have the television revenue, need close to 1.8 million to break even, and this is in 1978. We are projecting, when the new salaries go into effect, that the Royals will probably need an attendance of 2 million to break even. That is pretty hard to do when you think that this town only has 1.3 million people in or around it. It is unbelievable that the Royals have been able to draw the way they have. I am sure it is the quality of the players, the product, and the support the town has given to the Royals that account for this phenomenon. If the Royals do have less than 2 million in attendance, they would lose a lot of money. Every ticket lost between the 1.5 and 2 million would cost the Royals about \$5 per ticket, or over \$2.5 million in real cash. Likewise, if they draw 2 million people this year, they will not only break even, but they will also make a few dollars. Those of you who wanted to be owners, prepare yourself a breakeven analysis and figure out what attendance you would need in order to earn the money you want to make in your city.

Teams that have outside revenues have lower attendance breakevens. Other revenues such as radio, television, and outside endorsements push the breakeven point to the left. Examples of outside endorsements would be Fenway Franks and Yankee Dogs.

EXHIBIT 7



How about the fans in the community? We haven't talked about those of you who want to be fans. Are you going to lose anything? We think you are. We think that baseball is a major source of entertainment, particularly in the Midwestern community. It is not only entertainment at the gate, but it is also entertainment via the television and printed media. Look at the space in your newspapers devoted to baseball. If you were to lose a franchise because of economic reasons, you would have an entertainment loss to your community. The Pittsburgh Chamber of Commerce in 1976 tried to determine the impact a major league team has on a city. They found out that when there is a major league team in the town, the attitude in the town is that they are a "first class city – a major league city." It affects the type of industry you can attract to your city. Your name is shown on national television. Your team can get to the playoffs. You think you are first class. It affects the people who work in your city. It's civic pride! We saw the downtown areas of Cincinnati and Pittsburgh change when they moved their ballparks downtown. People like a town that is a major league town. It enhances efforts by businesses to recruit people. It adds dollars to the local economy.

Exhibit 8 shows how baseball dollars were spent in Pittsburgh during 1976. In Pittsburgh about 500,000 people came into the city from the surrounding areas. In the Pittsburgh case, about \$21 million was added to the economy. These revenues do not include the playoffs or World Series.

We tried to figure out what the Royals contribute to the Kansas City economy. We estimate that 750,000 people, or one-third of our attendance, came here from out of town. The 1976 Pittsburgh \$21 million in revenue adjusted for inflation would probably now be around \$30 million. If you extrapolate for higher attendance and more nonlocal people, you are probably talking close to \$40 or \$50 million being added to the local Kansas City economy from people staying here, buying gas, eating meals, shopping, and going to the games. That is a lot of money, not to mention what is paid in taxes at the gate. A team does have a tremendous economic impact, but we think it has even a bigger psychological impact on the community. If a baseball team should fold or move away, we think not only the fans would lose, but also the community as a whole would lose.

EXHIBIT 8

PITTSBURGH CHAMBER OF COMMERCE STUDY FOR 1976

- ◆ **500,000 PEOPLE CAME INTO CITY FROM SURROUNDING AREA
(GREATER FOR ROYALS)**
- ◆ **OVER \$21 MM WAS ADDED TO THE ECONOMY**
 - **PIRATES SPENT \$6MM**
 - **\$1MM PAID IN STATE AND LOCAL TAXES BY TEAM AND VISITORS, ETC.**
 - **VISITORS SPENT OVER \$3.5MM**
 - **FANS SPENT \$3.2MM BEFORE AND AFTER GAMES**
 - **VISITING TEAMS SPENT \$400,000+**
- ◆ **THIS INCLUDES NO SERIES OR PLAY-OFF REVENUES**
- ◆ **CHAMBER MAKES PIRATES A MAJOR SELLING POINT TO BUSINESSES
CONSIDERING RELOCATION-ESPECIALLY WHEN WINNING**

Let's summarize some conclusions for you.

Inflation: We think the amortization of the players' contracts is necessary because it helps ensure the quality of the sport. With inflation, the amortization of players' contracts is not even covering the replacement costs. Unfortunately with inflation, like most other businesses, revenues are increasing, but they are not increasing in real terms. We showed you earlier that there is zero real growth in baseball revenues. The costs are fixed within a year, and fixed costs go up dramatically from year to year. You get the realization that costs are fixed for the year when you drive up to the stadium. The stadium is there, the rent, the lights, the scoreboard, the attendants, and the players' salaries are there and fixed. You do not have any "up-side" on them, but it is very hard to reduce your costs once the year begins.

Free Agency: We think the marginal revenue of a player is growing faster than his marginal productivity. By that we mean the quality of the player and what he is getting paid are not the same. The new free agents who receive higher salaries are not as good as the older free agents who played out their options and received lower salaries. This industry is definitely labor-intensive. This is why we have these continuous labor negotiations. We think free agency is causing a salary and competitive imbalance.

Big cities versus small: We think the larger population areas have the advantage over the smaller ones. Why? Very simple, they serve larger markets. They currently have more television and radio revenues, and they have more market potential. They have more houses they can pass with a broadcast signal, so their television and radio revenues are more. Also, the larger population areas have a great chance of increasing gate attendance. Even so, because they have greater television revenues, the big cities are still less dependent on the gate. They get more advertising revenues. They have a larger market and less risk. We also think they have an advantage in the player procurement process. They can afford to pay more because they have more to gain, and they can offer the stars potentially higher paying endorsements because they are in the highly populated communication centers.

Profitability: The majority of teams are losing money or they are breaking even and, as a result, are uneconomic to most of the owners. The question you might ask is, who is getting ahead? The fans certainly aren't! In fact, they might stand to lose. The communities? Yes and no, but mostly no. We think the coast cities like Los Angeles and New York will get ahead. In the Midwest, however, we think you are going to see some teams fold or change ownership, or perhaps you will even see some civic endorsement. This endorsement or subsidy may be some sort of tax relief which will go to the owners to entice them to keep the clubs in their current location. Some owners realize that they are doomed to lose money but are willing to continue subsidizing the teams for community entertainment as well as their own pride. They are getting some psychological value out of owning the club, but it is not economic for them.

How about the players, are they getting ahead? The average player is not doing as well as the star. He is going to stand to suffer the most when the teams fold or if teams have to stand firm on a strike. I have a great respect and admiration for Marvin Miller. He represents his client very well, but eventually he is going to have to make a decision about whether his union wants to raise the average salaries, or raise only certain salaries and take the chance that other salaries might decline or that teams will fold. I think that issue is weighing heavily on him now. That is the decision he is going to have to make in the next year. While the average players are not big winners, the stars are doing pretty well. Agreed?

In conclusion, we will make some prognostications of what we think is going to happen in the eighties. We think things will get worse. Ticket prices will increase. The price of gasoline and other inflation factors will reduce attendance growth, particularly in areas where 25 to 35 percent of your attendance is comprised of people who are driving some distance to get to the park, which is typical for a midwestern town. We think it is logical to assume that gasoline and inflation will reduce people's desire to go to the ballpark. They may, however, decide to stay home from a long trip and go the ballgame instead. We think continued cost escalation will make most teams undesirable, even to the wealthy. It is one thing to lose money; it is another to be called cheap by the press and on television. We do not think many of the owners like to be abused by the media. Many are willing to lose money in order to make a contribution to the community, but they do not want the public aggravation.

If owners are abused by the press and continue to lose money, you will find teams turning over more frequently. The ownership will change. This will affect the smaller cities the most. They are either going to lose franchises or at least going to experience more frequent changes in the ownership structure. We think the public relations will worsen. We do not think the issues we have discussed are understood by the press; and, as you can see, there are complex problems. Over the long period of time the teams in the big metropolitan centers will continue to dominate baseball because of the economics we have discussed.

If this prognostication is correct, we might see a strategy evolve among the clubs in the smaller cities. You might see these cities spending more money on their minor league system, much like the Royals are doing. The Royals, for example, spend over \$3 million a year so that they can develop a stable of young players. With the current reserve clause, the players are locked into the team for at least six years. So if you think you may lose players because of the free agency market, or be unable to afford them, your strategy might be to develop a very strong minor league franchise and plow your money into the minor leagues so at least you can keep your assets protected for six years.

What else might we see? We might see some local and federal subsidy of teams. Baseball could become a political issue and might result in legislation being passed at the local or federal level. Counties might help by providing favorable stadium leases or maybe a ticket tax which goes to subsidize the team. There might be promotional or endorsement subsidies by people in the community to entice certain players to stay here. In other words, some civic-minded person might put a player on the payroll so that he does not move out of town.

In closing, let me address the question that I am asked most frequently: "Why do people own ball clubs?" One really never knows. We suspect that it is for non-economic reasons such as psychic income or public exposure. That would be true if the owner were a company such as National Brewers, who owned Baltimore, or Anheiser Busch, who owns the Cardinals. We think in Kansas City, as in most Midwestern cities, that the owner wants to make a civic contribution. Mr. Kauffman feels that he has made a civic contribution, that he has willingly subsidized to an extent the community's entertainment interest. It's fun for him. It's fun for the people. He likes doing that for Kansas City.

Others have said that owners – these are the psychologists talking – are transferring a child ego and fantasy to the adult life. It's like owning a big toy. They express that owning a baseball club and sitting up there in the suite is the ultimate big toy. Then there are others who say people who own clubs just like to be abused. They must be masochists.

That pretty much completes my presentation. I'm now available for questions. I'd like to thank again some of the people who sent us this information, Carl Mitchell who put it all together, the friends who came, and particularly the best hitter in baseball for showing up here to listen to this.

QUESTIONS AND ANSWERS

QUESTION: There is a basic difference between the way football handles television revenues and the way baseball does. As I understand it from Jack Steadman, President of the Kansas City Chiefs, football television revenues go into a pool and every team gets the same amount of money.

COMMENT: Correct. They split a very lucrative television contract.

QUESTION: So, therefore, it does not matter whether you are Kansas City or New York?

ANSWER: No, it doesn't. The key difference between football and baseball, and it is unique, is the distribution of the television revenues. Pete Roselle, Commissioner of Football, gets credit for this foresight in initiating this program. He made the owners pool all of the television revenues, so if you were in Kansas City or New York, you would get approximately the same television revenue, and it is quite large. It is a number like \$5 million plus a year. I would venture to say, and I haven't studied football economics, that those guys break even before they open the gates. I think they are making money in football because they have a big television revenue. Baseball has some weird bylaws. You must remember that baseball is the oldest major league professional sport around. We need something like 90 percent unanimous consent to change the television situation. So picture, if you can, Walter O'Malley or George Steinbrenner voluntarily dividing up their television and radio pie with their weak sisters. Not likely! So in baseball everybody sells his own local television rights. For the Royals it's about a half million for radio and television. It is about \$5 million for the Yankees. So the Yankees have \$4.5 million more to pay George Brett and Darrell Porter when they try to attract them to New York. That's why we think the small population center teams have to make their money at the gate. You must provide good family entertainment and get the people out there because the only way you can break even is to draw the 2 million attendance you need. There are some national television revenues that are split which go into a central fund. The Game of the Week goes into the central fund, but it is not a significant number like it is in football.

QUESTION: What effect are cable television and satellites going to have on baseball as an entertainment system?

ANSWER: I don't think anybody knows what the effect is going to be. It will depend on how cable television gets divvied up. The courts may uphold the position that, once the television station transmits its broadcast into the airwaves, it's in the public domain. If a cable company can pick up the signal and show it in the local area, then the team will not get any of those revenues. Obviously, the networks and the club owners are trying to say, "No, that's our property." But lobbyists for the cable industry are saying, "No, it's free." Whether the players or owners will share in the profits of the cable television companies will depend upon legislation.

Let me give you the example of Ted Turner, who owns the Atlanta Braves, a television station, and a cable satellite hookup. He is shooting the Braves' games up in the air, taping it himself, and putting the games on his cable television. What he then does is increase the local

revenue on his local television station. He then can go to a sponsor and say, "I'm not broadcasting to 2 million people in Atlanta; I'm broadcasting to 15 to 20 million people around the country. So why don't you buy the ad between nine and ten o'clock on my local station. By doing so I'll give you a real good price for an audience of 20 million." A clever guy like Ted Turner must be making money with cable television.

QUESTION: But how about the disclaimer that appears in every television show that none of the material of the game may be recorded, reused, resold, or whatnot?

ANSWER: That's what it says, but the courts are ruling that it might be public domain once it's transmitted. It's a legal fight which I'm sure a lot of vested interests and a lot of lobbyists are going to push around, and we'll read about it in the papers. I don't have a forecast on that.

QUESTION: Like the movie stars, will a free agent be able to offer himself and get the benefit of depreciation?

ANSWER: No, a free agent cannot depreciate himself. The only time depreciation figures in baseball is when the owner buys the franchise and allocates part of the purchase price to determinable life assets.

QUESTION: Do you envision a time when a star may have a limited investment interest in the franchise?

ANSWER: Definitely. As a matter of fact you may see that rather soon. You may see the stars saying, "I'd rather have a certain percent of the club rather than a salary." Unfortunately, if they find out the club is losing money, they will want to take cash. But if you were a player with a really profitable franchise, you might ask for equity ownership. He might ask for phantom stock in the club or a piece of the gate. To date, as long as you have owners who do not like partners, you probably will not see it as direct ownership. You may see it in a contract tying compensation to attendance. The players could get bonuses based upon the gate.

There are some weird rules governing ballplayer compensation. We cannot award a ballplayer based upon his performance. The Baseball Players' Association negated performance-type contracts. The Players' Association argues that the owners will set a guy down when he has 49 home runs or that the owners will not let the pitcher win his 20th game so they can deny him compensation. As a result, there are very few performance contracts in baseball. But I think you are right. If I were an owner and I were losing money, I'd give them equity instead of a salary.

QUESTION: Mike, you showed that your average increase in ticket price was 4.4 percent. Is there that much resistance to increased prices?

ANSWER: Many of the owners are very reluctant to raise ticket prices. Many of them feel baseball should be family entertainment; therefore, they keep the prices low so that you can bring your children to the games. We think they have underpriced their product. We happen to be of the school of thought that says that we could raise ticket prices a half dollar and no one would notice. There is no way to test this idea. We would just have to raise the ticket prices and see if it affects attendance. Even then, how can we determine what affected attendance? Was it the price increase or the fact that your team came in fourth instead of first? Price sensitivity is a very difficult thing to measure because of the conflicting variables.

QUESTION: The Royals cut ticket prices in half on Monday nights. Why don't they raise prices instead of lowering them?

ANSWER: We think the Royals are better at merchandising than anybody else in the majors. They have an excellent product; that's why they have specials on Monday nights, to attract new people.

QUESTION: Will we see public ownership of baseball teams, particularly in the Midwest with its civic support?

ANSWER: The problem is that most Midwestern clubs are losing money. Public ownership is usually good in situations where you do not have to go back to the well for more cash or guaranteed loans, so I don't think public ownership would be a good idea in that instance. It's probably better to have a wealthy person who can afford the losses or can guarantee the loans to keep it going.

As a desperation move, you might see a club have a public offering to raise the money because the owner can't afford it. We don't think that is a problem in our town, but in certain towns you might see it. Denver was going to take the Nuggets public and throw in a season ticket with it or something like that to raise finances. We don't think you could see a public issue in this stock market if the club is losing money. You might be able to sell a bond, a county-guaranteed bond or something like that, to be used to support the club. In other words, use the public ownership of debt to subsidize the club. But I do not think common stock would be used too often, if that is your question.

QUESTION: What was the antitrust aspect of baseball that you alluded to?

ANSWER: Baseball was exempted by Congress from the federal antitrust laws. I don't know whether it was in 1917 or 1921, but the Congress passed a law that excluded baseball from antitrust laws which allowed the owners to get together and collude. This is going way back before there was any free agency. It was a popular political issue, so obviously it was in the public interest in the twenties when the Congress passed it.

QUESTION: What's the variation on an average price of a ticket by team?

ANSWER: The price spread is significant depending on which town you are talking about. I don't have the data with me today, but there is a big difference in the price and a big difference in where you sit. I would say Kansas City is probably middle priced as compared to Boston and New York. Some cities subsidize bleacher seats. In some cities you pay almost \$15 for what would be our club level seats that go for around \$7 here. That's a big difference. Again, a lot of cities feature business entertainment at night, particularly in New York and Boston where many of the people at the games are business people. They pay higher ticket prices and I'm sure it goes on the expense account.

QUESTION: Will the unfortunate experience of the Angels have an effect on free agency?

ANSWER: If I could be lucky enough to afford to own a team, I would not be in the free agent market. I'd rather pay high salaries to the people that I've developed in my minor league system. After all, I know my own players; I know their mental attitude and makeup. I'd pay them well, and I'd spend the money and develop a minor league and have a stream of players year after year. When you purchase an agent who is 32 years old, he may be good for only a year or

two. I'd rather spread that money among my own players and buy young players or trade for them. There will always be a market for the free agent; some owners will always think that one player will make the big difference, and those owners will bid up prices to get the stars.

MICHAEL E. HERMAN is Senior Vice President, Chief Financial Officer and a Director of Marion Laboratories, Inc., in Kansas City, Missouri. Mike has been closely associated with Ewing and Muriel Kauffman in the direction of the Kansas City Royals, of which the Kauffmans are the sole owners. This association not only involves his duties as financial advisor to the Kauffmans, but also as a member of the Major League Baseball Players Relations Committee. As an economist Mike has advised both the owners and the baseball players.

Mike came to Kansas City to join Marion Laboratories in October 1974, from New York City, where he had been a partner in an investment banking firm. Active in a wide range of pursuits, he is currently a Director of the Boatmen's Bank and Trust Company in Kansas City and the Janus Fund in Denver. He also teaches graduate courses at Rockhurst College and the University of Kansas. He has a Bachelor of Science degree in metallurgical engineering from Rensselaer Polytechnic Institute and a Master's of Business Administration from the University of Chicago.



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Initiated in 1974 and continuing until 1994, the sessions of the Midcontinent Perspectives were arranged and convened by Dr. Kimball at four- to six-week intervals. Attendance was by invitation, and the audience consisted of leaders in the Kansas City metropolitan area. The lectures, in monograph form, were later distributed to several thousand individuals and institutions throughout the country who were interested in MRI and in the topics addressed.

The [Western Historical Manuscript Collection-Kansas City](#), in cooperation with MRI, has reissued the Midcontinent Perspectives Lectures in electronic format in order to make the valuable information which they contain newly accessible and to honor the creator of the series, Dr. Charles N. Kimball.