



# The Economics of The National Basketball Association

# Sports Business

- Sports entertainment industry
  - 4 types of income sources:
    - Gate receipts(tickets)
    - Concessions
    - Sponsorships
    - Media broadcasting



# Appeal to Spectators

- Uncertainty of outcome of the game
- High stakes: championship, playoffs, rivalry
- Heroics, dramatic events, great plays, social activity... etc.



# Location and Living Conditions necessary for Professional Sports

- High standard of living and area:
  - Time
  - Money
  - Transportation
  - Media access
  - Densely populated urban area



# ABA/NBA Competition

- **ABA: American Basketball Association**
- **The ABA existed from 1967 to 1976 - nine full seasons During that time, the ABA fought a bitter war with the established National Basketball Association (the NBA) for players, fans, and media attention.**
- **The ABA was the league that played with the red, white and blue ball and also invented the three point line**
- **The ABA was the Renegade league with big Afros and high flying dunkers**



# NBA/ABA MERGER



- In June 1976, the two rival pro leagues finally made peace.
- Four former ABA teams, New York Nets, Indiana Pacers, Denver Nuggets and San Antonio Spurs--were admitted as NBA franchises for a fee of \$3.2 million. The rest of the ABA players were disseminated throughout the league in a dispersal draft.
- The merger gave the NBA a monopoly over the professional basketball market in the US

# Effects of Merger

- The merger was legal: ABA was entering bankruptcy
- Anti-competitive: NBA gained full control of the market
- Monopoly with huge barriers to entry:
  - Talent (Players)
  - Arenas
  - Loyal Fan Base
  - Media Contracts.... Etc.



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# How the NBA Acquires Laborers(Players)

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- **NBA Draft: In order to enter the league one needs to make himself eligible for the Draft**
- **The draft allows all the teams to pick players based on an order determined by a lottery**
- **The players who do not get drafted are free agents and can offer their services to the highest paying bidder**
- **The players who are drafted get paid on a scale that is predetermined and they cannot offer their services to the highest paying suitor**

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# Cartel

- **Cartels are illegal in all other industries except professional sports**
- **NBA acts as a cartel because:**
  - **Protected from competition: territorial exclusivity**
  - **Control over number of franchises in league.... Very few expansion teams**
  - **Scarcity permits higher ticket prices**
  - **More beneficial media relationships**
  - **Value of each franchise increases with exclusive rights**
  - **Limits players bargaining rights**

# Cartel

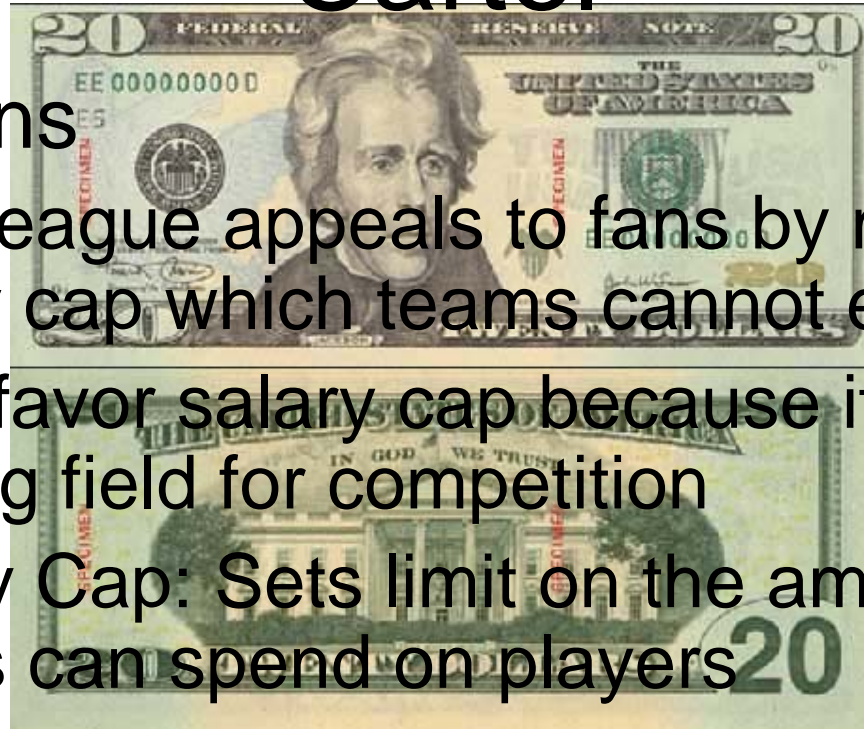
A photograph of LeBron James in a red Cleveland Cavaliers jersey with the number 23. He is wearing a red headband and looking to the right. The background is a blurred crowd of spectators.

- The league and the franchises are acting as a cartel by drafting the players rather than having only free agency
- Owners and League executives get together and collude to minimize costs of paying players
  - Ex. LeBron James the number 1 pick in the 2002 draft, would have demanded and received in excess of \$10 million on the open market however b/c of the collective bargaining agreement James will only get \$4,621,800

# Rationale for Acting as a Cartel

- The Fans

- The League appeals to fans by making a salary cap which teams cannot exceed
- Fans favor salary cap because it levels the playing field for competition
- Salary Cap: Sets limit on the amount teams can spend on players
- If team exceeds cap they must pay a luxury tax to the league





# Unions



- Unions form as a result of:
  - unequal distribution of monopoly profits and as a result of the cartel between the franchise owners and NBA Commissioner
    - Unions if they are effective drive wages up which would also drive prices up
    - Also possible that unions raise wages and prices which raises profits in an industry
    - Either scenario the consumer is harmed: **ticket prices continually climbing**

# NBA Franchises

- Two Part Pricing Scheme
- Sell the Franchise the rights to the team and NBA affiliation in exchange for a franchise fee





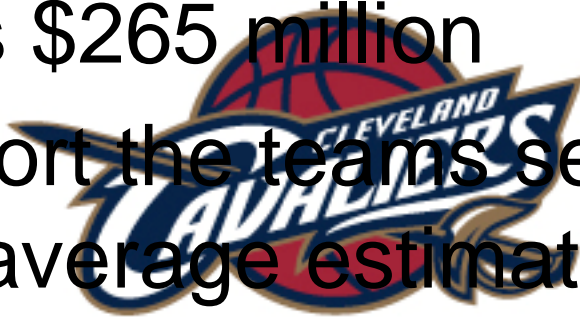
# League Contracts



- League contracts are negotiated for the betterment of the member of the cartel
- 1961 Sports Broadcasting Act: Sports leagues were able to sell rights to TV/Radio as a league
  - Made the three major networks at the time, ABC, NBC, CBS compete for one contract
  - Not subject to anti-trust laws

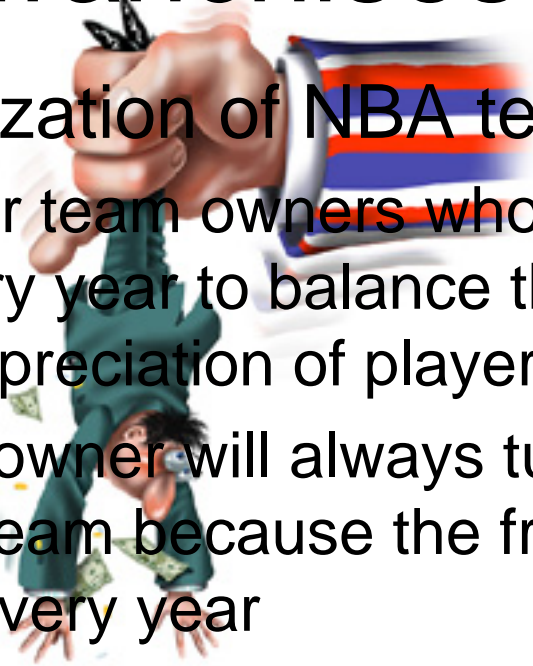
# Value of Franchises

- Estimated average worth of NBA franchise is \$265 million
- In every sport the teams sell for well above the average estimated value
- Dan Gilbert the new owner of the Cleveland Cavaliers recently purchased the team for \$375 million



# Cause of high prices of franchises

- Public Subsidization of NBA team franchises
  - Tax breaks for team owners who claim losses on the team every year to balance their gains in other industries (depreciation of players)
  - However the owner will always turn a profit when they sell the team because the franchise appreciates every year
  - Availability of arenas at low cost: city or county subsidized





# Continued

- Cont.: Reasons for the increase of the value of franchises:
  - Monopoly
  - TV money: hundred million dollar contracts



# Example of Publicly Subsidized Stadium

- Colorado Rockies Stadium subsidized by tax payers
  - Tax payers accounted for \$215 million
  - The owners sold the rights to the name for \$15 million
  - Owners don't pay rent
  - Get all income no matter what event; Act as stadium manager

# Corporate Ticket Sales

- NBA relies on corporations to buy blocks of tickets
  - 51% of tickets are bought by corporations



# Reserve Clause

- Further explanation of Owner/Player relationship
- Reserve clause: owner has exclusive rights to renew players contract annually
- Owner controls whether a player gets waved, traded, cut, bought or even sold
- Player only controls destiny during free agency period when their contract expires or if they choose to retire

# Price Discrimination

- Combining services: transportation and tickets (bart tickets and game tickets can be purchased for discount rate)
- Bundling of tickets in mini plans
- Season tickets
- Single game tickets
- Theme nights: student nights, church nights, animal nights, etc.



# Product Differentiation

- WNBA: Women's Basketball Association
- NBDL: National Basketball Development League



# *Why Pay Teams?*

- Nike/Reebok
- Pay a minimum of \$200,000 per team for the privilege of making their uniforms
- In addition -- pays leagues millions
- Logo exposure given ultimately sells more products