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 -- for 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.
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.
How the NBA Acquires Laborers (Players)

- 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 bidder
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
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