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Introduction to Sport Finance

Chapter Objectives

After studying this chapter, you should be able to do the following:

- Examine your own financial circumstances more critically.
- Identify the basic elements of sport finance.
- Describe the scope of the current financial problems facing sporting goods retailers.
- Interpret how financial issues flow throughout a sports organization.

Often when someone learns about a new topic, they try to connect it to something they already know. Likewise, when teaching sport marketing, a teacher might give examples of a Super Bowl advertisement that the students might have seen. When teaching sports facility management, a teacher might give examples of a well-known sports facility. Likewise, when examining sport finance, it is helpful to examine what students have done in the past with their own finances. This could include examining bank accounts, discussing whether students have ever created a budget, and exploring how often students pay credit card bills in full versus only making minimum payments. These issues also apply to various sports organizations, and this chapter will explore some of the basic financial issues faced by everyone. The chapter then moves on to explore financial issues facing the sporting goods industry as an example of how financial problems can destroy a business. Lastly, the chapter will explore how financial issues flow throughout an entire sports organization. The purpose of this chapter is to help the reader get their feet wet and appreciate how broad and exciting sport finance really is.

PERSONAL FINANCE BASICS

How financially astute are you? Do you pay off your credit card bill every month? Should you take out a student loan to pursue a new degree? Should you change your cell phone plan? Should you buy or lease a vehicle? Should you buy a used vehicle that might require some repairs or a new vehicle that hopefully would not require any immediate repairs? What is the harm of not having a credit card? These are just some of the questions that require a financial analysis.

Questions about credit cards are only the beginning. Another major question is, *what **assets** do you have?* Your education is an asset. Your vehicle is an asset. Your network of contacts in the industry is an asset, even though it is hard to place a monetary value on it. In contrast, not having an appropriate education, not having a vehicle, and not having contacts can all be potential liabilities.

How many times have you tried to buy something, only to find you did not have enough money to complete the transaction? Was your credit card maxed out? Were you expecting money to be deposited that wasn't? Were you not aware of how much cash you had in your wallet or pocketbook? These are all issues that deal with **budgeting** and **cash management**.

Have you thought about your financial future? When should you start saving for retirement? How much would you need to retire in a financially sound manner? Have you thought about whether you would be able to afford major expenses you might face, such as surgery from an accident or expenses you would incur if you want to travel abroad? These are long-term decisions, which require planning now to be ready for the future. Many people put money aside (often called a sinking fund) to make major purchases in the future.

These are just a sampling of financial issues and concerns that affect everyone. These same financial concerns affect every business. That means every sport business needs to understand these exact same issues. Without knowing the numbers, it is impossible for a sports organization to appropriately plan for the future. That is where this book comes into play. It will help cover various fundamental skills and issues and then put them into the context of how to plan for both the **short term** and **long term**. So what basic skills are needed by everyone and every sports organization? That is how this book is laid out.

Every individual, as well as every sports organization, is different. It is very difficult to compare one year to the next or one company to another. However, like every game, keeping score matters. You might know that your **income** increased $2,000 from last year when you get your W-2 or other tax forms. You also might be able to track your financial condition through examining bank statements or your retirement account and track them year to year or even day to day. Similarly, you might be able to compare yourself to your friends. If one of your friends makes more money than you, you might aim to earn more than them in the future. Sports organizations engage in the same activities. They check their bank accounts on a regular basis, they calculate their inventory over various periods, and they compare their tax and other government filings from quarter to quarter or year to year. Sports organizations can also compare themselves to their competition. This can often

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be seen by teams looking at their players' **payroll** expense, win–loss record, or average number of fans. Other sport entities might be publicly traded, and then their financial statements can be compared to see how they are doing compared to similar companies. Using this perspective, it would not be wise to compare yourself to a billionaire such as Warren Buffet or Bill Gates. Sports organizations also have to be realistic, and it would not be appropriate to compare two soccer teams and feel they should be in about the same financial position when one team is a youth soccer club in a small town being compared with Manchester United. Finance requires perspective. Financial decisions are also not made in a vacuum. Each decision will be affected by various considerations such as your age, income level, family situation, other expenses, credit history, risk tolerance, economic outlook, and other issues. Sports organizations are affected by many issues outside of their control, such as economic conditions, political changes, wars, **interest (*i*)** rates, sponsors' budgets, technological changes, and numerous other issues that need to be taken into consideration.

Just as you might not know what will happen in the future due to numerous variables, a sports organization has the same exact concerns. That might be why you try to save some money in case of an emergency. Well, organizations need to do the exact same thing.

These examples are designed to show you that you should not be scared of finance or think it is just a topic you will never deal with in the future. You are dealing with finance every day whether you like it or not. The most successful people master this skill. A famous book called *The Millionaire Next Door,* by Thomas J. Stanley and William D. Danko, examined how everyday people have acquired and maintained their millions by paying close attention to finance-related topics. These individuals often own businesses, but, most importantly, they have a great perspective of the value of money. They do not buy all the fanciest gadgets, they drive older cars, they do not eat out all the time, they save, and they invest. These are all things anyone can do. They are also steps that every sports organization has to do. That is why financial literacy is so important. You want to protect what you have worked so hard for, and everyone wants to create financial stability.

One thing everyone should understand is that there are various efforts to generate more revenue or take away money from people. An example is upselling at a fast food restaurant

MAKING AND KEEPING THE MONEY

There are several important strategies every person and sports organization needs to follow to be successful such as:

- *Know your numbers.* You need to have confidence that the numbers you are using to make decisions are accurate and that employees know and understand the numbers.
- *Measure twice . . . cut once.* While this is a common phrase for carpenters, it is similar with any financial decisions. Before undertaking any decision, make sure the numbers are correct.
- *Plan, plan, and plan.* You need to know where you want to go in the future, and the only way to effectively go there and make sure you can continue in a proper direction is through having a written plan, making sure the plan is followed, and tweaking the plan when necessary.
- *Always be prepared.* You never know what will happen in the future, and you need to prepare for financial issues that might arise.
- *Honesty counts.* Whether dealing with friends, colleagues, employees, the government, suppliers, or others, it is imperative that you are honest and maintain your honesty, as numbers leave a trail and financial fraud is one of the most damaging crimes for individuals and sports organizations.

or a concessions stand at a stadium or arena. For an additional $1 you might be able to purchase a large soda to go with the other food you were purchasing. You think it is a deal and buy the package, but is it really a deal? Computers (including cash registers) can now process the cost and profit points for each item, and the "deal" is actually a deal for the concessionaire—a way to maximize their own revenue and sell you something you otherwise might not have purchased. Being smart with your money is important, but there are times when both the seller and buyer can both benefit and not feel bad after a deal is completed. An example is selling furniture on Craigslist. The seller gets something when otherwise they might have donated the item or just thrown it away. The buyer gets a piece of furniture at a good price. This is an example of a win–win deal, and such deals normally make both parties to the transaction happy.

Similarly, there can be more sophisticated or nefarious means to separate someone from their money. This can be seen in terms of financial fraud. There are numerous scams online, counterfeit tickets being sold, unlicensed products sold as official merchandise, and other crimes. All these efforts can cause financial harm not just to consumers but to businesses as well. The most common scam according to government research entails pressure to pay an alleged tax liability or face arrest. Such a scam was forced on almost two million people, and as many as 200 people a week fell for the scam in 2016. Besides the Internal Revenue Service (IRS) scam (which received over 100 times as many complaints as the next highest concern), other major scams—which primarily took money from seniors—included fake sweepstakes, money transfer scams, and counterfeit bank website scams. In total, these various financial scams costs seniors at least $2.9 billion in 2010 (McCoy, 2017b). Customers and the general public need to cautiously guard their hard-earned income, similar to how businesses have to take steps to protect their assets and their integrity.

This section has tried to show that every reader is already using their existing financial background and understanding to make a multitude of decisions. These skills can be used to help make you—or save you—money if used correctly. Similarly, these same skills can be applied to any sports organizations to help address their financial issues.

WHAT IS SPORT FINANCE?

Sport **finance** can be viewed from numerous perspectives and can overlap with **economic** and accounting issues. For example, the concept of moving a team from one city to another is based on financial projections for the team and possible attendance and media rights deals. Through **accounting**, a team can determine how much money it has available and how to **budget** current and future funds. From an economic perspective, the team and local government agencies will examine the potential for economic issues that affect the area, the potential future interest rates that might affect bond interest rates, and other similar local, national, and international issues. When the Oakland Raiders decided to move to Las Vegas, staff examined a variety of financial, economic, and accounting-based data. Municipalities are willing to invest in order to hopefully generate additional future income streams. That is why the city of Las Vegas was willing to invest $750 million for a stadium (Schrotenboer, 2017b). While making money is important, that is not always the end result. Many stadium projects for teams, Olympics, or the World Cup have not produced the intended economic benefits promised to citizens. Before the Los Angeles Rams moved back to Los Angeles from St. Louis, the city of St. Louis offered to spend $400 million in public funds to help build a $1.1 billion stadium. The team turned down the offer and bolted. The citizens of St. Louis are still paying for the Rams' old domed stadium. Similarly, with the Oakland Raiders planning to move to Las Vegas, the city of Oakland still owes $95 million for a 1995 bond issue to renovate the old Oakland-Alameda Coliseum (Schrotenboer, 2017b). These two examples show that the investment to make money might generate a local economic benefit from the team, but in financial terms, the experiment with helping to pay for the honor of hosting a professional sports team might not generate a net economic gain.

This is not meant to say that a team or stadium cannot make a profit. In fact, the most successful teams in professional sports are often those teams that have financed and owned their own facility and all possibly affiliated revenue streams. In one interview, New England Patriots owner Robert Kraft examined how he got into the professional sports team ownership business,

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and he said his first stop was owning a professional team tennis franchise (the Boston Lobsters). He realized that in order to make money he needed more than just ticket revenue, and his team was not receiving the parking and concession revenue. His opportunity to own the facility came when Foxboro Stadium's owners, the Sullivan family, loaded the $6 million stadium (when it was initially built) with $48 million of **debt** after losing money on the 1988 Michael Jackson Victory Tour. When it became clear that Foxboro Stadium was going to be sold in bankruptcy, Kraft bought the stadium for $25 million. He then controlled all **revenue** except for ticket sales, which another tenant, the Patriots, received. The Patriots owners at that time were threatening to move the team to St. Louis unless they were able to get a better deal. Kraft, though, had the team under a long-term lease, which the team was obligated to complete or face significant penalties. The team offered him $75 million to buy the stadium. Kraft refused and then bought the team in 1994 for $175 million. That was the highest price at that time for any professional franchise, and the team was a franchise that had never had a sellout in 34 prior years. The day after he bought the team, 6,000 fans descended on Foxboro to buy tickets (Murphy, 2017). The prospect of a new owner willing to spend money and invest in a team, with the goal to win championships, was very attractive to fans. The team has not looked back since then. Besides their on-the-field success, the stadium was replaced with Patriot Place and Gillette Stadium. Patriot Place (www.patriot-place.com) became a destination location where fans and nonfans can spend a day eating out, going to movies, bowling, attending a comedy club, visiting a hall of fame, getting out of an escape room, and numerous other attractions—all benefiting Kraft's growing family fortune.

Kraft realized he needed to control all revenue. If a stadium is built with public funds, there might be restrictions on how much could be spent and what occurs with surrounding land, for example. Kraft, Dallas Cowboys owner, Jerry Jones, and Los Angeles Rams owner, Stan Kroenke, are examples of owners who have built or are building their own privately financed entertainment complexes to leverage as much money as possible from their investment while exerting complete control of decisions. Some professional team owners understand that they can make more money if they control more revenue but do not want to invest close to a billion dollars for a stadium, so they get others to pay for building the stadium or arena. That is why teams can spend a significant sum to get public support for a publicly funded stadium. One such example is the Texas Rangers' stadium scheduled to be completed in 2020 at a cost of around $1 billion. Those opposing public funds going to the project raised $7,000 in their Save Our Stadium campaign. In contrast, stadium advocates (primarily the team) spent $1.78 million, which included 7,000-8,000 lawn signs, 300 billboards, a door-to-door campaign that hit 75,000 homes, 300 volunteers, and 150 presentations in the six-month Vote Yes to Keep the Rangers campaign ("To build a ballpark," 2017).

These examples start to show how, with the right accounting and economic information, a team can start making sound financial decisions. Finance focuses on the science or art of managing funds. The authors have not found one best definition of finance—especially in the sport finance context. However, the following elements come to bear in understanding what sport finance entails:

- How to determine the value of various decisions
- How to appropriately allocate resources to meet organizational demands or goals
- How to effectively manage resources, whether buying, retaining, or selling them
- How to invest any additional resources
- How to leverage the relationship between time, money, and risk
- How to leverage cash and credit-related opportunities and constraints
- How a sports organization can make sound decisions for the present or future that aim to (1) not cause harm to the organization and its stakeholders and (2) generate a profit to help the organization grow, whether it is a nonprofit or a for-profit organization

Going back to the example of a team moving or building a stadium, the financial part of the equation explores what risks might exist and the potential for financial gains for a team. Owning a facility is important, but if it is in the wrong

market, it can actually harm a team's ability to generate revenue. For sports teams, location is the key to revenue growth. Take, for example, the parity in the National Football League (NFL). Many observers would feel that owning an NFL team is tantamount to owning a printing press to print dollar bills, but that is not necessarily true. Let's explore this in greater detail. In 2011, the NFL's salary cap was $120 million per team. By 2015, that had grown to $155 million and then grew again in 2016 to $167 million (Schrotenboer, 2017a). Each team was supposed to spend around this amount on player salaries. Yes, there was a major national broadcast contract bringing in millions (the league distributes around $225 million annually to each team from broadcasting, licensing, and similar league-wide revenue streams), but every market was different in terms of its ability to generate revenue. A small-market team such as the Oakland Raiders had a revenue gap of $300 million, while a major-market team such as the Dallas Cowboys had a $700 million gap. Revenue streams are affected by market size and opportunity (economic implications). A large-market team might be able to sell 250 luxury suites for $200,000 each a year. A small-market team might only be able to sell 100 such suites at $100,000 each. This would create a discrepancy of $40 million a year between the teams. This would mean that small-market teams might be spending 60% of their revenue on player payroll, while major-market teams might only spend 40% of their revenue on player payroll. To compound the pressures associated with expenses, the expenses are based on league-wide totals divided by the number of teams in the league. The collective bargaining agreement (CBA) guarantees players 47% of NFL revenue, including league-wide and local revenues. Thus, as revenue increases for major market teams, small-market teams are forced to increase how much they spend on payroll, even if their own local revenue is flat or even declining. It should be noted that the salary cap just applies to salary and does not apply to benefits. Benefits such as players' pensions, insurance premiums, and disability insurance typically cost an NFL team around $37 million a year (Schrotenboer, 2017a). These examples help show how sport finance has so many different tentacles. It might encompass some economic issues, such as the lack of large businesses in some small markets. It might examine revenue and expenses and their budgetary implications. Sport finance will examine how a team budgets and prioritizes for the future or what strategy it might take (such as moving to a different city) to address any specific revenue or expense-related issues it might have. These numbers are all calculated using accounting basics, and the resulting decisions are based on hopefully sound financial analysis.

CURRENT FINANCIAL PROBLEMS FACING SPORTING GOODS RETAILERS AND OTHER RETAILERS

One of the biggest sport finance stories in the past couple of decades is the bankruptcy of The Sports Authority (TSA) in 2016. TSA was owned by Leonard Green & Partners, which purchased the company in a leveraged buyout in 2006 for $1.3 billion (Xu Klein, Church, and Coleman-Lochner, 2016). A **leveraged buyout** occurs when a suitor buys a company primarily with debt and using the newly acquired company's assets as collateral for the debt, rather than buying the company with cash or possibly an exchange of stocks. At the time of the bankruptcy filing, TSA owed creditors $1.1 billion (Peltz, 2016). The situation for the United States' fourth largest sports retailer (behind Dick's Sporting Goods, Academy Sports, and Bass Pro Shops) started to unravel when it was not able to make a $21 million interest payment, which would have resulted in a default on its $343 million of subordinated debt. Several factors led to the bankruptcy filing. One was the heavy debt burdening the stores from when the company was purchased in 2006. Other factors included

- TSA's deep discounting of merchandise, to clear inventory from stock, which cut into **profit margins**;
- growing e-commerce sales that actually backfired by raising shipping and fulfillment costs; and
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Landlords are considered unsecured **creditors**, so if a company goes bankrupt and wants to cancel a lease, the bankruptcy court will normally allow the lease to be cancelled without significant compensation to the landlord. If a store voluntarily closes, the company would otherwise be obligated to keep paying the rent until another tenant can be found. This could mean that if TSA did not go bankrupt, it could have been on the hook for rent at around 450 stores for years to come.

While TSA was unraveling, a battle ensued from various parties trying to acquire some or all of TSA's assets during the bankruptcy process. One such suitor was Modell's Sporting Goods. However, the primary creditors—who owned a combined $300 million in term loans due by November 2017—felt that Modell's offer was too low (Xu Klein, Church, and Coleman-Lochner, 2016). Another suitor was Dick's Sporting Goods (DSG), which was exploring purchasing 80 to 180 of TSA's stores before backing out (Wallace, 2016a). In the end, DSG converted 22 TSA locations into DSG stores and purchased all of TSA's intellectual properties, including the website, which was redirected to DSG's website (Bomey, 2017c). This expansion increased DSG's size to 676 Dick's stores, 74 Golf Galaxy stores, and 27 Field & Stream stores (Bomey, 2017c).

TSA's primary brick-and-mortar competitor (other than Walmart, Target, and Costco) was DSG, which saw its stocks stumble in 2017 due to decreased apparel sales and an admitted computational blunder that resulted in overstating fourth quarter income by $23.4 million. The key metric for store sales is the sales at stores open for one year, and DSG only saw that number grow 2.4% compared with the projected increase of 3 to 4% (Bomey, 2017b). The decreased growth in sales was expected to increase inventory levels by 10%, which would result in less income and more carrying costs (Bomey, 2017b). Similar to TSA, DSG faced higher costs due to lease obligations and significant online competition, especially in the area of sport-related electronics—such as fitness trackers. Brick-and-mortar sales for the 2016 holiday season decreased 6.9% for sport- and entertainment-related businesses—while online sales for similar companies jumped 19% (Bomey, 2017d).

The TSA saga helps highlight how complex the financial system is. The financial system

A fancy display can help sell more sporting goods, but that would not have helped The Sports Authority and their significant financial challenges.

is composed of many different individuals and organizations, each with their own agendas and interests. Companies have their own rules and regulations, often contained in by-laws. Nonprofit organizations might have specific dictates of their boards and government regulations they have to follow. Government entities are involved in everything from tax requirements to bankruptcy courts, setting interest rates, and federal reporting requirements. There are numerous banks and other lenders involved. There are **stock exchanges** listing publicly traded companies. There are professional accountants and lawyers who have to act according to specific regulations. Besides all the different parties, there are also numerous ethical constraints—published or implied, which should guide most or all financial decisions. Is it okay to hurt some people in order to make some money? Should a product that can generate revenue but exposes someone to risk be sold? Is it okay to lie to get a deal done? These are the types of issues that affect the sport finance industry as well. When a company such as TSA goes bankrupt, it sends a ripple effect through the entire field. Lenders, landlords, employees, manufacturers, banks, local cities, state government, and others will be affected. Furthermore, many ethical questions will be asked: Was it appropriate for the private equity firm to buy the company and saddle it with so much debt? Is it ethical to lay off so many dedicated workers? Should executives be held accountable when they make bad decisions?

TSA is not alone. Midwest-based MC Sports shuttered their 68 stores in 2017. The chain had $5.4 million in net losses on sales of $174.6 million. MDC's bankruptcy was just one of several in 2016 to 2017 including the golf equipment chain Golfsmith, the outdoor gear chain Eastern Outfitters, and the 50-store chain of Sport Chalet (Bomey, 2017a). Another major sport bankruptcy in 2016 was Performance Sports Group (PSG), the parent company for Bauer hockey gear and Easton baseball equipment. The factors contributing to the bankruptcy included accounting controversies (the group delayed filing its 10-K [government-required financial statements] and **annual report**), a **default** in loan repayment, the slump in bat sales, and TSA's issues. The company listed $594 million in assets and $608 million in debts. PSG was able to acquire access to $386 million in bankruptcy loans (called debtor-in-possession financing) to keep going (Bomey, 2016) during bankruptcy, if it needed the funds. By October 31, 2016, the company had filed for Chapter 11 bankruptcy protection and then issued the following titled press release: *Performance Sports Group Enters Into "Stalking Horse" Asset Purchase Agreement With Investor Group Led by Sagard Capital and Fairfax Financial for U.S. $575 Million* (Jones, 2016). A stalking-horse bid is an initial bid on a bankrupt company's assets from a potential buyer that the bankrupt company chooses. This process requires the company to first go bankrupt and then accept the stalking-horse bid to set a bar so a suitor does not come in and try to lowball an offer to acquire the company. In essence, the stalking-horse bid sets the bar that any future offers have to be for more money. It should be noted that Sagard Capital and Fairfax Financial each had owned a significant percentage of PSG's shares that were traded on the New York Stock Exchange under the symbol PSG. After the acquisition, PSG was traded over the counter (OTC) as a wind-down entity (going out of business).

An example of the **ripple effect** of financial actions can be seen in the retail sector. The entire retail landscape has suffered through very challenging fiscal times. It was estimated in 2017 that between 20 and 25% of American Shopping malls might close by 2022 and that 8,600 malls would close in 2017 alone ("The bottom line," 2017). By the middle of May 2017, 2,770 national chain stores had closed. Many of the closures were due to inappropriate financial or marketing strategies. Some stores are nondescript—selling the exact same thing as everyone else. This has significantly affected stores such as Sears and Kmart, which are noted for being mall anchor tenants. Approximately 150 Sears and Kmart stores were scheduled to be closed in 2017, a trend across the country, where it is estimated that 25% of malls in the United States will lose their anchor tenant (Madhani, 2017). Why such retail carnage? Every situation is different, and many people like to claim that it is because the retailers (and other troubled businesses) have too much debt. Debt represents money the companies owe to others for everything such as leases or **mortgages**, to **bonds**, **inventory**, and even back-owed taxes.

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One big issue faced by Sears, Kmart, and other retailers is the lack of cash. Thus, owing $1 million is not necessarily bad for a large company. Even owing $100 million is not necessarily bad, especially if the company has revenue that greatly exceeds those debt levels. In contrast, if you owe $100, but your revenue is only $50, you do not really have a debt issue but rather an income issue, and once you have more income, the debt level becomes insignificant. This explanation comes into play when looking at Sears and Kmart, where they have been losing sales and have fallen well below their rivals. This has occurred in part due to the Internet. Sears used to be the location to shop for almost everything, but now a customer can just as easily shop for everything online. In addition, the company has not kept up with changing customer trends and the 2004 merger of Sears and Kmart left the company with significant debt (Jones, 2017b). One of the biggest issues has been poor management decisions that have led Sears to shedding some lucrative businesses to earn some quick cash, such as selling its $30 billion credit portfolio to Citibank in 2003 and the 2016 proposed $900 million sale of Craftsman to Stanley Black & Decker (Jones, 2017a). Selling some assets might generate quick cash now, but it also eliminated an income source for the future. Quick cash now would result in decreased income for years to come. In 2017, Sears' liabilities exceeded assets by $4 billion. Sears had other financial and legal concerns. Due to lucrative contracts given to employees and past employees, Sears Holding Company owed retirees and employees a combined pension obligation of $5.2 billion, but the fair market value of the pension plan was only $3.6 billion—resulting in $1.6 billion pension shortfall (McCoy, 2017a). Sears had incurred and continues to have significant debt. To address all its debt obligations, it has resorted to cutting costs and selling business units. Such acts could serve as a Band-Aid, but were not enough to keep growing the business. Maybe borrowing enough money to expand in the right areas (whatever they might be) would have been a better business decision—but such Monday morning financial quarterbacking is often wrong. Executives are paid a significant amount to help make solid business decisions, but there is no guarantee that such decisions will actually work. Decisions can be affected by actions of various stakeholders from government agencies, competitors, foreign markets, and consumers.

Another issue is that consumers are fixated on discounts (Wahba, 2017). They use Amazon and their smartphones to look up what they want to buy and see where they can purchase an item for the least amount. Some small stores have reported that customers come in asking for advice, obtain advice from the proprietor, and then admit they will not purchase the item from that retailer but will instead search online for a better price. An example of customer search for the lowest price (whether online or in stores) can be found with Costco's Kirkland Signature golf balls, which sold out in 2016 and sell for $15 a dozen—compared with name brands sold for up to three times that cost. The cheaper balls affected other companies with, as an example, Titleist golf ball sales declining 3.6% in the first nine months of 2016 (Bomey, 2017e).

While some physical stores are closing, others are opening. Outdoor Voices, a female athletic apparel company, has been able to grow to four stores rather quickly through focusing on brand experiences (rather than just sales). For example, the stores offer community brunch parties, community yoga gatherings, and even yoga classes where people can bring their dogs (Griffith, 2017).

FINANCIAL SOLUTIONS

The problems faced by the sports retail business are not alone. Many sports organizations can face financial hardships. A European soccer team can face relegation. A star player can go bankrupt. A team can misread fan interest and overprice its tickets, resulting in a fan backlash. A company can launch a new sports product, and it can take off as planned or fail miserably. A 5K run for a charity can lose money. There is no one formula for what will result in sport financial success. Possibly the best formula would be to spend less than the endeavor costs. But there can be other formulas—for example, don't invest what you cannot afford to lose, don't take too much risk, or take a number of small risks with the hope that one will result in a big payday. Each formula is what is right for an organization at that time and under specific circumstances. Even when all the stars are aligned and it seems like a no-lose situation, fortunes can be lost. This is where strategy comes into play. The best strategies would grow revenue and minimize debt. Yes, debt should

FINANCIAL FACTS

If you do not think you know finance, you are not alone. The following stats come from a survey conducted by the Business Literacy Institute:

- The average score a group of 300 executives received on a basic financial literacy exam—38%
- The percentage of test takers who could not define free cash flow (i.e., cash available after paying all business expenses including capital expenditures)—69%
- The percentage of test takers who did not think discounts offered by sales reps had an impact on gross margin—62%
- The percentage of test takers who could not distinguish between profit and cash—57%
- The percentage of executives who understood why return on assets is so important (it shows how effectively assets are being used to generate earnings)—46% ("Financial literacy," 2017)

be kept in check, but revenue also needs to be examined. Increasing revenue is where sport marketing really comes into play. Unsold game tickets represent lost potential income that can never be recaptured. Marketers need to work with their financial colleagues to develop a marketing budget that reflects how much will be spent on marketing and the anticipated return on such an investment. Just spending in hopes of increasing sales is normally an invitation for a fiscal disaster. If a sport business is facing some fiscal-related challenges, it can take some steps such as the following:

- Prioritize debt by identifying amounts owed, repayment dates, what **interest rate** is charged, and similar critical information to help prioritize repayment.
- Increase sales by rewarding loyal customers, decreasing price to sell more items, or increasing sales numbers, such as volume-based discounts.
- Cut costs by shedding unneeded equipment, downsizing facilities, and **cost sharing** with others.
- **Refinance** debt with high interest rates to a lower rate.
- Ask buyers to pay more quickly. This can be accomplished by giving a small discount if customers pay sooner rather than later (Nicastro, 2017).

HOW SPORT FINANCE AFFECTS AN ENTIRE SPORTS ORGANIZATION OR INDUSTRY

The best way to help understand and appreciate the financial issues faced by a sports organization is to use an example. The example we will use is a professional soccer team. Assume the soccer team is owned by one owner who has the team classified as a **limited liability corporation (LLC)** as a way to minimize taxes and maximize liability protection. That owner has to pay all the expenses and will benefit if the team makes any money. If the team loses money, she has to suffer the loss. The team has some key assets, such as soccer equipment, ticketing machines, and front office equipment (computers, phones, photocopiers, etc.). The team plays at a local college, and the rent is $50,000 a year. Other liabilities include loan repayments for when the owner bought the team, league fees, and payroll taxes.

The owner created a budget at the start of every year. She lists all the expenses she anticipates, from player salaries to all other personnel costs, operating costs, administrative expenses, marketing, insurance, and professional fees. Some expenses are borne by the local college, which pays for all field maintenance, lights, security, and related expenses. The college also provides

impact. That is why it is so critical to take a big picture look at a sports organization, with a keen eye to financial considerations.

CONCLUSION

Everyone needs to appreciate how revenue and expenses flow through an organization. Whether there might be too much debt or too little revenue, the failure to appreciate financial issues can lead to financial disasters. Many executives are now pursuing open book management, where the numbers are shared throughout an organization so everyone understands the financial issues encountered in running the organization. If an employee knows that their work directly increases the organization's bottom line, they often are more engaged and take more pride in their work. Similarly, the more the reader knows about finance, the easier it is to make sound decisions. Thus, throughout this text we hope that you keep an open mind to sport finance and appreciate how even seemingly small details can lead to significant problems.

Class Discussion Topics

1. Identify a specific plan to change your own financial situation.
2. What does sport finance mean to you?
3. How comfortable do you feel making sport-finance-based decisions, and what information would you need to make such decisions?
4. What do you think The Sports Authority could have done to possibly stave off bankruptcy?
5. Examine the implications of TSA's bankruptcy and what impact it might have had on others in the sport industry. Take a close look at how TSA's bankruptcy specifically affected sports apparel companies such as Under Armour. Students should examine various online articles concerning TSA and Under Armour to learn more about the bankruptcy's impact. What should Under Armour have done to protect itself from financial circumstances out of its control?
6. Research a publicly traded sport business and examine what it has accomplished in the past year and what its future plans are based on online chatter by analysts. If you had $10,000 to invest in shares related to that company, would you buy? Why or why not? Use only the information you currently know about sport finance. At the end of the class, after you have acquired a stronger financial background, you can revisit your analysis to see if your decision has changed.

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2

Sport Industry Financial Trends

Chapter Objectives

After studying this chapter, you should be able to do the following:

- Compare and contrast various segments within the sport industry and how they handle financial issues.
- Examine how sports facilities can become an economic engine for revenue generation.
- Forecast the future of the sport industry based on changes in the sports broadcasting field.

There are various trends in any industry. Sport finance is not immune to these trends. Some trends are long term while others are fads. Through examining various industry segments from a financial lens, we can determine how strong that segment might be or whether there are potential concerns—whether current, imminent, or far in the future and very remote. In Chapter 1 we discussed one specific topic associated with sporting goods retailers and how some companies were not able to coordinate their finances and strategy to avoid bankruptcy. Some companies and sports teams or organizations can effectively handle the financial bumps in the road, while others might implode from the financial strain. What causes one to succeed and the other to fail? Are there any specific factors or trends that can give guidance to where the sport industry might go in the future? What is the hot trend, or what might be a major disaster in the future? We will examine these trends in light of several select areas such as amateur participant sport, collegiate athletics, professional sport, e-sports, and sports broadcasting around the world.

TRENDS IN AMATEUR AND PARTICIPATORY SPORT

Amateur sport around the world can encompass a wide variety of issues. From fitness trends and extreme challenge events to youth sports and senior games, there are numerous possible financial concerns. While professional sports might have ticket revenue, broadcast revenue, licensing, and sponsorship as primary income streams, youth sports organizations often have to struggle. The primary expenses for professional teams include player salaries, administrative expenses, and **debt service** for building stadiums. The most common revenue sources for amateur sports are sponsorship, membership fees, registration fees, tax subsidies, national lotteries, fund-raising opportunities (such as raffles or 5K races), and social events. Expenses at the amateur youth sport level often go to field or facility expenses, as well as to uniform, equipment, travel, and related expenses. It would be impossible to explore every amateur sport, but we will explore fitness trends, travel teams, extreme competitions, and government funding of amateur sports as just some examples.

Fitness

Fitness facilities seem to open and close at a staggering rate. Several years ago, Curves was considered a very popular fitness chain. The chain started in 1992. The company began franchising in 1995. To acquire a franchise today, a franchisee needs an initial investment of around $40,000, a net worth of at least $75,000, and a liquid cash requirement of $50,000. The initial franchise fee is around $25,000, and franchises have to pay an ongoing royalty fee of around 6% of their revenue to the parent company (Entrepreneur, 2017). At its peak, Curves had over 10,000 franchises. In 2011 alone, 833 Curves franchises closed, representing 16% of all franchises at the time (Gibson, 2011). By 2014, there were 6,000 Curves clubs in 88 countries with 2,500 in North America (representing a 65% drop just in North America) (Strauss, 2014). If a club decides to close, it could still be on the hook for thousands of dollars owed to Curves International to cover lost future royalties. One element driving the lower number of franchises has been the resale value of clubs and whether an owner could get their original investment out if they had to sell their franchise.

Curves attempted to offer a one-size-fits-all experience to serve women with specific programs and hours. In contrast, other facilities utilize different approaches to generate revenue. Soul Cycle is an example of a relatively newer chain offering a high-end experience. Customized and high-end experiences are the in trend for fitness. With about one in five Americans paying for gym membership, some people are looking for a basic gym, while others are looking for the more high-end experience such as Equinox or specialty facilities focused just on kickboxing, spinning, or numerous other options. In contrast, the market might dictate having multiple activities or being open 24 hours. Each facility is trying to serve a specific market that management feels will generate the greatest return on investment.

The number of people working in the fitness industry is significant. There are an estimated 34,000 fitness facilities in the United States and over 180,000 throughout the world. It was estimated that over 500,000 people worked in the United States fitness field in 2014, and that number was supposed to increase by 8% by 2024 (Franchise Help, 2017). Many of these fitness

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Travel Teams

Over the past 20 years the number of travel teams in the United States has skyrocketed. That has led the youth sport industry in the United States to generate over $15 billion annually. It is estimated that nearly 20% of U.S. families spent over $12,000 a year on youth sports per child. Of these dedicated parents, 67% hope that their investment will lead to a college scholarship, and 34% think their child athlete will make it to the Olympics or become a pro (Shell, 2017). Travel teams are youth teams where the athletes often train year-round in one specific sport. The travel team craze has created a culture of families spending sometimes over $10,000 a year on coaching and team-related activities. This is on top of the amount families spend traveling all over for tournaments. The travel team explosion has not been without victims. There have been a number of cases where people trying to make a quick buck defrauded parents who are so focused on their kids becoming the next star athlete that they fail to notice the signs of trouble. Some signs might include practices being cancelled, the promised uniforms do not arrive, maybe a trip is cancelled, or maybe the coach or administrator stops returning parents' phone calls. Whatever the signs, the end result from unscrupulous promoters can be financial carnage for parents.

Travel teams are also affecting high school sports. Some high schools have developed rules stating that if a student plays on a travel team, they cannot play on the high school's team. Furthermore, competition between travel teams can be cutthroat for the dollars. There are tournament sponsors, team sponsors, travel agents, sports facilities, and numerous others who want a piece of the action. This is similar to any other facet of the sport industry or any other industry. Money is tight, and there are always those interested in generating as much revenue as possible—sometimes at any expense. So how can travel team maximize their revenue? It all starts with a plan. The financial plan is outlined in a budget.

Due to all the money involved with travel teams, there needs to be an accountable person tasked with monitoring the money, rather than relying on one person to collect and spend the money without any accountability. Travel Team Treasurer's for the Arlington Soccer Association (ASA) in Texas is a job description that outlines **treasurers'** duties as:

> developing and implementing a budget for the team, managing the team's account and team fees budget, as well as collecting team funds, assisting in the collection of player club and team fees and handling reimbursements and payments for team expenses. (Arlington Soccer Association, 2012)

Costs to play travel soccer include items such as coaching salaries, field fees, state or league fees, referee expenses, club administration costs, team equipment (first aid kits, game balls, etc.), tournament fees, coach travel expenses, and uniforms. Other expenses such as those for extra uniforms or equipment, team social events, awards, unexpected field rental fees, player scholarships for poorer kids, a team website, and additional tournament fees and travel will arise. Revenue is derived from parents paying club and team fees. When establishing a budget, the team treasurer for any travel team should explore some basic budgeting strategies such as:

- creating a budget and adding enough of a buffer zone so parents would not need to be approached again during the year for more money;
- making sure the first payment is the higher amount if parents are expected to make two payments;
- verifying cash flow will be sufficient to cover all the team's obligations;
- always having a contingency fund; and
- keeping records of all deposits and outlays and making the budget available to all officials or parents to ensure transparency (Arlington Soccer Association, 2012).

BUDGET FOR A TRAVEL TEAM'S EXPENSES

How much does it cost to outfit and run a 12-player baseball team with a 65-game schedule? The breakdown that follows helps highlight the potential cost.

UNIFORMS			
Hats (2 colors)	24	$20	$480
Socks (2 pairs home and away)	48	$5	$240
Jerseys (home and away)	24	$50	$1,200
Jerseys (coaches)	6	$50	$300
Pullovers (players and coaches)	30	$30	$900
Pants (home and away)	24	$30	$720
Helmets (batting)	12	$30	$360
Helmets (pitching)	12	$30	$360
Equipment bags (regular)	10	$50	$500
Equipment bags (catchers)	2	$55	$110
Equipment bags (team)	2	$55	$110
Shipping expense			$225
Subtotal			$5,505
EQUIPMENT			
Game balls (dozen)	6	$50	$300
Practice balls (bucket)	1	$100	$100
Scorebooks	3	$10	$ 30
Medical bag	1	$200	$200
Other gear (L screen, etc.)	1	$500	$500
Subtotal			$1,130
FIELD AND FACILITY RENTALS			
Winter indoor	1	$1,500	$1,500
Home games*	15	$50	$750
Practice field	1	$500	$500
Subtotal			$2,750
UMPIRE FEES			
Assignment fee	1	$50	$50
Scheduling fee	1	$150	$150
Game fees	25	$75	$1,875
Subtotal			$2,075
TOURNAMENTS, LEAGUE, ADMINISTRATION			
Season tournaments	8	$600	$4,800
League tournament	1	$500	$500
State tournament	1	$1,000	$1,000
National tournament	1	$1,000	$ 1,000
Team sanction fee	1	$50	$50

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Socks (2 pairs home and away)	48	$5	$240
Jerseys (home and away)	24	$50	$1,200
Jerseys (coaches)	6	$50	$300
Pullovers (players and coaches)	30	$30	$900
Pants (home and away)	24	$30	$720
Helmets (batting)	12	$30	$360
Helmets (pitching)	12	$30	$360
Equipment bags (regular)	10	$50	$500
Equipment bags (catchers)	2	$55	$110
Equipment bags (team)	2	$55	$110
Shipping expense			$225
Subtotal			$5,505
EQUIPMENT			
Game balls (dozen)	6	$50	$300
Practice balls (bucket)	1	$100	$100
Scorebooks	3	$10	$ 30
Medical bag	1	$200	$200
Other gear (L screen, etc.)	1	$500	$500
Subtotal			$1,130
FIELD AND FACILITY RENTALS			
Winter indoor	1	$1,500	$1,500
Home games*	15	$50	$750
Practice field	1	$500	$500
Subtotal			$2,750
UMPIRE FEES			
Assignment fee	1	$50	$50
Scheduling fee	1	$150	$150
Game fees	25	$75	$1,875
Subtotal			$2,075
TOURNAMENTS, LEAGUE, ADMINISTRATION			
Season tournaments	8	$600	$4,800
League tournament	1	$500	$500
State tournament	1	$1,000	$1,000
National tournament	1	$1,000	$ 1,000
Team sanction fee	1	$50	$50
Insurance	1	$200	$200
League fee	1	$500	$500
Miscellaneous (administration, party, etc.)	1	$1,000	$1,000
Subtotal			$9,050
Grand total			$20,510
Cost per player			$1,710 per player

*Assumes 15 home games—all other games are away or tournaments (StatsDad, 2011).

Extreme Competitions

Extreme competition started a number of years ago with triathlons and then advanced to ultramarathons. Over the past 10 years, it has morphed into CrossFit, Tough Mudder, Spartan, and American Ninja Warriors. There are numerous specialty events designed to push people to the extreme or to help people work as a team. They are also designed to generate revenue. The math is pretty simple. If Tough Mudder, as an example, runs an event with 10,000 participants paying $50 each, the revenue stream would be $500,000. This might seem like a lot, but then all the expenses need to be calculated. There is the cost of the race course, the administrative team, advertising, personnel, legal counsel, accounting, and numerous other expenses. That is why income can be misleading. Analyzing income without examining expenses will lead to failure. That is where the road map of a budget comes into play.

Numerous nonprofit organizations have been trying to run similar events over the years to generate revenue. Unfortunately, for many of these organizations, the result has been the opposite. They see the dollar signs but fail to properly calculate their expenses. It is not just extreme events, but even 5K runs have turned from strong money makers to losing propositions. This can be due to the fact that besides all the expenses, there are so many events competing for the same consumer dollars. This forces some nonprofit organizations to spend a significant sum to market their event, add the latest bells and whistles (which means more money), increase prizes, and incur other expenses. Some of these expenses are not as apparent. For example, while many executives understand the cost to add insurance coverage for an event, there is also a cost if someone is injured—in terms of legal fees, increased insurance premiums, and organizational resources spent on litigation rather than other activities. The more extreme the event, the more costs involved, the more possible revenue can be generated, but hidden costs also need to be considered in the equation.

Government Funding

Throughout the world, sport is often funded by the local or national government. Whether the sport is run by local parks, after school programs, high school sports, or elite athletic preparation programs, governments around the world are the largest funders of sport. With more pressure on governments to cut expenditures, there is a trend to cut such funds. Some physical education programs are being cut so kids are only having one hour of physical education a week. At the same time, there is an enhanced effort to reduce obesity, and sport can be a critical part of such health-related efforts. In the United States, there are some government funds that go to park and recreation departments, but most amateur and youth sports programs are funded by private citizens. While some nonprofit organizations might own their own fields or gyms, most are operating on small budgets and do not have the funds that government coffers can sustain. Thus, youth and amateur programs in various countries are often more robust than in others. For example, public-sector expenditure on recreational and sporting services in the United Kingdom declined

from 4,388 million GBP (Great Britain pounds) in 2011 to 2012 to 3,119 million GBP (approximately US$4 billion) in 2016 to 2017 (Statista, 2017). The decline could be attributed to an overall governmental decrease in spending. This represented a robust 0.4% of the country's gross domestic product (GDP). This amount might be higher than many other countries spending on recreation and sport, but it fell below the 1.7% of GDP spent by Bulgaria and 1.5% of GDP spent on recreation and sport by Iceland (Eurostat, 2017). Every country is different, but in Australia, a family with an income of around $59,000 (Australian) would have paid approximately $10,000 in federal taxes in 2016, and of that amount, $78 would go to recreation, arts, and sport expenditures by the federal government. This is part of the $3.4 billion spent by the Australian federal government on recreation and sport, but this figure does not include even more money spent by the states and local government (Evershed, 2016).

Every government will spend differently on recreation and sport depending on its goals and objectives. Spending is based on the perceived value or political value associated with such expenditures. While some governments might fund sport as part of a broader recreation or tourism initiative, others might fund sport to help win medals (international acclaim) or to reduce obesity and address other health-related concerns. The purpose of the expenditure helps drive what money is needed and the political muscle that would be required. This goes to the question, *what is the plan for the money?* The plan varies by government and every local, state, and national government will have different ideas and strategies. Strategies help drive collegiate athletics as well, and spending on collegiate athletics is influenced in the United States by alumni, students, administrators, faculty, sponsors, broadcasters, and government officials.

TRENDS IN COLLEGE SPORT

Over the previous two decades, athletic expenses have outpaced athletic revenues in all National Collegiate Athletic Association (NCAA) divisions. Consequently, collegiate athletic programs are facing unprecedented financial challenges. Although a myriad of factors are contributing to these challenges at all NCAA institutions, at the Division I level, coaching salaries, facility construction, and tuition increases appear to be the major items affecting collegiate budgets. Alabama's Nick Saban was the highest paid college football coach in 2017, earning over $11 million under his employment contract. The shouts to let athletes partake in some of the funds generated through college sport grew to screams with some when news broke during a 2017 pay-to-play Federal Bureau of Investigations investigation into college basketball practices. University of Louisville basketball coach Rick Pitino was eventually terminated as part of a scandal. Two months earlier, Adidas (also implicated in the scandal through the actions of several of its employees) renewed its 10-year $160 million apparel contract. Under the prior contract, while funds were meant to go to the athletic department, records indicated that 98% of cash provided by Adidas ($1.5 million) went just to the head coach, and only a small fraction went to the athletic department to benefit students ("Pitino pocketed," 2017). No wonder those challenging college athletics are claiming the system is broken.

One shining example of the problems with collegiate athletics is the University of Michigan. The storied athletic department was supposedly $240 million in debt due to significant facility construction and renovation related expenses (Dalgleish, 2017). This is only part of the athletic department's debt, which is expected to grow to $371 million by 2046. While that might be high, it is still lower than the University of California's $445 million debt (Dalgleish, 2017). However, the athletic department debt cannot be viewed in a vacuum as the entire university had debt of $2.1 billion.

The athletic department was banking on the Big Ten's new (2016) six-year media rights deal with ESPN, which, combined with FOX and CBS Sports contracts, would bring in $2.64 billion over a six-year period—approximately $188.6 million to each Big Ten member school during the contract. If such funds are insufficient, the school might have to raise ticket prices (Dalgleish, 2017). That was not a preferred option as ticket sales, especially for students, had declined

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COLLEGE ATHLETIC EXPENSES

What has happened to college athletic expenses over the past couple of years? The following table highlights the amount spent on each category as a total of an athletic department's expenditures (for public Division I programs).

Category	2014-2015	2015-2016	Change
Athletics-related financial aid	4.9%	8.8%	3.9%
Coaching compensation	7.6%	5.0%	-2.6%
Administrative and support staff	6.7%	4.7%	-2.0%
Team travel	4.3%	1.0%	-3.3%
Equipment and uniform/supplies	8.4%	3.1%	-5.3%
Game day operations	6.2%	3.1%	-3.1%

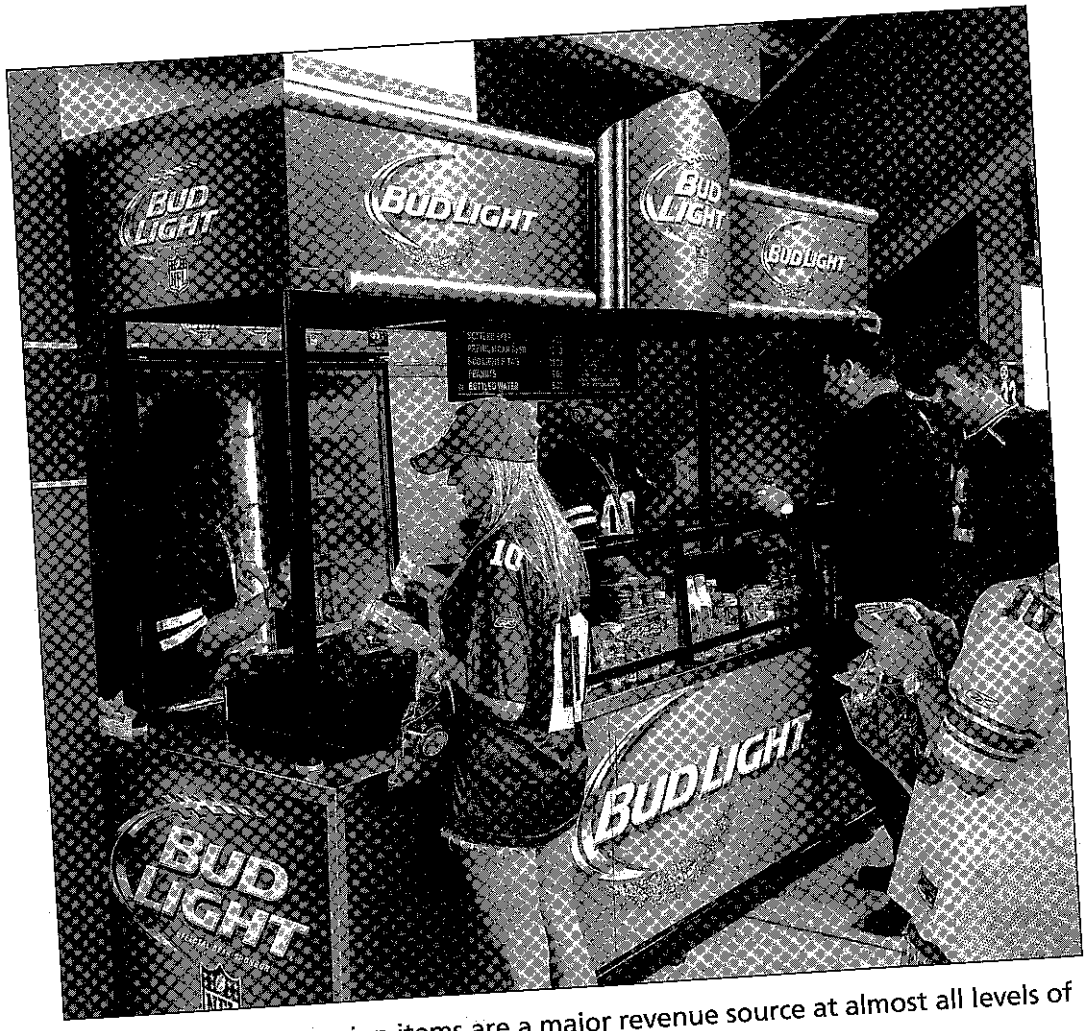
Source: Berkowitz and Myerberg (2017).

These numbers show that there is a significant amount of belt-tightening going on to reduce overall expenses associated with running an athletic department.

significantly (from nearly 19,000 students in 2013 to less than 12,000 in 2014) (Murphy, 2014). In 2014, the cost for a student season pass was $280, but due to weak demand, the athletic department dropped the price 37% to $175 for the 2015 season.

Besides highly paid coaches, athletic programs have been mandated to provide additional support for student athletes. The University of Arkansas absorbed a $1 million hit to help cover the full cost of attending college and paid $1.5 million to help feed student-athletes—all prohibited expenses until the NCAA changed its rules for 2014. Even with these added expenses, Arkansas was able to generate a $19.3 million profit in 2015 to 2016 (Berkowitz & Schnaars, 2017). The largest chunk of these increased expenditures to run athletic departments was financial aid for scholarships—covering tuition, fees, room and board, and the new category of incidental expenses.

In 2011, the University of Texas reached an agreement with ESPN to launch the Longhorn Network, a channel devoted exclusively to broadcasting and promoting both the university's athletic department and the university. As part of the agreement, UT was to receive payments totaling over $300 million distributed over 20 years. This money is in addition to the share of Big 12 revenues that the university already receives as a conference member. Although the University of Texas will certainly reap the financial benefit of having its own dedicated network, the biggest advantage for Texas may not be the financial payoff, because half of the money will initially go to academics but rather the biggest advantage could be the constant presence on television and other platforms. Potential high school recruits will see the Longhorn Network in their homes and on their tablets and smartphones. Potentially, the Longhorn Network became the nation's first regional college sports network focusing on one school with a limited high-profile inventory. Not every school can be similar to Texas. Notre Dame has had a major broadcast agreement with NBC since 1991 (and runs through 2025), but the value of that deal is relatively small (only $15 million a year) compared to the Texas deal, which spans more than just football. In 2014, the Southeastern Conference, famous for football powerhouses such as Alabama, Auburn, Florida, and Louisiana State University, created its own network (owned by ESPN through 2034 and similar to networks for the Big 10 and Pac-12 conferences). ESPN has made a significant investment in college



Beer and other concession items are a major revenue source at almost all levels of the sport industry.

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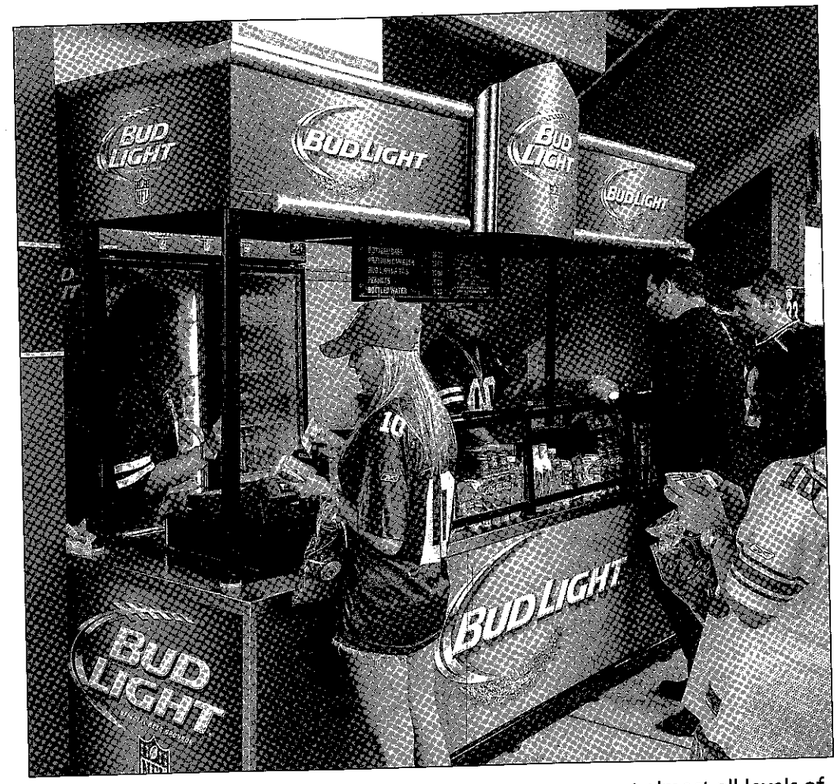
The NCAA has the most valuable properties in U.S. college athletics. It owns the NCAA basketball tournament popularly known as March Madness and helps administer the college football championship through the Bowl Championship Series. The rights to broadcast the basketball tournament were locked up in 2010, when the NCAA and CBS and the Turner Broadcasting System agreed to a 14-year, $10.8 billion deal that will run through 2024. The parties were so happy with the deal that they negotiated an eight-year extension worth $8.8 billion in 2016 (Sherman, 2016). The Bowl Championship Series contract entailed a 12-year contract from 2014 through 2025, worth around $5.64 billion, or about $470 million annually. These numbers help show the value of marquee events and top-level teams.

While salaries are growing, based in part on higher broadcast revenues, programs are asking for more money from state legislatures when it comes to public universities. Private universities do not have the same funding options and often



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While salaries are growing, based in part on higher broadcast revenues, programs are asking for more money from state legislatures when it comes to public universities. Private universities do not have the same funding options and often rely on donations or student fees to help cover the cost of running an athletic department. With student debt increasing to unsustainable levels, many are asking why students should be paying several thousand dollars a year to help support athletics when they are borrowing money to make these payments and it will burden them for years to come.

TRENDS IN PROFESSIONAL SPORT

The National Football league (NFL) is a behemoth of a league. It is considered the most profitable league in the United States. It has a short season, so its games are critical, and they occupy a space with minimal competition from other professional sport. This has helped drive up the league's revenue, yet it wants more. The NFL is interested in hitting the $25 billion mark by 2027. Is that number realistic? In 2014, the NFL generated revenue of $10 billion (Schrotenboer 2014). This would represent an annual revenue increase of 7% compounded annually, or around $1 billion increase in revenue annually. The 2014 revenue was estimated to have been broken down as follows:

- $5 billion from media and television rights for game broadcasts
- $1 billion to $2 billion in sponsorships, such as the league's long-term deal with PepsiCo, which is worth about $90 to $100 million per year
- $2 billion in ticket-related sales
- $1 billion in merchandise and licensing (Schrotenboer, 2014)

While the NFL has its sight set on growing revenue, the league faced significant issues and consumer backlash in 2016 and 2017. The backlash was attributed to player protests, election broadcasts, and people cutting cable cords. Viewership in 2016 and 2017 fell around 8% (Snider, 2017). Political wrangling between the league and Washington could possibly affect the tax benefit provided to bondholders for **municipal bonds** issued to help build stadiums or those in the surrounding area. Some financial dangers are endemic to the game itself. The concussion-related scare for current and future players could significantly affect the game, as many parents are discouraging their children from playing football, which could affect the pipeline for both future fans and future players.

The revenue from football (soccer) teams around the world has significantly increased over the past 10 years, and revenue can be closely tied to a star player (similar to Michael Jordan or LeBron James in basketball). Soccer star Neymar moved from FC Barcelona to Paris Saint-Germain FC in 2017, and his popularity sparked a frenzy for League One broadcast rights, which were expected to increase from around €750 million to €1.2 billion a season (Boksenbaum-Granier & Jefferson, 2017). The investment was one of a number of Middle Eastern investments in famous soccer teams in England and Europe over the past 15 years, which has sent player salaries soaring and increased the marketing and sales of soccer-related tickets, sponsorships, and broadcast rights. To help generate the revenue needed to pay for the added talent, teams are searching for new revenue sources. For example, some teams in Europe feel they have tapped out all their local revenue options and are looking for new markets such as the United States. FC Barcelona generated €655 million in 2017 and hopes to increase that mark by roughly 79% to €1 billion ($1.17 billion) by 2012 (Novy-Williams, 2017). In one 2017 trip to the United States, the team played against archrival Real Madrid in front of 66,000 fans, and 35,000 fans paid to watch the teams practice the night before.

The previous discussion is meant to show how much money is involved in professional sport around the world. Having significant revenue and **expenses** also generates significant issues. The NFL had to deal with a national anthem issue and the polarization of fans on the topic in 2017. There are other numerous topics that arise every day for professional teams. Although not exhaustive, this section focuses on various issues related to professional sport including stadium subsidies, franchise values, e-sports, and broadcasting issues.

Stadium Subsidies

One of the major concerns for professional teams is the ability to keep growing revenue. The

average family of four cannot afford to go to a game for $1,000. The average fan might become extinct. Professional teams realize that to charge more they have to find a market segment that can afford to pay more, and that market includes business people and corporations. They have more funds, and teams realize that they represent the future financial lifeblood for sport. That is why corporate seating, such as luxury suites, is so critical. To build or renovate facilities to tap this market, teams are often going back to the average fan to pay for stadium and arena renovations. That is where subsidies by local taxpayers has become such an important issue. Between 1990 and 2010, the total luxury-suite inventory in the four major sports leagues in the United States (Major League Baseball, the NFL, the National Basketball Association, and the National Hockey League) grew 147% to more than 10,000 luxury suites. Similarly, club-seat inventory experienced explosive growth, increasing by a whopping 624% to reach an estimated 450,000 club seats (Rhoda, Wrigley, & Habermas, 2010). This was fueled by the demand from major sponsors and wealthy businesses wanting a place to entertain clients and employees. While luxury seating has become a major revenue source all over the world, arena and stadium construction efforts have faced some challenges, especially from alienated fans.

Professional sports franchises face several significant challenges when attempting to obtain a stadium subsidy. Among these is the opportunity cost of the project. Specifically, what good or service is being sacrificed for the stadium to be constructed? In addition, political issues are often present, including obtaining voter approval through a public referendum. In 2011, the New York Islanders were unsuccessful in convincing voters to approve a new arena, which meant the team would have to leave its old arena when the lease expired in 2015. The vote encouraged the team to move to Barclays Center in Brooklyn. Also in New York, the famous Madison Square Garden spent over a billion dollars on a major renovation between 2010 and 2013. It was anticipated that the newly refurbished arena would still be able to generate a good **rate of return** on the investment, even when it would lose its lease in 2023 so Penn Station under the arena can undergo major renovations. The arena would have to find a potential home and hope voters approve the site and possibly some funds to help guarantee the facility would not move. As of this writing a new home has not yet been found, and a new lease has not been completed with MSG's landlord.

Cities are willing to help subsidize stadiums and arenas hoping to keep a team. While elected officials might want to build a facility to show they are doing something for the community, many voters are expressing their concern about spending money to help make a team owner wealthier. The promise from team owners and elected officials is normally that the city needs a big league team, and then there is a promise of job growth. Such promises have fallen on deaf ears around the globe. Besides possible Olympic bidders dropping out due to the high costs of building an Olympic village (see generally articles such as "Rome, Hamburg, and Budapest Dropping out of Bidding for the 2024 Olympics"), several elections in the United States resulted in "no" votes for using public funds to help build stadiums, with two recent and famous examples including San Diego and St. Louis, where both city's NFL teams relocated to a privately financed $2 billion stadium to be built in Los Angeles. The cost to build facilities has scared and will continue to scare voters and the public. To obtain voter support, team owners need to prove the business case for the voters. The voters will argue, if building a facility is such a great investment, why isn't the owner paying for the facility themselves? With that said, the most successful professional stadium projects have been destination locations built primarily with private funds from team owners, such as Patriots Place (Gillette Stadium) and AT&T Stadium in Dallas.

Franchise Values

One universal practice is for owners of professional sports teams to claim that they lose money operating their franchises. Consequently, they can justify raising tickets prices, charging premiums for concessions, and persuading the public to subsidize new stadiums. Because team owners are not required to disclose their financial statements publicly, the general population has to rely

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The success that Manchester United has enjoyed on the pitch, demonstrated by winning its record 20th league championship, is consistent with their lucrative sponsorship deals. In 2012, the team signed a new sponsorship agreement with Chevrolet. The seven-year deal was estimated to be worth £52 million annually. The team raked in £581.2 million in revenue during the 2016 to 2017 season, fueled in part by a 40% increase in broadcast revenue. That revenue mark resulted in a £80.8 million profit for the team. Just as important as the profit was that the team reduced its debt from £260.9 million in 2015 to £213.1 million in 2016 (90min, 2017).

E-Sports

Over the past several years, one of the trends in the sport industry has been the rapid growth of e-sports. This was an obscure activity played by some years ago, but there are now millions of players all over the world playing games such as League of Legends, Call of Duty, StarCraft and Counter Strike: Global Offensive. What is unique about e-sports is that games were developed by large computer gaming companies (many of them publicly traded corporations) as a way to sell products, and they have evolved into competitions with players from all over the world.

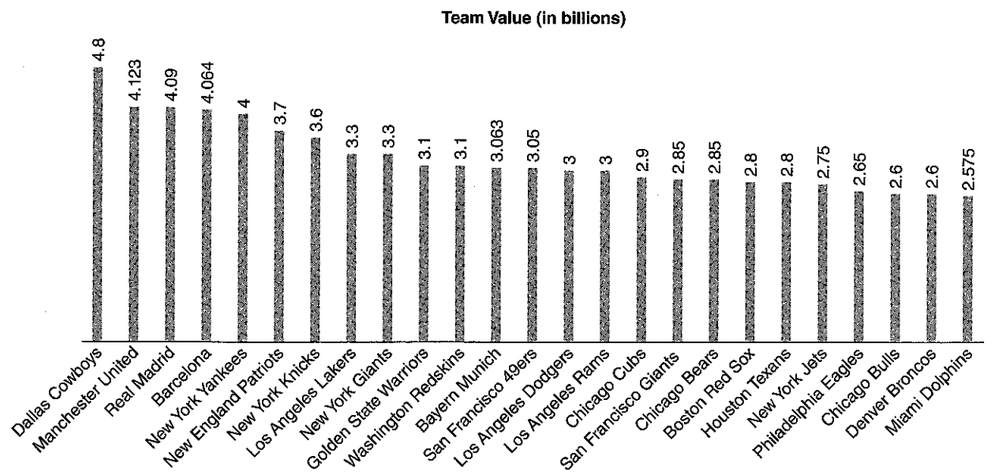

Figure 2.1 Most valuable sports organizations in 2016.

Matches are now regularly played in major arenas, selling out in a matter of minutes and making stars out of former nerds. The growth has been explosive and can be seen from the following facts just from the past several years:

- *Franchises.* Activision Blizzard's Overwatch League will have franchises in 28 international cities for $20 million each franchise. Similarly, Riot Games is planning on having 10 permanent franchises in its North American League of Legends Championship Series, costing $10 million for existing team owners and $13 million for new team owners (Badenhausen, 2017).
- *Broadcasting.* Riot Games struck a six-year, $300 million deal with Major League Baseball's BAMTech in 2016 to stream and distribute League of Legends content. Similarly, Activision Blizzard signed a two-year streaming deal with Amazon's Twitch (Badenhausen, 2017).
- *Microtransactions.* Riot Games is the king of microtransactions. It reportedly made $1.6 billion in 2015 by selling just cosmetic items for characters in League of Legends.
- *Professionalism.* Professional e-sports teams are popping up across the world with major sponsors (chasing the coveted 18- to 30-something males), competing in major tournaments, and having professional dieticians, trainers, coaches, and related personnel—similar to any major professional team.

Broadcasting

One of the recent developments in the sports broadcasting industry encompasses the world of new media. Some efforts have created major problems for sports promoters. For example, live streaming through platforms such as Periscope can significantly decrease the value and potential revenue for a pay-per-view fight if someone can stream the fight to others free, and millions of people could possibly view the fight without purchasing the rights through pay-per-view.

One of the major issues (and covered in a case study for part V) is the growing number of cord cutters. Cord cutters have cancelled their cable subscriptions to watch shows on Netflix, Amazon, Hulu, YouTube, and numerous other service providers. This has had a significant impact on the bottom line of ESPN and other sports channels. ESPN has lost an estimated 11 million subscribers in the United States alone from those who have canceled their cable subscriptions. This has resulted in significant losses from not only subscription fees but also lost revenue from advertisers, as there were not as many viewers, so advertising rates decreased. This revenue impact and the high price paid for broadcast rights were putting significant financial pressure on the cable sports giant.

While the United States broadcasting market might have been facing some hardships, the international broadcast market still seemed to be thriving. One example was Star India, which agreed to pay £1.97 billion ($2.6 billion) for the television and digital rights of the Indian Premier League (Cricket) for 2018 to 2022. Star group also owns broadcast rights for 18 International Cricket Council global events held during an eight-year cycle from 2015 and India's home international matches (Reuters, 2017).

CONCLUSION

Although anticipating future financial trends for amateur, college, and professional sport, as well as for e-sports and sports broadcasting will be difficult given their dynamic properties, it will be interesting to see how the issues discussed in this chapter evolve over the next decade. Clearly, several developments will affect the financial operations of sport, individual sports organizations, and overall league policies. For example, will the public continue to subsidize stadiums and arenas in times of scarce resources? Will broadcast rights fees keep growing? Will franchise values keep growing? Will high school athletic programs continue to be reduced or eliminated altogether in some circumstances? There are no clear answers to these and many other questions. However, through utilizing financial skills, sports executives can develop and implement appropriate plans to weather any potential financial storm or to, hopefully, financially thrive in the future. Some strategies will work while others will fail. Even the best planners might not see technological or other changes that can significantly affect the finances of a given industry, team, sport, or league.

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Class Discussion Topics

1. Should local, state, or federal taxes be increased with the resulting funds used to provide more fitness and sport opportunities? What could be the ramifications?
2. Are travel teams hurting the youth sport industry?
3. Provide three specific examples of how stadium subsidies can positively influence a local community.
4. What variables will continue to drive up the market value of sports franchises?
5. What do you think the future of e-sports will be, and will they make it to the Olympics? If they become full Olympic sports (rather than exhibition sports), how would that affect the game publishers?
6. Will broadcast rights decrease at a certain time? What variables might affect the future direction of broadcast rights? What is the best e-sports game publisher? Use financial data to support your conclusion rather than just what game you personally like.

3

Basic Financial Concepts

Chapter Objectives

After studying this chapter, you should be able to do the following:

- Distinguish between revenue and expenses.
- Describe the differences among finance, economics, and accounting.
- Identify the elements of the three primary financial statements: balance sheets, income statements, and cash flow statements.
- Define common financial ratios used to assess an organization's liquidity, activity, and profitability.
- Understand the concept of time value of money.
- Understand the concept of future value, including its calculation for a single amount of cash received today.
- Understand the concepts of present and future value.
- Calculate the present value of annuities.

Chapter 3 deals with the keys to financial understanding—revenue and expenses. Some of the basic tools of financial management such as financial statements, financial ratios, and time value of money will also be addressed in this chapter. All businesses revolve around money. Money is needed to pay bills, pay employees, order items, sell items, pay taxes, or borrow money. Businesses need to address where the money comes from, where it goes, how to track it, and why the economy functions in a given manner. This chapter investigates these issues by first examining revenue and expenses for various sports organizations. The chapter then examines the role that accounting plays in identifying and tracking revenue and expenses.

REVENUES AND EXPENSES

We all have bills to pay. We also normally have a source of funds, whether from a job, loans, or family. This section highlights how we make and spend money in the sport business. Revenues represent money coming into a sport business. Revenue can come from ticket sales, broadcast contracts, concession sales, sponsorship agreements, and a host of other opportunities. The opposite of revenues is expenses. Expenses are costs that are incurred. Typical expenses for a professional team include player salaries, equipment, travel, executive salaries, rent, and insurance premiums. Each business has different revenues and expenses, and they are constantly changing. A health club might have revenues of $2 million one year, but if 250 members do not renew their memberships, the revenues can plunge. Similarly, if members owe the club money, the club has **credit** in money owed. On the flip side, if the club does not pay its employees, then it owes money, which is a debt. If you have ever spent more than you could afford on a credit card, your expenses might spiral out of control and create debt. Debt is money owed to others.

Revenues and expenses are numbers; they are not abstract ideas. To understand and use these numbers to make financial decisions, one must have a basic knowledge of accounting concepts and audited financial statements. The next two sections will cover these topics.

Art of Accounting

Many refer to accounting as an art rather than a science (Griffin, 1991). There are two primary forms of accounting: financial accounting and managerial accounting. Both are important for sports organizations, but each serves a different purpose. **Financial accounting** is the process of recording, summarizing, and reporting the financial transactions of an organization. The end result of this process is the creation of three primary **financial statements**: balance sheets, income statements, and cash flow statements. In comparison, **managerial accounting** is the use of these financial statements to make managerial decisions about the organization. Overall, managerial accounting is for internal use to make decisions about the organization while financial accounting is outward focused toward external stakeholders. An audited income statement can be used to help make internal decisions, but it is primarily used for **shareholders**, other investors, and government authorities—so it is considered a tool of financial accounting. Managerial accounting will produce an internal budget, as an example.

Although financial analysis cannot exist unless accounting systems have developed the appropriate numbers for analyzing past performance, there is never any guarantee that the numbers relied on are correct. Accounting produces financial statements consisting of numbers, but the numbers refer only to those components of a business that are quantifiable. Over the past several decades, a new approach to managerial accounting has been the **balanced scorecard** approach, which examines numerical and subjective criteria to understand how an organization is doing. The balanced scorecard is a performance evaluation tool used to evaluate all aspects of a company's operation in an integrated fashion. Through taking a cause-and-effect approach, the balanced scorecard can help a business understand that every action has an effect and that without proper planning and acting across a company, the company will have a hard time meeting financial and other objectives.

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Accounting systems also use professional judgments and estimates when absolute objective evidence does not exist (Griffin, 1991). Although such judgments are typically accurate, anyone reading financial statements has to assume that the information may include inaccuracies. There is never a sure bet in finance, and the best you can hope for from financial statements is an accurate portrait of a business based on data analyzed by an accountant—a human being who can also make errors.

There is often confusion among the terms *accounting*, *finance*, and *economics*. As mentioned previously, accounting is a system of recording, summarizing, analyzing, verifying, and reporting business and financial transactions. Finance is the management, creation, and study of money, investments, and other financial instruments. In contrast, economics is a social science focused on the production, distribution and consumption of goods and services by people, companies, and nations. Economics studies how individuals, businesses, governments, and nations make choices on allocating scarce resources such as whether building a stadium will increase tax revenue for a community. Economics will not tell a sports executive the financial impact of a decision, but it can help identify needs or threats to consider when making a decision. For example, if a local economy is struggling, then economists might predict slower growth. This slower growth can affect the ability to sell tickets, which can result in lower ticket demands—which should be reflected in lower sales in a budget. Thus, finance, economics, and accounting all come to play when making sound fiscal decisions.

Audited Financial Statements

Financial statements are compiled from a firm's accounting records. These financial statements include the balance sheet, income statement, and statement of cash flows. Financial statements are intended to provide information about a business in a consistent manner as a result of efforts by accountants to follow **generally accepted accounting principles (GAAP)**.

Accountants can make errors, and some make outright falsehoods; an auditor is often the last person who can possibly discover any discrepancies. This concern was highlighted in the multiple accounting scandals at companies such as Enron, WorldCom, Tyco, and Adelphia in the 1990s and early 2000s. The ease with which companies, executives, and accountants could manipulate company records encouraged Congress to pass the Sarbanes-Oxley Act of 2002, forcing executives of publicly traded companies to certify that all their financial data were accurate. Violators could face significant fines and even incarceration. Executives still need accountants to **audit** the numbers to ensure their accuracy. Most companies attempt to obtain an **independent audit** of the work performed by their accountants. Such an audit is often undertaken even if an external accounting firm was used to prepare the initial financial statements. An **auditor** uses the statements on auditing standards issued by the Auditing Standards Board of the American Institute of Certified Public Accountants. These standards were developed to help ensure that audits are conducted in a systematic manner. After thoroughly analyzing all the financial statements, the auditor prepares a report that includes the following statements (Griffin, 1991):

- The auditor is independent from the company's management.
- The financial statements were audited.
- The financial statements are management's responsibility, and the auditor's role is to express an opinion on the financial statements.

After the audit is completed, the auditor prepares an opinion that addresses the fairness of the financial statements, the degree to which the financial statements comply with generally accepted accounting principles, and any noticeable changes in accounting principles from industry norms (Griffin, 1991). The final opinion reached by the auditor can be

- an unqualified opinion that the statements are accurate,
- a qualified opinion,
- an adverse opinion indicating that the statements do not conform with required principles, or
- a **disclaimer** indicating that the auditor was unable to complete the report because the company failed to provide certain data.

A typical unqualified opinion might include a statement such as the following:

> In our opinion, the financial statements above present fairly, in all material respects, the financial position of the team as of June 31, 2018, and the results of its operations and its cash flows for the year then ended in conformity with generally accepted accounting principles.

The accounting system objectives discussed in this section relate to what has already happened. Accounting statements are reviewed to determine what occurred during the designated period. But accounting does not indicate what should occur in the future. Budgeting is the process that can indicate what steps should be taken in the future. The budget sets the company's road map for the future and is based on the company's goals and objectives. Budgeting, which is covered in chapter 7, is the first step in the financial process after the accountants analyze past performance.

TYPES OF FINANCIAL STATEMENTS

The balance sheet displays the financial condition of a business at a single point in time, offering information about assets, liabilities, and owners' equity. The income statement describes a business' profit or loss over a given length of time, such as a month, quarter, or year. It provides information about a business' operating performance over that period. The statement of cash flows indicates how the cash position of a business has changed over a given period. For example, the firm may see its cash position depleted through the purchase of machinery or supplies. The firm's cash position can also be diminished through the paying down of debt or the paying of dividends to shareholders. For example, the income statement may show that a business had a profitable year, yet the company's cash holdings can decline. The statement of cash flows can be used to determine what happened to the business' cash. When examining financial statements, note that some terms are interchangeable whereas others are not. For example, *sales* and *revenues* are interchangeable; *profits*, *earnings*, and *income* are the same; but *costs* are different from *expenses*. Costs refer to money spent on manufacturing a product or service, whereas expenses refer to money spent on developing, producing, selling, and managing the product or service. Chapter 11 will go into greater detail on financial statements.

Balance Sheet

The balance sheet is used by accountants to give a picture of the business at a single point in time, as if the business were standing still. Here is the basic equation that all balance sheets follow:

assets = liabilities + owners' equity

Because this basic definition must always hold, **capital** provided by investors is always equal to the assets of the firm minus the liabilities of the firm. The left side of the balance sheet (debit side) is what a company owns; the right side (credit side) indicates how the assets were financed. Given the preceding equation, when any two variables of the equation are known, we can always solve for the third using basic math.

In the liabilities section of the balance sheet, liabilities are listed in the order in which they must be paid. Current liabilities consist of obligations that must be paid down in one year or less, and long-term liabilities consist of items that will not be paid for within one year. The liabilities and **stockholders' equity** (capital provided by investors) portions of the balance sheet typically reflect decisions about the sources of financing for the business.

Income Statement

The income statement measures a business' profitability over a specific period, such as a year or a quarter. Income is defined as follows:

income = revenue − expenses

Whereas the balance sheet provides us with a snapshot at a single point in time, the income statement can be viewed as a film portraying how the organization performed between the single snapshots depicted on two balance sheets.

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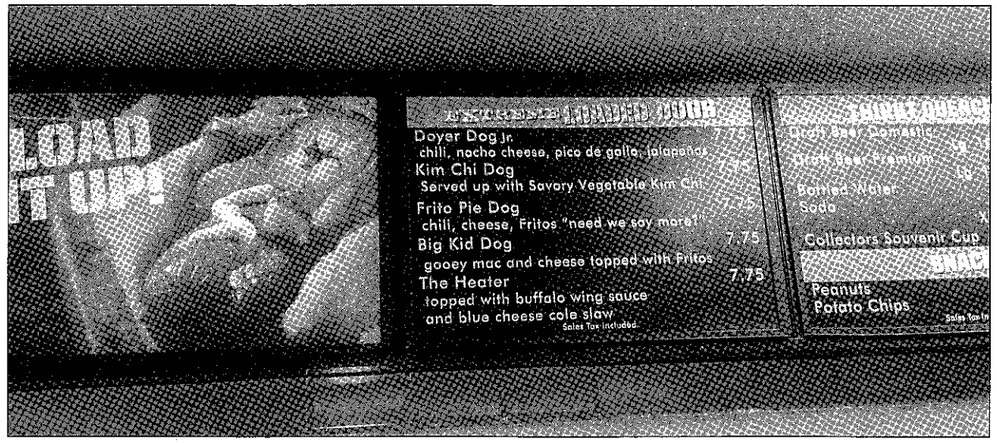
The income statement typically consists of three sections. The first section includes the revenues and expenses from the company's operations. Second, a nonoperating section of the income statement includes financing costs and any income earned by financial investments. For Under Armour, the interest expense represents financing costs. Typically, the nonoperating section of the income statement includes all taxes paid by the enterprise. The third section of the income statement is the net income of the business.



Selling concession items can generate significant revenue that will be reported on the income statement.

Statement of Cash Flows

From the perspective of financial analysis, the importance of financial statements lies in their ability to provide information about an organization's **cash flow.** Firms have value when they generate cash flow for investors. *Cash flow* refers to cash flowing both into and out of the business. Recall that income statements include noncash expenses such as depreciation. The amount of depreciation reported on a business' income statement has no effect whatsoever on the cash generated by the business. When the business reports depreciation, the dollar amount reported as depreciation is not directly paid to any vendors or employees, as would be the case with other operating expense categories. The statement of cash flows is a financial statement that reports changes in a company's cash holdings over a particular period.

FINANCIAL RATIOS

Now that we have a good understanding of financial statements, it is important to address the goal of financial ratios. Financial ratios aid in the evaluation of financial statements. Information from financial statements is used to compute financial ratios that provide insight into the condition of a business. Commonly used financial ratios focus on the following areas:

- Liquidity
- Activity
- Financial leverage
- Profitability
- Firm valuation

Liquidity focuses on the ability of an organization to meet its short-term financial obligations. Activity ratios measure how effectively a firm manages its assets, while **financial leverage ratios** provide information about the extent to which an organization relies on debt (loans) rather **equity** (stocks) for financing. When a firm relies on more debt than equity, its financial leverage ratio increases. Firms with a higher level of financial leverage may be more likely to face financial distress or bankruptcy.

The bottom line for for-profit companies is their ability to generate sufficient earnings to

continue to grow and reward shareholders. The level of profits for a sports organization is measured through a series of profitability ratios such as the **net profit margin**, **gross profit margin**, **return on assets (ROA)**, and **return on equity (ROE)**. Finally, **firm valuation ratios** inform us on the value of sports organizations. In general, this is achieved through two methods: **market value** and **book value**.

Financial ratios are also important for companies because they serve as a barometer against three different benchmarks:

1. Previous company ratios
2. Competitors' ratios
3. Ratios of other firms of similar size and scope

Chapter 13 will go into greater detail on the specific ratios such as the current ratio, inventory turnover ratio, debt ratio, net profit margin, and price–earnings ratio. But it should be remembered that financial ratios are a key component in the analysis of financial statements. They are critical in the analysis of sports organizations, their competition, and the industry as a whole.

TIME VALUE OF MONEY

No discussion on financial analysis can be complete without examining the time value of money. It is impossible to examine a $1 investment today versus one from 15 years ago without realizing that $1 from 15 years ago might be worth $5 in today's dollars. This section highlights why money is sensitive to time and how to calculate changes in value based on time constraints.

A key issue in valuing these flows is their timing. A dollar received today is worth more than a dollar received in the future. **Time value of money** represents the concept that money in today's dollars decreases in value the further out into the future it is expected to be received because it could be invested over that time. With this concept in mind, any investor or business needs to examine the time in which investment decisions will be made and critically examine how that time frame will ultimately affect the invested amount and projected payout.

CONCEPTS INTO PRACTICE

Assume that Under Armour (UA) has a parcel of real estate that it wishes to sell and has lined up two prospective buyers. One buyer, SportsTech, is willing to enter into a contract to pay $1,000,000 immediately for the parcel of land. A second buyer, Sports Worldwide, has offered to pay $1,025,000 for the land but will make the actual payment in one year's time. At first glance, it may appear that UA should take the Sports Worldwide offer, because Sports Worldwide is willing to pay more for the land, but looks can be deceiving!

The way to evaluate which offer UA should accept is to note that if it accepted the offer from SportsTech, it could hypothetically deposit the funds in a one-year certificate of deposit (CD) that earns 5% interest per year. UA would start out with $1,000,000 in the bank (**principal**) and would earn interest equal to 0.05 multiplied by $1,000,000. As a result, UA would have the following on deposit in one year:

$$\$1{,}000{,}000 + (0.05 \times \$1{,}000{,}000) = \$1{,}050{,}000$$

or

$$\$1{,}000{,}000 \times 1.05 = \$1{,}050{,}000$$

In other words, UA would have on deposit its initial $1,000,000 principal plus $50,000 in interest, which equals $1,050,000. By contrast, if UA accepted the Sports Worldwide offer, it would have only $1,025,000 available in one year—$25,000 less than it would have if it had invested the initial $1,000,000 in the one-year CD. Clearly, UA is better off taking the offer from SportsTech.

In working through this example we made use of the concept of future value. **Future value (FV)** is the value of an initial lump sum of money after it is invested over one or more periods. The future value in one year's time of the $1,000,000 received from SportsTech is $1,050,000. Note that the future value of any given investment income reflects the interest earned on that investment.

Another way of looking at this example is to examine how much money UA must deposit in a CD that earns 5% to have $1,025,000 in one year. The amount of money that would yield $1,025,000 if invested today at a 5% interest rate is the **present value (PV)** of $1,025,000 received in one year. We can solve for PV as follows:

continue to grow and reward shareholders. The level of profits for a sports organization is measured through a series of profitability ratios such as the **net profit margin**, **gross profit margin**, **return on assets (ROA)**, and **return on equity (ROE)**. Finally, **firm valuation ratios** inform us on the value of sports organizations. In general, this is achieved through two methods: **market value** and **book value**.

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A key issue in valuing these flows is their timing. A dollar received today is worth more than a dollar received in the future. **Time value of money** represents the concept that money in today's dollars decreases in value the further out into the future it is expected to be received because it could be invested over that time. With this concept in mind, any investor or business needs to examine the time in which investment decisions will be made and critically examine how that time frame will ultimately affect the invested amount and projected payout.

CONCEPTS INTO PRACTICE

Assume that Under Armour (UA) has a parcel of real estate that it wishes to sell and has lined up two prospective buyers. One buyer, SportsTech, is willing to enter into a contract to pay $1,000,000 immediately for the parcel of land. A second buyer, Sports Worldwide, has offered to pay $1,025,000 for the land but will make the actual payment in one year's time. At first glance, it may appear that UA should take the Sports Worldwide offer, because Sports Worldwide is willing to pay more for the land, but looks can be deceiving!

The way to evaluate which offer UA should accept is to note that if it accepted the offer from SportsTech, it could hypothetically deposit the funds in a one-year certificate of deposit (CD) that earns 5% interest per year. UA would start out with $1,000,000 in the bank (**principal**) and would earn interest equal to 0.05 multiplied by $1,000,000. As a result, UA would have the following on deposit in one year:

$$\$1{,}000{,}000 + (0.05 \times \$1{,}000{,}000) = \$1{,}050{,}000$$

or

$$\$1{,}000{,}000 \times 1.05 = \$1{,}050{,}000$$

In other words, UA would have on deposit its initial $1,000,000 principal plus $50,000 in interest, which equals $1,050,000. By contrast, if UA accepted the Sports Worldwide offer, it would have only $1,025,000 available in one year—$25,000 less than it would have if it had invested the initial $1,000,000 in the one-year CD. Clearly, UA is better off taking the offer from SportsTech.

In working through this example we made use of the concept of future value. **Future value (FV)** is the value of an initial lump sum of money after it is invested over one or more periods. The future value in one year's time of the $1,000,000 received from SportsTech is $1,050,000. Note that the future value of any given investment income reflects the interest earned on that investment.

Another way of looking at this example is to examine how much money UA must deposit in a CD that earns 5% to have $1,025,000 in one year. The amount of money that would yield $1,025,000 if invested today at a 5% interest rate is the **present value (PV)** of $1,025,000 received in one year. We can solve for PV as follows:

$$PV \times 1.05 = \$1{,}025{,}000$$

Solving for PV gives us the following:

$$PV = \$1{,}025{,}000 / 1.05 = \$976{,}190$$

So, if UA has $976,190 today, this lump sum can grow to $1,025,000 in one year as a result of earning interest.

In general, the formula for the present value can be written as follows:

$$PV = C_1 / (1 + r)$$

PV = present value

C_1 = cash flow received at the end of one year

r = appropriate interest rate

The variable r, the interest rate or percentage return that can be earned on an initial amount of money, is also known as the **discount rate**. In our example, the 5% annual return that UA earns on its financial investment (i.e., a one-year CD) is used as the discount rate to value the $1,025,000 received in one year.

Our analysis of present value indicates that a payment of $1,025,000 received in one year from Sports Worldwide has a present value of $976,190 today. In other words, at a 5% interest rate, UA would find receiving $976,190 today from Sports Worldwide or receiving $1,025,000 in one year equally acceptable alternatives. Given $976,190 today, the company can deposit the funds in a one-year CD that will allow it to receive $1,025,000 in one year.

Because SportsTech offered to pay $1,000,000 today, this offer has a present value of $1,000,000. Thus, our present value analysis suggests that UA should take the SportsTech offer.

CONCEPTS INTO PRACTICE

Assume that Jane Smith owns shares of UA common stock, and the return on the stock is 6%. To keep things simple, let us also assume that Smith paid $1 per share for UA's common stock. If she sells her shares at the end of one year, she will have $1 plus the return on that dollar at r% for each share. Because r is 6%, she will have $1.06 at the end of one year.

$$\$1 + \$1r = \$1 \times (1 + r) = \$1 \times 1.06 = \$1.06$$

r = expected rate of return

At the end of the year, she has two choices. She can cash out her stock and take the $1.06 per share or hold the stock for a second year. The process of holding the stock and accruing a further return over the second year is referred to as **compounding**.

If Smith decides to hold the stock for another year, then at the end of two years she will have the following:

$$\$1 \times (1 + r) \times (1 + r)$$
$$= \$1 \times (1 + r)^2 = \$1 \times (\$1.06)^2 = \$1.1236$$

At the end of two years, she will have transformed $1.00 into $1.1236. Notice that at the end of two years, she will generate $0.1236 in **compound interest** or return. That is, each payment of interest or return that is reinvested earns a return also.

This process can be generalized over many periods of time (t) with the following formula for the future value (FV) of an investment:

$$FV = C_0 \times (1 + r)^t$$

FV = future value

C_0 = initial amount of cash that is invested today

r = interest rate or rate of return

t = number of years over which the cash is invested

We can do this calculation by hand or with the help of a table. Table B.1 presents future values of $1 at the end of t periods, a variable number of periods into the future over which the $1 is earning interest. Traditionally, t periods on a future value chart range from 1 year to 20 or 30 years. To use the table, locate the appropriate interest rate or return column and move down to the appropriate period row as indicated in the period column. For example, you could find that the future value of $1

Future Value More Than One Period Into the Future

So far, we have looked at the concept of present value and future value in the context of cash flows over a single period. We will now show how this can be generalized over more than one period. This process is critical because most business deals do not start and end in one year but rather last several years.

that is received two years into the future is $1.1236. This figure is reached if you assume a 6% rate of return. If you started out with $500 and earned a 6% annual return over two years, then the future value at the end of two years would be $561.80.

$$FV = 500 \times 1.1236 = \$561.80$$

As another example, suppose that an investor buys a $1,000 bond issued by UA. The bond pays 10% interest and is redeemable in 20 years. Going to table B.1, you can find 20 years as the t period and then move across to the column labeled 10% interest. The number on the chart is 6.7275. Thus, FV = $1,000 multiplied by 6.7275, which yields a future value for the $1,000 investment after 20 years of $6,728. Through compounding interest, the bond increases more than sixfold if it is kept for the entire 20 years. This example highlights how the federal government can sell U.S. bonds for $50 now and guarantee payment of $100 in 10 years. Through compounding, the $50 investment can produce a four to five times greater return in 10 years, while still allowing the government to pay the investor double his or her money.

Present Value More Than One Period Into the Future

Assume that a professional athlete such as Mike Trout has signed a contract including $2 million in deferred compensation that will be paid at the end of two years. Assume that if he were to receive compensation today, he could invest that money in a financial vehicle (such as a CD) that earns a 4% annual return. We would like to know how much money received today would be worth $2 million after earning a 4% annual return for two years. This can be written as follows:

$$PV \times (1 + r)^t = FV$$

PV = present value

r = annual rate of return

t = number of years

FV = future value

$$PV \times (1.04)^2 = \$2{,}000{,}000$$

In this equation, PV is the amount of money that would need to be invested today to grow to $2 million in two years.

Solving for PV gives us the following:

$$\begin{aligned} PV &= \$2{,}000{,}000 / (1.04)^2 \\ &= \$2{,}000{,}000 / 1.0816 \\ &= \$1{,}849{,}112 \end{aligned}$$

This equation indicates that if Mike Trout received $1,849,112 today, invested it, and earned a 4% annual return, he would have $2 million at the end of two years. This process of obtaining a present value is known as **discounting**. The $2 million is discounted by a **discount factor**, or **present value factor**, which equals 1 divided by $(1.04)^2$, or 0.9246, in this example. Using this discount factor, we can calculate the present value as $2,000,000 multiplied by 0.9246, or $1,849,112.

An alternative way to calculate the results obtained from this equation is to use table B.2 in appendix B to obtain a present value factor. This table shows the present value of $1 to be received after t periods. To use the table, locate the appropriate number of periods row and go across to the appropriate interest rate column. In our example, the number of periods is 2 and the interest rate is 4%. Thus, the present value factor is 0.9246. If we multiply $2 million by the present value factor, we find that the present value of $2 million received in two years is $1,849,112.

In general, the present value of a sum of money received t periods in the future can be written as follows:

$$PV = C_t / (1 + r)^t = C_t \times PVF_{r,t}$$

PV = present value

C_t = cash flow received at the end of t periods

r = annual return of interest

$PVF_{r,t}$ = the appropriate present value factor for $1 received t periods into the future

We can extend this example to finding the present value of multiple payments. Assume that Elena Delle Donne, a player in the Women's National Basketball Association, has signed a contract that will pay her $100,000 immediately, $110,000 at the end of one year, and $115,000 at the end of two years. Assume that she can earn a

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$$PV \times (1 + r)^t = FV$$

PV = present value

r = annual rate of return

t = number of years

FV = future value

$$PV \times (1.04)^2 = \$2{,}000{,}000$$

In this equation, PV is the amount of money that would need to be invested today to grow to $2 million in two years.

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$$\begin{aligned} PV &= \$2{,}000{,}000 / (1.04)^2 \\ &= \$2{,}000{,}000 / 1.0816 \\ &= \$1{,}849{,}112 \end{aligned}$$

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In general, the present value of a sum of money received *t* periods in the future can be written as follows:

$$PV = C_t / (1 + r)^t = C_t \times PVF_{r,t}$$

PV = present value

C_t = cash flow received at the end of *t* periods

r = annual return of interest

$PVF_{r,t}$ = the appropriate present value factor for $1 received *t* periods into the future

We can extend this example to finding the present value of multiple payments. Assume that Elena Delle Donne, a player in the Women's National Basketball Association, has signed a contract that will pay her $100,000 immediately, $110,000 at the end of one year, and $115,000 at the end of two years. Assume that she can earn a 4% annual return investing the money. The present value of the cash flows is shown in table 3.1.

Table 3.1 Present Value of Elena Delle Donne's Cash Flows Over Several Years

Year	Cash flow ($)	Present value factor	Present value ($)
0	100,000	1.0000	100,000
1	110,000	0.9615	105,765
2	115,000	0.9246	106,329
Total			312,094

The present value of the cash flows under this contract equals $312,094. In other words, the payment structure under this contract is equivalent to paying Donne $312,094 in one lump sum today.

Annuities

For certain types of finance problems, shortcuts can be used to calculate present values. In particular, we will discuss shortcut methods for annuities. An **annuity** is a constant stream of payments that is received for a fixed number of periods. Annuities are common in the real world. Home mortgages, leases, student loans, and pensions paid at retirement are all examples of annuities. When evaluating annuities, we use the following formula:

$$PV = C / (1 + r) + C / (1 + r)^2 + C / (1 + r)^3 + \ldots + C / (1 + r)^t$$

PV = present value

C = a constant cash flow per period

r = annual rate of return

t = number of periods during which the cash flow will be received

This equation is cumbersome, but fortunately it can be simplified to yield the following formula for an annuity that is paid over *t* periods (Brigham & Ehrhardt, 2014):

$$PV = C\{1 - [1 / (1 + r)^n]\} / r$$

PV = present value

C = a constant cash flow per period

r = annual rate of return

n = number of periods during which the cash flow will be received

Concepts Into Practice

An example of an annuity is the compensation package received by Nick Saban, the head football coach at the University of Alabama. In May 2017, Saban signed a contract extension that would pay him approximately $7,000,000 in salary for eight years (Patterson, 2017). For our purposes, this is treated as an eight-year annuity, effective August 1, 2017. If the appropriate discount rate is 7%, then by plugging these values into the equation, we obtain the following:

$$\begin{aligned} PV &= \$7{,}000{,}000 \times \{1 - [1 / (1.07)^8]\} / 0.07 \\ &= \text{periodic payment} \times \text{annuity factor} \\ &= \$7{,}000{,}000 \times 5.9713 \\ &= \$41{,}799{,}100 \end{aligned}$$

The present value of Saban's contract, as of August 1, 2017, when he signed it (and assuming a 7% discount rate), equaled $41,799,100. The numbers in braces in the equation are the present value factor for an annuity. In this example involving the value of Saban's salary, the present value factor for the annuity equals 5.9713. Table B.3 assists in determining the present value of $1 per period for *t* periods. Again, interest rates are shown across the top row, and the number of periods is shown on each row in the far left column. Consulting the table, you will see that for an interest rate of 7% and an annuity that is received for 8 periods, the present value factor is 5.9713, which we obtained in the calculation.

ECONOMIC VERSUS FINANCIAL ANALYSIS

One final note of importance to those starting to analyze the foundation of sport finance is that, as with accounting and finance, there is significant difference between finance and economics.

Economics is the study of social, governmental, and numerous other factors that can influence the financial state of the sport industry, but economics is not sport finance. For example, economic analysis can highlight that the economy is in a tailspin or that that the oversupply of tickets will drive down the value of certain tickets. Such analysis would be important to help a sports organization make a financial decision if too many outstanding tickets exist.

One example of how economic analysis is critical for financial decision making is the concept of **elasticity of demand**, which measures the degree to which a change in pricing affects the unit sales of a product. Thus, if ticket prices were increased $10 for a previously $100 ticket, the demand would be inelastic if such a change would not affect demand. If 1,000 fans purchased a ticket at $100 the prior year and 1,000 will purchase the ticket at the new price, the demand is inelastic. But if 500 fans refuse to pay the increased price, the demand would be considered elastic.

Finally, **economic impact** is a key focus of sport economics. Many people disapprove of public funding to build sports facilities. The argument raised by these people is that a private owner is gaining a benefit when public funds are used to build these facilities. Supporters of such projects point to the increased economic activities associated with building a sports facility. Their claim is that the construction spurs economic activity and creates employment opportunities. Economic impact analysis is sometimes focused on financial analysis and the ability of a given public entity to afford to build a facility. This analysis would examine the cost for issuing debt and the source of the money to pay back the debt. Economists can track whether such deals are a value for a community. Sometimes a new stadium will produce a positive impact on a local community with new businesses opening around the stadium. At other times, the economic impact might be negative as local government might have provided the stadium developer significant tax incentives to build and that would pull away valuable tax dollars needed in a community. Needless to say, the process of determining the economic and financial costs and benefits of facility construction is quite complex.

CONCLUSION

This chapter provided an initial glimpse into the variety of revenues and expenses that sports organizations can encounter. The chapter then examined sport accounting as a means to determine where money is going or coming. By using standardized methods, all parties can hope to have accurate information on which to base financial decisions. Due to this, all sports organizations need to have timely and accurate financial statements in the form of a balance sheet, income statement, and cash flow statement. These financial tools are vital to a sports manager's knowledge of the financial situation of their organization.

Additionally, this chapter addressed ratio analysis. Ratios allow the sports manager to compare the financial performance of the organization to prior years, other organizations, and the industry as a whole. They are vital to understanding an organization's liquidity, profitability, and financial leverage.

Finally, this chapter covered the use of time value of money to place values on future expected cash flows. This concept is particularly important for sports organizations that must look at valuing a future stream of lease payments to make decisions about whether to own or lease an asset. As a result, understanding time value of money will be shown to be important in financial decision making throughout the rest of this book.

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Class Discussion Topics

1. What is the difference between accounting and finance?
2. Why is understanding sport economics important for someone working in sport finance?
3. Briefly explain the differences among a balance sheet, a cash flow statement, and an income statement.
4. What happens to the present value of an annuity if the discount rate is increased? What happens to the future value if the discount rate is increased?
5. If we assume an interest rate of 5%, would you rather have $1,000 today or receive $1,120 in 3 years?
6. Assume that two athletes sign 10-year contracts that pay out a total of $100 million over the life of the contracts. One contract will pay the $100 million in equal installments over the 10 years. The other contract will pay the $100 million in installments, but the installments increase 5% per year. Which athlete received the better deal?

4

Assets and Liabilities

Chapter Objectives

After studying this chapter, you should be able to do the following:

- Classify assets and liabilities for a sports organization.
- Differentiate between different types of assets and liabilities.
- Identify strategies to reduce liabilities and increase assets.

The goal of this chapter is to provide an overview of assets and **liabilities**. Some people might confuse assets with revenue and liabilities with expenses. However, they are a lot more. As discussed in chapter 3, assets and liabilities are reflected on a balance sheet. Revenue and expenses are highlighted on an income statement. While this is one difference, the major difference is that it is usually impossible to generate revenue without having some valuable assets. The amount of expenses owed can be affected by liabilities but will extend beyond liabilities. If a team does not have any liabilities, there still could be numerous expenses.

The best way to look at this is a personal example. Assume you are looking for work because you do not have any income. Because you do not have any income, you have no revenue coming in. However, you own a car. The car is an asset. You can start a driving service or start working for Uber or Lyft and turn that asset, which had value but was not effectively utilized, into an asset that produced revenue. Assume you are leasing your car and pay $200 a month for the car. The **note (promissory)** associated with your lease is a liability that is due every month, and failure to pay it will result in default and losing the vehicle (i.e., losing the asset that can make you money). There are going to be expenses with the vehicle such as gas and maintenance. These expenses are not liabilities because they are associated with how much you utilize the asset. Furthermore, if you prepay your auto insurance then that is not only an expense but also an asset because you have several months of insurance to protect you and the asset. This simple example helps highlight why it is so important to understand assets and liabilities in contrast to just revenue and expenses. Revenue and expenses are covered in the next chapters, but many people think only about making and spending money while their foundation—assets and liabilities—are the underlying key elements.

This chapter will explore what assets and liabilities are and their intersection with revenue and expenses. The chapter also helps explain what issues can affect an asset, which can result in the asset losing its ability to generate revenue. Lastly, this chapter will help show how liabilities are not necessarily a bad thing and that companies will normally need liabilities in order to grow.

WHERE TO FIND ASSETS

As mentioned at the start of this chapter, assets help generate revenue or have the potential to generate revenue. According to accounting standards, an asset is something an organization owns that can provide future economic benefits. Examples include cash, inventory, accounts receivable, land, buildings, equipment, and intangible assets. We will discuss the various types of assets shortly. Current assets, inventory, fixed assets, and employees are some examples. It should be noted that assets can be found throughout a sports organization. There are various ways to categorize assets, but a good manager knows how to find the necessary assets and leverage them to help a sport business achieve its goals.

There are multiple types of assets that can be owned. They are often classified as tangible and intangible. **Tangible assets** can be touched. A car is a tangible asset. In contrast, **intangible assets** cannot be touched. Examples can be your love of a car or the joy it provides you. There is value, but that asset associated with the car cannot be touched. Even with intangible assets, there are those that have no real value (love of a car) and those that do, such as the copyright or trademark of the car, which has value and can be sold by the car manufacturer.

Current Assets

Current assets refer to anything on hand that can quickly—usually in less than one year—be turned into cash to help pay bills. Because current assets can be converted quickly to cash, they are often called cash equivalents. Of course, cash is already **liquid** (and sometimes called a **liquid asset**), so it is easy to see how it falls within the classification of current assets. Typical current assets include the following:

- *Cash.* This can be in bank accounts or even a petty cash drawer.
- *Bank deposits.* These can be **certificates of deposits (CDs)** or other investments that can be removed from the account at a set date or early.
- *Marketable securities.* These can be stocks or bonds owned in other companies that can be quickly sold on the open market (some **securities** are encumbered and more dif-

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- *Bank deposits*. These can be **certificates of deposits (CDs)** or other investments that can be removed from the account at a set date or early.
- *Marketable securities*. These can be stocks or bonds owned in other companies that can be quickly sold on the open market (some **securities** are encumbered and more difficult to sell and as such would not be considered current assets).
- *Accounts receivables*. There are various accounts from customers owing you money to refunds that are owed. Not all receivables are current assets, as some debts might be hard or impossible to collect. An aged account is one that is older and might be hard to collect. For example, if you have not paid a bill in six months, the account has aged and might be considered uncollectable (don't think this means they will not have a bill collector chase you down or sue you). That is where aging of accounts receivables comes into play, and some debts that are owed will be written off if not paid in a certain time because they would either be uncollectable or litigation will be necessary to get any of that money back.
- ***Prepaid expense***. This represents any prepaid amount for items that have yet to be consumed such as insurance, phone service, advertising, Internet service, and legal services.

Inventory

There is a debate by some as to whether inventory should be a current asset or a more long-term asset. Part of this debate is whether an inventory item can be sold quickly. Some raw materials can be sold quickly. Other raw materials might be too specialized to sell easily in their raw state. Similarly, there are some inventory items that might be partially completed and would be hard or impossible to sell. Furthermore, there are costs associated with maintaining inventory as an asset such as storage and moving costs. The various types of inventory include

- raw materials inventory,
- work-in-process inventory,
- finished goods inventory,
- merchandise inventory, and
- supplies.

Many teams have significant inventory that might be overlooked. For example, how many uniforms does a team have, and in what condition are the items? Imagine having to purchase 90 to 100 new football helmets every year. Even if new helmets are not purchased, the old helmets might need to be reconditioned. It should be noted that a football helmet would be more closely compared to supplies (such as paper clips and pens), which are needed by the business but have a much lower resale value as only fans or youth sports programs might purchase such helmets. They are a major asset, though, because it could cost thousands of dollars if a team would have to replace all of its helmets.

One of the key job responsibilities for someone responsible for ordering equipment and supplies is the cost to purchase, store, and dispose of inventory. There is a cost to order items used by a sports organization. For example, if a team is going to print some T-shirts to sell at a concession stand, there will be various costs associated with the purchase. Some of these costs will turn into assets. For example, the ordering time, time to pick colors, and copyrighting or trademarking the logo and design all take time and cost money, but not everything in the process is an asset. The design, logo, and color scheme all represent intangible assets. However, the screens to undertake the silk screening cost money and can be used again, so they are an asset. Then there are the T-shirts themselves, the cost to transport them, to store them, to sell them, and even to donate them. This example helps show how assets do not just sit around but have various expenses associated with them.

Fixed Assets

Fixed assets refer to assets that are more difficult to convert to cash and are often associated with a facility. Some people refer to the term **property, plant, and equipment (PPE)** to refer to fixed assets. For many sports organizations, a stadium or arena could be the largest fixed asset as it can be worth hundreds of millions of dollars. Even if a sports organization does not own its building, but leases it, it will still have many fixed assets such as treadmills, spinning bikes, and weights. While the most common type of fixed asset is a building and the land it is on, there can be other fixed assets such as

- computer equipment and software;
- furniture, fixtures, and office equipment;
- leasehold improvements (if the organization does not own the land or building);

- machinery such as production equipment; and
- vehicles from cars to forklifts and golf carts.

The assets highlighted are tangible assets that can be touched. Some fixed assets are classified as intangible and are recorded on the balance sheet within a separate line item. Not all intangible assets are fixed assets. This has been seen when some teams have moved and taken their name and intellectual property with them (such as the Baltimore Colts when they moved to Indianapolis). These intangible assets are either purchased or obtained as part of an acquisition. Examples of these intangible assets are

- brand names,
- broadcast licenses,
- copyrights,
- domain names,
- franchise agreements,

PROFESSIONAL TEAM BALANCE SHEET

It is hard to find balance sheet examples of major professional teams in the United States. Unlike many international professional soccer teams that are publicly traded, very few U.S.-based teams are publicly traded. Published financial reports can shed significant light on how a team operates. Due to a lawsuit involving the owner of the Carolina Jaguars, financial data from 2012 was published, analyzing the financials of the Richardson Sports Limited Partnership and subsidiaries (the parent company for the team). Table 4.1 is a snapshot with the rough numbers from the 2012 balance sheet as reported by the partnership's accountants, Deloitte Touche.

This example helps show how player contracts represent both a noncurrent asset and a liability. As highlighted in some of the categories, areas that might be thought of as revenue are actually liabilities. For example, deferred revenue can come from season ticket sales. Revenue is received, but it is a liability since the team then has to play the games, and that is a liability.

Table 4.1 Balance Sheet

ASSETS		LIABILITIES AND PARTNERS' CAPITAL	
CURRENT ASSETS (IN MILLIONS 2012)		**CURRENT LIABILITIES**	
Cash and cash equivalents	$38	Accounts payable	$14
Restricted cash and investments	$0.25	Deferred revenue—current	$22
Accounts receivables	$4.3	Player contract liabilities—current	$53
Prepaid expenses	$23	Accrued interest	$1.8
Total current assets	$66	Total current liabilities	$91
NONCURRENT ASSETS		Notes payable to bank	$45
Investment in NFL franchise	$47.7	Customer deposits	$10
Player contracts (net)	$141.4	Fair value of interest rate swaps	$3.5
Fixed assets (net)	$36.6	Player contract liabilities	$33
Cash reserves held by the NFL	$0	Permanent seat license revenue sharing	$1.8
Stadium related intangible assets	$5	Deferred revenue	$11.7
Other assets	$16.5	Other noncurrent liabilities	$16
Total noncurrent assets	$247	Total liabilities	$214
Total	$313	Partners' capital	$99
		Total	$313

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- vehicles from cars to forklifts and golf carts.

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- goodwill,
- licenses,
- patents,
- permits, and
- trademarks.

Other items that are considered assets but will never find their way onto an organization's balance sheet can include

- the value of a brand image (Dallas Cowboys being America's team),
- a well-known win–loss record,
- the historical significance of a team for a region,
- employee training that makes workers more efficient, and
- a process or strategy developed or implemented by the business that helps the organization run more effectively.

The key for intangible assets is they have significant value, if they can be nurtured and grown. Some of the most common brand names include Nike, Coca-Cola, and ESPN. Teams can also have significant value in their names, such as the Dallas Cowboys, the New York Yankees, or Manchester United. Each team has numerous—even millions—of fans around the world and on social media. Each team has numerous licensed goods sold to a thirsty public willing to pay for numerous trinkets bearing the team's name and logo. These are only a sample of the value associated with the intellectual assets for many teams.

Employees

One asset that is often overlooked is employees. They do not appear on a balance sheet as an asset, but money owed to employees in terms of wages owed or pension obligations might appear as liabilities. However, employees are often considered one of the most vital assets for a sports organization. We can use a professional sports team as an example. There could be 10 to 20 full-time sales people selling everything from tickets to sponsorship packages. Each employee has experience they bring to the job, and each might have received specific training from the team to make them more valuable. Expenses were incurred in the hiring, training, and promotion process for each employee. Each employee has been trained to generate revenue—an asset. Imagine if a company lost a piece of equipment that helps generate $1 million in revenue a year. The company would be devastated. The same holds true if an employee who generated over $1 million in revenue due to their wonderful sales techniques and rapport with customers leaves. That is why a great employee is an asset. Similar to other assets, they have value and need to be protected. When employees are not treated well they will leave. Employees that have left will need to be replaced, and that process costs money. When so much is invested in employees, it is important to treat them well, train them, manage them, and work with them to maximize the investment made in them. Similarly, if an asset is not taken care of it will break down. That is why it is so important to invest in assets—whether they be personnel, equipment, or facilities.

Besides the value of each employee, some employees are actually classified as assets by government taxing authorities. Professional athletes are considered assets by the U.S. Internal Revenue Service (IRS). The cost of player salaries can be depreciated from a team's tax obligations. This is a very unique attribute to professional sports that is not shared by any other industry. In no industry other than professional sports teams can employees be considered similar to fixed assets such as the plant, equipment, or furniture. This tax break was provided in part by famous baseball team owner Bill Veeck and his loophole is known as the roster depreciation allowance (RDA). Veeck first claimed the RDA with the IRS in 1946, following his purchase of the Cleveland Indians. Veeck assigned 90% of the team's value to intangible assets or player contracts. Veeck argued for depreciation because over time players' skills diminished, similar to other pieces of equipment. The tax rule was meant to address depreciations in the productive value of aging livestock used for work, breeding, and milk production. Veeck might have been the creative one, but he is not alone. In 1970, Bud Selig (the eventual commissioner of Major League Baseball) bought the Seattle Pilots and moved them to Milwaukee. Even though Selig bought the franchise for $10.8 million, he reported to the IRS a purchase price of $600,000, attributing the rest to depreciating player payroll

obligation. Similarly, one owner of the Philadelphia Eagles bought the team in 1969 for $16.4 million, but he reported a $50,000 franchise sale price to the federal government (Lamberti, 2012). This is all legal and afforded team owners millions of dollars in tax benefits. It should be noted that this does not represent the price paid for the team, which could result in higher capital gains taxes when a team is sold but rather represents the use of asset depreciation to help reduce tax obligations.

Over the years, the RDA has become more complicated but not more stringent. For around 30 years (until 2004), new team owners could write off 50% of the purchase price over 5 years due to declining player values. In one example, Doubleday & Company sold the New York Mets to Nelson Doubleday Jr. and Fred Wilpon in 1986. Doubleday Jr., the head of Doubleday & Company, basically sold the team to himself, albeit this was technically a change in ownership. The sale occurred exactly six years after Doubleday & Company purchased the team from the Doubleday family so it could once again start the five-year depreciation clock all over again (Durso, 1986). Due to these financial gymnastics (which are all legal) teams could be operating in the red and then owners could transfer losses over to their personal income tax forms, resulting in millions of dollars in tax savings. Starting in 2004, the tax rules were changed so owners claiming the RDA could write off 100% of their franchise purchase price over 15 years of team ownership (Lamberti, 2012).

Similar to other assets, a professional player is not just an expense but an asset that can generate revenue beyond what normal employees might generate. When Real Madrid paid a then-world record for Cristiano Ronaldo in 2009, it was not just for his football (soccer) skills. The team was counting on increasing the sponsorship value and price and also selling numerous jerseys with his name. It was hoped that such revenue would add millions over the cost of his purchase and salary. Likewise, Manchester United signed Park Ji-Sung and Shinji Kagawa not only for their potential contribution to the team but also for their ability to grow the team's presence in Asia—opening up new revenue streams. Similar to other assets, a player can also become a liability. An injured pro player is still owed a salary, they are still technically an asset, but they represent a huge liability and may never reach their asset value potential in the future. That is why teams often purchase injury protection insurance that will compensate them if a player is injured.

Asset Valuation

While there are numerous types of assets, some assets are easier to value than others. As previously mentioned, cash is easy to value, while half-finished inventory might be difficult to value. A nonprofit organization has a charitable mission or objective, but being a nonprofit organization is also an asset. It can help generate more funds because people are willing to donate in order to receive a possible tax benefit. How much then is the nonprofit status worth compared to a similar company that is for profit? The answer depends on the organization. The ability to receive tax-deductible donations is a major benefit. However, the legal requirements and educational or community focus of a nonprofit organization might make many sports organizations incapable of going the nonprofit route. As an example, a YMCA (nonprofit) might be able to accept a donation of land to build a new gym. This reduces the cost of building the gym. In contrast, a for-profit organization would have to buy the land. In such an example, the nonprofit status has significant value.

Noncash assets aren't as easy to value. A building might have multiple valuations based on different perspectives. Someone might value the land a lot less if they want to tear down the existing building and put in a different building for a different use, such as replacing a warehouse with a condominium project. The **value (V)** could also be set by a local taxing authority at a certain rate. A real estate buyer or seller might value it at a rate comparable to similar buildings in the same area. Others might give the building an increased value if the business inside the building will be part of the deal. The value can also be affected by when the valuation was undertaken and numerous other variables. The primary asset valuation techniques are

- liquidation value,
- the difference between book value and market value, and
- the fair value option.

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- liquidation value,
- the difference between book value and market value, and
- the fair value option.

Liquidated value for a business is the value if all the assets are sold. This might be high if the business owns significant land or has valuable intellectual property. However, if the business leases its property and equipment, it might have very little liquidated value if all the assets were to be sold. Book value examines what a product is worth based on the balance sheet. This valuation often has a discounted rate in part due to depreciation of the asset, when it was purchased, the useful life of an item, and related variables. Book value can also refer to a published value of what the asset is worth. In contrast, market value is based on what people would pay for the asset. Thus, a car could have a Blue Book value of $10,000, but if someone really wants the car and is willing to pay $12,000 for it, then there is a $2,000 difference between book and market value. Most people would prefer selling the car for $12,000, while buyers would generally prefer to pay $10,000. The fair value option is what most people would consider to be the fair value of the asset. In our car example, the fair value might be $11,000.

One element that affects an asset's value is whether or not it is impaired. Impairment can take the form of various issues such as whether the asset is damaged, modified, under contract, or used as **collateral** to secure a loan. Any one of these issues affecting an asset will limit the asset's value or what can be done with an asset. For example, a sports organization might want to move an asset secured by a note from one location to another. However, the note holder (lender) might not agree with such a move and can force the organization to keep it where it is—thus limiting the ability to effectively use the asset. This might be done if the lender feels they will lose the ability to confiscate the asset if the borrower defaults on payment. An example could be a $1 million scoreboard where the lender would not want the team taking it to a new location without paying off the note.

Finding and Leveraging Assets

So far this chapter has examined the various types of assets and their value. The first part of the process is to find the assets. Every sports organization will have assets. Even a consulting company has the mental assets of the sports consultant as an asset. There are numerous assets that need to be tracked, monitored, and evaluated, whether they are employees, equipment, facilities, or the like. For example, a team might think it has $1,000 of food in a fridge, but what if $200 worth of the food has spoiled? Thus, on the books, the asset might be valued at $1,000, but in reality, it is only worth $800. Once the asset is identified, the sports organization has to determine how to leverage that asset.

The next topic to consider is how to leverage existing assets to generate additional revenue. Think of it similar to having a star player and having that player warm the bench. If you know the team will win with the player in the lineup, why isn't the player playing? Similarly, if you know you can make money through using a certain asset, then you should use it. Assume a team has paid $1,000 for a mascot costume. That costume can be used at various games, and the team will probably get its money's worth if the costume will last around five years (assuming $200 a year for the **payback period** and that the costume can be used for around 20 games a year). The team could leverage that asset to generate much more revenue through allowing the costume (and wearer) to go to birthday parties, community events, and other events that can generate revenue and at the same time generate publicity and hopefully more revenue for the team.

In financial terms, leveraging a resource means to multiply the resource's productivity. The goal is to get a given resource to **yield (rate of return)** a greater return without additional input of effort. In the costume example just discussed, once the purchase is made, the team has the costume. If the costume just sits in a closet most of the year, it is wasted. If it is used for birthday parties and 200 event days a year, then the team is really maximizing the benefits of the asset. As an additional example, if you can show your ticket sales people how to get customers to increase their average ticket purchase amounts by 20%, then you have leveraged your sales staff and increased your revenue by 20%. This approach often entails **upselling**, which entails encouraging a purchaser to buy more or more frequently. Current customers are an asset, and they are being leveraged to generate more revenue. The same approach can be used for leveraging any asset to minimize future expen-

ditures. The goal is to use the asset as much as possible. If a business normally replaces its car fleet every five years, instead of replacing all of the cars, maybe some cars can be used for a longer time period. This extends the life of the asset and can save money.

Every sports organization will have multiple assets, which are either not utilized or underutilized. One example is all the cardboard boxes that a stadium or arena will utilize. Numerous concession items will be brought in for every game in cardboard boxes. In the past, these boxes were just thrown away, and every arena already spends a significant amount of money on trash removal. Over the past 20 years, more and more facilities are now selling that cardboard. This turned a liability into an asset. Besides generating revenue, it also looked good for the facility and showed it was trying to be sustainable.

Concepts Into Practice

Another way to turn assets into cash is by selling items that might have been filling up warehouse space. The Boston Red Sox have had several sales where they have sold old giveaway items, bricks, jerseys, and other old items that were sitting around in storage. In one such sale, they put items into a bag and sold the bags for $75 to $100, and they had lines around historic Fenway Park for people wanting to purchase a piece of history, regardless of what the item might be. This is in addition to selling old seats from the stadium, which can still be purchased for $795 a pair. In addition, historic Fenway Park, as part of its 100-year anniversary in 2012, sold bricks for two entrances where fans could pay to inscribe a personal message. Similar fund-raising strategies utilizing a facility's historical nature and the cost to construct or renovate the facility can be seen at the NASCAR Hall of Fame and many other facilities. NASCAR was using bricks anyway as part of its walkway, so it created a fund-raising opportunity as well.

A well-known event can be an asset. For example, the Special Olympics has regular events, and these events are a major asset for the Special Olympics organization. Many nonprofits tend to utilize assets at their disposal to generate revenue. These assets can range from celebrity connections serving as fund-raising chairs to offering the use of their property for special events rather than the nonprofit having to pay to use another entity's facilities. Organizations can also utilize their facility to generate additional funds by renting the facility out for various external groups and hosting various dances, concerts, or fund-raising events. There are no limits to the imagination when deciding on what revenue strategies to pursue with assets under your control. The key issues to consider when examining how to leverage assets include

- whether the event is consistent with institutional goals;
- whether an event might run afoul of the law;
- whether an event might be inconsistent with existing contracts, leases, or insurance requirements;
- whether an event or asset usage will generate political conflict or possibly upset key stakeholders;
- whether an event might lead to an asset losing value or being damaged; and
- whether the event will be able to generate future **goodwill** or income.

If an event will satisfy these concerns, then an organization might pursue using its assets to generate additional revenue. Some organizations have valuable resources and decide not to use them. This decision can be made to preserve an asset or to prevent any decrease in the asset's value. Some organizations with a valuable resource might put that resource in a safe location and hope that the asset increases in value. In the Special Olympics example, the connection to the Kennedy family is a very valuable asset. Eunice Kennedy Shriver helped found the games in 1968, and the family is very connected. The Special Olympics needs to steward this asset and not abuse the relationship. While the Kennedy family might feel they need to stay involved, there is significant goodwill on Special Olympics' part when they do not center too many events or demand too much from the Kennedy family. Similar to the Special Olympics, many nonprofits have a famous spokesperson, and to avoid overusing them and the goodwill the spokesperson provides, the nonprofit might only use the asset (spokesperson) as a fund-raising chair

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every three years so they do not get burned out. A good way to examine this potential is if you have a valuable sports card. Assume you have a Mickey Mantle card worth $1,000. You can use that card as collateral to borrow money to buy more cards. You can sell the card for $1,000 and hopefully pocket some money. You can use that card as a way to market some less valuable cards you really want to sell. You might loan the card for dealers to use as a way to generate some rental income or goodwill with other dealers. Lastly, you might just put the card in a safe location and hope it increases to $1,500 in a couple of years. Similar decisions are made with assets every day by various sports organizations.

Lastly, assets can serve as one of the most important tools for obtaining financing. Any bank or lender will want to insure its loan or investment and will ask for some type of collateral. Having a valuable asset can serve as a great resource for a possible lender. As long as the asset is not overcollateralized (not having too many loans on the asset or having loans that almost reach the asset's resale value), a sports organization can use it to borrow money for possible future growth or cover expenses.

Concepts Into Practice

As an example of an asset's value in financing, we can explore the concept of asset-backed securitization, where assets serve to secure a major debt. In 1999, Bear Stearns sold a $315 million asset-backed securitization financing package for the STAPLES Center in Los Angeles. The taxable notes (as compared to tax-free bonds issued by many municipalities) bore an interest rate of 7.653% and had a final maturity of 27 years with an expected average life of 14.5 years. The financing received great rating support from Moody's Investors Service and Fitch IBCA, Inc. As part of the deal, STAPLES' owners pledged the rights to specific revenues, including the right to renewals of the underlying contracts, to secure the notes. The future revenue streams used for securitization came from contractually obligated fees from the arena's naming rights, a portion of the luxury suite and premier seat licenses, the concession leases, 10 founding partner corporate sponsorships, and an exclusive ticket sales agreement with Ticketmaster, Inc. Because the securitization structure dedicates only a portion of the arena's revenue streams, the STAPLES Center had significant financing flexibility to leverage other income sources if necessary (Roth, 1999). Similar financing was also used at the Pepsi Center.

IDENTIFYING LIABILITIES THROUGHOUT A SPORTS ORGANIZATION

While we have been exploring the benefit of assets, the flip side of the coin is liabilities. A sports organization can have no assets but significant liabilities. This can be seen with some technology start-up companies who blow through cash and have nothing to show for it until a product is actually produced—if a product is ever produced. Liabilities represent what a sports organization owes. These can be amounts owed to the founders, banks, investors, employees, customers, government entities, and other organizations.

Types of Liabilities

Similar to current assets, there are **current liabilities**. Current liabilities are debts that are owed in the short time period, normally less than a year. Long-term debts are obligations that are owed more than one year out—but could have some current payments. Thus, if a sports organization owes payroll to some of its employees, that would be a short-term liability, as employment law requires employees to be paid in a timely manner. A long-term debt may include bond obligations that were taken out when a facility was built. The bonds might need to be repaid within 20 years. The organization might pay monthly installments, but the majority of the debt is due in the future. Confusion might arise in classifying a liability if it is a possible long-term debt that can be demanded for early payment. A bank loan, for example, might provide that if revenue does not reach a certain point, the obligation is owed within 30 days, even if the loan was initially a 10-year loan.

There are numerous liabilities that any sports organization can have. That is similar to how an

average person might have numerous liabilities. A typical person might have current liabilities such as rent obligations, monthly utilities bills, monthly Internet and phone bills, and weekly food bills. An average person might also have several long-term liabilities, including a **mortgage**, car loans, or a student loan. Some of the liabilities a larger sports organization might have include

- 401(k) payable;
- accrued expenses payable;
- accrued liability;
- bonds payable;
- common stock dividend distributable;
- dividends declared;
- federal income tax withholdings payable;
- income and other taxes payable;
- interest payable;
- lawsuit payable;
- mortgage payable;
- net payroll payable;
- payroll taxes payable;
- pension payable;
- salaries payable;
- short-term debt;
- unemployment tax payable;
- utilities payable;
- vacation pay payable;
- wages payable;
- warranty liability; and
- workers' compensation insurance payable.

The amount owed to government agencies in terms of taxes, unemployment insurance, and related expenses is often a substantial amount. While it might seem that construction-related debts are going to be the largest liability, the actual culprit is employee-related expenses. Over the long run, employee expenses such as salaries, employment benefits, pension obligations, or training costs, will generate significantly more liabilities over the life of a facility than the facility itself.

Some liabilities are very clear. If a bond for a shoe manufacturer requires monthly payments of $10,000, then management can plan for such expenses. Other expenses, such as **fixed costs**, might be calculated. For example, the organization might know it has $3 from every shoe sold dedicated to fixed costs. The management might also know that variable costs can range from $5 to $10 per shoe, based on raw material used in the shoe. These basic expenses do not always bring into consideration other liabilities and costs that can affect profitability and amounts owed. For example, contingent liability might exist if there is a patent-related lawsuit associated with the shoe, and the manufacturer might be on the hook for millions of dollars if it loses the case or has to settle. Further potential liability can be associated with warranties associated with the shoes. If the shoes are guaranteed to last at least one year, the company will have to set aside resources to help fulfill such warranties, and that represents a potential liability. Other expenses might generate additional liabilities such as shipping costs, customs taxes, transportation-related expenses, and numerous other expenses that can create liability issues. One of the key liabilities might be the amount of money owed to manufacturers in other countries that might make part or all of a shoe. These submanufacturers might send the seller (such as Nike or Under Armour) material on a regular basis and might bill on a monthly basis. Nike or Under Armour would owe these suppliers or manufacturers money, but they might wait and pay them every 90 days. This creates an opportunity for the shoe company to invest its money and pay on a less frequent basis. This creates a very unique liability dance. Company A might owe Company B $1 million. Company B owes Companies C and D $500,000 each. Company D owes several suppliers over $100,000 combined. Company B might not be able to pay Companies C and D until it is paid by Company A. Thus, everyone in this chain might be waiting for Company A to pay. This represents a chain of liabilities with everyone owing everyone else.

Cost of Debt

It is very difficult to complete a large transaction without having some type of debt. Imagine wanting to buy a home, which is often the biggest purchase a person makes during their lifetime. Most people do not have the cash to make such a large purchase, and there will be significant upfront expense to purchase the house in addition

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to regular payments. The same issue arises in the sporting world where building a stadium might cost over a billion dollars and teams regularly sell for a billion dollars or more. One example was the purchase of Manchester United by Malcolm Glazer. Glazer bought United in 2005 for £790 million in a heavily leveraged deal (he utilized assets of the team to obtain the financing). Glazer then loaded the debt, £525 million worth, onto the team. Such a debt burden on most teams would push the team into bankruptcy because the debt payment would be close to £60 million a year. Through 2014, the team had spent over £680 million on debt service (interest fees, bank charges, and debt repayment), close to double what it had spent on players (Amir, 2014).

That is not the only liability for the team. It also has a dividend liability. Manchester United plc, the United holding company, is registered in the Cayman Islands, and shares of the team are floated on the New York Stock Exchange. In 2014 to 2015, Manchester United plc announced it will pay a dividend of $0.045 (£0.03) every quarter, for each share owned by a shareholder. After the death of Malcolm Glazer in 2014, his six children became the primary shareholders, owning 131 million shares, 80% of the total issued shares. Every three months the children will be paid $5.9m (£3.8m). Annually, the quarterly dividend payments will add up to $23.6m (£15.2m). Even when such dividend obligations were being announced, the team still owed over £400 million (Conn, 2015). Teams are not alone in being burdened by debt to pay for managerial decisions. The same debt concerns often arise when investment bankers purchase companies. In order to purchase the company the investment bankers need to borrow funds and then use the newly purchased company as collateral to secure the debt. This approach backfired several times and was highlighted in chapter 1 in the discussion of the closing of The Sports Authority.

Every debt obligation has an associated cost. Borrowing money from the bank takes time and resources. The borrower will have to repay the loan with interest. The money spent on the interest and debt repayment takes money away from other potential endeavors. Thus, a vicious cycle might arise as money is needed to grow, but as the company grows it is required to pay more for money borrowed to grow. A good example of this could be how some people get into debt using their credit cards. The amount they owe is a liability. In an attempt to lower their payments they might consolidate five different credit card debts under a new credit card that offers a great introductory rate for balance transfers. The new credit card company knows that if these people had not made full payments on past credit card debts, they probably will not be paying the new credit card in full. So it will turn what seemed like a wonderful promotion into a noose as after six months the new credit card would require high interest payments. Furthermore, due to the fine print specifying zero interest only if the balance is paid in full, the credit card company will charge interest on all the prior months. This will throw people into more and more debt—especially if they think they can find an easy solution to get out of debt (such as buying lottery tickets, gambling, or even illegal transactions).

Pressure to Repay Debts

One famous case of trying to reduce liabilities through illegal means involved John DeLorean. His car, famous for the *Back to the Future* movies, was initially launched in 1973, but delays had it leaving the production floor only in 1981. After a year, his company and its iconic car had failed to recoup its $175 million investment costs, and the company faced a dire financial situation. In 1982, DeLorean was charged by the federal government with trafficking in cocaine to help obtain money to keep his car company going. While he was later acquitted of the charges (due to entrapment), his desire to help reduce liabilities at almost any cost became well known, and his company ended up in bankruptcy (Cummings, 1982).

While the DeLorean example is sensational, there are several similar examples in the sports world. One famous example involved John Rigas, former owner of the Buffalo Sabers. Rigas was initially the founder and chief executive officer of Adelphia, once the fifth-biggest cable company in the country, but it went belly up after Rigas and others looted it and then concealed the debt. Rigas and his son, who was the chief financial officer, took cash advances of $1 million a month and used Adelphia's assets to pay $40,000 a year for a personal masseuse and to buy 17 cars and $500,000 worth of antiques. The senior Rigas was convicted in 2004 and sentenced to 12

years in prison, and his son was sentenced to 17 years (Gregorian, 2016). Adelphia disclosed in 2002 that it was on the hook for $2.3 billion in off-balance-sheet loans associated with the Rigas family. This included financing the family's $150 million purchase of the NHL's Buffalo Sabres. Adelphia paid a Rigas family partnership that owns the Sabres $744,000 for luxury-box rentals, hockey tickets, and other entertainment costs. The Sabers filed for Chapter 11 bankruptcy in 2003, and according to reports, the Sabres had more than $238 million in debts, with assets of less than $70 million at that time (UPI, 2003).

Whenever a sports organization undertakes liabilities, whether bonds, bad loans, loan sharks, credit cards, or any other means, the total cost needs to be analyzed. One of the often underanalyzed costs of liability is the psychological cost. Whenever you owe someone money, you might not sleep as well. Issues to consider are inability repay the debt, possible loss of collateral, and collapse of the business relationship. In business, these are legitimate concerns that will not appear on paper that can take a significant toll on an executive.

Lowering Liabilities

When examining assets, this chapter looked at how to appropriately leverage assets to generate the greatest amount of value or to protect an asset. The same analysis needs to be undertaken when examining liabilities, but it needs to focus on how to reduce liabilities. A good example of the dance around asset growth and liability reduction can be seen in calculating an organization's net worth. Net worth is calculated by subtracting liabilities from assets. If an organization has $2 million in assets and $1 million in liabilities, then it has a net worth of $1 million. To increase net worth, the organization will want to increase assets. However, to do that, the organization will probably need to increase liability. Assets normally do not increase without some investment. A company might have **retained earnings** that can be used to fuel future growth. However, those retained earnings might be better off paying dividends to owners (either directly to certain individuals or to shareholders). Growth can also come from issuing stocks. Stocks are not a liability similar to bonds or bank loans. Shareholders become owners and there can be some potential liability (such as required dividends for preferred stocks), but it is not a debt that needs to be repaid.

The main technique used by most organizations entails borrowing money. This can be done through specific loans or utilizing a **line of credit**. A line of credit is in essence a credit card type arrangement where a company can tap the line whenever it needs any money. The line is created in advance, and there is normally a fee to keep the line of credit open. The bank might require a larger organization to do its banking at a specific bank and might allow it to have an open line of credit for several hundred thousand to several million dollars. Whenever the organization needs money, it writes a check against the credit line and then it has to start paying back the principal (borrowed amount) with the interest on a monthly basis. If there is no money borrowed from the credit line, then the organization does not owe anything. It is important to have a good relationship with a bank to allow for flexibility in utilizing a line of credit.

Organizations can use different techniques to borrow, with issuing bonds being the most difficult due to the cost and time required to issue them. That is why bonds are only issued by the largest organizations, such as professional teams and large municipalities when building a stadium or arena. While costs associated with bonds and other borrowing instruments can be reduced, the amount of reductions is limited. The easiest way to reduce these liabilities is to pay off any borrowed funds. A homeowner's example of this is to pay off a mortgage early. Instead of repaying a 30-year mortgage over 30 years, a homeowner can pay back a certain amount of extra principal every month, and then in maybe 20 years the mortgage will be paid off—saving 10 years' worth of interest payments. Such repayment efforts take significant discipline and dedication. There will always be problems requiring financial assistance, but an organization needs to prioritize liabilities and determine what is critical.

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Some liabilities can be reduced through repayment or even by negotiating reduced amounts with lenders. For example, a sports organization can negotiate with employees to reduce its owed benefits. A sports organization might be facing hard financial times and might approach employees to reduce the amount the company contributes to a retirement program and that can reduce future liabilities. Other liabilities are owed regardless of what a company wants to do. Taxes are a perfect example. Even if an organization wants to reduce taxes owed, the government rarely reduces tax obligations. If an organization has set aside $1 million to pay quarterly taxes, the organization cannot take that to reduce other potential liabilities without incurring significant penalties. Another example of a required liability that would be difficult to reduce would be a union contract. Under the terms of the contract, the organization might have certain obligations that can only be reduced through the contract negotiation process.

CONCLUSION

Assets and liabilities are critical for any sports organization. Assets represent the ability to generate future revenue and the ability to grow in the future. Liabilities represent investments to grow a business. Every organization needs to identify its assets and leverage them to generate the greatest amount of revenue. An asset that is not properly leveraged will create lost opportunity, which might not ever be received in the future. Similarly, liabilities need to normally grow for an organization to grow, but liabilities need to be effectively managed so that the organization doesn't become insolvent through having too many liabilities and not enough assets to cover the liabilities.

Class Discussion Topics

1. What do you think is the most important asset for a youth sports organization?
2. Develop a list of the liabilities a traditional fitness club would have (assume it does not own the facility but owns everything else).
3. Create a list of all your current assets and liabilities. Examine each asset and ask yourself if you are appropriately leveraging it. Can you find a way to reduce some of your liabilities?
4. Do you think professional athletes should be considered assets? Defend your position.