

**Due to the peculiar economics of professional team sports, leagues must use restrictive controls in order to maintain a competitive balance. Discuss this utilising both theoretical and practical evidence.**

The economics of professional team sports can differentiate depending on the league. One thing they all have in common is the reliance on their competitors to create the product, this is known theoretically as the inverted joint product (Neale, 1964). In order for this product to flourish, competitive balance is one of many key factors driving attendance (Rottenberg, 1956). Competitive balance reflects on the uncertainty of outcome in professional team sports (Humphreys, 2002), despite being very important for attendance in some leagues, it doesn't matter for all. Every league uses different methods to create a competitive balance. In America, we see a profit maximisation model that prevents any sole team from dominating for a long period of time and offers a product that is constantly changing/evolving. In Europe, we typically see a utility maximisation model. Teams are more inclined to maximize their own personal satisfaction by winning trophies. Most owners are more concerned with on-field success rather than financials and as they typically see sport as a consumption rather than investment.

Regardless of how leagues are structured, the teams in it do require each other in order to produce the game. American leagues are more concerned with maximizing the joint welfare of all its member clubs while each individual team is concerned about their own success. For our favourite sport leagues to continue to succeed, demand must be maintained, whether that is attendance or TV demand. It should be known that each competitor does/should have an inherent interest in maintaining the health of their rivals (Groot, 2008, p.25). The result of a match should thus remain uncertain, the greater the uncertainty, the greater the attendance. Various researchers studying Major League Baseball in the U.S have found an improvement in competitive balance (season-to-season) due to the introduction of free agency thus narrowing team's market sizes and a compression of baseball talent (Butler 1995). Free agency is where a ton of players with expiring contracts can shop around other teams for new ones, offering player movement within the closed league. In America, there is no labour market. If you are an international, the best way to join is through the draft at a young age. Therefore the player movement is selective, creating a balance with athletes who are of older age. Meanwhile in Europe, Ramchandani (2012) conducted a study on competitive balance in the EPL (English Premier League) and found that the league had become moderately less competitive. His suspicion as to why this happened was due to the fact that perhaps the increase in takeover from foreign investors in ownership which then led to an increase in purchases for star players as they sought out immediate success. Teams

nowadays are successful because of how rich their owners are and it's leaving smaller clubs who play in the top leagues to vanish.

Focusing on the American side, their leagues tend to use different restrictive controls in order to maintain balance in their selective sport from what we often see in Europe. The entry draft is a model used to aid lower-ranked teams in achieving young talent. It can be seen more as the American labour market (Massey and Thaler, 2013). Young athletes get a chance to get drafted in seven rounds (32 picks each round) and become allocated to a certain franchise until the end of their already set rookie contract. A lot of fans are for and against this. Some argue it is good to refresh the structure of the league with different teams getting the equal chance to succeed but also that the players being drafted are stuck with whoever they get picked. To make the draft balanced, the NBA had to refine its original process. In 1984, the NBA added a draft lottery to the first fifteen picks in the round (Kahane, 2009. p.643). This was in order to disincentivize intentionally losing matches late in the season. Further American leagues followed with the same system. Despite adding random allocation to a degree, Duquette and Cebula (n.d) found that the rookie salary structure from the 2011 collective-bargaining agreement had to be corrected. The structure shows a decrease in market value as each round passes but the fall-off in players selected in accordance to tenured-career did not correspond. Krautmann et al., (2009) stated that with the implementation of the rookie salary structure, owners can exercise a monopsony power whenever and wherever they can. In general, the draft does give bottom-teams a chance to get back in the mix, this is what refreshes American leagues the most. What also refreshes American leagues is revenue sharing. The Pittsburgh Pirates had the lowest payroll in the MLB but revenue sharing allowed them to spend the most money in the last three seasons on drafting players (Addison, 2011). In the NFL, 90% of the revenues are shared among all franchises creating a financial balance between teams thus generating a competitive balance with the NFL's top teams (Grow, 2006).

Salary cap stabilizes a league's competition the most in America, restricting teams to a certain payroll every year. For the NHL, the current maximum is 82\$ million. However, every league is different as there are NFL quarterbacks who make almost 50\$ million a year for reference. The cap structure is different for each league, but another restriction to this is the roster size limit. The NFL has 54 players max, NHL 50, NBA 15 etc. Teams have to spend their money correctly on players within this restriction making it difficult for winning teams to stay on top. Meanwhile, we often see clubs such as Real Madrid and Barcelona remain a dynasty due to the different European restrictions. Of course for American teams, there are ways around this. In 1995, the Dallas Cowboys were

67% over the cap after signing Deion Sanders. They had signed him to a 35\$ million deal but worked out 13\$ million as a signing bonus (Badenhausen, 1996). Most of his contract wasn't allocated to him until four years after the signing. More recently in the NHL, the Tampa Bay Lightning won back to back stanley cups while being 18\$ million over the salary cap limit. Star players like Nikita Kucherov had missed most of the season on LTIR (long-term injured reserve) but was ready to play in the playoffs while working around the salary cap (Toronto Star, 2024). The Blackhawks did this in 2014 when star player Patrick Kane went on LTIR, vetoing his contract at the time, so they could trade for more good players, and then become eligible to join them in the playoffs. Salary cap in examples like the NHL can provide balance but the system is partially flawed as three of the last four teams to win the cup had used this method. The NHL is a closed league with 14 different teams in the last 30 have won it all, but is the competition truly balanced because of this?

American market restrictions in sport such as the salary cap could be an interesting addition to European leagues. However, it would be difficult to be placed in the Premier league as it is an open league with very frequent movement. As utility maximizers, it may not be in the best interest of top clubs like Manchester United, but for smaller ones like Burnley, it may help a lot. Every football league is different in Europe as well. If a cap were to be implemented, a closed league would be necessary in order to maintain balance and that would not work for the fans. In the Premier league, only 70% of a team's revenue can be spent on transfers, salaries and agent fees by clubs playing in European competitions (Harris, 2024). This makes it difficult for clubs with smaller revenue to compete with the top clubs as they don't make as much. Carlo Ancelotti pointed out that the Premier league can become more competitive by adding salary caps which would result in less money for managers and players but maybe equalise the playing field (Liverpool Echo, 2021). The great features from what a salary cap offers include: player salary distribution, holding down the excessive top player's salaries and guaranteeing club owners of both small and big clubs a reasonable profit rate (Késenne, 2000). The implementation of a salary cap in European football could then eliminate the need for FFP (financial fair play) rules. The new sustainability rules for FFP include no overdue payables, squad cost rule and the football earnings rule. UEFA has revised the rules for the fourth time (Kolke, 2022) as it seems they continue to give the top clubs more leeway which inevitably hurts smaller clubs more. Peeters and Syzmanski (2014) stated that the break-even rule may further separate top competition from bottom as it protects big market clubs from challenges made by clubs who are backed by outside investors.

In order to fully suggest that Europe should have had a salary cap, it should be mentioned of un-balanced some of the leagues truly are. I decided to conduct my own analysis on season uncertainty within the Eredivisie, Ligue 1 and La Liga. The data selected ranged from the 2012-2017 season's assessing total points in each season. I calculated the **C5 Index & C5 Index of Competitive Balance** (Michie and Oughton, 2004) which state total points won by top five clubs / total points won by all clubs (**C5**) and the ratio of the points for the top five teams in the league vs the share of points for the top five teams in a perfectly balance league (**C5ICB**). Lastly, I also used the Herfindahl-Hirschman Index (**HHI**) (Depken, 1999) to measure uncertainty of a match in the long run for each league. My findings were that the Eredivisie was the most competitive league analyzed with an **HHI** of **3.8**. Ligue 1 was a close second with **4.2** meanwhile La Liga was a shocker at **10.2** (see appendices below for data). What gets interesting is that despite having the most competitive league out of the three, the top five teams in the Eredivisie had the largest **C5I** at **40%**. This means that despite the array of winners, the top five teams still accumulate close to fifty-percent of the league's points. They also managed to average the lowest attendance level out of the three leagues. So despite having several different winners, the league isn't very balanced outside the top five. La Liga on the other hand saw FC Barcelona win three of the five seasons analyzed and maybe that drew in more attention to not only fans but the players. Since they have significant title success, players are more attracted to joining those top teams rather than mid-table in said league. This proves that the coase theorem is relevant today as it states that players are more likely interested in teams with winning records, generating an MRP (marginal revenue product), as the star players add to the team's revenue and winning percentage. The issue in Europe is that the fan bases are different from each other and some like a match that isn't competitive. Adessa, Caruso and Di Domizio (2019) conducted a study on the determinants of TV demand in Serie A and found that Italian fans are more interested in watching their own team for their satisfaction/benefit regardless of the strength in the competition. The amount of talent present in a game and the relevance of the game itself are separate factors that could potentially affect the demand for sport (Funk, Mahony & Havitz, 2003). If a salary cap were implemented, top talent would be reduced and scattered across other clubs and fans in Italy may not handle that well.

As briefly mentioned, FFP is a restriction that European markets use to create a competitive balance. The primary goal of FFP is to establish financial discipline and rationality in the management of European Football clubs (Birkhäuser, S., Kaserer, C. and Urban, 2019). However, there is concern that it has only decreased competitive balance in Europe. FFP has added limits for clubs with their spending but in terms of handing out disciplinary actions to the teams in breach of their rules, only the smaller

clubs have been found guilty. Everton and Nottingham Forest in the Premier league have received point deductions for breaching rule violations but clubs like Manchester City have not. They have allegedly breached 115 rules in spending but haven't been punished yet. FFP adds a restriction to Football spending but hasn't found the big clubs in breach of their rules as guilty. With a club as successful as Manchester City, an FFP point deduction would tarnish their reputation significantly and it almost feels like it would never happen. In some ways, FFP has limited competition in domestic leagues because a situation has been created whereby the same clubs are qualifying for champions league year on year (Flint, Plumley, 2015). But the effectiveness of FFP seems minimal since we mostly see the same champions league-competing teams every year. Therefore it should be noted how significant spending power nowadays has become in order to make a true competitive advantage as it is becoming difficult to catch up to these bigger clubs without external funding.

To conclude, it should be easy to point to the need for further market restrictions in Europe. Despite UEFA's methods to form balanced leagues, there is still quite a gap between top and middle tiered teams in some of the best leagues. However, I don't think anything is likely to be implemented soon. FFP rules will continue to update but unless the talks of a Super League comes back up, this road will continue further. If leagues like La Liga, Premier League, Ligue 1 etc. want an evenly balanced league, the simplest answer would be a salary cap. It's tricky seeing clubs like Luton Town FC have the same \$\$ as Manchester City but if every roster was balanced, adding that payroll limit provides a significant balance in sport. As it is mostly open leagues in Europe, maybe tweaking the FFP rules for teams who make a certain \$\$\$ could create a balance. Eliminating the theory of 'father clubs' when teams like Real Madrid continue to pick athletes off of young club's such as Dortmund and Ajax and ensuring youth contracts are of longer duration could go a long way.

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