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Interview with Peter Bavacci

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INTERVIEW WITH PETER BAVACCI

BY

MEL BYERS

ABSTRACT

Risk is one of the primary elements in any investment decision. Sports is a non-conventional type and is special because of the nature of sport in society. Peter Bavacci is president of one of the major marketing firms that represents investors. He has unprecedented success for his returns on investments for his clients.

MAJOR LEAGUE SPORTS AS A BUSINESS INVESTMENT--A RISK/BENEFIT ANALYSIS

Question 1: What is the nature of sport?

Answer: Sport is a mind-set that involves leisure and recreation. It is part of the culture and is engrained in Western civilization. It represents a cross section of society and brings together all sub-cultures. The business principles and aspects of marketing and promotion associated with this area is different from conventional investments because of the public's love affair with sport. The concept of play for profit is becoming an important aspect of the society the ever increasing demand by the public for more sports entertainment.

Question 2: What are the changes that you have observed in sports in the past ten years?

Answer: There has been little change in quality and a much greater change in quantity. New sports, as a result of technology, are in the process of being developed at an ever-increasing rate. This has a broad effect upon the market and has diversified the interests of the American public away from some of the more traditional sports. Discretionary income and population size are the two factors that have changed dramatically. Discretionary income that is available to the family expenditure on professional sports has increased and the number of individuals has increased proportionately, therefore, professional sports has become more successful because the market has an increased potential for participants, spectators, and investors. The main impact has been upon the interest in greater diversity of sport while still maintaining a high interest level in the traditional sports. The quality has remained high in professional sports in terms of the value for the entertainment dollar and the economic impact of sport, therefore, has increased proportionately.

Question 3: Because of the cultural influence of sport, does it respond more to market or non-market mechanisms?

Answer: It responds more to non-market factors and, therefore, the risk/benefit analysis is difficult because it is an unconventional investment. Conventional investments respond directly to the market cycles. Investment in professional/team sports is one of the most difficult types of economic analysis, even among unconventional investments because influences upon the market are complex.

Question 4: What type of risks make sport different from conventional investments?

Answer: There are external and internal factors that the owner or investor has little control over. For example, an external factor is weather. It can wipe out a home stand in an outdoor sport with a popular team and revenues can be significantly reduced. Two other examples of external risks that have influenced the market in the past, in most sports have been player contracts and other team salaries. An example of an internal influence is economic down trends which produce lay-offs and depress income levels in a local area. This reduces the amount of discretionary income available and the market is significantly reduced along with profits. Some examples of other internal factors may be bad partners and disputes among players. The investor has more control over the internal influences than the external. The basic nature of an unconventional investment is trying to get some control over these internal and external influences to the point that one can, at least, predict and prepare for the inevitable result. The more unexpected, the greater the impact upon the investment.

Question 5: If the market is not a primary influence, what is the basic factor that sets the selling price?

Answer: There are many investors who are willing to purchase professional sports teams. This demand has driven prices up to the point that they are out of proportion with the potential risks and profits that can be made from the industry. The number of franchises in the league are limited and therefore the number of opportunities to invest are small compared to the number desiring to own a major league sporting team. As a result, there is no basis for the purchase price that can be found in the market. It is strictly a function of a buyer's demand and seller's willingness to pay. Individuals enter into investments in professional sports and do not completely understand hidden costs associated with operations. Many times these hidden costs are an important factor which limit profits. Another influence upon the negotiation process is the fact that most sales make headline and, therefore, are under intense media scrutiny. This scrutiny causes problems since it is a factor that will influence profit because of the P.R. effect. Intense scrutiny is one of the major factors which causes major sports to be a non-conventional investment.

Question 6: Based upon risks and profits, is investment in a major sporting team wise?

Answer: Overall, no, but it primarily depends upon the league and the franchise. It is like any other type of investment, there are always those who turn a good profit and those who do not. It depends upon how the investor uses his opportunities and how successful he is at managing his investment. Besides, there are factors other than just profits that make it a wise investment, such as amortization schedules and tax advantages.

Question 7: Of the leagues in professional sports, which is the most successful in turning profit, ignoring such factors as tax advantages?

Answer: The NFL is the most profitable operation on a club by club basis. It is not a function of the market, increased gates, or television revenue. It is a direct function of structure because they have a revenue sharing plan among owners. This plan allows the risk to be distributed across the league. This type of structure forces owners to be accountable to the sport and have an interest in the development of the profession, not only their franchise. It also moves the emphasis from the franchise to the league and creates an element of responsibility outside their realm of influence. These owners, acting in concert through the contrived structure, can better control the external and internal factors that influence their unconventional investment. Risk is significantly reduced. This type of revenue sharing should not be adopted for all professional sports, but the owners or investors have to work together through some type of structure to help reduce the risk.

Question 8: What are the investment potentials in some of the other leagues, given that investors are primarily interested in franchises, not leagues?

Answer: The information provided is based upon an approximation of a league's condition and does represent any particular franchise. There are always some franchises that do well and some that lose excessive amounts of money. USFL-unprofitable with an average loss of two million dollars per team. The average cost of a new franchise is six million dollars.

National Hockey League-marginal profits.

North American Soccer League-dismal fiscal outlook. It was thought ten years ago that the North American Soccer League would be the next major spectator sport. This has not developed.

Major Indoor Soccer League-better than NASL, but still losing money. Its future depends upon the staying power and popularity of this sport.

NBA-a money loser with some losses excessive. It is just now recovering from the ABA challenge.

Major League Baseball-net lost was 80 million dollars for the 26 clubs

(based upon 1982 season).

Question 9: What are some of the factors influencing profits in the short run?

Answer: Two of the most important factors have been salaries of the players and television revenues. What has kept it profitable has been that revenues have stayed ahead of the salaries. Another important factor is the cycle of popularity. There are established sports that have traditionally attracted the average consumer. New leagues and administrators are trying to popularize their particular sport through the mass media. Television has helped popularize several sports and it has even helped bring a new concept such as the USFL into being. The primary factor under cycle of popularity is the consumer's willingness to accept the new product. Another factor is vertical integration. This is where an owner also has the TV rights and owns the stadium. The investor has a greater influence over operating costs and has been able to take his product and increase profit from a number of operations. Another element has been regional television. Some franchises have been able to market to a local TV audience and have been able to increase their revenues. Some of the leagues are also moving more toward a cooperative system. This has helped equalize the risks thus, the profit picture. Professional sports is a highly diverse product and there are many opportunities to realize profits. Those franchises or individuals who have been innovative in reducing costs and marketing their product to new audiences have been successful on an individual basis.

Question 10: What are some of the reasons that investors take the high risk and low profits in professional sports?

Answer: These are not listed in any order of ranking. There is a diversity of reasons that exist in ownership. Major product companies own a team as a marketing device. Others own it as a hobby or avocation. Investment for a profit is way down the line. The reasons are reflective of an individual's desire to own a "piece of America". Whether it is a spectator, participant, or an owner, sport has captured the imagination of the society, has had a dramatic impact on it and has kept the demand high for both investment, as well as an attraction for the entertainment dollar. Sport has become a cultural phenomena and is a reflection of the culture. The future depends upon sports and its ability to influence the public.
