



Broadening the Field:

The NFL's Option to Acquire Arena Football

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On February 8, 1999, the National Football League (NFL) secured an option from the Arena Football League to purchase 49.9% of it. As the deadline for exercising that option nears, the franchise owners wonder whether they should take the option or let it expire.

The National Football League

The National Football League (NFL) presides over professional football (American football; what the rest of the world knows as 'football' goes by the name of soccer in the United States). The season for NFL football runs from late July to the end of January. It culminates in the league championship, also known as the Super Bowl, and an all-star game, the Pro Bowl.

The National Football League began in 1920. Since then, it has grown dramatically. Today, the league generates more than \$3.9 billion in annual revenue from a variety of sources. It can reasonably claim the title of being the most successful and popular sport in the United States. Consider: Roughly 130 million Americans watch the league's championship game, the Super Bowl.¹ Indeed, Super Bowls claim 9 of the 10 spots on the list of most-watched telecasts in the United States.²

Some attribute its popularity to the drama perpetuated throughout the season. Relative to other team sports, the NFL produces an unusually large number of close games, and teams rarely find themselves out of contention for the championship midway through the season. For example, in the 2001 season, 21 of 31 teams still had a shot at the playoffs in the final week of the regular season. Moreover, thanks to the relative parity among teams, more than 20 games (nearly 10%) in the regular season went to overtime for a decision.

¹"Super Bowl is a big hit," Associated Press, February 1, 2000

² ibid

On the business side, the NFL is a holding company comprising 32 franchises (rights to field a team in the league).³ Each of the 32 franchise holders sits on the governing body of the league, directed by Commissioner Paul Taliahue. As with many other professional sports leagues in the United States, the NFL effectively holds a monopoly on its sport at the professional level. In fact, in 1986 it lost an anti-trust case brought by the (now defunct) United States Football League (USFL); however, the judgment resulted in a mere \$1 damage award to the USFL.

NFL teams pull in revenue from a variety of sources (see **Exhibit 1** for an example of a typical income profile). Ticket sales, by far the oldest source of revenue, remain an important source of income. In 2001, the average ticket price for attending a game exceeded \$50 (\$53.64), an increase of 8.7% over the average price charged in the 2000 season.⁴ Despite this increase, attendance declined by less than 1% from 16,346,740 total admissions in the 2000 season to 16,244,538 in 2001. Hence, ticket sales accounted for more than \$870 million in revenue in 2001. Even at these price levels, the NFL probably leaves money on the table. Many teams have long waiting lists for season tickets; for example, the Green Bay Packers have 56,000 people queued up to buy season passes.⁵ In the meantime, these fans must often settle for watching the games on television.

Given the demand for access to live events, the NFL has even begun promoting their training camps as a potential revenue source. Training camps run for the four weeks preceding the regular season, from the middle of July to the middle of August. In the 2000 season, the Redskins experimented with charging admissions to these sessions; between tickets, parking and refreshments, the team estimated that a family of four would spend \$100 to enjoy one day of the training camp experience.⁶

Like many other professional sports leagues, the NFL also receives significant income from broadcasting rights. In 1998, the league signed the largest broadcasting rights contract ever, an eight-year deal with ABC, CBS, ESPN and Fox worth a total of \$17.6 billion. Other smaller deals bring in additional revenue. For example, DirectTV paid \$150 million in 2001 to offer their NFL Sunday Ticket (satellite broadcasts of all NFL games).⁷ More than 1.3 million individual subscribers paid roughly \$169 apiece (in addition to the normal DirectTV subscription fees) to receive to this programming.

In addition to ticket receipts and television rights, NFL teams receive incremental revenue from several other sources. The NFL maintains licensing agreements with a wide range of merchandise manufacturers from which the league collects royalties. In most stadiums, teams sell corporate box suites. And the league also distributes proceeds from

³ Currently only 31 of these franchise holders exercises the rights to field a team. The Houston Texans, a newly issued expansion franchise, currently does not have a team, though it plans to play in the 2002 season.

⁴ "NFL ticket costs shoot up by 8.7 percent," CBS Sportsline, September 5, 2001

⁵ "Packers release final numbers on season-ticket user fees," Associated Press, April 20, 2001

⁶ "Redskins start charging fans to watch practice," Associated Press, July 20, 2000

⁷ "Talks heating up over NFL Sunday Ticket package," *CableWorld*, September 16, 2002

the sale of new franchises to its member teams (each team in the league receive more than \$9 million from the new expansion team the Houston Texans).

The league distributes revenue relatively evenly across its members. Teams evenly split television and radio broadcasting rights, licensing revenues and franchising fees. Teams even split ticket sales (excluding luxury box sales) with visiting teams. In total, the NFL shares roughly 62% of its gross revenues equally across its members (compared to 20% for Major League Baseball and 35% for the NBA).⁸ Hence, the richest teams bring in little more than the poorest; for example, the eight biggest moneymakers made only 28% more than the eight teams at the low end (versus baseball, for example, where the New York Yankees had revenues in excess of 21 times that of the Montreal Expos).⁹

NFL teams also have relatively similar expenses (compared to those in other professional sports leagues) thanks to a salary cap. The policy, adopted in 1993, specifies that no team may spend more than a certain amount (\$67.4 million in 2001) on player salaries (**Exhibit 2** shows how this cap translates into individual player salaries. Though teams routinely game the cap – for example, by paying rich bonuses in the first year(s) of a contract that they can amortize over multiple years, even after the player’s retirement – these manipulations eventually come back to haunt teams. The San Francisco 49ers had won four Super Bowl championships with their 1993 team when the salary cap hit them. Both fans and the team owner, Eddie DeBartolo, wanted to see the winning team stick together so the management mortgaged the future to keep the team together. Though it allowed the 49ers to reach another six playoffs and win another Super Bowl, by the 2000 season when most of their stars had retired, the team could barely afford to pay more than the league minimum for any player – they entered the season with a mere 20 players with more than three years of experience. In the words of Panther’s capologist Marty Hurney, “This isn’t rocket science...with each contract you put yourself over the edge and hope that you don’t fall off the cliff.”¹⁰

Despite occasional complaints about the constraints imposed by the salary cap, it as well as the other policies of the NFL has led to a healthy league. Every team in the league enjoys healthy positive cash flow (**Exhibit 3** details the revenues and player costs for each team in the league, as well as an estimate of the current value of the asset).¹¹ In addition to savvy management of revenue and expenses, observers also credit the success of the NFL to its careful management of its brand name. Given the investment that the league has made in developing a premium brand name, it does not take affiliations with other organizations lightly.

⁸ “The NFL machine,” *Business Week*, January 27, 2003

⁹ *ibid*

¹⁰ “Abuse a salary cap, go to jail,” ESPN.com, August 31, 2000

¹¹ www.forbes.com

Arena Football

Jim Foster, a former NFL marketing executive founded the Arena Football League in 1981. The idea came to him while watching the Major Indoor Soccer League All-Star game at Madison Square Garden in New York.¹² The first game took place in Rockford, Illinois on April 26, 1986. Unlike other attempts to start a second football league – the World Football League (WFL), the USFL and the XFL – the Arena Football League, now entering its 15th season, has shown staying power. A 1998 poll, commissioned by ESPN, suggested that more than 72 million Americans consider themselves fans of Arena Football.

Part of the success may stem from Arena Football's strategy. Jim Foster does not consider Arena Football a competitor to the NFL, rather he sees it as "a summertime complement to the NFL."¹³ Sixteen franchises, led by Commissioner David Baker, make up the Arena Football League. The teams begin playing each other in late March and continue their season through the league championship, the ArenaBowl, in August.

Arena football differs from NFL football on several dimensions.¹⁴ It only plays indoors. Instead of playing on the traditional 100-yard field, Arena Football has shortened the field to 50 yards. This change both intensifies the action and allows the league to use a wider range of indoor sporting facilities. Teams consist of 8 players who play both offense and defense, speeding play by eliminating the need to constantly move dozens of players on and off the field. Some "football purists have scoffed at Arenaball."¹⁵ But others recognize that though these changes modify the look and feel of the game, as Les Miller, Senior Assistant of Football Operations for the Cleveland Browns notes: "it's still football...blocking and tackling."

Although some view Arena Football as something like a minor league for the NFL, others consider them relatively distinct. Jerry Jones, the Owner/General Manager of the Dallas Cowboys, argues that the two leagues require players with "different skills." Whereas the NFL game emphasizes size and strength, Arena Football puts an emphasis on speed and mobility. Notably, with the exception of the highly publicized case of Kurt Warner (who went from Arena Football to become MVP on the Super Bowl), few players have transitioned successfully across the leagues.

The League earns revenue from a variety of sources. As Bill Prescott, VP of the Jacksonville Jaguars notes though, "[Arena football] today resembles the NFL of 20 to 25 years ago...when you survived on what local revenue you could generate." Similar to minor league baseball teams and other franchises targeting smaller markets, the league relies heavily on revenue from ticket sales. In the 2001 season, 1,167,350 fans attended games

¹² "The Arena Football League: Evolution of a Fan Friendly Sport," www.arenafootball.com

¹³ "NFL agrees to exclusive option to purchase equity interest in the Arena Football League," Arena Football League press release, February 8, 1999

¹⁴ *ibid*

¹⁵ "Elway part of group seeking Arena team for Denver," *Rocky Mountain News*, August 18, 2001

(**Exhibit 4** provides team-by-team statistics on attendance). Tickets for Arena Football events average \$17; in part, this low pricing reflects the league's belief in being accessible to everyone. In fact, the Arena Football League has drawn up an "AFL Fan's Bill of Rights." Among these rights, fans can expect 'affordable' ticket prices for a "total entertainment experience."¹⁶

Although the league receives revenues from national television broadcasts – it has deals with ABC, ESPN, ESPN2 and TNN – each of these deals only covers a single televised game per week. The total value of its national broadcast rights thus falls in the single-digit million dollar range. The prospects for increasing the value of these contracts also appears limited until the league increases viewership – the 2001 championship game, ArenaBowl XV, only garnered a 1.5% share. The Arena Football League does allow teams to pursue contracts with local or regional networks, for example the Los Angeles Avengers have deals with KCAL (Channel 9) and FOX Sports Net, but the revenue from these deals accrue only to the local teams making them.

In the short term, it expects to realize substantial proceeds from the sale of rights to expansion teams: each new team pays a \$8.5 million to \$10 million fee to join.

Labor, in the form of players, accounted for most of the cost of operating an Arena Football team. When the league started players earned wages of only a couple hundred dollars per game, plus a bonus if they won. Contracts in the early years of the league required players to sit out for a season before they could negotiate as a free agent with other teams. However, in 2000, the players formed a union and negotiated an 8-year collective bargaining agreement. The contract calls for rookies (1st year players) to receive a minimum of \$900 per game, plus a \$200 win bonus. Pay rises to \$1,450 per game (and a \$400 win bonus) for players with at least two years of experience. After four years in the league, all players may negotiate as free agents. Teams, however, face a salary cap (roughly \$1.5 million in 2001) for overall players' compensation.

Perhaps because of the price point or perhaps because of the differences in the game, Arena Football attracts a younger set of fans than the NFL. Surveys reveal that 32% of all of its fans fall in the 12 to 24 year-old age range.¹⁷ Many of these fans appreciate the flashy, unconventional flair of the league compared to the perceived stodginess of the tradition-laden NFL (nicknamed the 'No Fun League' by some disgruntled fans). As one enthusiastic fan wrote in on the Arena Football League's message board: "If the league maintains its innocence... count me in! For the day it doesn't, I'll find something better to do with my time and my money, and so will a lot of other people."¹⁸

The Arena Football League intends to capitalize on its popularity. Over the next two years, it plans to expand from its current stable of 16 teams to as many as 24 teams. In April 2000, the League also introduced af2, a developmental league with 35 teams akin to

¹⁶ www.arenafootball.com

¹⁷ "A brief overview," www.dallasdesperados.com

¹⁸ www.arenafanonline.com

the minor leagues in baseball. The Arena Football League owns 49% of this semi-independent entity. In addition to helping train players for the 'major' league, af2 will also bring live arena football action to midsize cities. If all goes well, it has plans to expand rapidly into these smaller markets, potentially authorizing as many as 74 teams for the 2004 season and up to 150 teams by 2010.¹⁹

In addition to expanding the number of teams in the league, Arena Football has also been reallocating franchises from less populous markets to more heavily populated ones. For example, one team moved from Des Moines (the 70th largest market) to Long Island (the largest market in the U.S.) to become the New York Dragons. The Firebirds, formerly of Albany, New York (the 53rd largest market) also moved to Indianapolis (the 12th largest market).²⁰ These moves have not been without cost. Some fans have stopped supporting the league in response to what they see as a lack of consideration for their concerns; as one columnist noted: "If there ever was a question that football has become a business instead of a sport, these moves prove it...So long as television networks, advertisers and Internet services continue to pay big money...the owners will continue to screw the fans."²¹

Despite its success, officials see room for improvement. For one, a substantial share of the population has little or no awareness of Arena Football. Beyond a \$2 million publicity campaign, the league has done little to promote the sport at a national level. Instead, it has relied on local teams to promote Arena football in their local markets. Thus, as AFL Commissioner Baker states: "I think our challenge is for more people to see and understand Arena football."²²

The Option

In its 80+ years, the NFL has watched other rival leagues come and go. Still, Arena Football has lasted longer than any of the others. The NFL owners thus wonder whether they should engage in a cooperative relationship with this new league. Purchasing a part of the league would represent the first step in moving towards a partnership.

On February 8, 1999 the two leagues agreed that the NFL would have the option to purchase 49.9% of the Arena Football League for \$10 million. The deal would likely require less cash to change hands, however, because the Arena Football League has already borrowed nearly \$4 million from the NFL against this exercise price.

The purchase would give the NFL rights to 49.9% of all *significant* future revenue. At the current time, that revenue would include expansion fees from new Arena Football teams, future television broadcast fees and national sponsorship deals, and any proceeds from "new media rights" (e.g., the Internet, cable television and satellite television). Dis-

¹⁹ "Q and A with Mary Ellen Garling of af2," *The Virginia Pilot*, April 7, 2001

²⁰ "Vision for the indoors," *Peoria Journal Star*, April 12, 2001

²¹ "Home sweet temporary home," TOTK.com Sports, April 10, 2001

²² "Arena's power picks up steam," *St. Petersburg Times*, June 15, 2001

tributable income does not include revenue generated at the local level (e.g., gate receipts).

The option agreement also gave NFL owners the opportunity to purchase rights to a new Arena Football expansion team at a discounted rate (about \$5 million, a little more than half the going price).²³ Seven NFL owners have already taken advantage of this provision, including K.S. “Bud” Adams, Jr. (Tennessee Titans), William Clay Ford (Detroit Lions), Jerry Jones (Dallas Cowboys), Tom Benson (New Orleans Saints), Daniel Snyder (Washington Redskins), Wayne Weaver (Jacksonville Jaguars) and the York family (San Francisco 49ers).²⁴ The NFL made a special amendment to its existing rule banning ownership in other professional football leagues to allow these investments.

The deal promises to “ensure the future of football” in four ways. First, it would help promote interest in football in small and medium sized markets that currently lack professional teams. Second, it would allow football to become a year-round sport. Third, the two leagues would work together in promoting interest in American football internationally. And finally both could coordinate their efforts to support youth football and grass-roots participation in the game.

From the Arena Football side, owners and league officials appear keen to draw on the NFL’s strong brand name and its access to large media deals. Alluding to the possibility of re-branding the Arena Football League, Jim Foster rhetorically asked: “What’s the value of being able to say, ‘NFL Arena Football?’”²⁵

Before the deal can proceed, however, the NFL rules require that 75% of the ownership (24 of the 32 teams) ratify the agreement. Owners tabled the issue at their last meeting requesting further due diligence. They have retained your team, as consultants, to help them better understand the issues involved. Should they proceed or should they let the option expire?

²³“Elway part of group seeking Arena team for Denver,” *Rocky Mountain News*, August 18, 2001

²⁴ www.arenafootball.com

²⁵“Vision for the indoors: Arena game drawn up 20 years ago now a must-have for cities,” *Peoria Journal Star*, April 12, 2001

Exhibit 1: Green Bay Packers income statements 1999-2001

	2001	2000	1999
OPERATING INCOME			
Ticket & Media Income			
Home games (net)	\$17,888,869	\$14,582,253	\$12,430,382
Road games	\$9,414,937	\$9,395,968	\$8,336,206
Television and radio	\$65,108,700	\$61,004,699	\$61,824,080
TOTAL	\$92,412,506	\$84,982,920	\$82,590,668
Other Operating Income			
Private box income	\$5,974,000	\$5,794,000	\$4,384,000
NFL Properties income	\$6,194,800	\$4,160,594	\$4,245,921
Expansion sharing income	-	-	-
Marketing\pro shop (net)	\$13,389,036	\$8,057,659	\$6,699,231
Other	\$6,010,879	\$5,818,832	\$4,783,810
TOTAL	\$31,388,715	\$23,831,085	\$20,112,962
Total operating income	\$123,801,221	\$108,814,005	\$102,703,630
OPERATING EXPENSES			
Player costs	\$77,288,196	\$76,639,234	\$66,005,634
Game expenses	\$2,159,366	\$2,304,104	\$2,148,365
General & administrative	\$41,289,682	\$30,290,184	\$27,555,686
Lambeau redevelopment	\$294,049	-	-
Total operating expenses	\$121,031,293	\$109,233,522	\$95,709,685
PROFIT (LOSS)	\$2,769,928	(\$419,517)	\$6,993,945

Exhibit 2: Player salaries²⁶

Season	National Football League			Arena Football League		
	Minimum	Mean	Maximum	Minimum	Mean	Maximum
2001	\$209,000	\$1,100,500	\$15,154,000 ²⁷	\$12,600	\$57,300	\$125,000
2000	\$193,000	\$1,116,100	\$8,537,900	\$12,600	\$50,000	\$115,000
1999	\$175,000	\$1,056,300	\$6,667,300	\$11,600	\$22,900	\$105,000
1998	\$158,000	\$992,700	\$7,579,000	\$8,400	\$19,800	\$60,000
1997	\$131,000	\$736,700	\$5,874,200	\$5,000	\$16,700	\$50,000
1996	\$131,000	\$787,500	\$5,372,500	N/A	N/A	N/A
1995	\$119,000	\$716,600	\$4,960,000	N/A	N/A	N/A
1994	\$108,000	\$628,300	\$3,667,000	N/A	N/A	N/A
1993	\$100,000	\$666,400	\$3,400,000	N/A	N/A	N/A

²⁶ Data compiled from www.usatoday.com, 10K filings of the Orlando Predators (Nasdaq: PRED)

²⁷ Individual maximum in 2001 reflects actual payments to player, while previous years reflect only salary cap numbers (i.e. amortizing bonuses over life of contract).

Exhibit 3: Team by team statistics for the NFL²⁸

Team	Wages	Revenue	Value
Arizona Cardinals	\$74,891,809	\$110 million	\$559 million
Atlanta Falcons	\$72,969,398	\$120 million	\$590 million
Baltimore Ravens	\$75,764,764	\$148 million	\$874 million
Buffalo Bills	\$36,012,210	\$131 million	\$696 million
Carolina Panthers	\$64,349,014	\$152 million	\$773 million
Chicago Bears	\$69,321,782	\$124 million	\$691 million
Cincinnati Bengals	\$76,609,956	\$130 million	\$684 million
Cleveland Browns	\$85,442,239	\$158 million	\$767 million
Dallas Cowboys	\$33,176,359	\$189 million	\$1,010 million
Denver Broncos	\$99,014,327	\$159 million	\$805 million
Detroit Lions	\$76,573,454	\$116 million	\$703 million
Green Bay Packers	\$68,979,435	\$132 million	\$773 million
Indianapolis Colts	\$63,835,431	\$127 million	\$686 million
Jacksonville Jaguars	\$58,244,865	\$137 million	\$760 million
Kansas City Chiefs	\$59,800,143	\$138 million	\$744 million
Miami Dolphins	\$64,898,971	\$145 million	\$749 million
Minnesota Vikings	\$47,086,528	\$123 million	\$664 million
New England Patriots	\$60,394,998	\$136 million	\$744 million
New Orleans Saints	\$67,326,988	\$139 million	\$656 million
New York Giants	\$77,617,916	\$134 million	\$740 million
New York Jets	\$69,980,467	\$131 million	\$679 million
Oakland Raiders	\$78,113,041	\$132 million	\$686 million
Philadelphia Eagles	\$70,893,988	\$120 million	\$763 million
Pittsburgh Steelers	\$77,711,029	\$142 million	\$830 million
St. Louis Rams	\$82,344,655	\$131 million	\$630 million
San Diego Chargers	\$78,852,865	\$129 million	\$709 million
San Francisco 49ers	\$50,374,331	\$119 million	\$725 million
Seattle Seahawks	\$81,034,664	\$136 million	\$698 million
Tampa Bay Buccaneers	\$76,976,459	\$151 million	\$888 million
Tennessee Titans	\$70,126,673	\$141 million	\$912 million
Washington Redskins	\$56,017,166	\$204 million	\$1,038 million

²⁸ Compiled from www.usatoday.com, www.forbes.com and “The business of football” (Paul Kagan & Associates, 1999)

Exhibit 4: Arena Football attendance in 2001²⁹

Team	Attendance	% of capacity	Change
Arizona Rattlers	89,226	75.4%	-9.1%
Buffalo Destroyers	56,188	43.6%	+14.0%
Carolina Cobras	83,548	70.3%	-9.8%
Chicago Rush	59,323	53.0%	New team
Detroit Fury	63,545	48.9%	New team
Florida Bobcats	16,569	13.5%	-15.0%
Grand Rapids Rampage	59,895	81.8%	+1.6%
Houston Thunderbears	36,759	51.3%	+54.6%
Indiana Firebirds	77,026	68.7%	New team
Los Angeles Avengers	53,567	47.5%	-30.6%
Milwaukee Mustangs	70,966	56.9%	-23.2%
Nashville Kats	75,109	68.6%	-9.8%
New Jersey Gladiators	23,185	17.4%	-25.0%
New York Dragons	66,774	79.7%	New team
Oklahoma Wranglers	56,129	61.7%	-20.4%
Orlando Predators	84,283	75.7%	-0.9%
San Jose SaberCats	99,067	83.6%	+3.7%
Tampa Bay Storm	98,978	69.7%	+18.2%
Toronto Phantoms	48,451	40.5%	New team

²⁹ Compiled from www.arenafootball.com.