Increased PE Investment in Sports Bound to Impact On-Field Results

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Much has been written—including within this newsletter—about the increased presence of private equity investment in sport. But nearly all of the coverage has focused on the cause (think: need to bring liquidity to franchises, need for operating and/or growth capital), not the effect—at least not as it relates to on-field performance. Conversations with a handful of sports bankers, financiers and club owners suggested the influx of return-oriented investors across the sports ecosystem would likely have both positive (think: ability to buy more/better players, attract free agents) and negative (think: conflicts of interest between generating profits and winning games) implications for the fans of these clubs. Who is investing, how the investments are structured and league rules will largely determine how much of an impact—and the type of impact—they have.

JWS' Take: Private equity investors have the potential to positively influence team performance. While those coming for the sole purpose of cleaning up a crowded cap table are unlikely to have much of an impact, if the capital is being used to build the business it certainly can. Massimo Marinelli (executive board member of Aser Ventures, majority owners of Leeds United) said: "Investment helps cash flow, which makes it possible to attract and keep hold of talent. The right investor will also help the club to strengthen its commercial operations and strengthen its infrastructure. And while that is not [as] exciting as buying a new player, those foundations help create the conditions for success on the field" (think: RedBird Capital's investment in YES Network and the revenues it generates for the Yankees).

It should be noted that while improved on-field performance can provide a lift to a team's P&L in any given year (think: extended NHL or NBA playoff run), in most cases it does not really impact enterprise value. The exception is if winning enables the organization to establish a permanent ticket-and-sponsorship-price increase and demand that creates a new baseline for franchise revenues.

It is important to distinguish between private equity professionals who have brought financial acumen—and their own money—to sports team ownership (think: Josh Harris, David Blitzer, Wes Edens, Marc Lasry) and investment funds that are buying into pro sports teams. As Marco Masotti (partner, Paul Weiss and controlling partner in the Sharks, a South African rugby club) reminded, funds "are different because they've got investors. They are investing other peoples' money." And those people are expecting outsized returns.

That is where the potential for conflict exists. Imagine a large cap private equity firm is the primary shareholder in a European soccer club. The middling team needs one more star player to get over the hump. But the player they've targeted is going to cost £100 million and spending the money means the club will finish the year in the red. What are PE investors going to do? While a wealthy individual owner may be willing to absorb the loss to satiate the fans' (and their own) desire to win, PE investors really do not have the option; they have a fiduciary responsibility to maximize returns.

To be clear, we're not saying wealthy individuals who acquired ownership in pro teams over the last two decades aren't also motivated to make money on a year-over-year basis. But at least they had the ability to portray themselves as sportsmen trying to win.

The player-trading business can also be a key source of team revenue in European soccer. Which means, in theory, a PE-backed club could prioritize monetizing the roster (i.e. selling the best players) over winning a championship. The possibility of relegation should prevent fire sales from occurring, though (in most situations). No club wants to suffer the fall-off in revenue that comes with dropping down a division. The exception would be if a team had a player or collective of players who could be sold for more than the franchise was worth.

PE firms are not just making a bet that their investments in sport will generate a return, they are betting it will over a short period of time. "The way [investment funds] are going to execute on their strategy is to quickly increase the value of their interest in the team," Masotti explained. "They need to make a profit for their investors. And a lot of these funds have finite terms or are required to provide liquidity to their investors within a period of time, such as [seven or] 10 years. They are going to need to make decisions based on that…. They are going to have to move quicker." A fund with a short-term horizon could look to "recruit more experienced and impactful players, as opposed to making decisions that are more long-term oriented," he said.

Similarly, a fund not as interested in continually funding losses or shortfalls may "place stricter financial controls on the business and perhaps [is] less inclined [to fund] long-term projects, such as stadium or training facility expansions," Masotti added.

The potential internal struggles referenced above are limited to the European pro sports leagues that allow investment firms to take primary, active investments in teams. Because the U.S. leagues, the NBA in particular, have restricted their involvement to secondary, passive investments, the potential for conflict between a firm wanting to maximize returns (or expedite the timeframe) at the expense of winning games does not really exist. PE investing in teams stateside is far enough removed from the ability to make decisions or drive change within club operations that it is a non-issue.

That doesn't mean there isn't potential for a passive, secondary investor—with holdings in a wide array of assets—to find themselves with a conflict of interest, or at least the appearance of one (think: fund invested in both a team and sports agency or team and sports betting company).

For more on the world of private equity and other investment opportunities in sports, register to join SporticoLive's "Invest in Sports" Summit today at noon ET, examining the new investment class of athletes, celebrities, media moguls, private equity funds and individual investors.