GEELONG CATS RESPONSE TO AFL ON EQUALISATION
February 2013

This note responds to the AFL's document on 'equalisation' dated 21 December 2012. It responds to questions posed to the clubs and also offers Geelong's view on how to proceed.

RESPONSE TO AFL PAPER:

1. We support the AFL's equalisation objectives - uncertainty of outcomes and the current 'equalisation framework' - draft, cap and revenue sharing.
2. We agree that the results have been good. Compared to most other sports competitions around the world, the gap between clubs on and off the field is smaller.
3. Our club does not have big issues with the current approach except to reiterate that we still believe that our club was treated unfairly with the distributions from the Club Future Fund. All other 17 clubs received multi-million dollar distributions for their own club facilities while our distribution was directed to building match-day public facilities at our stadium. The AFL has invested in all other stadiums and in no other case (except Geelong) has this been viewed as the AFL's contribution to the clubs. As well, from an 'equalisation perspective' we believe that the strategy was flawed. Allocating funds to the most wealthy clubs was unnecessary but, more importantly, fuelled football inflation and actually increased the spending gap between rich and poor clubs
4. We accept the data showing that the gap between the most and least wealthy clubs is increasing which enables larger clubs to invest more. We accept that the revenue gap between smaller and larger clubs has now grown to the point where adequate competitive balance is undermined and there is a case for addressing this.
5. We also accept that the 'dis-equal' distributions that may be required are not large relative to the industry's economics.
6. We accept that there are broadly three categories of clubs in terms of their wealth capacity – a few wealthy, a few struggling and a number in the middle that are basically OK if they are well managed (we see Geelong as being in this 'middle' group).
7. We accept that 'size of supporter' base is an important driver of revenue potential because it drives membership and attendances – in fact, our view is that it is the most important driver. We also say that 'supporter base' drives sponsorship because decision-makers in firms will be influenced by their club allegiances.
8. We also accept that 'fixture' and 'stadium returns' are important influences on revenue potential. We welcome the AFL's acknowledgement that smaller clubs are being disadvantaged because of the AFL strategy to maximise attendances and TV audiences.
9. We understand that clubs receive very different returns from their matches at stadiums. However, we point out that data about match returns is often not directly comparable – for example, Geelong pays lease costs and debt service costs on its investment in match-day stadium facilities which no other club pays.
10. We accept that non-football income (mainly gaming) is a further factor in driving the financial gap and needs to be taken into account.
11. We accept that the gap between clubs in their capacity to invest in non-player football department activities is growing and we accept that this gap will have some impact on on-field competitiveness - though hard to measure
12. We note the AFL's comment that the gap in player payments between clubs has remained "modest" while the gap in other football costs is increasing. We believe that this points to an important issue about the salary cap which we discuss later in this paper.

13. We accept that a combination of equalisation mechanisms will be required. Of the suggestions included in the AFL paper:
    a. *New Revenues:* new revenues coming into the competition will not deal with the gap unless they are directed to smaller clubs. So, only if this is done is this option worth exploring as part of the equalisation discussion
    b. *Centralising More Revenue Streams:* We are not attracted to this because it will worsen the "head office' syndrome. However, we accept that if the gains for centralising are overwhelmingly strong, the proposal should be in the table
    c. *Increased taxes or levies on club sourced revenues:* Yes, these should be on the table provided that nothing is done that threatens a club's viability or undermines a club's business model.
    d. *Match-day sharing:* Yes, on the table (but make sure that we understand that the current system was put in because sharing the gate was benefitting the strong clubs)
    e. *Cost Control – a cap/tax on non-player football spending:* In principle, happy to look at this but we believe it will be too hard to define what is 'football' expenditure. And as well, expenditure on non-football items is increasingly important too.
    f. *Larger distributions to smaller clubs:* Should be on the table.
14. The AFL has asked the clubs to respond to five specific questions. Our responses are at the end of this paper following some discussion of the issues

GEELONG'S SUGGESTIONS
We have a few points to contribute to the discussion. These are:

- More revenue is not the solution to this problem
- Poor management is not the problem
- There is no need to talk about 'taxes' or 'penalising success' because there are reasonable grounds for compensating smaller clubs for fixture and stadium size disadvantages
- The current 'equalisation fund' should be reshaped to increase its impact
- Any 'equalisation' adjustments should also be used to increase the salary cap
- Sufficient funds can be sourced from these sources

More revenue isn't the solution
Discussions about equalisation are often distracted by suggestions that the solution is to find more revenue. But this isn't the answer. In 1975, the average club revenue was around $300K. By 1985, the average was $3 million. Today, it is $42 million. The revenue growth has been huge and far in excess of inflation – and yet the proportion of clubs in financial trouble stays fairly constant. So, more revenue isn't the solution to this problem. The issue is the *distribution* of the revenue.

Rich clubs benefit more from revenue raising ideas than the poor clubs because they can 'monetize' any idea better – due to having many more supporters. Thus, suggestions that the key is to find new revenue sources usually make the 'gap' problem worse. (Of course, increasing revenue is important for other reasons but it increases inequality between clubs)

The financial gap between clubs is driven by the revenue raised by the richest teams. They set the cost benchmarks and smaller clubs go broke trying to keep up.

It follows that the only solution is to reduce the spending capacity of the richest teams and transfer some of that capacity to the poorest teams. Current policies do this pretty well (eg revenue sharing) but it is a constant issue and it appears that some more 'tweaking' is needed.

One suggestion in the AFL paper is worth considering. If variable pricing is introduced to selected 'blockbuster' games and the additional revenues shared with other teams and, in particular, allocated to smaller teams, the equalisation objectives would be met.

Poor Management isn't the problem

Discussions about the financial gap usually include comments about 'poor management' in less wealthy clubs. Small clubs often contribute to this by promising to fix the problem in their strategic plans. We should be very clear that the 'equalisation' discussion is about long term size disadvantages that cannot be overturned.

Of course, good and bad management makes a difference but not enough to overcome entrenched inequalities. Even wealthy clubs have had periods of very bad management – but they can dig their way out of trouble because of the size of their supporter base.

The huge differences in size of supporter base between clubs have been established over 100 years. They are not amenable to change in the short or even medium term even with "good management" or giving a club more funding to spend on projects. Similarly, in the newer states to the national competition, the first-established AFL clubs will hold advantage over their newer competitors for many decades and perhaps forever.

The 'size of supporter base' correlates with all club revenue sources – members, attendees, coteries and even sponsorship income. It is logical - if a club has four times as many supporters as another club, it is likely to have many more supporters among CEOs and marketing directors as well as among members.

Data suggests that over half of supporters follow their parent's team. There is little evidence that the relative size of supporter bases has moved much between clubs over the last 50 years. A few clubs may have lost a little ground after decades of poor performance and arguably only one club has gained due to a level of sustained on-field success 30 years ago that cannot be repeated.

There is even evidence that some smaller clubs have done a relatively better job than some of the larger clubs – such as converting a higher proportion of their supporters to members and often getting a higher yield per member. As well, some of the smaller clubs have achieved better win/loss records over the recent decades than have some of the stronger clubs and it isn't plausible to argue that they can do this consistently with inferior management.

'Equalisation' should not be seen as addressing management failings which are a separate issue and which the AFL may, or may not, choose to address. Rather, equalisation addresses long term inequalities that derive from differences in the size of supporter bases that cannot be overturned.

We don't need to talk about 'taxes' or 'penalising success'

The objective is to channel some of the competition revenues from the larger to the smaller clubs. But invariably, the discussion becomes couched in terms of 'taxes' or 'penalising good performers and success'. *"The AFL is taking funds away from clubs that they have earned by working hard and smart – and then distributing it as 'welfare' to weaker clubs".*

This may not be necessary if it can be shown that the adjustments are reasonable compensation for factors that are unfair to smaller clubs and which provide larger clubs with unfair advantages.

There are at least two areas where the playing field is stacked against smaller clubs and some compensation is warranted – and our guess is that this compensation would be more than enough to provide enough 'tweaking' to adequately reduce the financial gap. The two areas are:

- The fixture - which is used to maximise total attendances and audiences but does so in ways that are clearly unfair to smaller clubs
- The stadiums – which are sized by AFL policy in ways to benefit the competition but which seriously disadvantage smaller clubs

A logical case exists for compensation for these two factors

The Fixture: As the AFL paper points out, the AFL is using the fixture to maximise attendances and TV audiences – which hands a windfall to the larger (and therefore richer) clubs. These clubs are allocated the blockbuster fixtures like Anzac Day. They play other larger clubs twice in the year whereas smaller clubs don't receive as many top-drawing fixtures. They receive preferred time slots for their matches which means larger attendances and better television ratings. These advantages make a large and immediate difference to the bottom lines of clubs and will also, over decades, slowly change the size of supporter base.

Obviously, the logic is that the larger clubs can draw larger audiences and this is right. But, the opportunity is denied the smaller clubs to boost their revenues as well. And so there is a very legitimate case for compensating clubs that are consistently disadvantaged by the fixture.

Stadium deals: Our industry talks about 'good' and 'bad' stadium deals - and the implication is that some clubs have messed up while others have managed this well. But is this the case? Or is it simply that clubs with fewer supporters (attendees) can't negotiate the best deals?

Our competition is unusual (compared to most competitions) in that our clubs share stadiums and our stadiums are very large. Stadium capacity is not a decision left to the AFL clubs – in contrast to the NFL or European soccer. Sharing stadiums in Melbourne, Adelaide and Perth obviously makes competition sense but it is clear that it has a negative impact on smaller clubs because they play their games in stadiums that are larger than most stadiums around the world.

We forget how large our stadiums are compared with overseas competitions. In this last year, 18 of the 20 English Premier League teams played in stadiums that are smaller than Etihad (let alone the MCG). Most of these EPL teams are in stadia smaller than AAMI, Subiaco, the Gabba and the SCG. The recent NFL Super Bowl was played in a stadium much smaller than the MCG.

Playing in a stadium that is too large undermines a club's economics. For example, the gap between Adelaide's and Port's economics would look very different if these clubs shared a 25,000 seat stadium. Adelaide would earn less but Port would earn more because it could play the supply/demand game (membership sales and reserved seats) and the finances of the two clubs would look more alike.

Similarly, if the smaller Melbourne clubs were able to play in a 30,000 seat stadium, their economics would benefit from the supply/demand factors that strengthen Geelong's economics.

Contrary to some suggestions, it would be a bad move for our competition to build a 25,000 seat stadium in Melbourne. This would be hugely expensive while undermining the economics of the MCG and Etihad.

And so, while we accept that our stadiums are large on international standards and that this makes sense for the competition, we should also accept that this means that many of the smaller clubs cannot 'right size' their stadium to fit their demand. Therefore, it would be fair to adjust each club's return to eliminate this impact of stadium size on their economics.

This might go a long way towards dealing with the equalisation problem. Again, it isn't a tax on high performers but rather a recognition that stadium capacities have been chosen in ways that are particularly damaging to smaller clubs. There is a legitimate case for compensation.

Reshape the 'equalisation fund'
The idea behind this fund is fine but its impact is inadequate. Each club –even the smallest - contributes $2 per attendee but then receives an equal payment from the fund. As we understand it, the net impact is not enough. The net result leaves the smallest club receiving around $700,000 more than the largest club each year. Arguably, this doesn't go anywhere near compensating them for the fixture disadvantages they incur.

Two possible changes would increase the effectiveness of this fund:

- At present, all attendees are 'taxed' for the $2 – which assumes that all attendees are equally profitable to the club – which they are not. A simple adjustment would be to only tax attendances over a break-even crowd for particular stadiums.
- As well, rather than distributing the proceeds equally to all clubs, the fund could be solely used to transfer funds to the smaller clubs.

Increase the 'salary cap'
The salary cap for players is pretty much held down to the level that is affordable by the least wealthy clubs. Thus, as the financial gap between clubs grows, the excess spending capacity of the large clubs goes into non-player expenditure in and outside the football departments.

If this view is correct, the fabric of our competition is threatened if this gets too far out of kilter. The players won't put up with it and will have reasonable cause to challenge the salary cap.

The competition objective should be to re-allocate funds away from the wealthiest to the least wealthy clubs (which will reduce industry cost pressures) while ensuring that a good part of this reallocation goes into increasing the salary cap. In other words, the objective should be to increase the capacity of the smallest clubs to pay the players more while, at the same time, reducing the capacity of the rich clubs to spend on non-player items.

A SUMMARY SUGGESTION
While we do not have all the data, we believe that the sources of funds described above could easily make up the pool (of $15m to $20m per year) for payments to smaller clubs. These are

- Dollars taken from larger clubs in compensation for fixture advantages
- A reshaped 'equalisation' fund that only collects on attendees above stadium break-even
- New dollars funded by 'variable' pricing on specified blockbuster games
- An allocation from AFL funds as some compensation for 'stadium size disadvantages'.

GEELONG'S SITUATION
Geelong accepts that the AFL will make some judgements about where to take revenues and which clubs will finish up with less or more or be unchanged.

Our request is that the data on which the AFL makes its judgements takes into account particular circumstances of each club and a thorough analysis of the balance sheets to assess the real wealth of each club.

We regard Geelong as being in the 'middle' group of clubs when it comes to supporter base and inherent wealth. We rank in the second quartile on the core measures – just above the median of the 18 clubs. In 2012, we ranked 7th in size of supporter base and 9th in numbers of members. In 2011, we ranked 8th in attendances (2012 data is distorted by loss of capacity during our rebuild).

In terms of balance sheet strength, we will have debt of around $8.5 million at the end of this year while a number of the clubs have millions in the bank – several in excess of $10 million. (Our debt will consist of $4.9m in stadium facilities debt and $3.6m in gaming)

We accept that we 'punch above our weight' in our revenues because of our stadium economics which provide favourable yields per member. But comparisons of our match returns with other clubs are often made but they are flawed unless they take into account the costs that we uniquely incur. These include lease costs to the City of Geelong and debt service costs on our club investment in the match-day facilities at Simonds Stadium. Our own calculations using 2011 data indicate that, when these costs are included, our match revenues rank 6th among the clubs.

Over the past five years, our club has invested $15 million in our stadium of which around $10.6 million is on public match-day facilities. In addition, we pay the Geelong Council $750,000 each year as a lease on the stadium and much of that can be attributed to match-day facilities. We also fund interchange benches, safety fencing and other match-day facility costs. All up – and taking account of the funding costs on our investment in public facilities, we estimate that we incur costs of around $150,000 per game (a total of over $1million per year) which should be deducted from our match revenues in order to reach a figure comparable to other clubs. We are happy to provide full details if required.

RESPONSE TO THE AFL QUESTIONS

1. Yes, Geelong believes "that there is a relationship between Club football department expenditure and on-field performance". But the relationship is a broad one and not linear and so it is only necessary to keep all clubs 'in the ballpark' with their spending capacity. They don't all have to be the same. Our club's situation is instructive of what happens. We achieved success with relatively low expenditure but a consequence of on-field success has been that many of our staff have been offered jobs elsewhere and so our cost structure has risen, partly as a consequence. And so, over the long haul, a club that is not competitive in football expenditure will fall behind.
2. Yes, Geelong believes "that if the equalisation framework does not change that the smaller clubs will struggle to consistently make preliminary finals in the future". However, we believe that only modest adjustments to the equalisation amounts are required. An additional payment under the equalisation scheme (say $2 million pa) adds the same amount to the club's bottom line – whereas earning the same amount in the normal way would require the club to earn many multiples of that number in revenues.
3. Yes, Geelong accepts "that the AFL equalisation system requires broadening and strengthening". But we believe that this is a constant requirement and that, as explained in this paper, the required adjustments at this stage are relatively modest.
4. Of the AFL's list of suggestions mechanisms:
    a. We support industry approaches to revenue generation but emphasise that 'equalisation' is only assisted if new revenues are directed to smaller clubs.

b. We do not support centralising more revenue streams unless the AFL can make a very strong case for it

c. We prefer to minimise talking about "taxes" and "levies" because these imply that the financial transfers are 'welfare'. We believe that compensating for fixture and stadium disadvantages are justified

d. We believe, for the same reason, that it may not be necessary to put much effort into match-day revenue sharing arrangements other than to refine the current equalisation scheme as outlined

e. We don't believe that caps on non-player spending can work and so this would be a last resort. There are huge definitional issues and the bureaucracy required to police it would be large

f. We accept that some unequal distributions to smaller clubs are justified but would like to see these defined not just as gifts but, where possible, as a logical compensation for fixture and stadium impacts

5. Geelong's view of the various mechanisms has been outlined in this paper. We suggest

- Dollars taken from larger clubs in compensation for fixture advantages (this would require some calculation) and allocated to smaller clubs
- A reshaped 'equalisation' fund that only collects on attendees above stadium break-even and only distributes to the smaller clubs
- New dollars funded by 'variable' pricing on specified blockbuster games and added to the equalisation fund
- An allocation from AFL funds as some compensation for 'stadium size disadvantages'.

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We appreciate the opportunity to contribute to this discussion and will happy to enlarge on any of these issues if asked to do so

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