

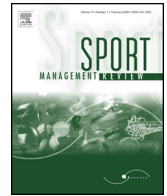


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The not-so-free agent: Non-performance factors that contribute to free agent compensation premiums

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ABSTRACT

In this study, the authors examine Major League Baseball free agency to identify whether certain factors beyond a player's on-field performance contribute to contract premiums. These premiums are considered to be the difference between the compensation a player receives in free agency and the marginal revenue product (MRP_{t-1}) in their contract year. Using 345 free agent transactions over a four-year period (2012–2015), the authors examine the relationships between potential free agent contract premiums and the attributes of a player's previous team, as well as how contract premiums may be influenced by the level of interest from other teams and certain facets of the acquiring teams. Results suggest that free agents tend to receive compensation premiums when they played for a successful team during their contract year. Playing for a large-market team during their contract year also influenced contract premiums. In addition, free agents tended to realize compensations premiums when multiple teams were bidding for their services, the acquiring teams were in playoff contention the prior year, and the acquiring teams possessed relatively more financial resources. Findings shed additional light on how factors peripheral to a player's on-field performance may influence the free agency market. Recommendations include that effective control mechanisms are necessary to ensure free agent compensation is commensurate with the value of the player.

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1. Introduction

Free agency is widely considered Major League Baseball's (MLB) second season because organizations aggressively compete for available talent to field successful teams for the following year and beyond. While scholars have examined the links between free agency offers and a player's on-field performance (e.g., Magel & Hoffman, 2015), gaps in addressing how non-performance factors influence such offers remain. This area is particularly intriguing for research because MLB teams guaranteed roughly \$2.5 billion in free agent contracts in 2016, alone, and every indication suggests this figure will only increase in the future. Consequently, managers and team executives need a more comprehensive understanding of what

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elements—beyond on-field performance—influence a free agent's perceived value. Without such an understanding, team payrolls will increase without a commensurate improvement in team performance.

Intuitively, players who have demonstrated superior performance should command more lucrative contracts than their less productive counterparts. Moreover, on-field performance plays a significant role in compensation decisions (e.g., [Berri, Brook, & Schmidt, 2007](#); [Lewis, 2003](#)). But, do certain factors peripheral to on-field performance also play a role in such decisions? We argue MLB free agents may receive compensation premiums simply because their previous team was successful; where premiums refer to the difference between the compensation players receive in free agency and the marginal revenue product (MRP_{t-1}) in their contract year. We also contend that other factors—unrelated to an individual player's on-field performance—contribute to escalating free agency contracts, such as the market size of the player's former team, number of teams interested in a particular player, an acquiring team's financial resources, and the acquiring team's playoff contention.

We substantiate our arguments using MLB free agency transaction data from 2012 through 2015. Our article begins by reviewing the extant literature that corroborates our hypothesized relationships between free agent contracts and the various non-performance factors. Next, we explain regression techniques used to analyze the data and conclude with a summary of the findings and a discussion of the implications for research and practice.

2. Literature review and hypothesis development

There is a rich literature addressing the determinants of professional athletes' free agent contracts in an effort to access the efficiency of the labor market in professional sports. The role of individual, performance-related factors on compensation has been the primary focus of much of this research ([Wicker, Prinz, Weimar, Deucher, & Upmann, 2013](#)). MLB salaries, for instance, tend to be related to on-base percentage and slugging average ([Hakes & Sauer, 2006](#); [Lewis, 2003](#); [Stone & Pantuosco, 2008](#)), fielding percentage ([Kahn, 1993](#)), length of contract ([Krautmann & Oppenheimer, 2002](#)), race ([Johnson, 1992](#)), position ([Wallace, 1988](#)) and player durability and consistency ([Stone & Pantuosco, 2008](#)). Additional factors have been identified in other sports. For example, ambidexterity ([Bryson, Frick, & Simmons, 2013](#)), effort ([Wicker et al., 2013](#)), talent, and popularity ([Franck & Nüesch, 2008](#)) are significant predictors of the value placed on professional soccer players. Player mobility, draft ranking, and number of points scored appear to influence free agent contracts in the NHL ([Kahane, 2001](#)), NFL ([Massey & Thaler, 2013](#)), and NBA ([Berri, Brook, & Schmidt, 2007](#)), respectively.

While considerable effort has been devoted to identifying individual-level factors that help explain variance in player salaries, fewer researchers have addressed compensation predictors not related to the individual player ([Frick, 2011](#); [Hall, Szymanski, & Zimbalist, 2002](#)). In the following sections, we present five factors unrelated to an individual player's performance that likely influence a free agent's perceived value.

2.1. Previous team's positive performance

One largely overlooked potential predictor of free agent contract premiums is prior team performance. Indeed, few scholars have explicitly examined how previously playing for a successful team may influence a free agent's future value. One exception involves a small sample of NHL players from the 2012–2013 and 2013–2014 seasons, where contracts for players who were members of the Stanley Cup winning team the prior year earned significantly more than other NHL free agents ([Lanoue, 2015](#)). Researchers focusing on professional soccer also hint that prior affiliation with a successful team may influence player salary. Soccer players in the German Bundesliga league who moved to a German team after leaving a first division club in a foreign league commanded compensation premiums ([Frick, 2011](#)). Clubs in the German Bundesliga league typically offer higher salaries to lure talent from other top divisions relative to players from lower divisions. Along similar lines, Nippon Professional Baseball teams overestimate talent from the MLB and pay these foreign players higher salaries ([Jane, 2014](#)). It is likely that MLB players receive free agent contract premiums simply because they were members of the world's most competitive baseball league. Perhaps equally compelling, empirical evidence suggests that players on successful teams anticipate higher salaries ([Hall et al., 2002](#)) and free agents from these teams may command compensation premiums.

Anecdotally, prior affiliation with a successful team appears to influence free agent value in MLB. The Kansas City Royals advanced to the playoffs in 2014 for the first time in nearly three decades. The Royals had an impressive .549 winning percentage and were successful in the postseason, making it to Game 7 of the World Series. Billy Butler, the team's designated hitter, struggled through this season. His Wins Above Replacement (WAR) statistic of $-.3$ suggests the Royals would have actually been more successful if he sat on the bench. During free agency, Kansas City was understandably willing to part ways with Butler and his \$8 million annual salary. The Oakland Athletics perceived the situation quite differently and promptly offered him a three-year, \$30 million contract. Butler's WAR fell from $-.3$ to $-.9$ his first year in Oakland. His performance rebounded slightly but still fell far short from expectations, and the Athletics released him before the end of his second year with the team. Similarly, Dan Haren and Justin Masterson both entered the free agent market after playing for successful teams: the 2012 Los Angeles Angels and the 2014 St. Louis Cardinals, respectively. Each player was rewarded with lucrative contracts despite a less than impressive WAR statistic of $-.4$ and -1.6 , respectively, during their contract years.

MLB is a game of numbers, statistics, and metrics. As such, an extensive amount of information exists among the baseball community on several aspects of team and player performance. Furthermore, teams invest a significant amount of time and

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