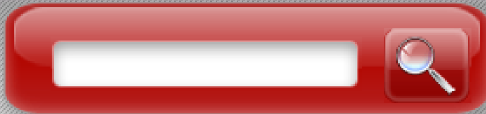
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Advantages of Diversifying the Funds of Sports Organizations

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Advantages of Diversifying the Funds of Sports Organizations

Diversification of funds is a hot topic in the business world. The sports world must adapt and apply diversification principles in order to maximize the stability of sports organizations. Diversification is a generic term that can be applied to assets, funds, and investors. Making sure these financial factors are well maintained is critical to the overall fiscal success of a sports organization. This paper seeks to establish the importance of diversifying funds within sports organizations. It also investigates the financial advantages of diversification, which include percentage return, stability, and investors. The paper is an exploration tailored to individuals who want to discover the importance of diversification, for example coaches, administrators, and the general public.

One definition of diversification is “an investment fund that contains a wide array of securities to reduce the amount of risk in the fund” (Diversified Fund, n.d.). The logic beneath advocating diversification is that “Actively maintaining diversification prevents events that affect one sector from affecting an entire portfolio, making large losses less likely” (Diversified Fund, n.d.). Diversification, then, is a key component of achieving long-term financial stability and success.

In discussing diversification of funds, one acknowledges two general categories of funds, the *diversifiable* and *undiversifiable*. Diversifiable funds are those that can be controlled by the company, for example choosing where to invest monies, choosing the amount of money to be diversified, the business and financial risk associated with types of investments, and the current status of diversification options. Undiversifiable funds involve matters beyond an organization’s control, such as rates of currency exchange, political developments, fluctuations in investment fields, and interest rates. To become and remain financially sound, a sports business must take all of these under consideration as it identifies the method of diversification that best serves its needs (Chamberlain, 2003).

Diversifying funds is a serious endeavor for financial organizations. There are many factors to consider before reaching a final decision. An organization must decide if diversification will benefit its financial needs, including determining any long-term benefits to its fiscal well-being (Brooks & Kat, 2002). Every sports organization has unique needs; every team in a league has its own unique needs, as well, given that different team-owning corporations emphasize different areas of finance. Deciding on the proper amount of diversification can be an arduous task, but it is worth the time and effort, because the economic stability of the organization is at stake.

Because diversification has become increasingly popular, diversification options have expanded. Many banks, other financial outfits, and sports establishments now offer guidance or services aimed at funds diversification. Understanding one’s organization’s particular needs is essential in determining the most effective diversification method. Its monetary structure must be thoroughly scrutinized. Investing without fully understanding the organization’s status could prove disastrous.

Importance of Liquid Cash

Liquidity describes “how fast something can be turned into cold hard cash” (Kennon, n.d.). Keeping much liquid cash is considered by many to be a waste of investment potential; however, it has proved beneficial in some instances. For example, when catastrophe strikes some area (or areas) of investment, those portions of a financial portfolio which are liquid would suffer minimal damage. The September 11, 2001, events, for example, had a tremendous negative effect on financial stability. In the wake of the attacks, many of the United States’ financial structures suffered from a dramatic decrease in consumer confidence. Stock market investors even had to endure a 4-day freeze on their holdings. This had an incredible impact on America’s confidence in the market. Because catastrophe in inherently unpredictable, there is a sense of security in keeping some part of an organization’s finances liquid (Kennon, n.d.).

Traditionally, bank accounts have been regarded as a safe alternative to investments. Although savings accounts generally offer less return on one’s money, the money in such accounts is generally secure even in the event of an emergency. Having quick access to money can be the difference between a business’s success and its failure. When companies or sports organizations have most of their money tied up in nonliquid investments or holdings and an immediate need for funds arises, it can be difficult to fulfill that need. If a sports organization is going through a downturn in terms of ticket sales or sponsorships, the team may find itself unable to make payroll, which requires liquid cash. Such instability can have far-reaching effects on consumer support, fan support, and the general appeal of the organization within the sports community. Keeping adequate supplies of liquid cash allows sports organizations to continue to function throughout trying economic periods, and persisting in rocky times will allow an organization to develop and achieve success.

Diversification of finances helps to eliminate the effects of sudden changes in particular areas of investment. These specific changes are generally referred to as unsystematic risks, and they strike when least expected, by their very nature producing devastating effects on those invested too heavily in the stricken area. In this instance, the term *unsystematic* means that the investment did not meet expectations, but was drastically affected by an unforeseen circumstance like fire, strike, or scandal. Unpredictable, unsystematic risks frequently influence the liquidity of an investment.

Liquidity, again, is the capacity of a financial holding to be turned into cash without being affected by the present economy. The liquidity of diversification can prove to be extremely beneficial to sports organizations, because of their constant need for liquid cash. Furthermore, the more liquid the diversified investment, the safer is the money that was invested. However, liquidity’s price is often a lower return. Common forms of liquid assets are certificates of deposit, stocks, and bonds. While most experts consider certificates of deposit to be relatively liquid, there is a penalty for withdrawing funds froms certificates prior to a date set as the certificates’ date of maturity. Stocks and bonds are regarded as slightly less liquid than certificates of deposit, although both can typically be converted into cash within a couple days.

Liquid cash is viewed as an organization’s heart and soul. This is particularly relevant to sports organizations because of their direct need for cash. Operational cash flow must be sustained by the organization if the organization is to be deemed successful. Banks are the safest course for organizations aiming to maintain operational cash flow, because banks often act as a mediator between investments and ready cash. The basic rule of liquidity is simple and finite within a sports organization: If the organization cannot meet its financial needs, it will fail.

Savings Accounts

Savings accounts are commonplace in today’s economic structure. They are a safe alternative to risking money in investments which may never produce a return. Savings accounts are a way to save money that does not immediately need to be spent; the money is considered liquid because it is easily accessed—although it is not as liquid as funds in a checking account. Checking accounts are the most fluid form of investment, because banks administering the accounts assume the money will be promptly retrieved. For this reason, checking accounts

tend to offer lower interest rates than savings accounts. Banks offer many types of savings accounts, but it is important to research associated fees and interest rates before determining which savings account is right for one's business. Because savings accounts are not accessed as frequently as checking accounts, banks pay a higher interest rate on savings. Savings account interest rates are often between 1% and 3%, depending on the institution and type of account.

Savings accounts have changed over the past 20 years. Online banking services have led to a transitioning of the traditional savings account, one in which deposited savings slowly built interest. Owners of savings accounts in the past had to wait for earned interest, which was applied to deposits only on a few preset dates throughout the year. With online banking, interest is applied minute by minute, making an account's maturity instantaneous.

Banks can pay interest on savings deposits because they use the money to fund loans, on which they charge interest greater than the interest paid to savers. In short, the banks are selling the money (Pritchard, n.d.). Savings accounts are viewed as safe because the money is insured. If something were to happen to the bank, the money would always be recoverable, thanks to the Federal Deposit Insurance Corporation, a government bank-insurance program established after the Great Depression.

Sports organizations often take advantage of savings accounts to keep their resources in a safe place, out of the hands of individuals, since there is a history of individuals mishandling teams' funds. Keeping money in a secured savings account eliminates part of that problem, because the money is easily traced to and from the bank. Professional sports teams that have substantial sums to keep in savings accounts can benefit greatly from interest earned. In short, it has become a necessity for businesses to possess savings accounts. Savings accounts allow businesses to store money and yet, simultaneously, gain interest. One of the prime advantages of a savings account is that the money stays separate from the normal circulation of funds.

Investors

Obtaining investors is one of the most challenging, and also most potentially profitable, aspects of stabilizing a business's finances. When businesses begin operations, money is often hard to come by; money from investors can mean the difference between success and failure. Investors are individuals or businesses that provide money to an organization, in hopes of receiving a financial return on their investment. Investors can invest money in various facets of organizations, ranging from advertisement to stocks and bonds. The bottom line is that organizations have a great need for investors' money during the start-up phase, and investors expect financial progress on an organization's part, in order to maximize return on their investments. It is a situation not free of stress: The start-up business and its investors are concerned that the business become financially stable and able to turn a profit (Arnold, n.d.). And investor confidence is time sensitive; the longer it takes the business to become established, the greater the impact on investor confidence.

Small sports companies and entrepreneurs may be able to fund their business opportunities helped by friends and family only. Or, they may look to "angel investors." Corporations must be cautious about involving angel investors (Advani, 2006). They typically do not have access to large amounts of money, and a corporation will need to ensure that the funds offered are actually available.

Information is the key to attracting investors. Investors need to know the current status of the organization and the rate of growth within its market. Having information about an organization's competition can also enhance investors' confidence. Many investors require the signing of an investment agreement establishing a framework, rules, and guidelines for the investment, outlining the steps to be followed to achieve success. An investment agreement makes clear that a new business is serious about its long-term profitability. Companies often use two forms of communication to maintain healthy investor relationships, the *record of growth statement* and the *financial statement*. The information in these statements provides investors the bottom line on their investments' current status. If used properly, the statements also show investors that the business is

able to set and meet (or at least approach) goals, which can be a great advantage in maintaining investor confidence.

Stock and Bonds

Professional sports organizations that own sufficient resources have an opportunity to make investments of their own—in stocks and bonds. If the investments are sound, the organization's worth can grow markedly. Purchasing stocks and bonds is a common means of diversifying funds. Stocks can be purchased by the general public and represent ownership in companies. The price of stock issued by companies that are experiencing success goes up, allowing the investor to receive more money than he or she invested. The price of stock issued by companies that struggle goes down, and an investor may not only see no return on investment, he or she may lose the money initially paid for the stock. Unlike stocks, bonds do not represent ownership, being more akin to a loan. A company issues a bond in order to raise money to fund its daily operations. The purchaser of a bond is essentially loaning the purchase price to the company for a specified time, having been promised by the company that when the time elapses, the loan and interest will be returned. Both stocks and bonds are means of diversification that are considered lucrative and are readily accessible in today's financial structure.

In the stock market, where stocks are bought and sold, the basic strategy is, of course, buy low and sell high. But investors regularly fall short of this aim, since the market can be unpredictable. In such instances, diversification can play a major role in investors' overall success in the stock market. To use the old cliché, not putting all the eggs in one basket—in other words, investing in more than one kind of stock—can protect an investor, since falling stock prices in one area of the market may not affect prices in other areas. Diversifying the categories of stocks in which one invests is also a protective measure. If all of one's eggs are transportation-related—if one purchases only automotive and aerospace and railroad stocks—the development of adverse economic conditions affecting transportation could wipe out the investment. Bonds are viewed as more stable than stocks, since they comprise a financial agreement between investors and bond issuers. Because they entail fewer risks, bonds generally yield smaller returns than stocks.

Advantages and Disadvantages of Diversification

The basic reasoning behind diversification is to make a financial portfolio less volatile. Diversification lowers the possibility of one bad investment affecting the stability of a financial portfolio. In order to take full advantage of diversifying a portfolio, one must invest in different types of assets that move in different directions and to different rhythms. The following are some key advantages of diversification, according to Klein and Saidenberg (1998):

- Money is invested in various assets, not consolidated in one
- Investors may benefit financially from many markets
- Investors are not wholly financially affected by one poor investment
- Return on diversified investments is higher, traditionally, than return on money kept in cash holdings
- Diversification adds stability to and reduces volatility within a financial portfolio

While diversification tends to serve investors well, *overdiversification* is not advisable. Overdiversification means spreading investments over too many opportunities too thinly. Overdiversified investments lack opportunity to prosper. While essential in today's economy, diversification of funds does have a limit, and most experts set it at 20 investments or assets at one time (Dangers of Over-Diversification, n.d.). An organization that invests in more than 20 entities may well find that its funds begin to plateau rather than increase, because the amount of money available for each investment does not carry its own weight within the investments (Dangers of Over-Diversification, n.d.).

Summary and Conclusions

Anything a sports organization possesses or controls is considered an asset. How

its assets are managed determines the financial steadiness of an organization. Today, sports organizations' assets typically extend far beyond bank accounts. For example, corporate funds are invested in stocks and bonds. In order to achieve financial success, professional sports organizations must acquire funding. When it is not forthcoming from a league, it may be obtained from other corporations, from private investors, or in the form of secured bank loans.

Diversification of assets may have become a buzzword, fun to discuss, but it should be remembered that diversification requires understanding and serious preparation, including trial and error that frequently comes with a price tag. To truly diversify one's funds requires constant monitoring of one's investments. Investments are never foolproof; unavoidable risk is the nature of investment. Businesses that seek to diversify their funds do so to reduce the volatility of their financial portfolio. Many sports organizations benefit from diversification, in light of the financial fluctuations which occur from month to month and, especially, season to season. In the course of a competitive season, a sports organization may be responsible to pay out millions of dollars. It is thus vital that the organization maintain a sound financial structure providing ready access to needed funds. If a sports organization is unable to fund its own team, the consequences reach beyond angry players; they can shake the foundation of the organization: fan support, community support, ticket sales, consumer sales, advertising sales, consumer confidence. Diversification acts against such a situation by sustaining investments in various investment fields, increasing the chances of having accessible money.

Ready availability of the professional sports organization's money can mean success; the lack of it can mean failure. Professional sports businesses are always in need of cash—not just assets, but cash. But keeping assets in cash means the money is not earning much interest or otherwise making the organization money. Money will always earn more when it is placed in the hands of financial institutions that loan or invest it. Because professional sports organizations require a frequent turnover of funds, a smaller portion of their overall worth is available to be invested. Thus the recommended ratio of liquid funds to other funds is different for professional sports organizations than for many other corporations: 60:40. Professional sports organizations are unlike many other businesses in needing substantial amounts of cash to sustain day-to-day operations. Of course, from team to team, unique and varying needs and financial statuses mean that the 60:40 rule is actually a rule of thumb.

Diversification today is looked on as a prerequisite for securing financial permanence. The world has embraced the concept, and many options are offered for taking full advantage of diversification's benefits. Professional sports corporations operate within a highly volatile system that nevertheless demands financial stability. Diversification of funds helps sports organizations develop a solid base able to withstand bumps in the road. The telephone, when it was newly available, seemed a luxury for the few; today it seems a necessity. The same can be said of funds diversification; once a strategy for investment adepts to consider, it has become a necessity for operating corporations. Knowledge of diversification is key, and the sports organization that does its homework is likely to benefit greatly from diversification, minimizing the strategy's risks.

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