Impact Investment Structure Draws New Capital Into Sports

JohnWallStreet
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Athletes Unlimited (AU) recently raised a $30 million funding round. Harris Blitzer Sports & Entertainment co-founder David Blitzer and Kevin Durant's 35 Ventures were among those who participated.

It was not a surprise to see either of those names in the press release, because both have an extensive portfolio of sports-related investment holdings. The same cannot be said for Schusterman Family Investments, Earlystone Management's

Jane Gottesman or film producer Sharon Harel-Cohen, all of whom made their first foray into sports with an investment in the collective of professional women's leagues.

Athlete Unlimited's unique capital structure—one that caps investors' financial returns and awards any surplus to key stakeholders and the broader mission—helped open the door to a pool of new investors. "The mission equity structure was one of the factors that attracted me to invest in AU," Gottesman said in an interview. "I believe that investors should be willing to share upside with players, employees, and other stakeholders."

The global impact investing market now has more than $1 trillion in assets, so sports properties in need of capital may be tempted to replicate AU's mission-centered capital structure.

But others who try are unlikely to match Athlete Unlimited's fundraising success. Sports investors are increasingly looking for returns, as evidenced by the infusion of private equity, and AU's connections to the finance world are virtually unmatched. As one sports financier said, "They're not your typical startup."

Charles Baker (co-chair, entertainment, sports & media, Sidley), who worked on the Athletes Unlimited launch, added that "most investors want to know their money is actually making an impact and driving innovation and change with the business's excess profits. Under the AU model, those funds largely benefit the players. Of course, given what these female athletes are paid, that money would be impactful."

JWS' Take: Impact investing and ESG-related corporate initiatives are undoubtedly en vogue. Just a few weeks ago, Patagonia founder Yvon Chouinard announced he was giving away his company to a purpose trust that would use its profits to combat climate change.

But Chouinard is the rare exception in that he built a large company without outside capital, which allowed him to prioritize non-financial concerns with his business. Athletes Unlimited co-founder and JS Capital Management CEO Jonathan Soros believes the bulk of the estimated $1 trillion in impact investments are what he would call “mission-aligned.” While they allow investors to take positions in companies they can feel good about, they do not actually change underlying business practices.

In some cases, like Walmart’s move to decarbonize their logistics infrastructure, the efforts save the company money. By reducing reliance on carbon, Walmart was able to reduce their costs and maximize shareholder profits.

In others, a consumer-facing business will pass the financial costs associated with any positive societal impact on to the customer. Ben and Jerry’s and Toms are values-oriented companies that do not compromise shareholder returns.

There is nothing wrong with either of those efforts. There is certainly room in the world for business practices to improve in ways that serve the public benefit. But those changes must always be justified by maximizing shareholder returns. Soros said true impact investing has a cost: “There needs to be some compromise. There’s no free lunch.”

The investment world has lacked a structure that enables impact investors to make what Soros called “non-financial maximizing choices.” Historically, mission-focused individuals have been forced to invest their returns outside of the company structure.

In response, Soros created the Mission Equity structure to link profit and purpose within a commercial organization. “It’s trying to get at this question about how do you actually aggregate

capital at scale around businesses that are willing to really make tradeoffs over time to support the mission and impact, even when it comes at a cost to shareholders," Soros said.

Athletes Unlimited is serving the test case for Soros' experiment. He set out to see if investors would be willing to explicitly give up a portion of their returns to benefit other stakeholders, and to do in in a way that "allows those securities to be transferable; and for a secondary market to exist in those types of securities," he said. Athletes Unlimited has elected to prioritize its athletes; they maintain representation on the leagues' board of directors and have a voice in all key decisions.

Historically speaking, much of the value created in pro sports has been tied to franchise appreciation, the benefits of which flow up, almost exclusively, to the ownership level. There is nothing wrong with that structure. It is how most businesses operate.

But to ensure AU players have a chance to participate in that upside, each investor in the collective of leagues has "agreed to cap their financial returns to a 6-10% annual rate of return," Patricof said. The surplus goes into a pool that is split equally between the players and efforts to further the company's mission. That includes investments in a voter-registration program formed under AU's Power My Voice brand and its commitment to becoming carbon neutral.

The organization is not profitable today.

Capping returns should have made it more difficult for AU to raise money. Challenger leagues do not have a strong history of success and many investors willing to assume the risk of a relatively illiquid private market investment going to zero want to enjoy any potential upside for doing so.

“A 6-10% annual return on a private, growthy investment like this, in any normal world, would be really disappointing and shy of what you would underwrite an investment like this to,” said one banker who frequently works on sports deals. “If you’re a growthy media, tech, software investor, chances are you are modeling to at least a 2.5-3 times on your money.”

So, AU’s investors will be forgoing tens of millions, if not more, if their investment pans out.

But the equitable investment structure did not hamper AU’s fundraising efforts. In fact, Patricof said the ability to sell social impact fundamentals alongside its platform approach to league ownership has been “a really big competitive advantage for [us] that no one else is really capturing.”

Schusterman, Gottesman and Harel-Cohen’s participation seemingly validates Soros’ thesis that there is a percentage of investors, including some retail investors, who are willing to accept smaller returns to produce more value in the companies in which they are invested. There may even be a greater concentration willing to back sports assets compared to other industries because it is more fun and a higher-profile platform. In other words, there is more tangible, non-economic value that can be derived from their involvement.

That does not mean other challenger sports properties looking for capital can replicate AU’s social impact model and expect to find the same success. “People, broadly speaking, have increasingly looked at sports properties from a profit-maximizing angle. The arrival of private equity funds in particular is indicative of that,” Soros said.

And while capping investors returns at 6-10% on a startup league leaves tremendous upside for other stakeholders, it likely wouldn’t at the big-five sports level. That is the range

many prospective team owners are underwriting to anyway. “You shouldn’t be buying the Phoenix Suns trying to 5x your money over a standard hold period,” the banker said.