The big gamble
How the legalization of sports gambling brings new economic opportunity and risk
Sports gambling has been a fixture in American society for centuries, regardless of its legality. According to the research firm Eilers & Krejcik Gaming, Americans place $50 billion to $60 billion a year in illegal sports bets.\(^1\) This staggering number, which dwarfs the $5 billion in legal bets placed in Nevada,\(^2\) represents the potential of the enormous market that has just opened in the United States after the Supreme Court’s decision to overturn the Professional and Amateur Sports Protection Act (PASPA) last May.\(^3\)

To put these numbers into perspective, the revenue of the entire sports industry in 2018 was estimated to be about $71.5 billion\(^4\)—which includes tickets, media rights, sponsorships, and merchandise. Even conservative estimates predict the total amount legally wagered in the United States will eclipse that mark in the next three years. Beyond the sports industry, this new legalized market will have a significant impact on other businesses tangentially affected by sports gambling, including technology, telecom, and media companies.

What happens in Vegas no longer needs to stay in Vegas, as each state now has the power to decide whether to legalize sports gambling. Since the Supreme Court decision, some initial developments have begun to shape the industry while many unknowns remain. This paper will take a closer look at the remaining critical uncertainties that will have a major impact on the size and scale of the industry—and opportunity—moving forward.
Current state

In the immediate aftermath of the Supreme Court decision in May 2018, some states scrambled to pursue this lucrative opportunity independently, without a federal framework in place. Delaware and New Jersey, the plaintiff of the Supreme Court Case (Murphy vs. NCAA), were the first to act and have seen major returns, with more than $385 million a month being wagered in New Jersey alone. Eight states currently have legalized sports gambling with five additional states passing bills in their state legislatures in the spring of 2019. These near-term developments will be interesting to watch as sportsbooks lobby for legalization on the state level.

The federal government is attempting to secure a wider blanket agreement on the federal level to protect public welfare and the integrity of the game and generate sufficient tax revenue. The leagues support a federal framework because it can address their interests on a national level. The sportsbooks would prefer legislation that mirrors the way gambling is currently regulated on the state level by the Nevada State Gaming Commission. This situation, like many legalization efforts, is extremely fluid and will change rapidly as the critical uncertainties mentioned below unfold.
Critical uncertainty #1: Number of states that legalize

The number of states that legalize in the next five years will dictate the potential size of the market. Experts predict that roughly half of states will have legalized gambling in the next five years. Even at 50 percent market penetration, the revenue potential for both the sportsbooks and the leagues is sizable. More legalized states could mean a larger pool of potential bettors. As average fans become more familiar and comfortable with the idea of sports betting, the market will likely grow, increasing its attractiveness.

One of the key drivers is not only the number of states that legalize but which ones end up legalizing. More populous states like Texas and California would likely have a larger impact than less populous states such as Vermont and Wyoming.

States that have professional sports franchises are also important to watch as legalization bills are brought before state legislatures. Those states likely have the most to gain or lose with franchises operating within their borders. In addition, the magnitude of deals at the league level will be affected by the number of markets where the sportsbooks can expect to activate and monetize their investment.
Critical uncertainty #2: Legality of mobile wagering

Each state has the ability to decide whether to permit wagering on mobile devices. The ability to place wagers virtually as opposed to in person is crucial to the development of the market. The legalization of mobile wagering allows potential new entrants into the industry without the large expense of physical assets—making the fight for market share and consumers more competitive.

Additionally, the increased convenience of placing a wager from your couch or a sports bar would be ideal for fans, likely leading to a larger volume of bettors and total handle. Lastly, this would add another revenue stream for sportsbooks, as they would have the opportunity for targeted advertisements on betting platforms. Sportsbooks and leagues agree mobile wagering is an important aspect of any legalization effort. If this doesn’t happen, it could stifle the growth of a nascent market as fewer wagers would be placed, and there would be fewer entrants into the marketplace.
Critical uncertainty #3: League rights to shape the market

There are many other key indeterminate decision points involving the leagues. They are currently lobbying for the ability to opt out of certain bets offered by sportsbooks. This would allow the league to take bets off the board that they believe could be detrimental to the game—especially exotic bets that are decided on a single play and could be susceptible to fraud. While sportsbooks argue that this would cause a significant loss in revenue, leagues argue it is necessary to protect the integrity of the game. Sportsbooks maintain they should have the right to offer whatever bets they choose, and any exceptions should be individually negotiated between sportsbooks and leagues as opposed to the government forcing terms upon the sportsbooks.

This decision would go hand in hand with integrity monitoring. Leagues currently want access to the betting data from all sportsbooks for fraud monitoring. Leagues would have a large responsibility with limited experience and would become the primary monitoring source. Leagues have recently begun to shift their focus to individual deals with sportsbooks to generate additional revenue and address the data and integrity concerns listed above. Although the leagues are still lobbying the government for integrity fees to be written into law, these individual deals represent a potential compromise between the two stakeholders.
Experts agree that the widespread legalization will lead to massive growth of a new sponsorship category. What is less certain is the potential negative impact sportsbooks will have on existing sponsorships deals in other categories. Some companies may not want to be associated with sports gambling entities—financial services firms being one example.

Ultimately, it is likely this new sponsorship category will be a net gain in sponsorship revenue for leagues and teams. However, it will be worth watching how teams choose to activate with sportsbooks and any attempts they make to separate sportsbooks from their existing sponsors. While some international sports associations have banned gambling sponsorships, US sports leagues seem anxious to get a piece of the action. If the negative reaction from existing sponsors ends up being stronger than originally anticipated, leagues and teams may need to rethink their relationships with sportsbooks.
Critical uncertainty #5: Federal regulation

In his majority opinion on the reversal of PASPA, Justice Samuel Alito said Congress has the right to regulate sports gambling if it chooses, but if it elects not to, then each state is free to act on its own.\(^\text{27}\) At this point, it seems unlikely that the federal government will choose to regulate sports gambling on a national level, thus allowing each state to make its own decision.\(^\text{28}\)

However, this does not mean that the federal government will remain a bystander as the market unfolds. Senators Chuck Schumer (D-NY) and Orrin Hatch (R-UT) have stated that the federal government has an obligation to put some uniform and fundamental regulation in place around sports gambling for any state that chooses to legalize.\(^\text{29}\) They recently introduced a bipartisan bill with three objectives: 1) create safety measures to protect consumers, 2) preserve the integrity of sporting events, and 3) ensure the propriety of the sports wagering market.\(^\text{30}\) Without such regulation, each state can set its own policies, making it difficult and confusing for leagues and sportsbooks to operate on a national level.\(^\text{31}\)

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Stakeholders across the industry (sportsbooks, leagues, and fans) had been anticipating PASPA being overturned by the Supreme Court. Now that it’s happened, the United States stands at the precipice of a market ready to explode. In the United Kingdom, where sports wagering has been legal for more than 50 years, officials are now exploring ways to restrict a market that some feel has spiraled out of control. The next three years will go a long way in determining whether the United States will adopt the UK’s zealous approach to grow the industry or take a more tempered approach. Where and how sports gambling is permitted to take place are the key questions that will dictate the future of this emerging industry. Regardless of the answers to these questions, stakeholders across the industry are jockeying for their piece of the action.

With so much happening so quickly, many stakeholders across the spectrum are left with some key questions to answer. How will all this affect my industry and my business? How should I capitalize on this potential opportunity? What risks should I be mindful of as the market evolves? Due to our virtually unparalleled breadth of experience across consulting, advisory, tax, and audit, Deloitte is positioned to help clients answer these essential questions as they determine the right strategy based on the opportunities and potential risks involved.

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Endnotes

9. Ibid.
11. Cork Gaines and Shayanne Gal, “Here are the states where sports betting is expected to be legal within 5 years,” Business Insider, May 19, 2018.
13. Handle is defined as the total amount of money wagered by bettors at a sportsbook over a given period.
16. Ibid.
17. Ibid.
18. Ibid.
19. Ibid.
20. Ibid.
24. Ibid.
25. Ibid.
26. Ibid.
28. Ibid.
29. ESPN News Services, “U.S. senators Charles Schumer, Orrin Hatch introduce federal sports gambling bill.”
30. Ibid.
31. Ibid.