As we approach Super Bowl Sunday in the US, I think there’s a useful parallel to draw between athletes and business owners with regards to how they should think about managing their assets. It comes down to human capital.

Human capital is broadly defined as the attributes that enable someone to produce economic value through his or her labor, and includes knowledge, skills, training, creativity, and judgment, among other traits. Human capital can be applied toward working for a wage, being an entrepreneur, or competing as an athlete. Business owners use their human capital to build large, successful enterprises. Athletes use their human capital to perform at the highest level in their sport.

Professional athletes are, in fact, not that different from successful business owners. Successful athletes beat the odds. Only three or four of every 10,000 high school athletes eventually make it to the professional leagues. They also have a very concentrated position—their human capital—on their balance sheet. For many athletes, their athletic human capital represents the most valuable asset they will ever own. Liquidity events also occur over a short period of time, as most athletic careers are limited in duration.

Successful business owners also beat the odds. It is thought that most—96% or so—of businesses eventually fail. The odds of creating a very successful business are not even that different from making it to the professional leagues: only three of every 10,000 households in the US have a net worth above USD 100mn, and virtually all of those households created their wealth through a private business.

From a wealth management standpoint, professional athletes have to manage a very concentrated human capital position that is liquidated in a short period of time, all while ensuring that the proceeds are (hopefully) sufficient to pay for their post-career spending. Business owners face a similar scenario, although it typically occurs much later in life. After spending years or decades building a company (in effect, converting their unique human capital into a
valuable business), they need to exit the business with sufficient liquid assets to pay for their future spending. The exit tends to occur all at once.

Should athletes and business owners, both of whom have high-risk human capital, invest only in cash and bonds? The short answer is no. It’s true that an athlete’s career could be cut short by injury or their sport could become less popular, but bonds can’t hedge those idiosyncratic risks. A company could fail from technological disintermediation or simple mismanagement, among other reasons. Again, these are mainly idiosyncratic risks that can’t be hedged through a bond portfolio. Aside from having sufficient liquidity available to bridge the gap between their playing careers or business ownership and retraining for whatever is next, holding a well-diversified portfolio leads to better long-term outcomes.

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For more, see Athletes, business owners, and human capital, Jan 31., 2019.
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