Football and Regulation: Why German Teams Might Win in the End

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Starting Point I

When is financial regulation justified?

1. From a market economics perspective:
   ➔ implies restrictions of investment decisions and business behaviour (inter alia …)

   Justified …
   ➔ … if football clubs are like banks …
   - incentives for over-investment and excessive risk-taking PLUS
   - ‘too prominent to fail’ (➔ moral hazard) PLUS
   - special effect: vagabond liquidity bubble

   ➔ if risk decision and risk liability are incongruent ➔ market failure!
Starting Point I

When is financial regulation justified?

2. From a league management perspective:

- if financial troubles harm the value of the product (the league)
  - negative publicity
  - distortion of sports competition (failing teams)
  - loss of valuable brands
  - pressure to bail-out insolvent clubs

- if the league carries some of the costs and burden of tumbling clubs

  negative externalities
Starting Point II

Competitiveness

1. International (Inter-League) Competitiveness
   ➔ how do the league’s clubs perform in international tournaments (UEFA Champions League)

2. Domestic (Intra-League) Competitiveness
   ➔ how does the league perform (➔ competitive balance)

3. National Team Competitions
   ➔ How does the league promote success of the national team?

Short-run vs. long-run perspective
Financial Regulation in the Bundesliga

Three Pillars:

(I) Licensing System
(II) Safeguard Fund
(III) Ownership Rules
Financial Regulation in the Bundesliga

(I) The Licensing System; Financial Conditions

Every league participant ('club') must submit by March, 15th comprehensive financial data to the DFL

- for the year before and the running year
- as well as a forecast for the upcoming season,
- each certificated and commented by an auditing firm.
- DFL is granted comprehensive information disclosure rights reg. banks, auditors, etc.

Conditions for Approval:

- forecasted positive liquidity situation at the end of the upcoming season,
- positive net equity in the last regular balance sheet,
- forecasted positive net equity at the end of the upcoming season.
Financial Regulation in the Bundesliga

(I) The Licensing System; Financial Conditions (cont’d)

DFL may demand additional materials or corrections to the clubs’ submissions.

Final verdict regarding economic viability by the DFL:
- license without conditions and obligations.
- license without conditions but with specified obligations (e.g. debt reduction).
- license under conditions and with obligations (usually if negative liquidity is expected).
- no license.

Clubs may appeal to the licensing board, a DFL arbitration court and to ordinary courts.
Financial Regulation in the Bundesliga

(1) The Licensing System; Financial Conditions (cont’d)

Sanctions (in case of violation of conditions and obligations):

- warning,
- temporary suspension (max. two months),
- points deductions, and
- monetary fines.
Financial Regulation in the Bundesliga

(II) Safeguard Fund

Goal: bridging temporary liquidity crisis of clubs in order to safeguard match and league operations.

Financing: solidarity

Volume: 10 million € per season

Payment: max. two-months of salaries or 5 million €

Consequence for the club: up to 3 points deducted

Reimbursement: next rate of media contracts money
Financial Regulation in the Bundesliga

(III) Ownership Rules (“50 plus 1 clause”)

- football club (“eingetragener Verein”) must hold the majority of voting rights of the attached football company (plc., ltd., etc.) [50% + 1 voting rights in the General Assembly]

- the issuing of non-voting shares remains unaffected (pure capital contributions are not restricted)

- two exceptions (incumbents' rights): Leverkusen (Bayer AG) and Wolfsburg (Volkswagen AG)

- no ownership of more than one club
Financial Regulation in the Bundesliga

Critical Review

- Discretionary power of the DFL: are prominent clubs treated equally to ‘nobodies’?
- Effectiveness and credibility: are ‘too prominent to fail’ and ‘moral hazard’ problems really solved?
- Free-riding on the Safeguard Funds: taking the money when points do not matter no more? (“Arminia Bielefeld case”)
- Double standard of ownership rules (“Bayer Leverkusen & Volkswagen Wolfsburg”): just to keep Red Bull out?
- Questionable motivation of ownership rules: if the licensing system works, then why keep investors out – protecting the incumbents’ rents?
Financial Regulation vs. Competitiveness?

How can financial regulation harm competitiveness?

- prevention of “over”-investment relying on future sports success to finance today’s expenses
- prevention of capital injections by ‘rich hobby owners’ – and by private equity companies, (reputable) football management companies, etc.
  ➔ short-run investment limits harms international competitiveness with unregulated football markets
  ➔ limits to new investors and incumbent privileges (50+1 rule) harm domestic competitiveness
  ➔ *German teams might lose (international competitiveness) at least in the short run.*
Financial Regulation vs. Competitiveness?

How can financial regulation promote competitiveness?

- promoting sustainable business models (instead of debt accumulation until breakdown)
- sustainable league product (no midseason insolvencies; revenue-based expenditures: restriction of revenue / capital-inflow substitution)
- promoting competitive balance? *(licensing conditions vs. ownership rules)*
- better opportunities for home-grown talent

→ more fans, more viewers, more revenues promotes domestic competitiveness
→ more competitive balance promotes domestic competitiveness
→ effect of more competitive balance on international competitiveness?
→ promotion of home-grown talent supports national team competitiveness (?)

→ German teams might win (international competitiveness) in the long run.
Conclusion

1. Gains of financial regulation are more in the long run than in the short run.
2. Intra-League competitiveness likely to increase.
3. This might increase international competitiveness.
4. But probably only if top clubs in unregulated leagues actually break down.
5. A hypothesis: financial regulation tends to benefit mid-size and smaller clubs but tends to harm the big clubs.
6. German Bundesliga financial regulation is far from being without flaws.
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