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An Assessment of UEFA's Financial Fairplay Rules

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Financial Stability

- "If we carried on in the way we are, with several clubs in Europe losing more than 100 million euros each year, then it is only a question of time before we have a big, big problem”

- “There is more money than ever coming into the game but it seems to me we are spending more and more. This is a good moment to bring the game back to a more rational way."

- Karl Heinz Rummenigge

Professional sport and finance: The American model

- Profit driven owners collectively manage a “closed league” system
- Closed to entry (no promotion and relegation), closed to local competition (exclusive territories)
- In the name of preserving competitive balance, owners agree on collective restraints

    a) Labour markets (e.g. reserve clause, roster limits, salary caps)

    b) Product market (e.g. Gate sharing, sharing of broadcast and merchandising income)

Professional sport and finance: The European model

- Not-for-profit owners compete in an “open league” system
- Open to entry (promotion and relegation), open to local competition (no exclusive territories)
- Limited agreement among owners on collective restraints to preserve competitive balance

  a) Labour markets (e.g. Bosman, some roster limits, no salary caps)

  b) Product market (e.g. Limited gate sharing, unequal sharing of broadcast income, no sharing of merchandising income)

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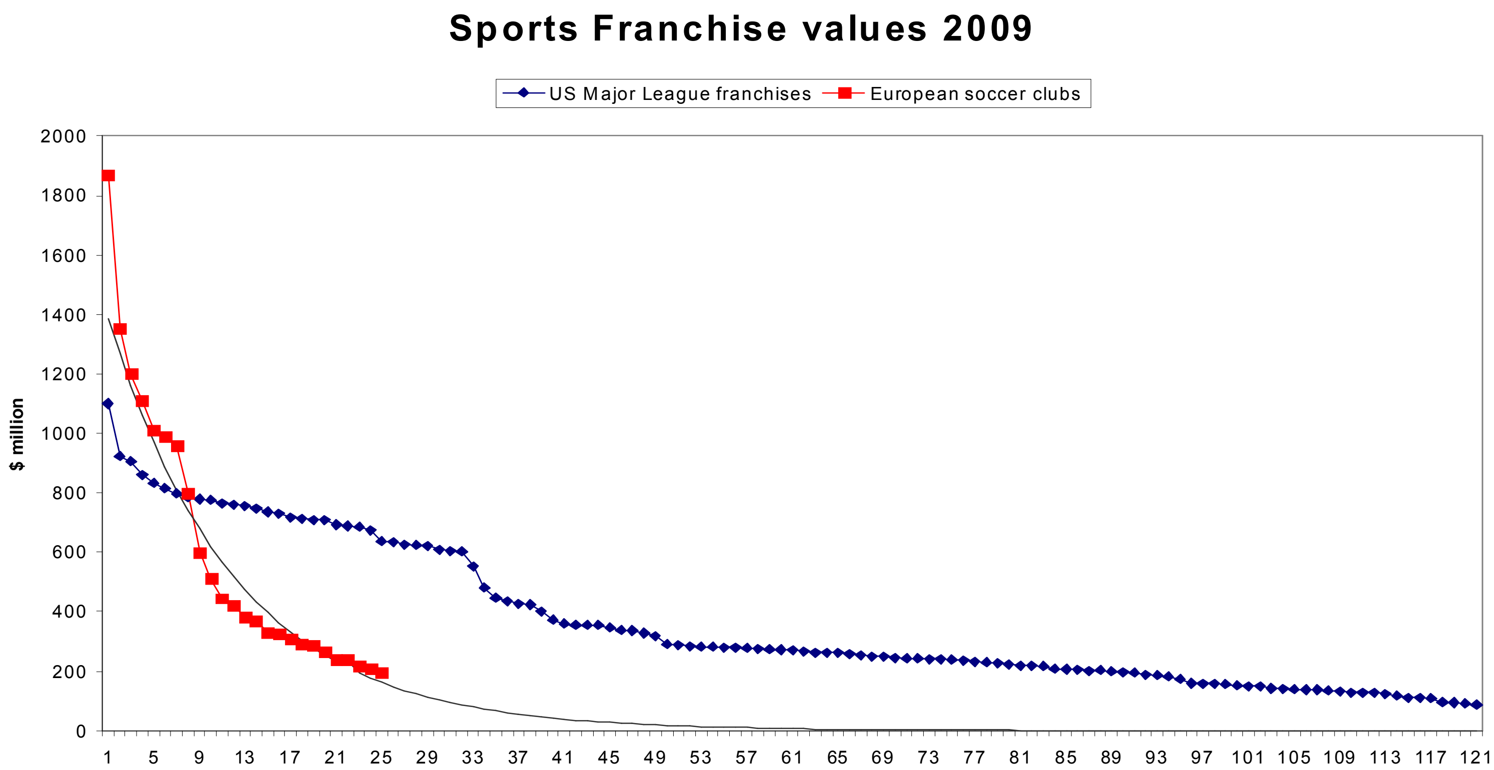
The consequence: equality and profits in the US, inequality and losses in Europe



Source: Forbes

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UEFA Financial Fairplay

- Rules published 2010
- Enforced 2013/14
- Based on financial data from 2011/12
- Must meet designated criteria in order to participate in UEFA competition
- Licenses issued by national FA to member clubs if criteria met
- UEFA panel to oversee the process

UEFA Financial Fairplay

Article 2 – *Objectives*

These regulations aim...to achieve financial fair play in UEFA club competitions and in particular:

a) to improve the economic and financial capability of the clubs, increasing their transparency and credibility;

b) to place the necessary importance on the protection of creditors by ensuring that clubs settle their liabilities with players, social/tax authorities and other clubs punctually;

c) to introduce more discipline and rationality in club football finances;

d) to encourage clubs to operate on the basis of their own revenues;

e) to encourage responsible spending for the long-term benefit of football;

f) to protect the long-term viability and sustainability of European club football.

Criteria for granting a License

- Four main criteria
    - Going concern
    - No negative equity
    - Breakeven
    - No overdues payable
- Based on averages of audited data supplied for the previous three seasons
- Transitional rules apply until 2017/18

Breakeven

- Relevant income must be at least equal to relevant expenses
- **Relevant income:**
  - Gate money, broadcasting income, sponsorship income, advertising, commercial activities, other operating income, profit or income from disposal of player registrations, excess proceeds from the sale of tangible fixed assets, finance income
- **Relevant expenses**
  - Cost of sales, employee benefit expenses, other operating expenses, amortisation and costs of acquiring players, finance costs, dividends

Assessment of objectives

- Are the objectives reasonable and proportionate?

- Transparency and credibility
- Defend creditors
- Discipline and rationality
- Operate on “own revenues”
- Responsible spending
- Long term viability

- To what extent to these reflect the functions of a governing body?

Functions of a governing body

1. Legislative: maintain the rules of competition

2. Judicial: enforce agreements and sanction rule-breakers

3. Executive:

    a) Regulate entry into competition
    b) Promote competitions
    c) Endorse competitions

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Related objectives: competitive balance

- Is this about competitive balance?
- Not mentioned directly in FFP but clearly implied
- Not clear how competitive balance would be affected
- Generally speaking, improving performance requires an initial investment
- It may be that FFP would limit the capacity of weaker clubs to become stronger

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Related objectives: wage control

- Is this about cutting wage costs?
- If so, this becomes tantamount to a cartel agreement – it may violate section 101 of the European Treaty, which prohibits

"All agreements between undertakings, decisions by associations of undertakings and concerted practices which may affect trade between member states and which have as their object or effect the prevention, restriction or distortion of competition within the common market"

Assessment of methods: Negative equity

- Balance sheet: stock of wealth
- Income statements (profit & loss, cashflow): flow of wealth
- Negative equity- value of assets less than the value of liabilities (i.e. If all assets were sold creditors could be repaid in full)
- This may mean the club is already insolvent, although a business may be “balance sheet insolvent” but “cashflow solvent”, e.g. Where it has long term debts that do not require servicing in the short term
- Exclusion of clubs with negative equity is not much more than saying that the club must be financially viable

Assessment of methods: Breakeven

- **Issue 1**: Does failure to breakeven imply insolvency?

- Answer

  (a) not if current shortfalls are compensated out of accumulated reserves or future surpluses

  (b) not if the company has “non-football” alternative sources of funds

- **Issue 2**: why discount “non-football” income?

Issue 1

- If insolvency is grounds for disqualification from competition, we want good predictors of insolvency
- Is there evidence that breakeven is a good predictor?
- Accounting literature tend to focus on balance sheet ratios:
  - Total liabilities/total assets
  - Current liabilities/current assets
  - Sales/total assets
  - Net income/total assets
- But also a history of positive net income can be used

Issue 1- evidence from Leach (2006)

- Financial distress (qualified accounts and Qui scores)

- Predicted by

  (a) Underperformance on the pitch relative to wage spending

  (b) Underperformance in terms of income relative to league position

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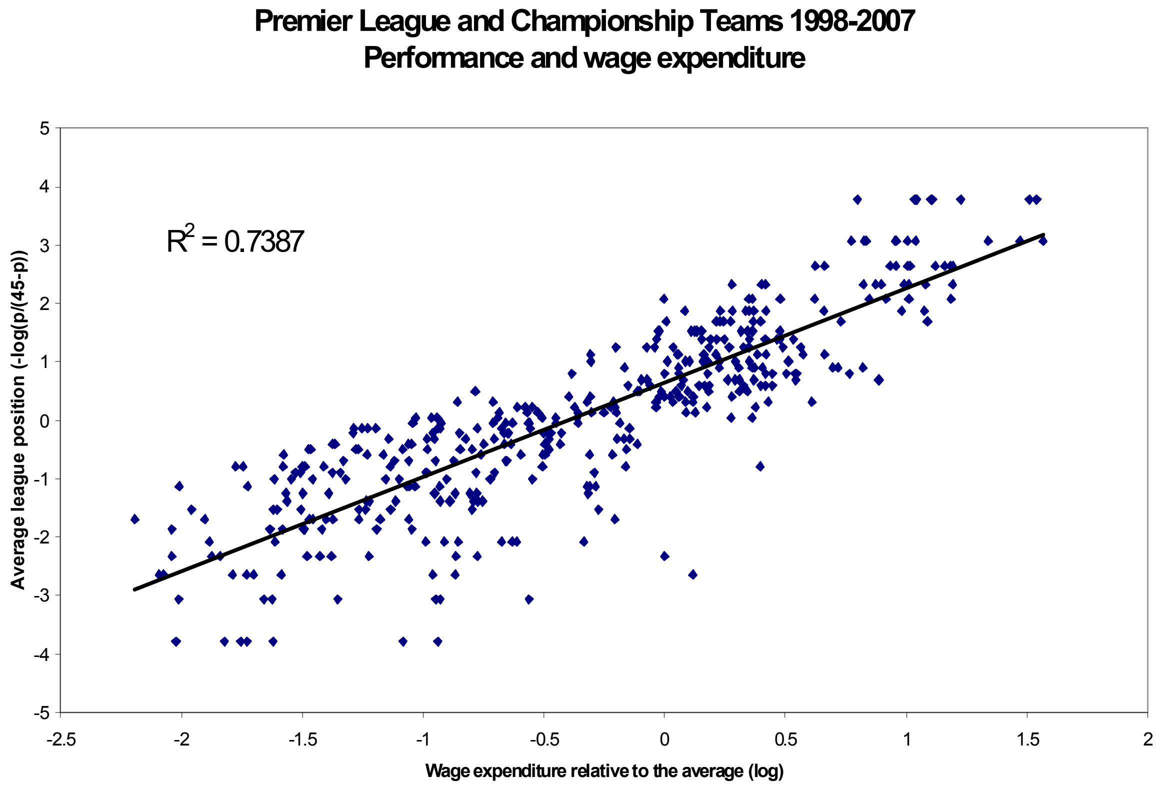
Wage expenditure relative to the average



Teams that achieve lower league positions than the regression line suggests are more likely to exhibit financial distress

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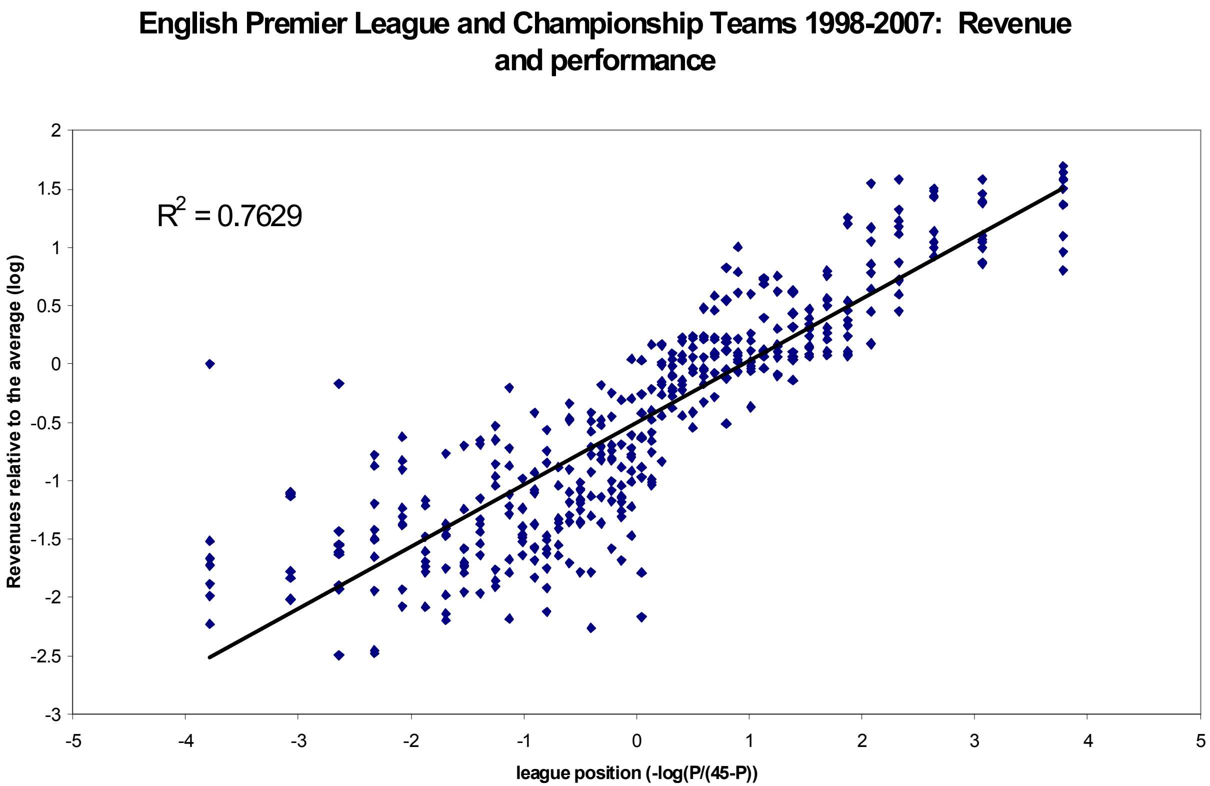
Revenues relative to the average



Teams that achieve lower revenues than the regression line suggests are more likely to exhibit financial distress

What does this tell us?

- Breakeven in year t may be a poor predictor of financial distress in year t+1
- Financial distress seems to occur when a “rational” plan unexpectedly fails- i.e. Bad luck
- Breakeven rules may not reduce financial distress

Another important fact...

- Out of 54 cases of insolvency recorded by Deloitte in the English leagues since 1992, all related to lower division clubs, except for the case of Portsmouth, which was about to be relegated from the Premier League

- UEFA benchmarking report showed that only 5 out of 80 clubs would fail to reach breakeven if rules were applied to clubs entering competition in 2010/11

- The financial problems in European football reside not primarily with clubs in the top divisions, but with clubs aspiring to reach the top divisions

Issue 2: exclusion of non-football income

- Is this legally defensible?
- Is the financial contribution of an owner more unfair than the financial contribution of a corporate sponsor?
- Does it create systemic risk?
- Will the exclusion restrict the capacity of owners to invest?
- Will it ossify the football hierarchy?

Example: Impact on Premier League

- Balance sheet: large debts and even larger assets (stadium ownership and player contracts) – limited risk of negative equity
- Breakeven- risks for Chelsea, Manchester City and Liverpool – but (a) are the rules enforcible? (b) what would the sanctions be?
- Premier League clubs in general have better cashflow than most leagues because of (a) large broadcasting contracts (b) high ticket prices (stadium ownership).
- Impact therefore likely to be minimal

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Conclusions

- Sensible for UEFA to agree rules on solvency
- Important to distinguish balance sheet and cashflow solvency- cashflow issues not well understood
- Exclusion of non-football income may be unsustainable
- Significant risk that the dominance of the strong clubs will be enhanced, while the financial instability of lower divisions is not addressed
- May face a challenge under competition law if competition in player markets is reduced