Department of Business and Management

Chair of Performance measurement and financial reporting

IS FINANCIAL FAIR PLAY REALLY FAIR?

A COMPARISON AMONG THE MAJOR EUROPEAN LEAGUES

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Football is a business able to gather the highest revenue than the other industries. Deloitte[1] states that in 2011/2012, the European football market grew to the exorbitant amount of €19,4 billion. In the period 2007-2011, the CAGR of the total turnover of the European clubs that play in the first divisions has grown of 5,6 per cent, compared to the 0,5 per cent of that of the general European economy in the same period[2]. Unlikely, the prosperity of the sector is impacted by the even higher costs that clubs have to suffer in order to improve their performance.

Starting from this data, the interest has been moved toward a remedy that UEFA has imposed in order to solve the bad situation. In particular, since the measure has to be applied to several European clubs, the analysis will focus on its fairness, trying to understand whether the sizeable discrepancies among different leagues could falsify the rule's validity. Indeed, this analysis and in particular the simulations aim at answering to the question "Are the European leagues comparable under the FFP in spite of their structural discrepancies?".

The desire to obtain the success on pitch has compelled teams to spend enormous amount of money to purchase the strongest players, this has triggered a vicious circle in which the second phase, a growing level of debt, brought clubs on the verge of bankruptcy. This has created a consisted gap between poor and rich clubs since only rich owners could inject massive amount of cash to recover the bad situation of their teams. The consequences are two: richer clubs have continued

[1] Deloitte, Annual review of football finance - Highlights, 2013

[2] PricewaterhouseCoopers, Report Calcio, 2013

paying exorbitant wages, increasing their indebtedness but being able to achieve sportive success that gave back other money to be spent in order to become more competitive. On the other side, poorer clubs worsened their critical situation greater and greater without any chance to win in order to obtain money and improve the quality of the team.

UEFA issued the document including all regulations useful to ensure the long term sustainability of the business and they can be divided into two main parts: the club licensing system and the club monitoring process. The difference is that the breach of club licensing criteria implies the refusal of the license and the consequent exclusion from European competitions, while the non-fulfillment of monitoring requirements entails the application of sanctions, later better explained. The emphasis is given to sporting and infrastructure criteria, but administrative and personnel, legal and financial criteria have to be met as well.

The extended and more complete measures than the club licensing are the monitoring requirements. Three issues are essential to understand what UEFA asks clubs to consider in order to meet the break even requirement:

- ✓ the monitoring period (Art. 59): is the long term in which the club is subject to the control of UEFA for what concerns the break-even result. It involves three shorter reporting periods. Taking as datum point a certain sportive season (e.g. 2015/2016), the first reporting period, T, coincides with the first calendar year of the sportive season (2015), the second reporting period, T-1, is the calendar year before the one of the first reporting period (2014) and the third reporting period, T-2, is equal to the calendar year before the one of the second reporting period (2013). This is a fundamental issue considering the importance of the long term of the measure that will be better examined in the paragraph regarding pros and cons of FFP.

- ✓ the break-even result (Art. 60): is the difference between relevant income and relevant expenses. The following table shows which income and expenses have to be considered relevant so as to be included in the computation. This distinction is made to distinguish the good expenditures from the excessive ones.

RELEVANT INCOME	**RELEVANT EXPENSES**
✓ Revenue – Gate receipts ✓ Revenue – Sponsorship and advertising ✓ Revenue – Broadcasting rights ✓ Revenue – Commercial activities ✓ Revenue – Other operating income ✓ Profit or income on disposal of player registrations ✓ Excess proceeds on disposal of tangible assets ✓ Finance income	✓ Expenses – Costs of sales/materials ✓ Expenses – Employee benefits expenses ✓ Expenses – Other operating expenses ✓ Amortization/impairment of player registrations and loss on disposal of player registrations (or costs of acquiring player registrations) ✓ Finance costs and dividends

What it is worth underling is that the following expenses are not considered relevant:

- expenditure on youth development activities;
- expenditure on community development activities;
- finance costs directly attributable to the construction of tangible fixed assets.

- ✓ the acceptable deviation (Art. 61): is the maximum break-even deficit a club may afford to remain in line with the regulations. The following amounts are even considered acceptable deviations only if the contributions from equity participants and/or related parties are able to entirely covered the excess:
  - EUR 45 million for the monitoring period assessed in the first two license seasons (2013/2014 and 2014/2015);
  - EUR 30 million for the monitoring period assessed in the three following period (2015/2016, 2016/2017 and 2017/2018);
  - A lower amount to be decided for the monitoring period assessed in the following years.

Then, an analysis of the so called "Big five" European leagues is dealt with. The point of departure for examining the European football is the fact that the enormous revenues that European clubs are able to collect makes football the most attractive industry in the world but they are not enough to avoid the tremendous losses caused by the as much huge wage costs[3]. So, although a crisis exists in the sector, it is not a crisis of income.

Making a comparison with the North American situation, it appears clear that even if extra European sports have suffered difficult financial periods, the extent and the regularity have been very different. The structural reason that has led to this condition is that European clubs adopt a profit maximizing approach while

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[3] Solberg H., haugen K., European club football: why enormous revenues are not enough?, Sport in society: culture, commerce, media, politics, 2010

the North American ones behave like win maximizers. This means that European teams are willing to spend more than they can afford in order to reach the best performance on the pitch, causing big losses in their financial statements. Moreover, empirical evidence[4] shows how the aggregate profit of profit maximizing clubs will be higher than that of win maximizing ones. This is due to the fact that European clubs recruit more talents than North American ones in order to reach their goal of maximizing the financial performance, causing a boost in the wage rates and thus high losses, not covered by even enormous revenue.

Nevertheless, there are other contingent events that have shaped the European football as it now is.

The first one is surely the sharp increase of TV broadcasting rights. In 1990s TV rights started to be sold through intermediaries, the pay-tv broadcasters, that acquired the right of broadcasting football events and on behalf of the football teams sold the product to the end users, causing an explosion of income in the clubs financial statements for the following decades, mainly in the largest national markets. The most direct negative consequence was that the price that the television companies paid to the clubs depended on the size of the corresponding national market, leading to wide differential of income among clubs in the biggest and the smallest leagues. So the diffusion of new technology to broadcast football match has been one of the causes that have triggered the vicious circle in which before than the richest clubs become richer and the poorest one are not able to compete with them, what it happened was that the largest leagues became richest

[4] Solberg H., haugen K., European club football: why enormous revenues are not enough?, Sport in society: culture, commerce, media, politics, 2010

and the smallest ones poorest. In this sense, it could be affirmed that the commercialization of the game has had negative effects on the competitive balance.

The second event was the liberalization of the transfer market through the Bosman rule that led players to obtain a strong bargaining power. Indeed, when players became free to move across the Europe, they preferred to move towards leagues that offered the highest salaries, causing a huge increase in those.

Further, in the s.s. 1991/1992, Champions League (CL) was introduced in the European scenario. For the purpose of this work, the negative effects it has brought regard again the competitiveness raised to participate to the competition. National clubs desired to participate in order to win the attractive prizes that would have helped the club to strengthen its squad to become stronger for the next season. Indeed, CL has been considered responsible for the growing domination of the elite clubs, bringing negative effects on the CB. Indeed, again this is a further factor that has contributed to trigger the vicious circle in which just the richest clubs could afford to buy the strongest players and make a squad able to compete in the most desired competition.

Then, in the last decades, there was an internationalization process in which clubs exploited their brands to increase its awareness also in geographical regions not belonging to their club. This phenomenon has contributed to reinforce and to make stronger the popularity of the biggest clubs, reducing further the power of the smallest ones.

The investigation focuses on the three European non-regulated leagues, Italy, England and Spain. They have in common the fact that they haven’t been affected by strict regulation and they may exploit larger freedom. Indeed, these football clubs run as normal commercial companies free to borrow and since regulation doesn't impose strict controls and sanctions, they haven't too big concerns about the growing indebtedness. The problem is that the strong competitive imbalance rises between clubs that can afford to spend in order to maximize their competitiveness and clubs that can't. They are highly indebted compared to their French and German competitors but are highly competitive in European tournaments. This is the main reason why there is a so strong financial and sportive inequality between the two groups of European leagues.

So far, financial regulation hasn't appeared mainly for two reasons: the first is that the state has never played a role in football regulation because it has never been interested in and if it was, it brought financial assistance without restriction. For example, in Spain, during the crisis in 1980s, State helped clubs to eliminate their debts without setting up strict rules; also in Italy in 2002, the "save football" law provided several ways out. Then, a few powerful teams are dominant in championship and acquired the power in leagues, they are in a situation of moral hazard due to the certainty they will be saved in case of debt accumulation and are thus scared of financial regulation, which would eventually restrict their sporting hegemony[5].

The practical part aims at simulating the computation of the break – even requirement in three European football clubs and at matching the theoretical concepts of FFP with the peculiar characteristics of the European football in order

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[5] Drut B., Reballand G., The impact of governance on European football leagues' competitiveness, University of Paris, Working paper no. 27, 2010

to understand whether it is really fair although the differences among the different leagues.

The clubs used for the simulation are Manchester City FC, Barcelona FC and ACF Fiorentina and they have been chosen because represent the three biggest differences characterizing their belonging countries: the ownership of sportive infrastructures and the kind of ownership structure. Indeed, Italy, England and Spain manage football in different ways and the analysis of three clubs of different countries could provide a food for thought whether they are really comparable as UEFA believes; or, on the contrary, the missing homogeneity could cause that the measure, aimed at comparing patchy groups, favors someone rather than other.

Going deeper in the choice of selecting those clubs, Manchester City represents a club held by the so-called sugar daddies that are willing to inject massive amount of money in order to make their squad competitive in the most rewarding tournaments; they are allowed to make it because in non-regulated leagues, there aren't so strict regulations that prevent owners from throwing excessive money, increasing the level of indebtedness.

Barcelona has been chosen because of its ownership structure. As in the second chapter it has been mentioned, the club has remained a member association and didn't transform itself in a SAD, preventing owners to increase the capital in order to cover the indebtedness, raised to buy the star players. Therefore, Barcelona has been chosen to represent all the teams that are not organized in form of companies and it will be useful to demonstrate whether UEFA has really acted favoring profit-oriented organizations at the expenses of associations.

So, the objective is to verify whether in implementing the regulations, UEFA has taken into account all the needs of the different European leagues without penalizing some categories.

In other words, "Are the European leagues comparable under the FFP in spite of their structural discrepancies?".

Starting from the English club, the expected break – even result of Manchester City was strictly depending on the wealth of its owner. Indeed, as the former president of Barcelona anticipated, it was expected that, at first sight, Manchester City, being a company and not an association, would have exploited an aggregate surplus for the first reporting period. This forecast was due to the club's possibility of increasing the capital in any moment in order to cover potential debts. However, the results of the computation are really different from the expected ones and are reported in the following table[6].

[6] The Manchester City's financial statement is denominated in pounds and in order to convert the values in euros, the average exchange rate of the reporting period, as provided by the European Central Bank, has been used

RELEVANT INCOME	2012/2013	2011/2012	Δ
Turnover	326.236	274.707	19%
Revenue - Other operating income	57.456	15.213	278%
Profit/income on disposal of player registrations	7.069	12.654	-44%
Excess proceeds on disposal of tangible fixed assets	0	0	
Finance income	280	2.157	-87%
TOTAL RELEVANT INCOME	391.042	304.730	28%
RELEVANT EXPENSES			
Expenses - Cost of sales/materials	8.225	8.088	2%
Expenses - Employee benefits expenses	280.619	239.823	17%
Expenses - Other operating expenses	58.441	43.268	35%
Amortization/costs of acquiring player registrations	97.352	98.681	-1%
Finance costs and dividends	8.548	3.254	163%
TOTAL RELEVANT EXPENSES	453.184	393.114	15%
EBT	-62.143	-88.384	-30%
ADJUSTMENTS TO RELEVANT INCOME			
Income transaction with related party above fair value	0	0	
Non monetary credits	0	0	
Income from non-football operations not related to the club	0	0	
ADJUSTMENTS TO RELEVANT EXPENSES			
Expenses transaction with related party below fair value	0	0	
Non-monetary debits/charges	0	0	
Expenses of non-football operations not related to the club	0	0	
Expenditure on youth development activities	18.127	15.725	
Expenditure on community development activities	291	275	
Finance costs directly attributable to the construction of tangible fixed assets	4.050	5.156	
ADJUSTED EBT	-39.675	-67.229	
ITEMS THAT MAY BE INCLUDED			
Depreciation/impairment of tangible fixed assets	6.963	7.827	
Amortisation/impairment of intangible fixed assets	0	0	
Tax expenses	0	0	
BREAK EVEN REQUIREMENT	-32.712	-59.402	
ANNEX XI			
Contracts with players prior to 1 June 2012	0	62.395	
BREAK EVEN REQUIREMENT	-32.712	2.994	

Contrary to any expectations, Manchester City presents critical accounts. The support, that UEFA has wanted to grant to clubs through the adjustments, improves the final result but it is not still enough; indeed, expenditure on youth development activities, expenditure on community development activities, finance costs directly attributable to construction of tangible fixed assets positively adjust the EBT but it is still lower than zero. But the club has even another chance provided by Annex X[7] of the "UEFA Club Licensing and Financial Fair Play Regulations" where it is specified that depreciation/impairment of tangible fixed assets, amortization of non-player intangible fixed assets and tax expenses may be excluded from the calculation of the break – even result.

Nevertheless, surpluses continue being negative. The club is allowed to resort to a provision of Annex XI where it is stated that what UEFA would take into account in a favorable way is the condition in which "the licensee proves that the aggregate break – even deficit is only due to the annual break – even deficit of the reporting period ending in 2012 which in turn is due to contracts with players undertaken prior to 1 June 2010"[8]. This means that for the reporting period 2012/2013, the break – even requirement may be upward corrected by the sum of the contracts with players undertaken till then. In this way the final result is finally positive while that of the following year remains negative because it can't exploit the subtraction of players contracts.

However, what accounts for avoiding sanctions is that the aggregate result is positive and it is given by the sum of the results of each reporting period covered by the monitoring period. Because the aggregate break – even result doesn't exceed the acceptable deviation of EUR 45 million, borne for the first two monitoring periods, UEFA could show itself permissive.

What it could be expected from the Spanish club's analysis was a quite deviated break – even result from the acceptable threshold. The ownership structure would seem a consistent obstacle for the achievement of the break – even. Being a

[7] Letter C, number 2

[8] UEFA Club Licensing and Financial Fair Play Regulations, Annex XI

members association where the ownership is held by several supporters, there isn't the possibility of increasing capital in any moment, so the club would more suffer the indebtedness. but again the results differ from the expectations and they are reported in the table.

RELEVANT INCOME	2012/2013	2011/2012	Δ
Turnover	443.767	438.041	1%
Revenue - Other operating income	36.858	43.820	-16%
Profit/income on disposal of player registrations	-9.708	-6.167	57%
Excess proceeds on disposal of tangible fixed assets	0	0	
Finance income	1.888	1.992	-5%
TOTAL RELEVANT INCOME	472.805	477.686	-1%
RELEVANT EXPENSES			
Expenses - Cost of sales/materials	5.619	5.573	1%
Expenses - Employee benefits expenses	237.817	233.312	2%
Expenses - Other operating expenses	111.113	112.312	-1%
Amortization/costs of acquiring player registrations	70.496	72.031	-2%
Finance costs and dividends	6.222	6.894	-10%
TOTAL RELEVANT EXPENSES	431.267	430.122	0%
EBT	41.538	47.564	-13%
ADJUSTMENTS TO RELEVANT INCOME			
Income transaction with related party above fair value	0	0	
Non monetary credits	0	0	
Income from non-football operations not related to the club	0	0	
ADJUSTMENTS TO RELEVANT EXPENSES			
Expenses transaction with related party below fair value	0	0	
Non-monetary debits/charges	0	0	
Expenses of non-football operations not related to the club	0	0	
Expenditure on youth development activities	17.251	17.205	
Expenditure on community development activities	690	688	
Finance costs directly attributable to the construction of tangible fixed assets	0	0	
ADJUSTED EBT	59.479	65.457	
ITEMS THAT MAY BE INCLUDED			
Depreciation/impairment of tangible fixed assets			
Amortisation/impairment of intangible fixed assets			
Tax expenses			
BREAK EVEN REQUIREMENT			
ANNEX XI			
Contracts with players prior to 1 June 2012			
BREAK EVEN REQUIREMENT			

Thanks to its efficient management leading to positive measures, the adjusted EBT is already positive and it doesn't need to apply all the softening provisions provided by UEFA, such as items that may be included, players contracts prior to

1 June 2012 and the acceptable deviation. Its financial conditions make the club safe in terms of possible sanctions.

The reason why Fiorentina has been chosen as symbol of Italy is that it has all the most common characteristics of the most Italian clubs. That are the ownership of the stadium by the municipality and the ownership of the club held by an entrepreneur with activities in unrelated activities. These factors brought to expect a critical management of the club followed by the difficulty of reaching the break – even requirement. Also in this case, the practical examination has revealed discrepancy between the expectation and the reality, as showed in the following table.

RELEVANT INCOME	2012	2011	Δ
Turnover	60.734	62.247	2%
Revenue - Other operating income	11.530	4.072	-65%
Profit/income on disposal of player registrations	36.795	757	-98%
Excess proceeds on disposal of tangible fixed assets	0	0	
Finance income	3.003	6.254	108%
TOTAL RELEVANT INCOME	112.062	73.330	-35%
RELEVANT EXPENSES			
Expenses - Cost of sales/materials	17.853	15.805	13%
Expenses - Employee benefits expenses	52.396	54.404	-4%
Expenses - Other operating expenses	10.602	12.937	-18%
Amortization/costs of acquiring player registrations	26.980	33.489	-19%
Finance costs and dividends	747	527	42%
TOTAL RELEVANT EXPENSES	108.578	117.162	-7%
EBT	3.484	-43.832	-108%
ADJUSTMENTS TO RELEVANT INCOME			
Income transaction with related party above fair value	0	0	
Non monetary credits	0	0	
Income from non-football operations not related to the club	0	0	
ADJUSTMENTS TO RELEVANT EXPENSES			
Expenses transaction with related party below fair value	0	0	
Non-monetary debits/charges	0	0	
Expenses of non-football operations not related to the club	0	0	
Expenditure on youth development activities	4.343	4.686	
Expenditure on community development activities	174	187	
Finance costs directly attributable to the construction of tangible fixed assets	0	0	
ADJUSTED EBT	8.001	-38.958	
ITEMS THAT MAY BE INCLUDED			
Depreciation/impairment of tangible fixed assets			
Amortisation/impairment of intangible fixed assets			
Tax expenses			
BREAK EVEN REQUIREMENT			
ANNEX XI			
Contracts with players prior to 1 June 2012			
BREAK EVEN REQUIREMENT			

Fiorentina shows different results from the other two cases: the EBT of the two reporting periods have opposite signs. However, this fact doesn't undermine the club's ability to reach the goal, being the aggregate break – even included in the acceptable deviation. So, like in the Barcelona's case, Fiorentina also doesn't need to benefit from softening help provided by UEFA.

What mainly emerges from the investigation is that all the results of the break - even requirement diverge from the expectations. An expectation was that FFP would have favored clubs that have the possibility of receiving massive amount of money by their wealthy benefactors at the expenses of clubs organized in form of associations that can't benefit from this privilege. But by comparing the results of Manchester City and Barcelona, being the representatives of the two ownership structures, what can be noted is that Barcelona is more virtuous than Manchester City in implementing the regulations although the former is organized as a members associations and shareholders aren't induced to put money.

Another expectation was related to the fact that FFP was introduced without considering that some clubs don't own their sportive infrastructures and for this reason, they are victims of a difficult management of club where expenses are too high to be covered by even high revenue. So, it was expected that Fiorentina was obstructed by the vicious circle triggered by the non-ownership of the stadium in achieving the break - even requirement, in particular if compared with its colleagues owning their stadia. For example, by making a comparison between Fiorentina, not owner of its stadium, and Manchester City, owner of its stadium, it was expected that the former couldn't fulfill the requirements while the latter could. But the results have again reversed the suppositions: Fiorentina is more virtuous than Manchester City.

Therefore, on the basis of these considerations, the main conclusion is that UEFA has been able to impose a measure that doesn't negatively affect the clubs on the basis of their structural factors but that strongly depends on the managing ability of the owners. So, the answer to the question "Are the European leagues comparable under the FFP in spite of their structural discrepancies?" is yes. Structural discrepancies don't affect the break - even requirement as an unable management do.

UEFA has been able to find an effective remedy for restoring the football industry from damages caused by the widespread mismanagement without undermining the normal and unavoidable weaknesses that any club suffers. Another noteworthy factor is that UEFA has launched the regulations by softening as much as possible their strictness and it has shown itself flexible in accepting deviations. Indeed, of course, the rules have to be considered a point of departure with a lot of point of deficiencies to be covered in the next future but what it has to be laudable is the effort of the association of starting convicting those club whose owners have made football a business from which just obtaining profit and not a sport that wants to give entertainment and emotions.