FOOTBALL
BUSINESS
INSIDE

# Strategies for Football Clubs

*Financial Sustainability.*

Ladies and Gentlemen,
dear readers,

For as long as I can remember, football has been my biggest hobby. Ever since I was a little boy and my dad took me to the stadium of VfL Bochum for the first time, I have fallen in love with that sports. When I grew up and had to decide what I want to do for a living, I seriously considered studying sports or journalism to start working in the football industry. However, the business world also fascinated me, as a skier I love the mountains, and thus I decided to move to Switzerland and study business there.

Now, twelve years later, I still live in Switzerland and now am a lecturer at the university I studied at. And I love it. I never regretted my decision to move and study here. Yet, my love for football and my fascination for the whole industry has not shrank a bit. I still watch every single game of my club, nowadays just mostly on TV. Watching Germany win the World Cup live in the stadium in 2014 is still one of the best experiences of my life. That is why I always felt the urge to connect my love for the game and my professional life and have frequently engaged in research and practical projects in the football industry.

This report is a consequence of all of that. Now, that the whole industry is facing challenges and public interest in the financial stability of football clubs has risen, I felt the need to show two things: first, the football business as a whole is not as financially unstable as it is often portrayed. Plenty of clubs are managed in a very stable and sustainable way. But second, there are some severe problems that have to be solved if we want to continue enjoying the game that we all love. The good news is: there are various approaches for improvement that are already being discussed. And that makes me optimistic that in some years, my future children will still feel the same emotions about football that I do.

Good luck and best regards,

**Dr. Florian Hohmann**
florian.hohmann@unisg.ch



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Thomas Maurer e.U.
Dietenberg 205/4
8563 Ligist
Austria
**www.footballbusinessinside.com**

**Responsible for the content**
Dr. Florian Hohmann
**florian.hohmann@unisg.ch**

**Layout**
Thomas Maurer

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# Management Summary

Managing the finances of a football club is complex. The revenues a club can generate are very much dependent on its sporting success. In return, however, sporting success is also highly dependent on how much revenue a club can generate and therefore invest in the squad. Financial executives always need to find the right balance between investing enough money in the team to maximise sporting success, without taking excessive risks and harming the financial stability. This balance act is even more complicated by the fact that the football business is under great public scrutiny and very much driven by emotion. In recent years, the football industry has been publicly criticised and accused of being unsustainable and disconnected from reality. Now, since the whole industry is struggling due to the COVID-19 pandemic, public interest in the financial situation of professional football has risen. Club managers have to plug the holes left by the COVID-19 crisis while simultaneously being successful on the pitch. League associations and federations are discussing new regulations that could positively change football in the future. Hence, now it is the perfect time to critically reflect on the financial sustainability of the football industry and to set the course for a successful future.

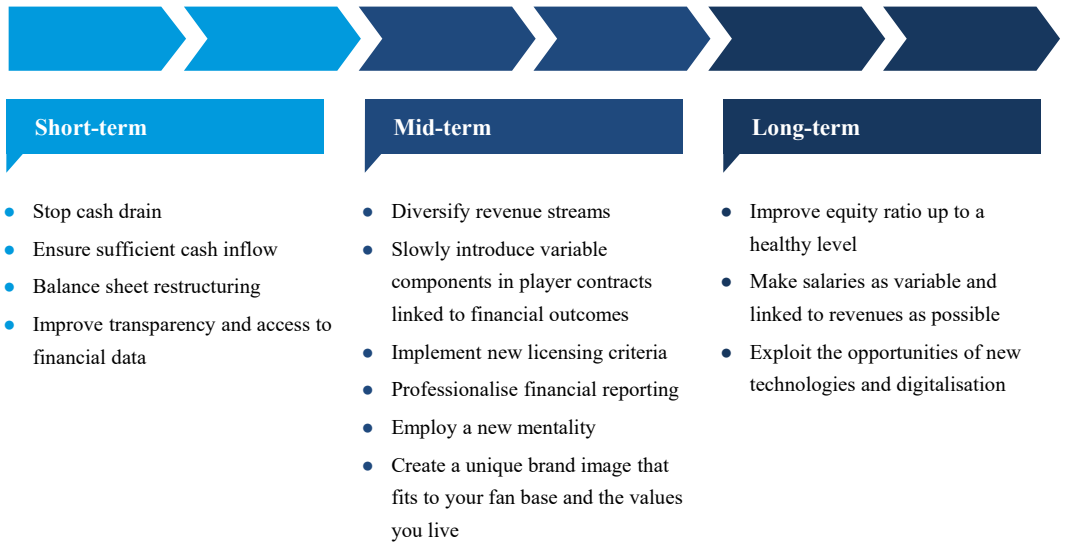
Analysing financial ratios of European football clubs shows that it is wrong to say that the football industry as a whole has a fundamental financial problem and is bound to fail. However, many clubs, especially in smaller leagues, were already in financial difficulties before the current COVID-19 pandemic. Therefore, it seems worthwhile to come up with ideas for how such clubs can be set up in a more stable way – especially now, when the business is more receptive to change than ever.

There are various approaches and ideas of how to make financial management in football more sustainable, some of them already being discussed in league associations or committees of UEFA and FIFA.

Within this report, several approaches for improvement are introduced and a timeline with possible short-, mid- and long-term measures is set up.

The short-term measures are all aimed at ensuring the immediate survival of the clubs now during and after the COVID-19 pandemic and have largely already been implemented. The cash drain during the first lockdown had to be stopped and clubs had to ensure that enough liquid funds are available to keep the business going. Clubs have negotiated with their players to agree on salary waivers, have stopped certain investments and introduced measures like short-time work. Additionally, assets were sold and loans were taken out to obtain fresh liquid means. There are clubs that also might have to carry out balance sheet restructuring. Due to the low reserves of some clubs, the crisis can lead to over-indebtedness, from which the clubs have to recover as fast as possible. Furthermore, the crisis should be used as an opportunity to become more transparent and report more openly about the financial situation. Mid-term, it will be utterly important for clubs to retain profits in order to plug the holes left by the COVID-19 crisis. New revenue sources could be developed that are ideally not directly linked to sporting success. A strong and authentic brand image, professional financial reporting and close customer relationships can help clubs stabilising their revenues. Additionally, the eSports market and trends such as digitalisation and sustainability will grow in importance. Furthermore, either a new mentality or new licensing criteria are needed for clubs to be more profitable after the crisis. Regulations like a determined minimum equity ratio or a flexible salary cap could help to end the currently prevailing “rat race”. The football industry can take its cue from the Basel III regulations, which were developed for banks after the global financial crisis of 2007-2008.

Long-term, if based on new regulations or not, all clubs, also in smaller leagues, should be able to raise their equity ratio to a healthy level. This would make the whole system more stable and resistant to crises. If clubs succeed in linking more components of the variable part of a player’s salary to their revenues, this would further increase their stability. Last but not least, digitalising the processes of financial management is currently a big trend within all major corporations. While this is not an important topic for football clubs at the moment, in the long run, when some technologies are more established and also accessible for smaller companies, utilizing the possibilities of new tools like RPA or AI will also be very beneficial for the football industry.



# About the Author
# Dr. Florian Hohmann

Florian Hohmann is Project Leader and Lecturer for Financial Management at the University of St. Gallen (Switzerland). His consulting projects as well as his research and teaching activities are focused on the areas of Accounting, Management Accounting, Auditing and Corporate Finance. He also works for the Swiss accounting standard Swiss GAAP FER, is leader of an expert group in the International Controller Association, consisting of Swiss finance executives, and host of the Podcast Meet the CFO. His previous experience is in the areas of banking, strategy consulting and consulting of sports organizations.

Florian Hohmann holds a PhD in Management from the University of St. Gallen as well as two Master's degrees: Banking & Finance and CEMS International Management. He is a passionate football fan, however his own football skills are rather mediocre. He has already spoken about the financial situation in football at different events, panel discussion, podcasts, and on German TV. In 2020, he joined our Football Business Inside network as a member of our expert hub.



# Introduction

Football is emotion. Football is the most popular sports in the world. For many people, football is an essential part of their lives. But football is also business. A business that has often been publicly criticised and accused of being disconnected from reality and unsustainable. Now, since the whole industry is struggling due to the COVID-19 pandemic, public interest in the financial situation of professional football has risen. Club managers have to manage the balancing act of plugging the holes left by the COVID-19 crisis and being successful on the pitch at the same time. League associations and federations are discussing new regulations that could positively change football in the future. Hence, now it seems to be a perfect time to release a report about the financial sustainability of football clubs.

The purpose of this report is twofold: first, to present the general challenges of managing the finances of a football club, as well as a snapshot of the current financial situation. Second, to derive concrete ideas for future improvement from current challenges and issues. What makes managing the finances of a football club different from financial management in an ordinary market-focused company? What did the financial situation of professional football clubs in Europe look like before the COVID-19 pandemic? What were the main issues? How severe is the effect of the pandemic on what kind of clubs? And what measures can be taken to make the system more sustainable in the future? These questions will be systematically answered in the course of this report.

Lastly, Ilja Kaenzig (Managing director VfL Bochum) and Raphael Landthaler (former CFO SK Rapid Wien) share their practical insights and critically reflect on some topics of this report in an interview.

# Chapter 1
## Distinctive Aspects of the Financial Management of Football Clubs

Professional football clubs are medium-sized, often internationally operating businesses. As such, professional financial management is essential. However, the financial management of football clubs is not entirely comparable to the usual accounting, reporting and control practices of ordinary market-focused companies. In the following, the most distinctive aspects of the financial management of football clubs are discussed in order to provide the basis for all subsequent analyses and recommendations.

### *Volatile revenue streams*

Business forecasting and budgeting are crucial activities within financial management. Since budgeting always involves assumptions about future developments, it is always associated with great complexity and uncertainty. While ordinary companies are often able to forecast future sales trends or cash flows with relative accuracy, such forecasts are extremely complex for football clubs, as financial success heavily depends on sporting success. If clubs are very successful and qualify for international competitions or win titles, they earn more money from broadcasting, sponsoring, and in many cases also have higher matchday and merchandising income, as fans are more excited about the club. However, this relationship also works in the other direction and in years when clubs unexpectedly do not qualify for international competitions or are even relegated to a lower division, incomes are much lower than predicted. In order to be able to adequately depict this correlation in the management accounting system, financial executives of football clubs must demonstrate a high level of scenario capability. They always need to be able to answer questions such as what happens if they advance to the Champions League, the Europa League or the national cup, what happens if they sign another player or organise another concert in their stadium.

Today, even many companies outside the football industry indicate that financial planning has become increasingly challenging, since we are currently living in a so-called VUCA world – an economy determined and driven by volatility, uncertainty, complexity and ambiguity. Within the football industry, these factors have always been present. Financial executives must draw best-case scenarios (e.g. qualifying for the Champions League and winning the national cup), worst-case scenarios (being relegated to the second division) and many scenarios in between, calculating how much money can be invested in the licensed player squad for each scenario. While budgets for each scenario can be calculated quite precisely, the sporting success is hard to predict. Clubs must decide which scenario they will use as a basis for their financial planning when determining how much can be invested in the player squad, always keeping in mind that the money they invest can also have a big impact on the performance on the pitch. Should you draft a conservative budget plan based on the worst-case scenario, even though this could be a self-fulfilling prophecy, whereby investing less you are also less likely to be successful on the pitch? Or should you take risks and invest more money, hoping for sporting success and consequent increase of income? Whilst this planning is already utterly difficult for one season, the complexity increases significantly when it comes to multi-year planning.

### *Financial vs. sporting success*

As mentioned above, financial and sporting success are reciprocally related. On the one hand, if your team performs well in your respective competitions, this usually leads to considerably better financial results. On the other hand, if you invest more money in your squad, your chances to win more games can be much higher. This can create a vicious circle of clubs deciding to spend more money in anticipation of significantly higher future returns due to greater sporting success. While this strategy can work in some cases, it is at the same time very risky, since sporting success cannot be fully planned. If the results fail to materialise, the clubs need to deal with big deficits.

It is important to note that the goals and financial objectives of football clubs and commercial enterprises are fundamentally different. An ordinary company strives for the highest possible annual profit in order to earn interest on the money invested by the shareholders. Football clubs are not primarily profit-driven companies. For them, money is much more a means to an end – something that is important to increase the sporting success, which in normal situations is always considered the primary goal. In July 2019, before the COVID-19 crisis hit the global football industry, Dr. Claudio Kasper, Head of Management Accounting & Corporate Finance at FC Schalke 04, expressed in an interview the rationale that many football clubs have traditionally followed:

*"Frankly speaking, it is a successful season for FC Schalke 04 if we manage to qualify for the Champions League and at the same time break even in our annual result. Not making a profit nor a loss shows that we have used our available resources optimally. A high profit is not very beneficial for us, since we have no shareholders that demand a dividend. Of course, we are not opposed to a high profit, but we are not actively trying to reach one."*

FC Schalke 04 has become one of the clubs with the biggest financial problems in the course of the COVID-19 crisis. The club could only survive the short-term consequences of the crisis with a debt guarantee of the local government.

In a conversation with the CFO of a Swiss Super League club, the manager explained that they actively try to be exactly break even and not make a profit in good years, so the club does not have to pay any profit taxes.

While it is clear that football clubs are not primarily profit-oriented companies and sporting success is always the main goal, actively not trying to make any profits by allocating all of your resources to your squad or using accounting tricks to avoid taxes can be very dangerous in the long run. If you do not make any profits you cannot build up any reserves that would give you stability and security in financially challenging years, as they act as buffers in absorbing losses (see chapter 2). Various clubs even operate with a so-called "structural deficit". That means that in normal years, excluding any extraordinary revenues and expenses, the clubs report a loss. The negative result can only be avoided by unexpected sporting success or other one-time effects like selling a player with a profit.

Now during the COVID-19 crisis, it became obvious that relying on extraordinary income to avoid losses and to operate with little reserves is very risky (see chapter 2). Also, fans started to realise the challenges some clubs are facing and the topic of financial sustainability has become much more prominent within the public discourse, which could be an opportunity for many clubs. When talking to CFOs of football clubs, many indicate that it is emotions and public pressure by fans and the media that decoy managers into taking more financial risks. Football is a game that is played for the fans, and fans mostly care about what is happening on the pitch and not about financial numbers. The pressure to invest as much money as possible in good players and to make expensive, high-profile transfers is mostly very high. However, due to the recent crisis, fans have understood how important a solid financial basis is, which could foster a mentality change (see chapter 3).

### *Legal forms & financing options*

Football clubs appear in various different legal forms. Many clubs such as FC Barcelona or Real Madrid in Spain or FC Schalke 04 in Germany are still registered as sports associations. Other clubs operate as corporations and use the legal form of a limited liability company (LLC) or public limited company (PLC). Some clubs, like for example Ajax Amsterdam, Borussia Dortmund, Celtic FC, Manchester United or Juventus F.C. are also publicly listed.

Every country has their own specific legal forms and rules. In Spain, for instance, the legal status of a sociedad anónima deportiva (S.A.D.) (public limited sports company) was introduced in 1990 and is mandatory for most professional football clubs. However, due to tradition, some clubs like FC Barcelona and Real Madrid are allowed to keep their status as non-commercial sports associations. Also in Switzerland, the Swiss Football League made it mandatory for every Super League club to transform their legal form into that of a public limited company, even though some clubs wanted to maintain the form of a sports association. In the English Premier League and the Italian Serie A, clubs are usually public limited companies and owned by wealthy individuals or investment firms.

In Germany, on the contrary, a majority control by a single entity (person, or company) is not permitted. Clubs are allowed to be organised as associations or limited companies. However, if they take the form of a limited company, the so-called "50+1 rule" states that the registered associations, and thus their members, must hold a majority of the voting rights – 50% plus one vote – in the football club. An exception applies to companies or individual investors who have substantially funded a club for at least 20 years. They are allowed to gain a controlling stake in that club. This is the case for Bayer 04 Leverkusen, VfL Wolfsburg (owned by companies) and TSG Hoffenheim (owned by a private investor).

The legal form obviously influences the financing options of clubs significantly. Football clubs, just as any other business, can finance their activities through internal or external funding (see figure 1).

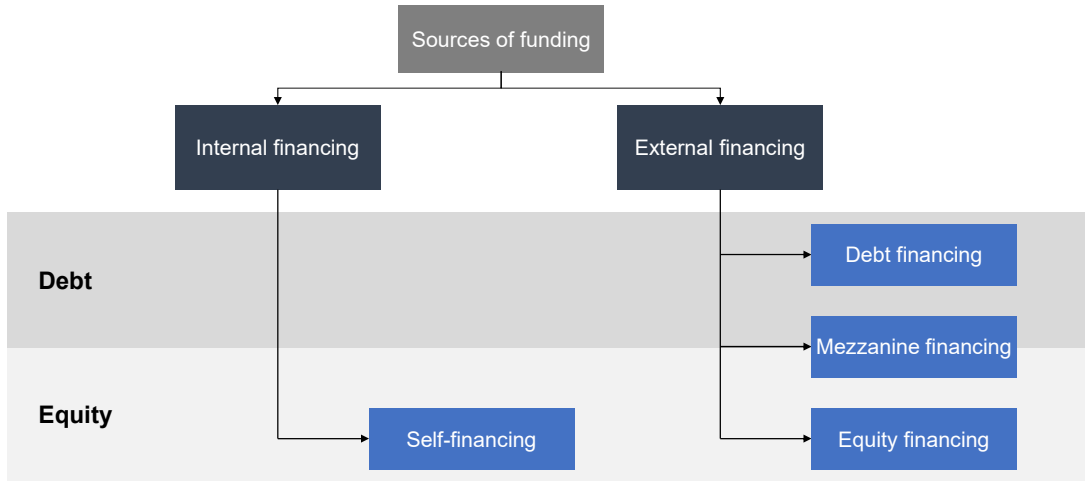



*Figure 1: Sources of funding*

The potential of internal financing does not depend on the legal form of the club, since self-financing is realised through retained earnings. If clubs manage to make a profit, these profits can be retained and used to strengthen the equity position and as sources of internal funding. However, the options of external financing significantly vary with the legal form of a football club.

The potential instruments of debt financing are the same for all clubs, regardless their legal form. The most common form of debt financing, taking out a bank loan, is used by plenty of football clubs, in most cases for long-term infrastructure investments. Various football clubs have also already issued bonds to raise debt. A football-specific instrument, which has already been used in some cases, are so-called “fan bonds”. Taking a loan from fans can help clubs to raise debt for better conditions, but the amount of capital that can be raised through “fan bonds” is usually limited. Some clubs have also made use of asset-backed securities (ABS), which are bonds collateralised by assets such as receivables (future cash inflows).

Mezzanine financing is a hybrid type of financing, having both debt and equity characteristics. Some mezzanine instruments can also be used by football clubs that are still organised as associations. One of these typical instruments are subordinated loans, which are riskier for creditors than normal loans, since in the event of insolvency they are not repaid until the other creditors have received their money. For football clubs, liabilities from subordinated loans are mostly towards private benefactors or patrons. Subordinate loans have the advantage that even though they are reported as debt in the balance sheet, they can be allocated to equity in the balance sheet analysis, which can help clubs in licensing procedures (see chapter 1). This allows patrons to provide financial resources to football clubs and preserve repayment claims without increasing the clubs' indebtedness. Another mezzanine instrument, which can only be used by limited companies, are convertible bonds. Just like normal bonds, convertible bonds are fixed-income corporate debt securities that yield interest payments. Yet, investors have the right to convert their claims into a predetermined number of common stock or equity shares if certain criteria are met.

External financing through equity capital by selling shares is only possible for limited companies. There are numerous clubs that have sold some or the majority of their shares to investors. Yet, the type of investors football clubs work with varies. In Germany, where clubs are generally not allowed to sell the majority of their voting rights to investors, some clubs bring strategic partners on board (e.g. FC Bayern München, Borussia Dortmund). Strategic partners are mostly sponsors that acquire a certain number of shares of a club to strengthen the relationship and leverage synergies. In England, France and Italy, most of the big football clubs have sold the majority of their shares to either wealthy individuals or investment firms.

### *Financial Fair Play & Licensing*

Football clubs are not as free in their financial planning as most industrial companies. Due to certain regulations by the national football associations or the UEFA, specific financial standards have to be met in order to be allowed to participate in competitions.

For international competitions organised by UEFA, the “UEFA Club Licensing and Financial Fair Play Regulations” apply. While the club licensing system criteria are designed to assess the clubs’ financial situation in the short term (e.g. no overdue payables towards other football clubs, employees, tax authorities, etc.), the goal of the Financial Fair Play (FFP) rules is to increase long-term financial sustainability and improve fairness. Clubs are monitored by the UEFA Club Financial Control Body. The rules state that the difference between “relevant income” (income from e.g. gate receipts, sponsoring, broadcasting, merchandising, etc.) and “relevant expenses” (cost of sales/materials, salaries, interest payments, etc.) should not be greater than EUR 5 million, aggregated over three years. However, the gap between relevant income and expenses is allowed to be up to EUR 30 million, if equity participants of the club cover the losses. If clubs violate the FFP rules, they can be punished with fines, transfer bans, point deductions or exclusion from UEFA competitions.

As UEFA states itself, due to the FFP, financial results of European clubs have improved significantly, with club balance sheets strengthening (net equity doubling), and net debt to revenue plunging from 65% to 35%. Yet, as recent developments show, the rules of FFP can easily be bypassed, as there is some leeway for clubs when it comes to third party transactions. In practice, club owners can try to increase the club’s revenues instead of covering losses by signing, for instance, sponsoring agreements. The rules of FFP state the following:

*“For the purpose of the breakeven result, the licensee must determine the fair value of any related party transaction(s). If the estimated fair value is different to the recorded value then the relevant income must be adjusted accordingly […]”*

If the UEFA Club Financial Control Body believes that the declared fair value of the related party transaction is too high (i.e. a club owner signed a sponsoring contract with a value much higher than it would have occurred between independent parties), an independent third-party assessor will perform a fair value assessment. Obviously, such decisions on a by-case basis are open to interpretation and can be contested on legal grounds.

In addition to the UEFA regulations, there are licensing regulations by national football associations. The licensing system that is one of the strictest in Europe and has served as a role model for other regulations is the licensing process of DFL, the German league association.

Besides sporting, legal, infrastructural, media technology, personnel and administrative criteria, certain financial criteria have to be met to obtain a license from DFL. The basis for the financial assessment of a club are its consolidated financial statements. This is important, since many clubs operate with corporate structures and several subsidiaries. Only taking individual financial statements into account would lead to false conclusions and offers room for manipulation. The clubs have to present their audited consolidated balance sheets, income statements, notes, management reports of the last fiscal year as well as several forward-looking budget statements.

What is striking about the German licensing regulation is that the rules are very liquidity-driven. The primary criterion for assessing the economic performance of a license applicant is its liquidity situation and thus the question of whether the applicant will have enough liquid funds to ensure match operations for the duration of the season in question.  The source of financing is questioned less. While there are detailed rules regarding the liquidity situation and how to assess it, the financing situation is only mentioned briefly

*"The statement of financial position must be transparent and orderly. The applicant's assets should not be permanently reduced as a result of the match operations. In the event of negative equity/association's funds, the applicant is obliged by a condition to improve this value."*

As the excerpt shows, the rules concerning the financing structure are very softly worded and short. There are no concrete numbers or hard limits for the debt-to-equity ratio. Just in the (for most companies already threatening event) of negative equity, which in financial terms is nothing else than over-indebtedness, clubs must improve their balance sheet structure.

Hence, it can be summed up that football clubs do not have complete freedom of action in terms of financial management but are bound to national and international regulations. Yet, while some of these rules have in fact helped to improve the financial sustainability within the football industry over the previous years, there are still some flaws and loopholes in the regulations. UEFA's Financial Fair Play can be circumvented with creative accounting and even the German licensing regulations, which are seen as some of the strictest in Europe, help preventing short-term illiquidity of clubs but do not sufficiently foster long-term stability (see chapter 2).

***Particular reporting practices***

Another factor that has to be kept in mind when analysing the financial situation of football clubs is that there are some peculiarities in the clubs' financial reports due to their specific business model. The most striking aspect is probably the high amount of hidden reserves plenty of clubs possess. Hidden reserves occur if the fair value of an asset is greater than its book value. For football clubs, this is mostly the case when it comes to the value of their players.

When football clubs transfer a player, the acquisition costs of the player's registration are usually capitalised as intangible assets. However, the International Financial Reporting Standards (IFRS) as well as local accounting standards and the UEFA Club Licensing and Financial Fair Play Regulations all state that football clubs can only capitalise these acquisition costs. This means that if the market value of a player increases in the future, or if a locally trained players (who will always have a book value of zero) make it into the first team and increase their respective value, this is not shown in the balance sheet. The UEFA Club Licensing and Financial Fair Play Regulations specify the following:

*"Only direct costs of acquiring a player's registration can be capitalised. For accounting purposes, the carrying value of an individual player must not be revalued upwards, even though management may believe market value is higher than carrying value. In addition, whilst it is acknowledged that a licence applicant may be able to generate some value from the use and/or transfer of locally trained players, for accounting purposes costs relating to an applicant's own youth sector must not be included in the balance sheet – as only the cost of players purchased is to be capitalised."*

Hence, a player that initially cost EUR 10 million will never have a higher book value than that, even though the management might (even rightfully) believe that they could sell them easily for EUR 30 million. One additional aspect is that the capitalised costs of acquiring the player's registration is to be depreciated over its useful life. This means that in the example above, the initial book value of EUR 10 million decreases every year until it is zero at the end of the player's contract with the club. The difference between the estimated market value of a player and the book value is called hidden reserves. In some cases, the hidden reserves can be considerable. Let us look at a concrete example.

In 2017, Borussia Dortmund acquired Jadon Sancho from Manchester City for EUR 7.84 million and signed a three-year contract with the player. In 2018, the club extended the contract until 2022. In 2019, it was extended again until 2023. Assuming that the EUR 7.84 million are the whole direct costs, this is the development of the book value of the capitalised costs from acquiring Jadon Sancho:

| Year | Book value (beginning of the year) | Useful lifetime | Depreciation (in million EUR) |
|---|---|---|---|
| 2017 | EUR 7.84m. | 3 years (until 2020) | 7.84/3 = 2.61 |
| 2018 | EUR 5.23m. | 4 years (extended until 2022) | 5.23/4 = 1.31 |
| 2019 | EUR 3.92m. | 4 years (extended until 2023) | 3.92/4 = 0.98 |
| 2020 | EUR 2.94m. | 3 years (until 2023) | 2.94/3 = 0.98 |
| 2021 | EUR 1.96m. | 2 years (until 2023) | 1.96/2 = 0.98 |
| 2022 | EUR 0.98m. | 1 year (until 2023) | 0.98 |
| 2023 | 0 | | |

Note: Borussia Dortmund applies straight line depreciation. Any potential directly attributable contract negotiation costs (e.g. agent/intermediary fees), which could also be capitalised, are neglected due to lack of information. The future book values until 2023 will only develop as presented above if the contract is not extended. If the player is transferred to another club before 2023, the carrying amount will be derecognised.

*Table 1: Exemplary development of the book value of the player's registration of Jadon Sancho.*



The website transfermarkt.de estimates the current market value of Jadon Sancho to be EUR 100 million. Thus, Borussia Dortmund possesses estimated hidden reserves of around EUR 97 million just attributable to this player. In the current annual report 2019/20, Borussia Dortmund discloses capitalised player registrations of EUR 228.3 million. The overall market value of the squad is estimated to be EUR 592.1 million, resulting in estimated total hidden reserves of more than EUR 360 million.

# Chapter 2
## The Current Situation

The football industry, just like various other industries, has to deal with the challenges of the COVID-19 pandemic. Most clubs are forbidden to sell any tickets and to have their fans on the stadiums for matches. This has serious consequences for the financial situation of most football clubs. However, while the crisis has severely hit the industry as a whole, some clubs were significantly more affected than others and faced greater financial trouble after a short time. If we want to see this crisis as an opportunity to learn and try to develop ideas for making the whole system more stable, it is crucial to study why some clubs were hit harder than others. Hence, the following sections analyse the pre-COVID-19 financial situation of various clubs and leagues, demonstrating its concrete effects on some clubs.

### *Revenue streams and costs*

The biggest challenge for football clubs in the course of the COVID-19 pandemic is the collapse of some revenue streams. In general, most professional clubs have three main recurring revenue streams: the marketing of media rights (broadcasting), income from sponsoring contracts and the sale of merchandise, and matchday income (ticket sales as well as revenue from refreshments during games). In some countries like Germany or France, other recurring revenues are also reported separately (e.g. income from granting usage rights for the clubs' brands, public catering, rentals and leases, membership fees or other smaller revenue streams). Obviously, for some clubs, revenues from transfers are also a crucial part of the turnover. However, as transfer fees are usually extraordinary income, they are not considered part of recurring revenue.

Before the COVID-19 pandemic, revenues within the European football market have constantly grown. In 2018/19, professional European football clubs have disclosed revenues of in total EUR 26.2 billion. Yet, turnover is distributed very unequally, since 65% (nearly EUR 17.0 billion) of the total revenues are attributable to the top 5 European Leagues. The English Premier League alone reported total revenues (excluding income from transfers) of EUR 5.85 billion, followed by the Spain's LaLiga (EUR 3.38 billion), the German Bundesliga (EUR 3.35 billion), Italy's Serie A (EUR 2.50 billion) and the French Ligue 1 (EUR 1.90 billion). However, what is more interesting than the absolute number of revenues is how they are composed in the different leagues (see figure 2).

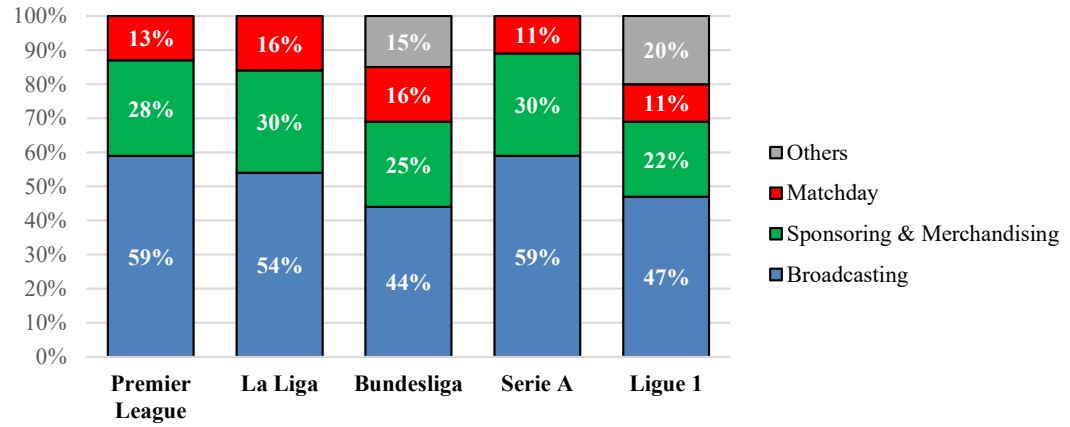



*Figure 2: Composition of revenues in the top 5 leagues 2018/19*

As it becomes clear from figure 2, Bundesliga and Ligue 1 have a rather diversified revenue profile, while for the other three leagues broadcasting is by far the most important revenue stream. While usually diverse revenue profiles are seen as positive, since diversification reduces the dependency on specific sources, clubs with a higher share of broadcasting income currently benefit from that. When football games in most leagues in Europe and all international competitions were suspended between March and May/June (Ligue 1 even cancelled the remaining games of the season completely), also revenues from broadcasting were threatened. However, since the resume of league games and international competitions, matches are shown normally on TV and the original contracts concluded with television providers apply again.

Matchday income, on the contrary, will continue to be seriously impacted due to the ban of fans in the stadiums. Also, income from sponsoring and merchandising can be heavily impacted by the COVID-19 pandemic. Sponsors might be financially impacted by the crisis as well and reduce future payments. Sponsoring activities

in the stadiums cannot be carried out without fans. For some clubs, especially in Germany, income from hospitality is crucial as well. It is normal for many sponsors and corporate partners to have their own boxes or business seats in the VIP area of the stadium. For the season 2018/19, it is estimated that on average 40% of the sponsoring of the German Bundesliga can be attributed to hospitality. When it comes to merchandise, some clubs could also experience a decline. Fans might also be financially impacted by the COVID-19 pandemic and, since they cannot go to the stadiums anyway, might not spend money on merchandise at the moment.

Thus, the higher the share of broadcasting income, the better it is for clubs right now. This also becomes apparent when looking at the annual reports of football clubs whose fiscal year ended at June 30, 2020. For Manchester United, revenues decreased by nearly 19% compared to the previous year, which resulted in a loss of EUR 25.56 million. While revenue from sponsoring and merchandising increased by 1.4%, broadcasting income decreased by 42% and matchday income by 19%. However, as Manchester United describes in its annual report, broadcasting income was only deferred due to postponement of the remaining games of the season 2019/20 to July and August after the balance sheet date. Therefore, the remaining broadcasting fees from the season 2019/20 will be recognised in the annual report of 2020/21. The lack in matchday income, on the contrary, cannot be made up for later, as fans are still not allowed to be in the stadium. A similar development can be seen in the financial statements 2019/20 of Borussia Dortmund. While most revenue streams could be held constant or improved, matchday income saw a decline of 27%. Juventus F.C. reports a decrease in revenues from ticket sales of 30%. Unlike Manchester United and Borussia Dortmund, Juventus F.C. also showed a decrease in merchandising income of 28%, which according to the club is attributable to "the provisions stemming from the spread of the COVID-19 pandemic which, among other things, imposed the lockdown, with a subsequent considerable drop in store product sales."

Whereas large clubs are already struggling with these declines, smaller clubs are being hit even harder. Clubs in smaller footballing countries and those in the lower leagues of larger countries usually receive less broadcasting income and are thus more dependent on other income streams.

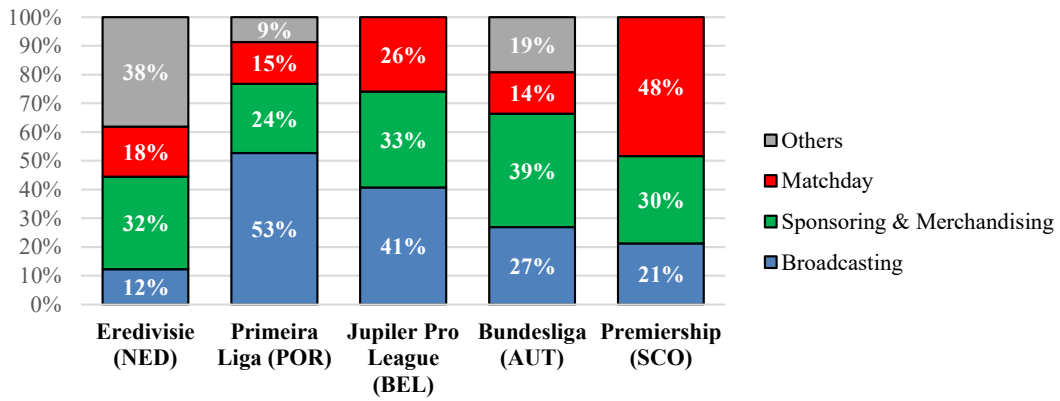



*Figure 3: Composition of revenues in selected non-top 5 leagues 2018/19*



As figure 3 shows, only for the Portuguese Primeira Liga broadcasting revenue accounts for more than 50% of all revenues. In other leagues, it is significantly less.

The revenue structure is also important when it comes to the question of how much money can be invested in the professional squad. As already described in chapter 1, football clubs usually try to spend as much money as possible on their sporting success. This is also reflected in the cost structure of football clubs. Out of the total expenses of German Bundesliga clubs, 37% were attributable to salaries of players and coaches and 22% were attributable to transfers. Therefore, revenues that can be generated without incurring large additional costs are particularly important for football clubs. This is why clubs with a larger share of broadcasting revenues can usually allocate more money to players and their salaries. More matchday income usually also leads to higher costs from match operations and more merchandise sales also result in increasing costs of goods sold. In contrast, an increase in broadcasting revenues is not usually accompanied by higher costs. This is also partially reflected in the salaries/revenue ratio of the top 5 leagues (see figure 4).

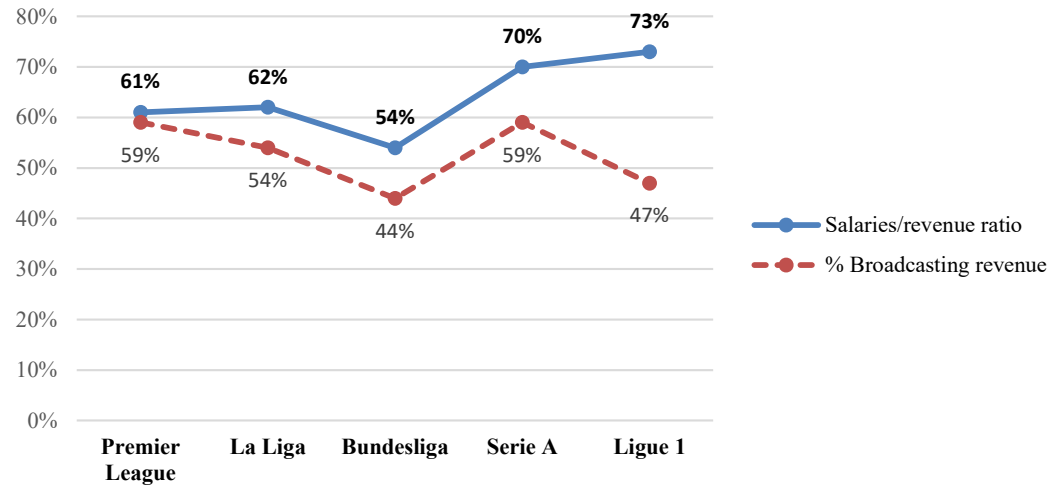



*Figure 4: Salaries/revenue ratio 2018/19 top 5 leagues*

The German Bundesliga shows a much lower salaries/revenue ratio compared to the other top 5 leagues. In general, especially when looking at the first four leagues, the salaries/revenue ratio seems to correlate with the share of broadcasting revenues. Ligue 1 is the exception amongst the top 5 leagues, with a very high salaries/revenue ratio of 73%. 13 out of the 20 clubs show a ratio above 70%. Two clubs, AS Monaco FC (132%) and Lille OSC (112%) even had a ratio of above 100%, meaning that their salaries are higher than their recurring income and they are thus highly dependent on extraordinary income from player transfers or surprising sporting success. The UEFA has included a salaries/revenue ratio of 70% as a risk indicator in their Financial Fair Play Regulations. The benchmark is explained as follows:

*"Given that other – mainly fixed – operating costs tend to consume between 33% and 40% of revenues, a wage-to-revenue ratio in excess of 70% is highly likely to result in losses, unless there is a significant surplus from transfers."*

Particularly clubs outside the top 5 leagues with lower revenues seem to struggle to meet this benchmark. In the last "Club Licensing Benchmarking Report" that was published by the UEFA in 2020, the salaries/revenue ratios of all European first leagues of the year 2018 were presented. Wages exceeded 70% of revenue in 10 of the top 20 countries. Besides France, the benchmark was met or exceeded on average in the first leagues of the following countries:

Russia (70%)
Turkey (79%)
Portugal (75%)
Belgium (71%)
Switzerland (71%)
Ukraine (76%)
Greece (74%)
Israel (78%)
Poland (74)

The same can also be observed in the second leagues in top 5 countries. Clubs of the English Championship, for instance, reported a salaries/revenue ratio of 107% in 2018/19.

The numbers presented in this chapter show that football clubs generated, on average, high revenues, and pre-COVID, they were constantly increasing. Yet, most of the income is used for the players' and coaches' salaries and for transfers. In some competitions, a kind of "rat race" has developed: if some clubs take high risks and invest an increasing amount of their revenues in salaries and transfers, other clubs feel the need to do the same in order to maintain sporting competitiveness. In the end, a vicious circle develops where all clubs invest more money and the sporting difference between the clubs is the same as before, only with a higher salaries/revenue ratio. This can cause severe problems, especially during the recent COVID-19 pandemic. As the UEFA already stated when analysing the financial key figures of 2018: "In addition, a continuation of the low revenue growth reported in FY2018 coupled with a reduction in transfer profits could leave clubs with high wage to revenue ratio's heavily exposed and potentially lead to financial distress." Today we are in a situation where revenues are not just growing slowly, they are collapsing. Matchday income is already deteriorating, sponsoring income (especially when it comes to hospitality) will most likely go down, revenue from merchandising is already decreasing for some clubs and some industry experts believe that even broadcasting revenues might decline as there could be less consumer interaction with the sport in the future.

Whilst some costs such as matchday expenses are mostly variable costs, salaries are fixed costs that have to be paid even though revenues are declining. This is a problem for most clubs – especially for those with an already high salaries/revenue ratio. These clubs also have problems to realise high extraordinary gains to make up for the structural loss, since most clubs are facing financial challenges and the transfer market has slumped significantly. If these clubs cannot agree with their players on voluntary salary waivers, they will face heavy losses. The amount of losses that a club can absorb depends to a large extent on its stability and financing structure, which will be analysed in the following.

### *Financial stability*

To assess both financial stability and risk of a company, usually certain financial leverage ratios are calculated. Security and thus the security ratios are aimed in particular at a balanced financing and financing structure of the assets. The security of a company depends to a large extent on the proportion of equity in its total capital. Therefore, the equity ratio is a common measure to analyse how much risk a company can bear. In contrast to debt capital, which must be repaid in full, equity capital can bear the corporate risk. For safety and stability considerations, the aim should be to achieve the highest possible equity ratio. Debt capital entails a dependence on lenders. For example, lenders may demand collateral or contractually agree restrictions with the company. Contractually agreed restrictions in connection with the granting of debt capital are referred to as covenants and are often used by banks.

The amount of equity a company needs to be seen as stable heavily depends on the business model, firm- and industry-specific characteristics as well as the risk tolerance of debt providers. As a general rule of thumb, most investors consider companies with an equity ratio of over 30% to be solidly financed. Particularly in the current situation, an equity cushion can be utterly important for clubs. Equity capital can absorb current losses and avoid over-indebtedness. Therefore, it is interesting to look into the pre-pandemic equity ratios of football clubs in different countries in order to assess their capability to deal with losses.

As previously described, clubs of the German Bundesliga are limited when it comes to raising equity due to the "50+1 rule". Yet, the strict li-

censing process could lead to higher equity ratios due to self-financing. The equity ratios of all 18 Bundesliga clubs of the season 2018/19 are shown in figure 5.

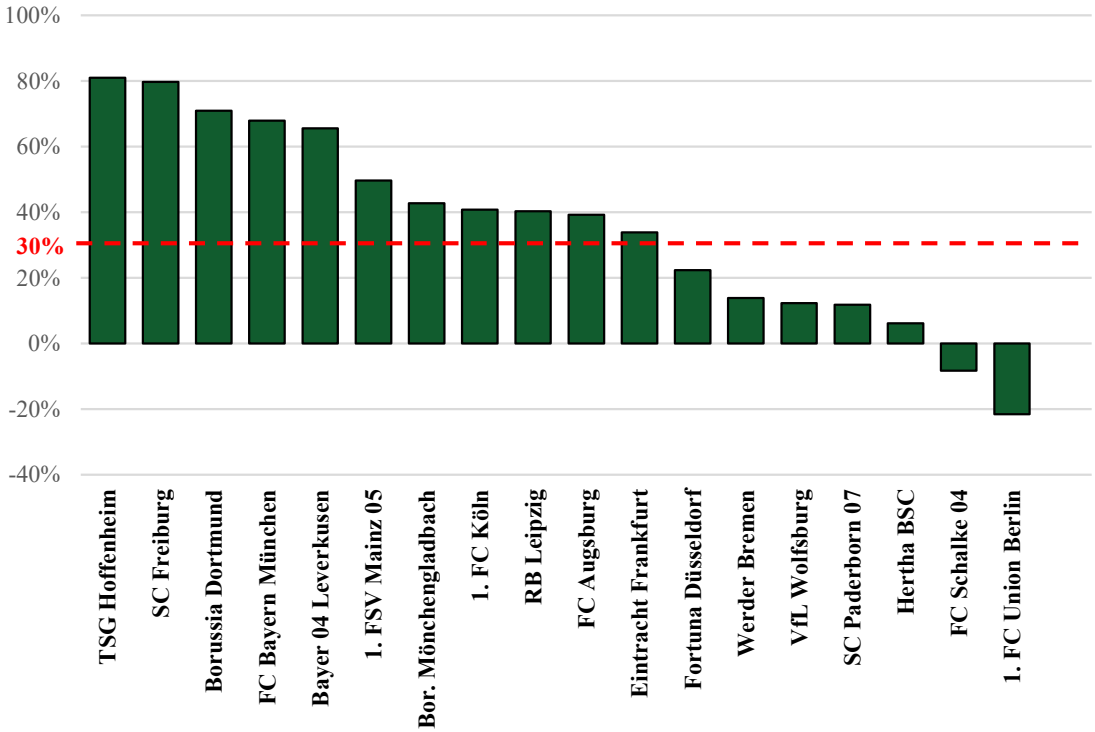



*Figure 5: Equity ratios of German Bundesliga clubs 2018/19*

It can be seen that the majority of teams are quite stable. Eleven teams are above the threshold of 30%. The average pre-Corona equity ratio of German Bundesliga teams amounted to 36%. However, seven clubs show an equity ratio of below 30%, two clubs even show negative equity and are thus over-indebted.

What has to be kept in mind is that as explained in chapter 1, due to special regulations Bayer 04 Leverkusen, TSG Hoffenheim and VfL Wolfsburg are fully owned by investors. This explains the very high equity ratio of TSG Hoffenheim, while also showing that VfL Wolfsburg can easily operate with a low equity ratio as they are backed up by Volkswagen AG. Also, Hertha BSC was able to attract new investors in the 2019/20 season, who acquired shares in the club and thus increased the equity ratio to a current 18.7%. Further investments are planned. The low equity ratios of SC Paderborn and especially Union Berlin, who were just promoted to the first League at the end of the season 2018/19, reflect the efforts and financial risks some clubs (have to) take in order to win the "rat race" and advance to a higher league.

What is striking are the cases of Werder Bremen and FC Schalke 04. Both teams are in the first league for several decades already and have played in the Champions League or the Europa League several times. Yet, Werder Bremen had a pre-pandemic equity ratio of only 14% and Schalke 04 was even over-indebted with a ratio of -8%. This shows that the "rat race" does not only exist in lower divisions when teams are trying to be promoted, but also in first leagues if clubs take risks to qualify for the Champions League. Werder Bremen used to have an equity ratio of nearly 50% until the fiscal year 2012, which then deteriorated and went down to only 4.8% in 2015. While Werder Bremen had mostly played in the Champions League during the 2000s, the season of 2010/11 was Werder Bremen's last participation in the Champions League. Afterwards, the club still invested a lot of money in the squad in order to qualify for international competitions again but failed, and with high salaries but declining revenues, equity shrank constantly.

Schalke 04, on the other hand, has always taken big financial risks to play in the Champions League. As already shown by the quote of Dr. Claudio Kasper in chapter 1, Schalke 04 never tried to make profits but to maximise sporting success at any cost. Since 2014, the only time that Schalke 04 disclosed slightly positive equity was in 2018. Otherwise the club has always been over-indebted and operated with great financial risk. Over-indebtedness occurs when the loss carried forward by a company is greater than its equity (see figure 6).

| Assets | | Liabilities | |
|---|---|---|---|
| **Current assets** | **20** | **Debt** | **50** |
| – Liquid funds | 5 | – Short-term | |
| – Receivables | 10 | – Long-term | |
| – Inventories | 5 | | |
| **Noncurrent assets** | **29** | | |
| – Financial assets | 9 | | |
| – Tangible assets | 10 | | |
| – Intangible assets | 10 | | |
| **Loss carried forward** | **51** | **Equity** | **50** |
| | | – Share capital | |
| | | – Non-voting non-ownership share capital | |
| | | – Reserves (legal, free/statutory) | |
| | **100** | | **100** |

*Figure 6: Example of over-indebtedness in the balance sheet*

In the simplified situation presented in figure 6, the company's creditors are not covered anymore by assets valued at book value. The resulting equity would be -1. The reason that Schalke 04 has been able to survive financially with these disastrous figures so far is that the going concern forecast has always been positive, partly because Schalke 04 always had high hidden reserves due to the market value of some of theira players (see chapter 1). However, relying on this is, as mentioned before, very risky, especially because Schalke 04 does not only show a threatening pre-pandemic equity ratio but also low liquidity. Cash and cash equivalents were very low at the end of the 2019 financial year and net of current account liabilities were even negative (EUR -5.1 million). The current ratio (the ratio of assets with short-term availability to short-term liabilities) was down to 22.5%. The current ratio should be at least 100% so liabilities becoming due in the short term can be covered with resources available in the short term and thus on time.

In the annual reports, Schalke 04 justifies its poor financial situation with the argument that profit retention plays a subordinate role for sports associations and also refers to the already mentioned hidden reserves. In its 2010 annual report, Schalke 04 even claims that the club's financial situation is actually much better than it appears, as the group equity is negative, but the equity in the individual financial statements is positive. While the latter is true, this statement is utterly misleading. The financial situation in the individual financial statement of the club only looks better since the club has sold club-owned rights such as naming rights to its own subsidiaries. The club has done business with itself, and such intragroup transactions must of course be eliminated again in the consolidated financial statements.

In general, some football clubs often claim that profit retention and their equity ratio is not as important as for other businesses. While it is true that in a volatile environment, as is the case in football, equity can fluctuate more, efforts should always be made not to fall below a certain equity ratio in order to provide stability in bad times. The German DFL also emphasises in their last business report that "the equity ratio is an indicator for the financial stability." The importance of a solid equity base is now becoming clear in the wake of the COVID-19 crisis. Clubs with a healthy equity ratio can absorb the current losses. If there are short-term liquidity bottlenecks due to a lack of cash inflows, such solidly financed associations can more easily raise short-term debt capital to bridge the liquidity bottlenecks. It is no surprise that Werder Bremen and Schalke 04 are two of the clubs that were hit the hardest by the current crisis. In its 2020 half-year report, Schalke 04 reported a 32.5% decline in turnover compared to the previous year. Equity became even more negative. Further loans had to be taken out to bridge the liquidity bottlenecks. Due to its risky financing structure, the club was only able to obtain the necessary loan with the help of a guarantee from the state of North Rhine-Westphalia. In the years before, Schalke 04 had already secured various liabilities through mortgages and the assignment of receivables and trademark rights, so that there was hardly any collateral left for the current crisis.



While in the German first league financial stability seems to be sufficient for most team, the second league already appears to be a bit less stable (see figure 7).

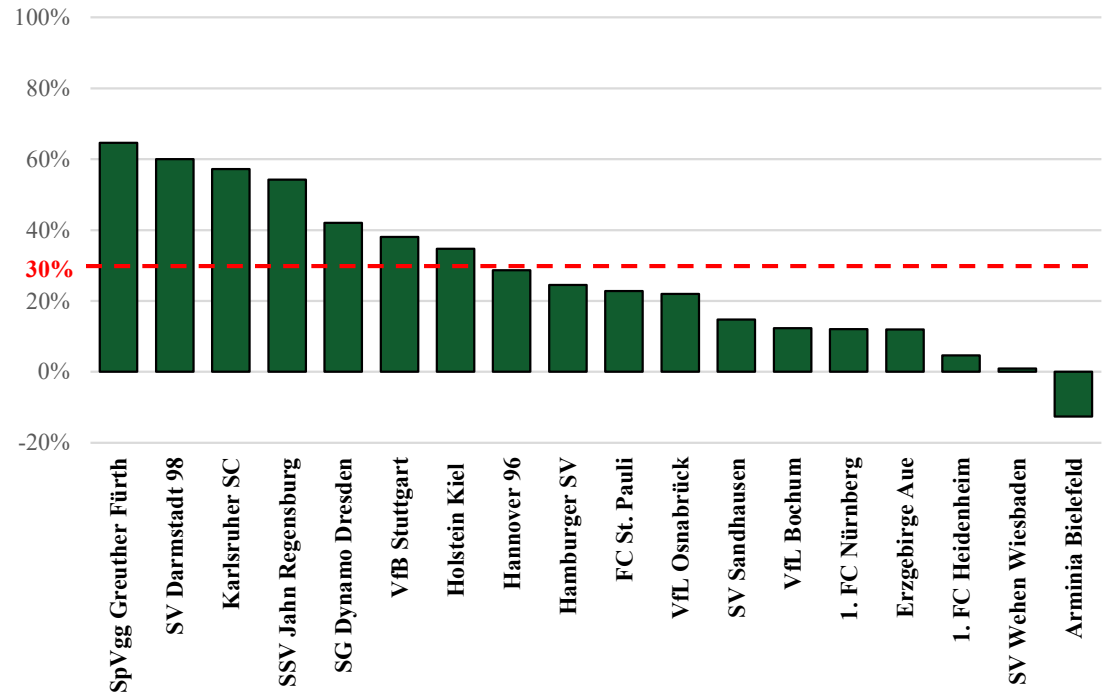



*Figure 7: Equity ratios of German 2. Bundesliga clubs 2018/19*

The average pre-COVID-19 equity ratio of German 2. Bundesliga teams amounted to 27% (compared to 36% in the 1. Bundesliga). Eleven (compared to seven in the 1. Bundesliga) clubs show an equity ratio of below 30%. Arminia Bielefeld had negative equity in 2018/19. Yet, just like Union Berlin the year before, they won the "rat race" and were promoted to the first league at the end of the season 2019/20.

The situation looks even more serious when looking at first leagues besides the top 5. In the Austrian Bundesliga, the average equity ratio was 16% and only four out of twelve clubs reported an equity ratio above 30% in 2019 (see figure 8).

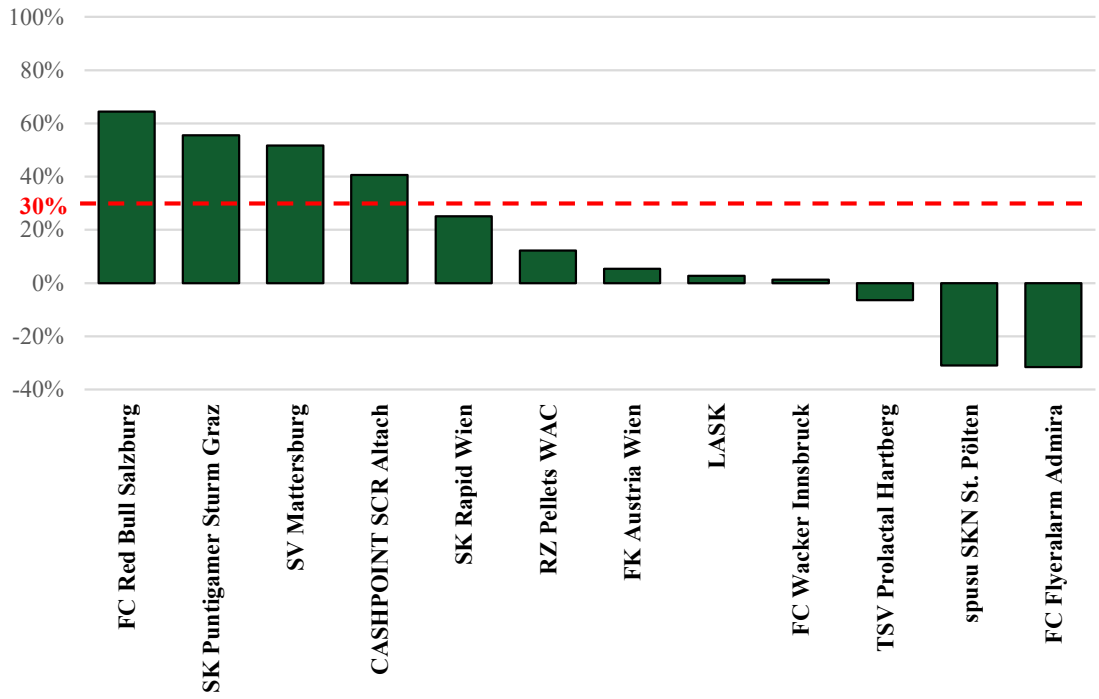



*Figure 8: Equity ratios of Austrian Bundesliga clubs 2018/19*

When looking at the big European teams, there is a diverse picture. Most teams show a solid financing structure, some of them obviously because they are owned by very solvent investors. In the English Premier League, Arsenal disclosed a very solid equity ratio of 42.6% in 2019, Liverpool was at 33.3%, and Manchester United at 27.7%, which went down to 25.4% in 2020 due to the first implications of the COVID-19 pandemic. Looking at the balance sheet structure of Manchester City, it become obvious how investors can make up for continuous losses in football clubs. Manchester City had an equity ratio of 64.0% in 2019. However, this ratio is only that high due to the investments of the club owner. In their balance sheet, Manchester City discloses accumulated losses of more than EUR 600 million. Due to share capital amounting to more than EUR 1.4 billion, the equity ratio is still high. Yet, also in the English Premier League, where most clubs raised equity from investors, some clubs, such as West Ham United and Wolverhampton Wanderers, showed negative equity in 2019.

A similar situation to Manchester City can be seen when looking at Juventus F.C.'s financial report. In 2019, the club reported a loss of EUR 39.90 million and an equity ratio of only 3.3%. With the COVID-19 pandemic starting in 2020, the loss became even greater and amounted to EUR 89.68 million at the end of the 2020 financial year. The losses were absorbed by a capital increase of around EUR 300 million, so that the equity ratio is currently standing at 20.3%. However, in can be stated that Juventus F.C. is currently not pursuing a sustainable business model. Absorbing losses by raising fresh equity only works as long as investors have no problem burning money.

In Spain's LaLiga, the two big players FC Barcelona and Real Madrid show very different financial situations. Real Madrid managed to achieve continuous profits during the last years and increased its equity ratio up to 46.8% in 2019. On the contrary, FC Barcelona disclosed an equity ratio of only 9.8%. It is no coincidence that FC Barcelona is named as one of the big clubs that has severe problems at the moment. Other than Manchester City or Juventus F.C., FC Barcelona cannot carry out a capital increase to improve the financial situation, since as mentioned in chapter 1, the club still keeps its status as a non-commercial sports association.

### Summary

Due to the COVID-19 pandemic, the football industry is experiencing a sharp decline in revenues. Matchday income is already deteriorating, sponsoring and hospitality income is going down and revenue from merchandising is decreasing for some clubs. Furthermore, some industry experts believe that even broadcasting revenues might decline as there could be less consumer interaction with the sport in the future.

At the same time, most football clubs have high fixed costs. Player salaries are the largest expense item for most clubs and have to be paid even though revenues are declining. Especially for clubs outside the top 5 leagues, this situation is very challenging. Not only do clubs from smaller leagues rely more on matchday revenue than clubs from top leagues, but player salaries also account for a significantly larger proportion of revenue on average. Most clubs will have to deal with significant losses in the current scenario.

The amount of losses that a club can absorb depends to a large extent on its stability and financing structure. In general, the more equity a club has, the more stable it can get through the crisis. A solid equity base can not only absorb losses, but also improves the risk assessment of clubs and thus offers them the possibility to borrow money at short notice in case of liquidity shortages.

In Germany, seen as the country with one of the strictest licensing regulations, Bundesliga clubs had a pre-pandemic equity ratio of 36%. However, even there, seven clubs showed an equity ratio of below 30% and two clubs even reported negative equity. As recent developments show, the clubs with the lowest equity ratios are also the most vulnerable ones and currently being hit hardest by the crisis. Clubs outside the top five leagues seem to be even more in danger. Not only are they often hit harder by the crisis, but on average they also have fewer reserves to draw on.

Taking a look at the biggest international clubs leads to a mixed picture. Most of the clubs are on a solid foundation and will survive the crisis with a few scratches. Clubs like Manchester City and Juventus F.C. currently do not follow a sustainable business model, but they have solvent investors who provide enough capital to absorb the losses. One club that could face major problems is FC Barcelona. The pre-pandemic equity ratio was already very low at 9.8%, and as a non-commercial sports association, the club cannot currently sell shares to raise capital.

# Chapter 3
# Approaches for Improvement

As can be concluded on the basis of the figures presented in chapter 2, it would be wrong to say that football as a whole has a fundamental financial problem. There are enough clubs that are solidly financed and are now faced with unexpected problems due to the COVID-19 pandemic. On the other hand, many clubs in smaller leagues were already facing financial hardships before the current crisis. And even for some of the bigger clubs, it took only little to cause great financial distress after a short time. Therefore, it seems to be worth reflecting on how the system as a whole can be made more financially sustainable.

Within this chapter, various ideas and approaches that could possibly help the football business in the long term will be discussed. Obviously, it is not the idea to present a ready-made plan to restructure the football business. The ideas are only meant to stimulate thinking about possible future approaches to improvement. After all, one should learn from crises, and a system that does not evolve will not last forever.

### *New mentality & financing structure*

It is important for people engaged in the football industry to keep in mind that despite all the emotion and public attention, in the end, most football clubs are subjected to the same rules as normal companies. If companies do not make profits for years and do not build up reserves, they are very susceptible to crises. The same accounts for football clubs that do not have wealthy patrons or investors without big return intentions.

As described in chapter 1, for many people who work in the financial area of football clubs, it is quite normal that there is no attempt to make a profit. This rationale has been prevalent in the football industry for a long time. It is believed that if you do not use all of your income for sporting success, you do not use your resources efficiently and have to suffer severe consequences in the competitions. While this is true in some cases, there are also various examples of clubs who manage to reach their sporting goals while making constant profits. In the German Bundesliga, SC Freiburg, which is still a registered association and can thus not sell any shares, has the second highest equity ratio in the league (see figure 5 in chapter 2), as profits have been continuously kept in the company every year and reserves have been built up.

Perhaps the current crisis is an opportunity for a change of mentality in some parts of the industry. It is clear that many clubs, especially in smaller leagues, feel the pressure to squeeze the last out of their financial resources. When your competitors do not aim to build up reserves but plan with structural deficits and always invest all resources in the first team, you feel compelled to do the same in order to be able to keep up in sporting terms. This creates a vicious circle from which very few can break out. The current COVID-19 pandemic shows, however, that a certain amount of reserves is also indispensable for football clubs to be able to survive crises. Therefore, it should be the goal of all clubs to generate profits in good times at least until sufficient reserves have been built up. Otherwise, the fate of a club depends on the goodwill of creditors, politicians or patrons and one faces the risk of destroying a club to which many people have a great emotional attachment and which is often important for its region.

### *Introducing new licensing criteria*

The approaches described earlier are admittedly very idealistic. Changing the mentality of a whole system and restricting yourself on a voluntary basis is often difficult. Therefore, it could be helpful to adjust the licensing criteria in order to discipline clubs from the outside.

As mentioned before, the licensing process of the German league association is considered to be one of the strictest in Europe. Yet, as the analysis in chapter 2 shows, even those rules do not prevent clubs from having little or even negative equity. The reason for this is that the licensing process, like the entire football business in general, is very liquidity-oriented. The main focus is to ensure that the clubs have sufficient liquid assets and expected cash inflows to be able to finance the respective following season. Regulations regarding stability are much less strict, as already described in chapter 1.

It is normal that in constantly growing markets without any major shocks, the focus of regulators lies on the daily operations and the short-to-medium-term liquidity. However, when shocks like the current COVID-19 pandemic hit a system, the importance of long-term stability becomes apparent. Thus, it seems to be a good time to adapt some regulations.

Even though the origin of the crisis itself and the main actors involved are entirely different, some parallels can be drawn between the global financial crisis of 2007-2008 and the current COVID-19 crisis. The crisis rapidly spread into a global economic shock, challenging global economies and several business industries. The financial crisis of 2007-2008 resulted in several bank failures and many banks were rescued by states. The experiences made during the crisis lead to changes in regulations, as the German Government describes:

*"One of the most important lessons from the global financial crisis is: Those who have opportunities for profit must also bear the associated risks. The goal must be to reassert the principle of liability. Especially with regard to the events of 2008 and 2009, it had become apparent that the institutions did not have sufficient equity and liquidity to cover the risks on their books. Stricter regulations are necessary to ensure the stability of the financial markets in the future and at the same time to avoid burdens on the states due to aid packages for credit institutions."*

To increase profits, many banks had operated with very low equity ratios before the financial crisis of 2007-2008. Due to the lack of stability in the financing structure, these banks were hit hard by the crisis and would have gone bankrupt. In numerous countries, banks were then rescued with aid packages from states, as they were considered systemically important and a series of bank failures would have had far-reaching consequences for the entire financial system. The term "too big to fail" was created to describe this situation. However, saving bank comes with a price, since, as pointed out in the highlighted quote, banks had taken big risks for profit reasons, but did not have to bear the economic risk. Knowing that you can take high risks without having to face the consequences can create a moral hazard, because you would not have a reason to take less risks in the future. The same applies to the football industry. In principle, it is up to each club to deliberately take big risks as long as they also bear the financial consequences. Yet, it can certainly be argued that, just like banks, some football clubs are "too big to fail". Football clubs are surely not as relevant for the global economy as banks. Nevertheless, for many countries and regions, football clubs are essential for social cohesion and the everyday life of many people and thus also relevant for the system. That is why there are many examples of football clubs that were saved from insolvency by public aid, which in return creates the same moral hazard as for banks.

In response to the experiences made in the banking crisis, in 2010 the global regulatory framework of "Basel III" was introduced. The Basel III standard aims to strengthen the requirements on bank's minimum capital ratios and to improve corporate governance as well as transparency. Higher minimum equity ratios were defined and implemented to strengthen the stability of the banking system and make banks more resistant to crises. As a result, equity ratios of European banks nearly doubled between 2008 and 2019.

The football business could learn from the conclusions that were drawn from the financial crisis and also implement certain capital requirements for football clubs. This would force them to take less risks and build up reserves in good years that act as a risk buffer in bad years. Obviously, just like for banks, the minimum required equity ratio would have to be defined by international associations and then implemented step by step. Football clubs cannot massively increase their equity in the short term unless they sell shares. The strengthening of the equity basis of banks was carried out successively until 2019. In addition, it has to be clearly defined what constitutes risk-bearing equity. In Basel III, the core capital (tier 1), which is the capital that can bear the most risk, is composed primarily of common shares and retained earnings.

Another measure which has recently more often been discussed and that could help mitigating the problem of the "rat race" is a salary cap. Salary caps are traditional components of sport competitions in the United States. In principle, they aim to limit salaries in professional sport. However, there are different ways in which such a salary cap can be designed. One option is the so-called "hard cap", which is used in the NFL. A hard cap represents a maximum amount of wages for the whole team that a club is not allowed to exceed. For the season 2020/21, the salary cap in the NFL is USD 198.2 million. In August 2020, clubs in the English League One and League Two (the 3rd and 4th league in England) have decided to introduce hard salary caps to oppose the prevailing wage inflation and improve financial sustainability. The fixed caps amount to GBP 2.5million (approx. EUR 2.76 million) for League One clubs and GBP 1.5 million (approx. EUR 1.66 million) for League Two clubs. The caps include basic wages, taxes, bonuses, image rights, agents' fees and other fees paid directly or indirectly to all registered players. The English Championship (2nd highest league) is also discussing a potential hard salary cap of GBP 18 million (approx. EUR 19.89 million) from next season on. Yet, the salary caps could be challenged in the courts by players or clubs that are not in favour.

A second option would be the "soft cap", which allows you to exceed the cap under certain circumstance, for example if you pay a "luxury tax" that benefits the poorer clubs. However, since the salary cap in European professional football is not intended to ensure similar sporting conditions for all clubs, but is rather an instrument to make business models more sustainable, neither a "hard" nor "soft" but a variable salary cap would probably be the most suitable. Rules could be introduced to stipulate that clubs can only spend a set percentage of their turnover on salaries. LaLiga in Spain is heading in a similar direction. Even though they do not impose hard salary caps, the league has introduced squad cost limits. A group of analysts reviews the financial situation of every club before the transfer window opens and establishes squad cost limits for each team. The participation of the clubs in the process is key to come up with budgets and in case of disagreement between club and league, clubs can turn to independent bodies to settle any differences that may exist. LaLiga has just published the squad spending limits allocated to the clubs for the 2020/21 season. Due to the significant decrease in revenues, the total budget for the 20 first division clubs has been reduced by EUR 610 million compared to 2019/20, now amounting to EUR 2.33 billion. FC Barcelona has experienced the highest cut with a budget of now EUR 382.7 million, down from EUR 671.4 milli-

on in 2019/20. Since contracts that have been signed with players in the past are obviously valid, clubs are negotiating with players to achieve voluntary salary cuts

A flexible salary cap (cap as percentage of revenues) in European football is something that should at least be considered, since many clubs and leagues are already starting to go in this direction. It is obvious that implementing a salary cap or caps in European football is not simple. Assuming this would be a UEFA-wide move, one has to wonder how the caps would differ from country to country. As already described in chapter 2, leagues with a higher share of broadcasting revenues, such as the Premier League, can certainly use a greater share of their revenues for player salary than others. Furthermore, some experts are questioning whether salary caps can be implemented in the EU from a legal perspective. And in practice, it is difficult to adjust your salary costs every season according to your revenues, since players usually have long-term contracts with fixed wages. A flexible salary cut might have to be accompanied by a new form of player contracts, as presented later in this report.

Finally, no matter if you want to introduce new capital requirements or a flexible salary cap, close attention has to be paid to different accounting shenanigans some clubs already make use of today to gloss over their financial reports. As pointed out in chapter 2, FC Barcelona already reported a risky financing structure before the COVID-19 pandemic, and Juventus F.C. managed to increase its equity through a capital increase but has recently reported constant losses. To polish the numbers during the pandemic, the clubs have carried out a player swap which will result in a large book profit for both parties right before 30 June, the deadline for UEFA to request the Financial Fair Play figures from the clubs. The players Arthur (formerly Barcelona) and Miralem Pjanić (formerly Juventus) changed sides. Arthur officially cost Juventus F.C. a transfer fee of around EUR 70 million, while FC Barcelona had to pay around EUR 60 million for Pjanić. While only around EUR 10 million flowed from Turin to Barcelona for the exchange deal, both clubs were able to record large book profits. Arthur, whom FC Barcelona bought for around EUR 31 million in 2018, still had a residual book value of around EUR 20 million at the time of the swap, while Miralem Pjanić, who joined Juventus in 2016 for EUR 32 million, had a residual book value of around EUR 13 million. Hence, neglecting any taxes to keep it simple, the swap resulted in book profits of around EUR 50 million for FC Barcelona and EUR 47 million for Juventus F.C.

These profits improve both the profit and loss account, which is important for Financial Fair Play, and the balance sheet situation. Various other clubs have engaged in deals like that as well, although mostly with youth players and thus not publicised as much. If two clubs agree to swap youth players for officially EUR 10 million each, they both record book profits of EUR 10 million. However, this approach is also risky and can quickly end up in a vicious circle, because players exchanged for a large sum are then on the club's balance sheet for exactly this amount and are depreciated over the term of the contract, as explained in chapter 1. This means that a player swap with high sums significantly above the book values promises me, as a club, a high profit today, but in return I have significantly higher depreciation in the coming years, which reduces my profits.



### *Making revenues less volatile*

In chapter 1, it has been already described that a distinctive feature of the financial management of football clubs is the volatility of revenue streams. Everything is related to the sporting success. If clubs perform poorly on the pitch, they will get a lower share of the money generated from broadcasting, often less fans are interested in buying tickets to watch the games at the stadium, fans are less inclined to spent money on merchandise and with poor performance, the market value of players can also decline. Now, the external shock of the COVID-19 pandemic has shown how massively most revenue streams collapse if clubs cannot play with fans in the stadium. While this is obviously very normal, since playing football is the business model of all football clubs, it could be worth reflecting on how clubs could disconnect some revenue streams from sporting success.

One way of doing so is strengthening your brand apart from what happens on the pitch. Whilst this seems pretty straight-forward and is also tried by many clubs, in practice it seems to be challenging. Strengthening your brand does not mean simply hiring a marketing agency that develops a fancy claim and a marketing campaign for your club. There are plenty of examples of clubs who tried to work on their brand image but at the same time completely forgot about their fan base and their values. If you really want to develop a strong brand, you need to know who your fans are, understand their values and needs. You cannot try to establish an international premium brand if most of your fans are local working-class people who want their club to be close to the fans. Knowing who your fans are and what they want before developing marketing slogans and hashtags is key. Of course, the best brand image and communicated values that the club should stand for are of no use if these values are not lived in practice. A brand quickly becomes untrustworthy if the people acting do not match the values. For example, a club that propagates sustainability and environmental awareness, but whose representatives fly in private jets at every opportunity, quickly becomes untrustworthy.

A good example of a club with a strong brand that stands for certain values and bases its actions on them is the German second league club FC St. Pauli. St. Pauli is located in an utterly political and alternative area in Germany and is thus very politically active itself. The club has been credibly campaigning against sexism, racism and homophobia for a long time before such campaigns became bigger in football in general. Outside of campaigns, the club has also repeatedly let action speak for itself. St. Pauli has already let homeless people and refugees spend the night in the stadium. People buy merchandise with the FC St. Pauli logo are not necessarily fans of the football team but identify with the values that the logo and the club stand for. On various festivals in Germany, which have nothing to do with football, you can find FC St. Pauli stands where you can buy merchandise. Just recently, the club has announced that they will produce their own football jerseys from the season 2021 on. As the club states, in its search for a supplier of sustainably and transparently produced performance apparel, it had not found a provider that fully met the criteria. Now FC St. Pauli wants to produce the world's most sustainable team sports collection with its own brand called "DIIY". With this project, the club is also responding to the wishes of its fans, who demand real sustainability from their club. Of course, the preconditions for FC St. Pauli are very special due to its history and origins and the model cannot be copied. Also, not every club has to be political. But every club should

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be aware of its origins and fan base and know what makes them unique, just like FC St. Pauli. If clubs know what they and their fans stand for, this can also be beneficial for their revenues.

FC St. Pauli might create new sustainable revenue streams now by creating their own sports brand. Also, a strong brand that stands for certain values disconnects merchandise income from sporting success. If fans do not buy jerseys or other products just to cheer for the club in the stadium but because they identify with the brand, you will have more stable revenue streams, no matter how you perform on the pitch. In addition, it becomes more important for clubs to really know about their fan base anyway, since this is increasingly demanded by sponsors. More and more companies are looking for closer alignment of brand purpose and want to transport certain values when cooperating with a club. Football clubs with fewer fans, but which serve a certain market segment that is interesting for a sponsor, can be more attractive than clubs with more fans that do not know their audience well or do not stand for specific values.

Besides making your revenue streams more stable by knowing your fans and strengthening your brand, it is also important to constantly try to diversify your income and to look for new revenue streams. Clubs might get creative and think outside the box, just like FC St. Pauli did with creating their own sports brand. What will continue to increase in importance for most football clubs is digital content and eSports. The revenues clubs can make from eSports are also hardly connected to the sporting success and not impacted by the COVID-19 pandemic. On the contrary, due to the pandemic, the importance of digital content actually increased. Even pre-pandemic, nearly 50% of Millennials and Gen Z watched livestreamed and recorded videos of others playing videogames each week. The final of the ePremier League Invitational competition during the first lockdown between Trent Alexander-Arnold (Liverpool) and Diogo Jota (by then Wolverhampton Wanderers) was watched by 3.5 million viewers on Facebook, YouTube and Sky TV.

In 2019, the worldwide eSports market generated revenues of EUR 787.83 million and is expected to grow up to EUR 1.315 billion until 2023. eSports, social viewing and livestreaming will become increasingly important sources of income for football clubs.



### *Making fixed costs variable*

One reason for financial problems of clubs is collapsing turnover. A second reason is that costs can hardly be reduced when turnover falls, as a large part of the costs of football clubs are fixed costs. As shown in chapter 2, the biggest expense item of football clubs is salaries. Players usually sign contracts with a fixed salary and various variable components. Those variable components are usually linked to the performance of the player (number of appearances, scored goals, etc.) and the team (number of victories, titles, etc.). Also, there are often clauses that if clubs are relegated to a lower league, salaries are reduced accordingly. However, maybe in the future, it is worth considering linking the variable parts of the salary rather to financial but sporting results. In situations like right now, revenues are significantly declining, while players can still fulfil all their sporting goals and receive all of their bonuses.

Obviously, the main criterion for a player's performance is always the results on the pitch. Hence, players and their agents will initially find it incomprehensible if variable remuneration components are linked to financial results, because a player does not influence these on the pitch as directly as wins or losses. However, the financial results are indirectly very much influenced by the performance of the players. If players perform well, clubs receive more money due to better sporting results. Furthermore, well-performing players attract fans. This is often not only reflected in an increase in merchandise sales, but also by selling more tickets for matches. Finally, very skilled and well-known players can increase the sponsoring value of a club. When the media and some fans criticise the high salaries in professional football, it is often argued that it is the players who generate the high revenues for the clubs through their performance on the pitch and that they should therefore also receive a fair share of these revenues. While this argument is valid, it should also be applied in the other direction: if a club's turnover decreases, the absolute salaries of the players must also decrease. So, if the players are ultimately responsible for the revenues with their performance, what is the argument against also remunerating them on the basis of turnover?

It is clear that this is much easier said than done. Changes in the remuneration also require mentality changes. All relevant stakeholders would need to understand what it means to be variably remunerated based on turnover and why this could be beneficial. The transfer market is an overbidding competition. If a club starts to link salaries to revenues, but other clubs keep the current system and this is also preferred by players and their agents, the club has no chance of signing good players. Yet, as stated before, now is a good time to at least talk about new approaches that might make the business more sustainable. In times of constantly growing revenues, at least in the big leagues, clubs managed to keep their salaries/revenue ratios quite constant and there was no need for change. Now that revenues heavily decreased due to an external shock and that the whole industry is unsure about what future developments will look like, some stakeholders might be more open to new ideas.

For sure, new variable remuneration components based on economic criteria must be introduced slowly and step by step. The practice of making a larger part of players' salaries variable and linking it to sporting criteria was also not implemented overnight, but has slowly been established. Today, for some players, a decent amount of their income is linked to sporting success. Therefore, it might also work to initially link small parts of the variable remuneration to economic developments and then gradually increase this share. What will probably be

implemented in many future player contracts anyway are contractual clauses about what happens when revenues plummet due to external events. A key learning from the crisis is that clubs should not fully depend on the players' goodwill to waive their salaries if they are in severe financial problems due to unexpected endogenous shocks.

The ideal (and probably utopian) scenario for every club would be to have salaries fully linked to their revenues. This would mitigate the problem of volatile and therefore often difficult-to-predict revenues by giving the professional squad a remuneration linked to turnover on a percentage basis. In this way, the salaries/revenue ratio could always be kept constant and the risk of unexpected large losses mitigated. Also, within this system, a flexible salary cap as a squad cost limit in terms of X% of a club's revenue could be introduced much more easily. The example of LaLiga that was presented earlier in this chapter shows how hard it is to define squad costs limits based on a club's predicted turnover every season without salaries of the players being linked to the financial performance. Clubs like FC Barcelona and Real Madrid, whose limits were decreased significantly by LaLiga, now have to negotiate with their players to be able to meet the criteria. Table 2 shows an example of how such a (admittedly fictional) complete variable remuneration of a squad could look. In this simple example, a squad of 23 players is assumed. All other taxes and social contributions are included in the salary costs. We assume that we are dealing with a large Champions League club with a turnover of EUR 500 million. The salaries/revenue ratio of the club is set at 50%.

| Player | Salary (share of revenue) | Salary (in million EUR) |
|---|---|---|
| Player 1 | 5% | 25.0 |
| Player 2 | 4% | 20.0 |
| Player 3 | 4% | 20.0 |
| Player 4 | 3,5% | 17.5 |
| Player 5 | 3,5% | 17.5 |
| Player 6 | 3% | 15.0 |
| Player 7 | 3% | 15.0 |
| Player 8 | 3% | 15.0 |
| Player 9 | 2,5% | 12.5 |
| Player 10 | 2,5% | 12.5 |
| Player 11 | 2,5% | 12.5 |
| Player 12 | 2% | 10.0 |
| Player 13 | 2% | 10.0 |
| Player 14 | 1,5% | 7.5 |
| Player 15 | 1,5% | 7.5 |
| Player 16 | 1,5% | 7.5 |
| Player 17 | 1% | 5.0 |
| Player 18 | 1% | 5.0 |
| Player 19 | 1% | 5.0 |
| Player 20 | 0,5% | 2.5 |
| Player 21 | 0,5% | 2.5 |
| Player 22 | 0,5% | 2.5 |
| Player 23 | 0,5% | 2.5 |

*Table 2: Exemplary fictitious distribution of fully variable player salaries*



As is already the case today, players receive different salaries depending on their sporting abilities and other value to the club. This fictional club has a star player, who has stood out with his performance for years, and several other players who are among the best in the world in their position. Otherwise, a few other players form the (extended) regular squad, and the squad is completed by some clearly supplementary players. If salaries are fully variable now and agreed on as a percentage share of revenue (column 2 of table 2), players are remunerated just like today in absolute terms (column 3 of table 2). However, if the club's turnover drops, absolute salaries are automatically adapted accordingly.

Summing up, it can be concluded that especially due to the volatile revenues in football, making as many fixed costs as possible variable would help increasing the clubs' stability. Since player salaries are the largest expense item, it would be a great help to link the level of salaries to the development of turnover. Such a change could certainly not be introduced overnight and would be met with resistance from various stakeholders. Still, now seems to be a good time to at least try to increasingly tie smaller components of the variable remuneration of players to financial criteria rather than purely sporting ones.

### *Increasing financial transparency*

One thing that should definitely improve in the short term and that is also part of sustainable financial management is financial disclosure and transparency. For plenty of football clubs, only few financial figures are publicly available and fans as well as the media and other relevant stakeholders do not get much insight. In the English Premier League, you can find comprehensive financial reports for most clubs. Also, clubs that are listed on the stock exchange (see chapter 1) or that have outstanding bonds tradable on a stock exchange are obliged to provide comprehensive financial reporting. Yet, for most other clubs, numbers are hard to find.
In the past, there have already been developments towards increased financial transparency. National and international federations now publish some selected figures that are also relevant for the various licensing procedures. While this development is positive, the published figures are limited to a few relevant core parameters. From clubs themselves, there is still often little published information on the financial situation. However, for a few reasons, it would be beneficial for all parties involved to publish comprehensive financial statements just like other companies do.

As already mentioned before, in addition to the goal of strengthening the capital base, another key learning from the global financial crisis that lead to the Basel III regulations was that transparency within the banking industry had to be increased. The same accounts for the football industry today. When a growing number of stakeholders are increasingly critical of an industry, increased transparency helps. Already for at least the last decade, but particularly now in times of the COVID-19 pandemic, many fans and the media critically question the financial stability of the football system. For years, there has been talk of a "sick system" that is developing in the wrong direction and is gradually ruining itself in order to be able to pay players and their agents too much money. While part of this criticism is valid and there are some clubs that definitely do not follow sustainable business models, the results of this study also show that there is a high number of clubs that are managed sustainably. By disclosing comprehensive financial results and explaining them to people, prejudices and mistrust towards the football industry could be reduced. Of course, clubs would also have to disclose and explain negative results. At the moment, one can often

observe how clubs engage in massive impression management in financially bad times. There are many cases of clubs that have reported and celebrated revenue increases at their annual general meetings in recent years, even though they were making losses at the same time and the financing structure was very risky. Many clubs in the past have also repeatedly emphasised the figures of their individual financial statements to the fans, which often looked much better than the consolidated results. This practice does not help anyone in the end, as it leads to negative surprises if financial situations get severe and increases public mistrust.

Negative financial results do not need to be hidden. For every result there are reasons, and those reasons can be explained to fans. Especially after the experiences made in the course of the COVID-19 crisis, the interest of the fans in the finances of the clubs and the understanding for negative results seems to be bigger than ever before. This momentum must now be used to become more transparent and to explain financial developments more honestly. Of course, in the current situation, it is easier for club officials to explain negative financial results, because they are due to externalities that every fan understands. Yet, negative results should also be openly communicated and explained in the future, even if the causes for them are no longer rooted in external factors. As various scientific studies from behavioural research show, people do tend to shift responsibility for negative results away from themselves. However, it goes down much better with fans and investors if you also take responsibility for poor financial results, as this suggests control and shows that you know the reasons for the development.

Furthermore, if the public knows more about the financial situation of a club, fans will understand some decisions much better. As already described in chapter 1, the public pressure on some managers to take financial risks to maximise sporting success can be very high. Fans sometimes do not understand if clubs do not invest in new players before a season starts or if they transfer good players to another club. However, if it is carefully explained why money cannot be invested at the moment or why it is important for the club finances to transfer a player to another club, fans will understand much better and the problem of public pressure will be mitigated.

Last but not least, lack of transparency always leads to inefficiency on markets. Hence, by being more transparent clubs could actually decrease some costs in the future. Attempts have been made for many years to cap expenses for players' agents. In addition to that, some clubs will have to reduce player salaries in the next few years. In transparent markets, where financial information is accessible to everyone and comparability is therefore much greater, such projects are easier to implement.

### *Digitalisation in financial management*

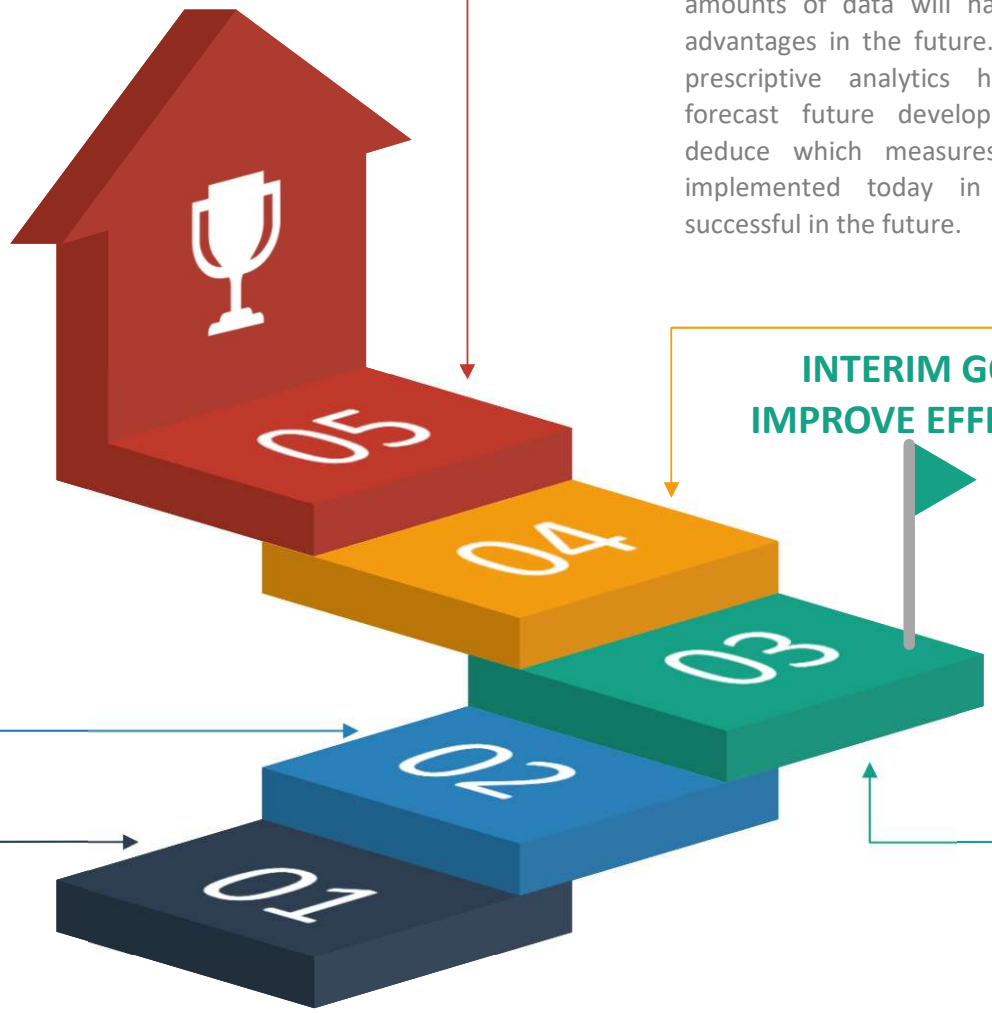
A very recent topic that most financial executives are currently dealing with is digitalisation. Many companies are investing in automating their processes or analysing data with artificial intelligence. Since football clubs have a different focus than these firms and also much less money to invest than big corporations, the topic of implementing new digital tools in the finance function will not become relevant short-term. However, in the long run, when these tools are more established and their implementation is cheaper, also football clubs will also have to think about which new technologies to make use of. Therefore, it could be interesting to already look at the new opportunities that digitalisation offers for financial management in the future. Since I have been leading workshops about digitalisation with financial executives from different corporations for the past years, I want to share some of the insights and key learnings here.

For most big companies, the digital transformation of financial management is already happening. A 2019 survey of 130 European CFOs and other financial leadership decision-makers found that 95% of respondents currently see skills gaps in the finance function. When asked what specific skills were missing, 64% of respondents said they lacked skills in using new tools and digital technologies. CFOs are sitting on a valuable pool of data, which, however, cannot yet be adequately analysed. Necessary technologies and knowledge are not yet sufficiently available. Building up such resources is time-consuming and costly.

Most people have recently heard about digital trends such as artificial intelligence, predictive and prescriptive analytics, big data, automation, robotics, process mining, blockchain, and so on. There are many fancy new technologies and digital buzzwords. The main question is: Which technologies are useful for my business model in the future and where do I start? In general, there are two arguments for making use of new technologies: increasing the quality of output or decreasing costs. When it comes to digitalisation projects, most companies focus on technologies that increase efficiencies and thus reduce costs first. It is particularly important to be able to report the first success stories quickly in order to convince as many people as possible within one's own organisation of the necessity of the innovations. Therefore, quick wins should be taken along first, before engaging in long-term and expensive digitalisation projects. Simple staff training in the use of the current IT infrastructure is often enough to achieve initial efficiency gains. Many large companies that are now launching their first digitalisation initiatives in the finance sector are starting to automate repetitive processes. Robotics is used to automate processes such as capturing incoming and outgoing invoices. In the long run, CFOs are planning to utilise the possibilities that artificial intelligence and analytics offer. Especially pre-dictive and prescriptive analytics is a field that will also play a role for football clubs in the future. Scenario planning, which is utterly important for football clubs (see chapter 1), will be much easier and more accurate with predictive analytics tools. Simply put, predictive analytics comprises a variety of statistical techniques from data mining, predictive modelling and machine learning that analyse current and historical data to predict future outcome. Those who can efficiently evaluate large amounts of data will have competitive advantages in the future, not only in the normal business world, but also in football.

The step-by-step digitalisation roadmap for financial management, that has been built with CFOs and other finance executives based on their practical experience, is illustrated in figure 9 on the next page.

## GOAL: QUALITY & EFFICIENCY IMPROVEMENT




## BIG DATA & AI

Those who can efficiently evaluate large amounts of data will have competitive advantages in the future. Predictive and prescriptive analytics help to better forecast future developments and to deduce which measures need to be implemented today in order to be successful in the future.

## DEFINE LONG-TERM STRATEGIES

After efficiency gains can be demonstrated through initial digitisation projects, long-term strategies can be tackled that require more effort but also bring great strategic benefits in the long term.

## INTERIM GOAL: IMPROVE EFFICIENCY

## START SIMPLE!

The first concrete measures should be as simple as possible. Often, no new technologies need to be implemented to achieve short-term efficiency gains. Simple staff training in the use of the current IT infrastructure is often enough for initial efficiency gains.

## DEFINE QUICK WINS

It is important to be able to report the first success stories as quickly as possible. Projects that promise short-term efficiency gains/cost savings with little effort should be carried out first.

## STANDARDISATION & AUTOMATION

Those who want to take the first steps towards digitisation often start with process mining to identify trends and patterns in existing processes, make them more efficient and, if necessary, standardise and/or automate certain process steps.

*Figure 9: Digitalisation roadmap for financial management*

# Chapter 4
## Interview with Ilja Kaenzig and Raphael Landthaler

This study was written to provide some food for thought for decisionmakers in the football business. Therefore, it is important to discuss the various topics of this study with experts from the field to reflect on them critically. To do so, an interview with Ilja Kaenzig and Raphael Landthaler was conducted to get two different points of view.

### Ilja Kaenzig
is Managing director of the German 2. Bundesliga club VfL Bochum. Before, he worked in different roles for Bayer 04 Leverkusen, Hannover 96 (both Germany), Grasshoppers Club Zürich, BSC Young Boys (both Switzerland) and FC Sochaux-Montbéliard (France).

### Raphael Landthaler
worked as CFO for SK Rapid Wien (Austrian Bundesliga) for many years. During that time, he was also Board Member of the European Club Association (ECA) representing subdivision 2. Afterwards, he was Executive Board Member of the Austrian Bundesliga (ÖFBL).



***Mr. Kaenzig, Mr. Landthaler, thank you very much for discussing the topic of financial sustainability in profession football with me today.***

**Ilja Kaenzig:** I'm actually very excited to discuss this topic, since this is one of the most pressing issues for all of us at the moment. Currently, we all have to be very dynamic and adapt to the new realities.

***In the report, we describe how financial planning in football usually carried out and how it became even more challenging now due to the COVID-19 pandemic. How difficult is financial management in football and how has it changed due to the current pandemic?***

**Raphael Landthaler:** Financial planning in football has never been easy. I worked for Rapid Wien, a club that is still 100% owned by its club members. There is no investor that could compensate for losses. So, the question has always been: How much risk can we take? Sporting success leads to higher revenues, but to achieve sporting success, you usually need to invest more money and take higher risks, because if sporting success doesn't materialise, you'll have to deal with great losses. I don't know how often I have heard the phrase: "We need to invest now in order to take the next step." But who's carrying the risk if we fail? As the CFO, you always have to be the "party pooper" and say "no, we can't buy this player."

**Ilja Kaenzig:** Before COVID-19, we could plan our revenues with 80%-90% security. We knew how much broadcasting income we would get, what our sponsors will pay us and can usually quite accurately estimate how much tickets we will sell in one season. The budget we could allocate to our squad remained quite stable during the last years. What we had to do was mainly finetuning. Do we have to spend a little less money because a sponsor drops out? Or can we maybe generate additional income that we can directly allocate to the budget of our first team? Now, things are differently. Ever since the pandemic, our main question is: How much risk can we take? I'm currently discussing with my team on a daily basis to assess all developments.

***Do you already have an answer to the question of how much risk you want to take in the current situation?***

**Ilja Kaenzig:** Before the season started, we agreed on adopting the strategy of a, as we call it, "controlled offensive". This means that we decided to keep our budget for the squad stable so we don't have to give up our sporting am-

bitions. We are convinced that despite the current situation, we have to remain competitive in order to be able to generate additional income in the future. But mind you: I am not speaking about promotion. In the 2. Bundesliga it`s just about winning the next match. The league is so balanced, you can get quickly in trouble – on and off the pitch. It`s not about fantasies when we talk about ´remaining competitive´.

***In normal times, do you try to allocate your budgets in a way that you can report profits at the end of the year or do you try to break even and invest all of your resources in the squad?***

**Raphael Landthaler:** At Rapid, we have always planned our season with a structural deficit of around EUR 3-5 million. But we have based our planning solely on income from national competitions. This means, to break even or to make a profit, we either had to reach the group stage of the Europa League or we needed to sell players. To decrease the risks a little, we frequently did a kind of market value assessments for our players to get a feeling for how much other clubs might pay for them. Despite all that risk, during my seven years at Rapid Wien, we have reported profits every year, even though they we very little sometimes. But we had quite some extraordinary income from transfers and the Europa League.

**Ilja Kaenzig:** In the second division, it is very difficult to pursue ambitious sporting goals and to make profits at the same time. Just like Raphael said, you need an extraordinary season, for example winning several games in the Cup competition, in order to make profits. We would like to retain profits and use them for other kinds of investments. We have defined important areas in which we want to invest. Yet, our main goal has always been to keep the budget for our first team stable, which hasn't been easy at all times. Our squad budget is very much based on our broadcasting revenues, which in return depend on our TV ranking. Recently our ranking has been stable, but it is possible to fall short EUR 2 to 3 million from one season to the next, particularly if you are already high up in the ranking. So, we have used most of our resources to keep our salary budget stable. Secondly, if any resources are left, we want to invest money in players that ideally yield a return on investment one day. Third, we would like to invest in our youth teams and infrastructure. Last but not least, we also set up a development plan to increase future revenues. However, we do not have the money to initiate the projects necessary. But as I said, that's only possible when there are extraordinary effects like surprising sporting results that impact earnings.

***So, reducing certain costs in order to increase your reserves is impossible?***

**Ilja Kaenzig:** Yes, that's not possible. Our financial goal is to break even. We can only build up reserves when there are extraordinary effects. Our boards want to see the best sporting results possible. Football is such an emotional business with so much public pressure. You can't invest less in the squad to retain earnings. At the latest, when you lose too many games, the pressure becomes so high that you have to change the coach or sign a new player.

**Raphael Landthaler:** I agree. Breaking even is the optimum. Rapid doesn't have any owners who demand a dividend. If I report profits of EUR 10 million but am only fifth in the Austrian league, people will ask me why we didn't invest more to reach the second or first place. Our members don't want to make profits, they want to see sporting success.

***The fact that it is difficult for you to make profits also means that it is nearly impossible to build up equity, if you do not have any positive external effects. Hence, quite some teams operate with low equity ratios, which will further decrease now due the pandemic. Would you find it useful to implement regulations regarding a minimum equity ratio for football clubs to make the whole system more stable?***

*"Our members don't want to make profits, they want to see sporting success."*

**Ilja Kaenzig:** As you have described in your study, especially in second divisions, a kind of "rat race" has developed. This problem has been apparent in many smaller leagues and has now also reached the 2. Bundesliga in Germany. Most teams are trying either to be promoted or to climb in the TV ranking, which has caused a sharp increase in player salaries that's not healthy for the system. We gave ourselves an internal salary cap that we don't exceed. But the salaries some of our competitors are willing to pay are no longer in balance with the revenues they can generate. Generating income by selling players should not be part of your business model. Relying on income from transfers to break even is rather risky. You should be able to finance your squad with your recurring revenues. But for plenty of clubs this is the case, even though the 2. Bundesliga is very strong in terms of overall turnover. So, yes, we have to be alarmed and think about new rules. I am part of a working group discussing exactly these topics and trying to come up with regulations to prevent this "rat race". The topic will get even hotter now due to COVID-19, since a lot of clubs will be more willing now to search for investors. We are heading for an iceberg and must try to avoid the crash. Within the working group, we are talking about the solution you mentioned and intend to increase equity requirements and limit losses. But the question is always how much clubs are actually willing to limit themselves and what kind of measures are possible from a legal perspective.

**Raphael Landthaler:** What I would like to add: this "rat race" exists, because we are all constantly in bidding competitions to get the best players. A few years ago, FIFA has started a task force to discuss new rules for the transfer sys-

tem. One rule that's been discussed is limiting squad sizes, which in my eyes could help mitigating the problems of the "rat race". Imagine every club worldwide would only be allowed to have a squad that consists of, let's say, 25 players that are above 21 years old. That would take a lot of pressure off the transfer market, as player "hoarding" of some big clubs would stop. FIFA is also discussing capping agent fees. Those are all measures that could help. Implementing a minimal equity ratio is something we should discuss but could be difficult, since clubs have different assets in their balance sheets. In Austria, a few clubs have built their own stadiums. Obviously building your own stadium increases your total assets and your liabilities by a lot. What I would find very useful is for licensing bodies to evaluate the revenue at risk of football clubs. That would be a forward-looking analysis and help assessing how risky the budgets of clubs are.

***Have you also discussed the potential introduction of salary caps in Germany or Austria?***

**Ilja Kaenzig:** Yes, in our working group we have, but it seems to be too difficult legally. However, the system of LaLiga of establishing squad cost limits for each club that are linked to their revenues is very interesting. That would be a promising system for us as well. However, so far, we didn't find a way to implement it. But I personally believe that salary capping is the future.

**Raphael Landthaler:** It's an interesting idea we can definitely discuss. But it definitely has to be linked to turnover in percentage terms. A fixed hard salary cap would not make any sense in football. And the percentage that you are al-lowed to spend on salaries must differ between league, since leagues are different and you can't just put one business model on all of them. Maybe this can be also linked to equity ratios and then only apply to clubs which are in difficulties.

***Mr. Kaenzig, as you say, it is not easy to agree on salary caps and implementing them could take a while. At the same time, clubs have to deal with big losses at the moment. This is especially difficult for clubs with only little equity. I believe, also your club VfL Bochum will report negative equity at the end of this season. What is your plan for dealing with this in the future?***

**Ilja Kaenzig:** Our plan is based on two pillars: on one hand, we are planning to decrease our squad budget step-by-step in the future, inline with the falling TV revenues from the TV deal starting in 2021. On the other hand, we are also trying to come up with new projects that can lead to quick wins for us despite the pandemic. The digital market is very interesting for us. We have also been in the eSports market very early, which is beneficial for us right now and will probably grow in importance. Furthermore, we believe that sustainability is a crucial topic and we already developed some project ideas in that area. In addition to these two measures, we are still keeping our eyes open for investors that fit to our club. This could also lead to smaller investments by strategic partners or to a pan-continental cooperation.

***Since you have already mentioned potential new sources of revenue now: Can it be possible for football clubs to make revenues less dependent to sporting results?***

**Ilja Kaenzig:** You can never completely disconnect the financial from the sporting success. We need to stay ambitious, otherwise we will be less attractive for sponsors. However, it is possible to make revenues more stable by diversifying them. I already mentioned how important eSport, or more precisely eFootball became for us. We are very successful in the virtual Bundesliga and have our own talent pool with players from the region now. This market is already as important as a sponsor for our income and I believe that it will grow significantly in the future. We also have ideas for projects with "passive fans", which could generate additional income in the future. But, as I said, what happens on the pitch will always be crucial.

**Raphael Landthaler:** In Austria, matchday revenues are very volatile and vary with your sporting success. Sponsoring is more stable, since contract periods are usually 3 to 4 years. We are also trying to get longer contract periods with our hospitality partners. There is a major difference to German teams, as they are mostly working with selling bodies like Lagardère to market their rights and attract sponsors. I'm not a fan of that, because you lose the personal contact to your clients and thus cannot build strong relationships. I believe that with strong personal relationships, you can make your sponsoring income much more stable. Look at all the new big international companies out there: Uber doesn't own any cars and Airbnb doesn't own any real estate. Their main asset is customer contact, and that is one of the key assets nowadays, which I believe we have in Austria. If you are in direct contact with your customers, be it sponsors or fans, you can keep your revenues more stable, because you know if they are unhappy and can change things.

***How important is a strong brand for a football club?***

**Ilja Kaenzig:** You need to be authentic and know where you come from. In Germany, there are clubs like FC St. Pauli or Union Berlin that are very political. But this is deeply rooted in their history and you can't copy that. Other clubs developed into big glamorous brands. We are neither of the two. Here in Bochum, every-thing is down-to-earth and handmade. It's football as you know it from the 80s and 90s, and this attracts people. Some clubs that are struggling right know forgot where they come from. I know about big clubs that tried

*VfL Bochum*

to become an international brand but want to be like us now. But as I said, you can't copy a brand. What we are is deeply rooted in our history and no marketing agency can just give us a brand image.

***Does the brand image that you have just described have a direct positive effect on your revenues?***

**Ilja Kaenzig:** I'm sure it does. For instance, despite the pandemic and the fact that our fans can't come and watch our games in the stadium right now, we had higher merchandise sales than ever this year. I have the feeling that the distance we have to our fans due to the pandemic made them try to be close to us by showing our colours.

***What is your opinion on the suggestion, made in this study, to link variable components in player contracts more to financial than sporting success in the future?***

**Ilja Kaenzig:** German football also managed to make salaries more variable by implementing bonuses for appearances or victories in the past, so I wouldn't say that this is completely impossible. You would have to start somewhere and then convince more and more players. Right now, it doesn't seem feasible, because revenues are so uncertain, and I don't think that players would take that risk at the moment. Maybe we can do that in the long run, but we will have to see.

**Raphael Landthaler:** In Austria, there are already way more variable compensation components in player contracts compared to Germany or other big leagues. Sometimes, 30% to 50% of the total salary is variable. I don't know if linking the variable components to financial success can work. But I'm sure that there will be a pandemic paragraph in every player contract in the future, so clubs don't have to start negotiating with players about salary cuts anymore when revenues collapse due to exogenous shocks.

***What do you think about increasing financial transparency? Is that something football clubs should do?***

**Ilja Kaenzig:** Yes, definitely. I believe that we are already quite transparent. But there are clubs who just show revenues and costs of the fiscal year. That's it. No club that I know about shows the budgets for the upcoming fiscal year. We always present our budgets to our members on the annual general meeting. Even this year, during the pandemic, we showed our numbers, despite the fact that they obviously looked really bad. To say it clearly: I believe that it would be an asset for the football business to make transparency criteria stricter. But then you need to implement rules that actually increase transparency. Right now, for example, every club of Bundesliga and 2. Bundesliga has to publish the agent fees they paid. This information alone doesn't give me much. We need comprehensive standards just like listed companies. Apparently, this topic is currently discussed in the DFL task force. So, let's see. I would be in favour, because we don't have anything to hide. A greater transparency could be a USP and also might help us to attract new sponsors.

**Raphael Landthaler:** I believe that we have set a standard in Austria, because at Rapid Wien, we published an annual report for the first time in 2013. Now more and more clubs are doing that. So, I agree with both of you that financial transparency should definitely increase. If I may add another advantage: more transparency would also decrease information asymmetries. Right now, player agents can earn a lot of money mainly due to the lack of transparency. They can tell me in negotiations what other clubs are offering, and it's on me to decide if I believe that or not. If the financial results of all clubs are publicly available, I know roughly how much other clubs can offer. And the agent does not have the information advantage anymore. Thus, more disclosure requirements can help taking pressure off the transfer market And, by the way, publishing annual reports is also a good marketing instrument, as it shows sponsors and other partners that you are not an old-fashioned sports association but a reliable and solid business.

***Thank you both for discussing these topics with us and sharing your insights. As already said in the report, I think we all agree that we are not dealing with a broken system that has to be completely redesigned. But one that has some issues that should be fixed, and the current situation seems like a good time for change. Do you have any other final ideas, which would make the financial management of football clubs more sustainable and that we have not discussed yet?***

**Raphael Landthaler:** There is actually one thing that I would like to add. Generally, it is crucial to create an ecosystem that also makes sustainable business possible for smaller clubs. The FIFA solidarity contribution scheme is an important lever for small clubs. At the moment, all clubs who have contributed to a player's education and training receive a proportion of up to 5% of the fee that is paid if the player is transferred before the expiration of his contract. However, the solidarity contribution scheme applies exclusively to international transfers. This means, if Ilja sells a home-grown player to a Spanish club, he receives a transfer fee. If the Spanish club sells the player to an English club a few years later, VfL Bochum will receive 5% of the transfer fee. Yet, if the club sells the player within the Spanish league, VfL Bochum doesn't get any compensation. This system is not fair. The solidarity contribution scheme should also apply to national teams. We could also talk about increasing the proportion from 5% to 7% or something like that. And if a player doesn't change the club at all after he has left your club, you don't see any money anyway. Why not implementing a rule that small clubs that trained a player who plays for a bigger club now get 2% of the player's salary as compensation? It could also help small clubs if they were allowed to sign 5-year contracts with youth players. If I sign a 5-year contract with a 16 years old player, I will probably receive a higher transfer fee later when I sell him to a bigger club. To cut a long story short: big clubs need smaller clubs, because they supply them with players. But for that, they should also be fairly compensated so they can survive. In Austria, more and more amateur clubs are closing down, which is a problem for the whole industry.

**Ilja Kaenzig:** I also have another point in mind. At 2. Bundesliga, all clubs, maybe besides Hamburger SV, are in the same boat and have to deal with similar problems. That is a distinguishing factor from first leagues. RB Leipzig has different issues than SC Freiburg. But in the second league, we are mostly facing the same challenges and have similar financial structures. We should make use of that and try to collaborate more. We could try to uncover new revenue opportunities all together. Or we cut costs together by undertaking mutual investments. For instance, if we need to fly somewhere, we currently all charter planes separately. Why not chartering planes for the whole league and then splitting costs? Overall, that would be much cheaper for every club. The second league in France is a good example for this, because from my experience, they are collaborating much more.

# Chapter 5
# The Conclusion

Managing the finances of a football club is complex. The revenues a club can generate are very much dependent on its sporting success. In return, however, sporting success is also highly dependent on how much revenue a club can generate and therefore invest in the squad. Financial executives always need to find the right balance between investing enough money in the team to maximise sporting success, without taking excessive risks and harming the financial stability. This balance act is even more complicated by the fact that the football business is under great public scrutiny and very much driven by emotion. In recent years, the football industry has been publicly criticised and accused of being unsustainable and disconnected from reality.

Analysing some financial ratios of European football clubs shows that it is wrong to say that the football industry as a whole has a fundamental financial problem and is bound to fail. However, as shown in chapter 2, many clubs, especially in smaller leagues, were already in financial difficulties before the current COVID-19 pandemic. Therefore, it seems worthwhile to critically reflect on how such clubs can be set up in a more stable way – especially now, when the business is more receptive to change than ever.

There are various approaches and ideas of how to make financial management in football more sustainable, some of them already being discussed in league associations or committees of UEFA and FIFA. This study was written to further foster these discussions and help football executives to critically reflect on the ideas presented.

In figure 10, the most important approaches for improvement offered in this report are summarised and placed in a timeline.

The short-term measures are all aimed at ensuring the immediate survival of the clubs now during and after the COVID-19 pandemic and have largely already been implemented. The cash drain during the first lockdown had to be stopped and clubs had to ensure that enough liquid funds are available to keep the business going. Clubs have negotiated with their players to agree on salary waivers, have stopped certain investments and introduced measures like short-time work. Additionally, assets were sold and loans were taken out to obtain fresh liquid means. There are clubs that also might have to carry out balance sheet restructuring. Due to the low reserves of some clubs, the crisis can lead to over-indebtedness, from which the clubs have to recover as fast as possible. Furthermore, the crisis should be used as an opportunity to become more transparent and report more openly about the financial situation. Midterm, it will be utterly important for clubs to retain profits in order to plug the holes left by the COVID-19 crisis. New revenue sources should be developed that are ideally not directly linked to sporting success. A strong and authentic brand image, professional financial reporting and close customer relationships can help clubs stabilising their revenues. Furthermore, either a new mentality or new licensing criteria are needed for clubs to be more profitable after the crisis. Regulations like a determined minimum equity ratio or a flexible salary cap could help to end the currently prevailing "rat race".

Long-term, if based on new regulations or not, all clubs, also in smaller leagues, should be able to raise their equity ratio to a healthy level. This would make the whole system more stable and resistant to crises. If clubs succeed in linking more components of the variable part of a player's salary to their revenues, this would further increase their stability. Last but not least, digitalising the processes of financial management is currently a big trend within all major corporations. While this is not an important topic for football clubs at the moment, in the long run, when some technologies are more established and also accessible for smaller companies, utilizing the possibilities of new tools like RPA or AI will also be very beneficial for the football industry.

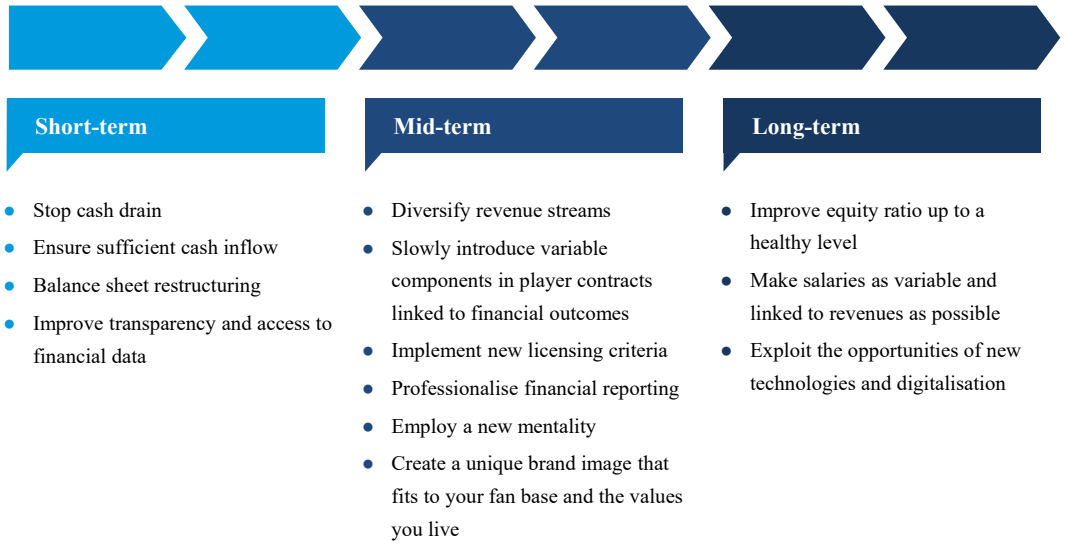



*Figure 10: Approaches for improvement after COVID-19*

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