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Financial plight in english premiership football: An impact of recent global recession

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Resumen

Este trabajo describe el impacto de la reciente recesión global sobre los clubs de la liga de fútbol inglesa. También explica las principales fuentes de ingresos y cómo esas fuentes se han visto afectadas por el entorno cambiante. Además, el trabajo revisa los principales gastos en los que incurren los clubs y las principales razones que los explican. Finalmente, proporciona indicaciones sobre el uso apropiado de los fondos para reducir el impacto de las recesiones globales en el futuro.

Palabras clave: Crisis financiera; Liga de fútbol inglesa.

Abstract

This paper describes the impact of the recent global recession in English Premiership football clubs. It also explains the main sources of revenues and how these sources were affected by the changing environment. In addition, the paper reviews the major expenditures incurred by clubs and the main reasons for incurring the expenditure. Finally, the paper provides direction on the appropriate use of funds to reduce the impact of a global recession in future.

Keywords: Financial crisis; English premiership football.

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1. INTRODUCTION

The recent global financial crisis had a number of impacts in several businesses. Most financial experts think the crisis has affected world leading industry, banking and that the failure of watchdogs has let that crumble to dust. Football is not immune to the troubles caused by this changing environment. However, economic fundamentals underpinning the football industry remain relatively resistant to the economic downturn. Revenues generated through club fanbases, long term broadcast and sponsorship contracts which are secured in advance may enable some clubs to run their business smoothly. Concerns have been raised about the impact of this crisis in English Premiership clubs. Traditionally, most football clubs in England had financial difficulties for a number of years. We will see background of these financial problems in the next section.

In this paper, I concentrate on the recent global financial crises its main impact on clubs' financial situation. The objective is to provide an understanding of football's finances to both practitioners and academics in particular considering the impact recent global financial crisis on football firms. I use English premiership football as a laboratory to achieve this objective. This paper contributes to the understanding of financial crisis in the following issues. First, it reviews origins of financial problems in the English football sector. This provides information explicitly the way financial problems started in English football clubs.

Second, it provides an understanding of financial sources and expenditures for football clubs with examples of recent revenue figures. All major sources of finance such as gate tickets, broadcasting and commercial revenues are explained. Besides, main expenditures such as investment in playing talent and stadium development costs are described. This paper also discusses key reasons that drive clubs to undertake massive investment in playing talent. Third, the paper identifies risk associated with revenues sources paying particular emphasis on the impact of global financial crisis. Finally, it notifies on main mistakes that are normally taken by most football clubs and how they can be avoided.

The paper is structured as follows. Section 2 provides a brief background of financial problems in English football. Section 3 explains main sources of revenues in football clubs. Section 4 describes main expenditures. Section 5 explains the real financial situation of clubs. Section 6 presents the credit score ranking conducted by financial experts (Equifax). Section 7 discusses main investors in English premiership football. Section 8 provides conclusion with caveats on main mistakes typically done by most clubs.

2. BACKGROUND OF FINANCIAL PROBLEMS

The football league was established in 1888 as a step forward to handle financial difficulties in English football. The main purpose was to ensure clubs generate enough income to pay players' salaries and other involved costs. Revenue increases rapidly in the early 1900s when the game of football becomes more popular. This was attributed by the maximum player's wage set at £4 per week in 1901. Additionally, the Football Association (FA) imposed a maximum transfer fee of £350 following the first ever £1000 transfer fee of Alf Common from Sunderland to Middlesbrough in 1905 (Morrow, 1999).

Despite these controls small clubs remain in financial troubles. Most of these clubs were rescued by local businessmen with their small fortunes. Without these rescuers, clubs that are unable to pay its creditors can choose or forced to administration. However, this option was not pleasing for creditors because an administrator is entitled to pay himself or herself for his or her task and the charges are always high.

Some clubs spent heavily to achieve success in early 1930s. The best example is Wigan which has a debt of £20,000 in 1931 after struggling to attract supporters, faced with strong competition from two Rugby League teams also located in the town (Buraimo, Simmons and Szymanski, 2006). In the 1940s, particularly after World War II football enjoyed a boom as attendances reached all-time high. By the 1960s, football faces competitions from alternative leisure activities, and weaker teams began to face falling attendances. Furthermore, the FA abolished player's maximum wage in 1961. This again leads to significant player salaries that cause greatest concerns on financial stability. For example, Accrington Stanley faced with debts of £62,000 in 1962 (Buraimo et al., 2006).

Another wave of financial disaster hit the Football League in early 1980s, after a combination of declining attendances and increasing player wages. Most small clubs were affected including Bradford City, Bristol City, Southend, Swansea and Wolverhampton. A report published in 1982 found 92 league clubs in England generating 6m operating loss (Buraimo et al., 2006). During this period, clubs with financial suffering were struggling negotiating wage cuts with players' union and in many cases direct subsidies. Some clubs such as Aston Villa, Chelsea, Leeds United, Manchester City, and Nottingham Forest sold their stadia to local authorities. Despite this financial calamity, no club failed during this period.

The Football league was in a much healthier state in the late-1980s after started generating revenue through sponsorship and TV deals in the mid-1980s. Prior to 1990s, it was not common for English clubs entering administration. Ideally, clubs with financial plight would sell players, reduce their aspirations and sometimes suffer relegation to lower divisions as a consequence. Administration became more common in the 1990s and early 2000s where more than thirty clubs were involved. For example, larger debts of £30m to £40m were accumulated by clubs in administration including Bradford City, Ipswich Town and Leicester City in early 2000s. Flotation which was common in the mid-1990s was another way for clubs generating more revenue for financing stadium development and investment in player assets (Morrow, 1999). However, balancing demands of shareholders and on-the-field performances has proved difficult and some clubs have delisted.

3. WHAT ARE MAIN SOURCES OF REVENUE?

This section review main sources of revenues generated by football companies. It is important to understand that clubs are not wholly consistent with each other in the way they classify revenue. Hence, I split revenue into three categories namely matchday, broadcast and commercial sources. Matchday revenue largely includes revenue from gate receipts (including seasonal tickets and membership). Broadcast revenue includes revenue from television and radio, from both domestic and international competitions. Commercial revenue includes sponsorship and merchandising revenues. Deloitte's recent report shows that total Premier League revenue for 2007/08 season was £1,932m. The larger source of the revenue was from broadcasting contracts amounting to £931m. Matchday and commercial revenue amounted to £554m and £447m respectively.

3.1. Matchday revenue

Prior to huge broadcast deals in recent years matchday revenue was contributing a larger part of clubs' finances. For example in 2005, Manchester United and Chelsea had 42% and 38% respectively of their revenues accumulated from matchday sources. Basically, matchday revenue depends on ground capacity, attendance levels and ticket prices. In 2006, Manchester United's matchday revenue increased with the expansion of its Old Trafford stadium capacity from 68,000 to 76,000. Despite the relative decline of gate receipts due to increase in television deals, Arsenal has successfully increased its finances since 2006's move to Emirates stadium by maximising club's fanbase. The matchday and broadcast elements of football business are mutually dependent meaning that massive TV deals leads to fall of match attendances that reduces overall matchday revenue.

3.2. Broadcast revenue

Broadcasting revenue was the main driver of Premier League growth in 2007/08 season prior to deep global crisis. It is estimated that Sky and Setanta have paid a total of £1.7bn for domestic Premier League rights in 2008/09 season and overseas rights amount to £625m. The television rights for the Premier League are renegotiated every three years. The most recent deal relates to 2007 until 2010, with the Premier League poised to begin negotiations for the period from 2010 until 2013. Richard Scudamore, the chief executive of Premier League accepts that it is possible to have fluctuations in domestic rights, but expects the entire package to increase in the next deals (Wilson, 2008).

3.3. Commercial revenue

Sponsors are essentially interested with increased awareness or direct marketing of their products or services. The aim is to achieve return on investment through increase in sales or business. Football clubs with larger supporter bases such as Arsenal and Manchester United are able to secure significant sponsorship deals because the sponsor is able to market its products directly to a larger number of supporters. This also increases its awareness through media coverage of the clubs and the Premier League in general. It is clear that football clubs with global, regional and strong national profiles have a distinct advantage in the sponsorship market because it helps sponsors to reach a broad audience.

Negotiations of sponsorship deals are free for all clubs. Most Premier League clubs have their own primary sponsors. For example, Arsenal’s primary sponsor is Emirates, one of the world’s leading airlines, Chelsea is sponsored by Samsung, an electronic goods manufacture and Manchester United is sponsored by American International Group (AIG), an international insurance and financial services company. Most of these sponsorship deals generate superbly profits. The most known is that of Manchester United with AIG that worth 56.5m over four years. The length of sponsorship contracts and packages vary from club to club, though shirt deals typically last for around four years. For example, Blackburn Rovers and West Ham United (three years), Stoke City (eleven years) and the longest contract is that of Liverpool and Carlsberg (fifteen years).

4. WHAT ARE THE MAIN EXPENDITURES?

4.1. Playing talent costs

The main expenditure of any professional football club is the costs associated with playing talent. Players’ salaries take greater part of the total expenses incurred by a club. Financial losses in most clubs can be explained by excessive wage spending and inflated transfers registrations. For premiership clubs, extravagant player wages and overstated transfer fees are motivated by retention to the Premier League status and qualification to European competitions. Simmons and Forrest (2004) found positive correlation between wage bill and qualifications to European competitions. In fact, revenue that can be generated from European competition is an incentive to increase investment in player talent. The wage bill/turnover ratio has been fluctuating but has remained between 50% to 60%, see in (*Deloitte and Touche. Annual review of football finance*, various years).

4.2. Stadium development costs

Another significant expenditure relates to stadiums developments. According to Deloitte and Touche, a total of 1,473m have been used on stadia constructions and expansions for the period 1998-2007. The expenditure was dipped in 2006 following completion of Arsenal’s Emirates stadium and extension of Manchester United’s Old Trafford stadium. In particular, Arsenal spends considerable amount of its revenue to service the loan used on construction of a new stadium. Other Premier League clubs that plan building new grounds are Chelsea, Everton, Liverpool, Portsmouth, Tottenham and West Ham.

5. WHAT IS THE REAL SITUATION?

5.1. The amount of debt

Deloitte and Touch latest estimate for the Premier League's total debt was around £3.1bn. The debt at the biggest clubs is particularly large, with Arsenal, Chelsea, Manchester United and Liverpool accounting for almost £2bn. Deloitte's report showed that a total of £1.2bn is a non-interest bearing soft loans from club owners. In particular, Chelsea's debt is regarded as “soft loan” because it is owed to Roman Abramovich and not, therefore, "external". Arsenal's debt relates to the loan used for constructions of Emirates stadium. Manchester United and Liverpool debts are associated with money borrowed during takeovers by American tycoons. The owners borrow money to finance the acquisition of these clubs. Net interest charges paid for the season 2007/08 were £188m which is about 6% of the overall debt balance.

5.2. Sponsors' level of risk

The turnovers in the Premier League are relatively stable, particularly given the broadcast revenue and growing popularity of English premiership football. However, the sponsors are in various degrees of trouble. For example, AIG, the Manchester United shirt sponsor was recently the subject of a rescue deal from the US Federal Reserve and West Ham's XL sponsors have gone bust. The financial sector remains a major concern. The nationalisation of Northern Rock means Newcastle United is partly funded by taxpayers' money. Britannia, which sponsors Stoke City for eleven years contract, has been exposed to risk by its trust on capital markets for the money it lends. The airline industry has been affected by shocks of thirty airlines closing within a year, but Arsenal sponsored by Emirates is unlikely to be too adversely affected because the airline has its reserves in the Middle East.

Financial experts' beliefs that electronics manufacturers such as Samsung sponsor of Chelsea, LG sponsors of Fulham and Garmin SatNav sponsors of Middlesbrough are operating on sturdy financial ground. More recently, business analysts suggest electronic companies will not hit too badly by the credit crisis as uncertain economic times prompt consumers to seek comfort in entertainment. Reebok and JJB, sponsors of Bolton Wanderers and Wigan Athletic respectively, are top sportswear companies in the world and are on a sound financial footing apart from the reduced spending in retail goods.

Carlsberg sponsors of Liverpool and Chang sponsors of Everton are more likely to encounter problems as the government is acting more on binge drinking than the credit crunch. Blackburn's Crown Paints sponsors have annual revenue of around £180m, and the company is targeting £200m revenues over the next two years. Hull's sponsorship with Karoo, a local internet service provider, looks safe. The company arranges bills in the trend of rising household costs and has little local competition. Sunderland's sponsorship with Boylesports is almost protected as the company is debt free and looks to expand its business to other countries.

5.3. The threat of ticket prices

Ticket pricing is a sensitive issue simply because high prices may reduce attendance in football matches. It is obvious that ticket prices have been rising since the creation of the Premier League in 1992. According to Mintel (2008)'s report, clubs associate the rise of ticket prices with the quality of the product on and off the pitch and the level of demand for it. Recently, most football fans are reluctant to pay high ticket prices as a consequence of credit crunch.

One best example of ticket price conflict is that of Queen Park Rangers and its supporters in 2008 where the club sanctioned £10 hike from its ordinary price of £40. Fans were unhappy to pay the sum for a single game. Under such circumstances the club can lose a lot of revenues if many of its supporters cannot afford the sum. Ideally, the ticket price depends on the reputation of the club and its particular game opponent. Queen Park Rangers plays in a second tier competition in England commonly known as "Championship League". Thus, the club should consider the importance of the competition before setting the price.

During the same season first tier clubs like Arsenal and Chelsea were charging £96 and £65 respectively. However, their fans were happy to pay the sum due to nature of the competition in the Premier League. This is an important area where clubs requires closer scrutiny prior setting ticket prices in every new season. According to Virgin Money Football Fans' Inflation Index in 2009, the average cost of a matchday in the Premier League was £95.60 (Phillips, 2009). This figure is approximately 22.6% higher than it was in 2006. However, according to 2008's report of Virgin Money Survey, the average matchday cost was £106.21. Therefore the 2009's average matchday cost is about 10% lower than the 2008's average matchday cost. In this instance, there was an indication that prices in football are falling.

5.4. Broadcasting's level of risk

Broadcasting revenue increased significantly since the breakaway of top division clubs to form the Premier League in 1992/93 season. Prior to this formation, television revenue were shared in 50%, 25%, 12.5% and 12.5% for division 1, 2, 3 and 4 respectively (Buraimo et al., 2006). The purpose of the breakaway was to increase revenue in the Premier League. For the seasons 1992/93 to 2002/03, the Premier League's share of revenue was 74%, compared to 18%, 6% and 2% for divisions 1, 2 and 3 of the Football League, respectively. But this does not mean that revenue is consistently guaranteed from TV deals.

Setanta, one of the broadcaster in the English Premier League have gone bust since June 2009 with around 30m debt. The broadcaster is also failed to pay 3m instalment due to Scottish Premier League. Accordingly, the Premier League has terminated its contract and now is selling the deal for the 2009/10 season. Apart from Setanta economic failure, other broadcasters such as Sky Sports and ESPN have relatively stable conditions and their revenues are expected to rise in the future. For example, the Premier League's oversees broadcasting deals are expected to double from 625m to 1.4bn in the next three years. This prospect reveals that the level of risk in broadcasting deals is fairly small.

6. HOW DO FINANCIAL EXPERTS RANK PREMIERSHIP CLUBS?

Equifax a credit rating agency have ranked premiership clubs during the season 2008/2009 particularly at the mid and end of the season. Table 1 below presents the scores showing Arsenal and Manchester United were highly ranked while Portsmouth was poorly ranked during both periods. Apart from Chelsea and Liverpool which have large amount of debts, the rankings corresponds to individual club performance both on-field football success and off-field financial success. To the large extend, this credit score ranking roughly reflects the league position of each club in a particular period.

The ranking shows that more than half of the teams in the Premier League have financial problems. The first ranked nine clubs have no financial problems while the last eleven clubs have insolvency problems. The main implication of this ranking is that clubs with insolvency problems they would struggle to pay-off the debts if everyone came at once to ask them. The credit ranking scores of Chelsea and West Bromwich Albion are two major surprises in the table. Chelsea was ranked as an insolvent club despite it's on the pitch performance due to its massive debts from its owner Roman Abromovich. The logic is that, there might be severe financial problems if the current owner considers selling the club in the near future. On the other hand, regardless of its poor performance on the pitch, West Bromwich Albion, a newly promoted club has better credit rating of 71 only below Manchester United and Arsenal.

Table 1
Premiership club credit scores

	January 2009-Mid of the season				May 2009-End of the season		
Club	Score	Rating	Remark	Insolvent	Score	Rating	Changes
Arsenal	98	A+	Very good	No	98	A+	SAME
Manchester United	93	A	Very good	No	100	A+	UP
West Bromwich Albion	71	B	Good	No	78	B+	UP
Tottenham	65	B-	Good	No	50	C-	DOWN
Blackburn Rovers	43	D	Average	No	68	B-	UP
Manchester City	40	D	Average	No	27	E	DOWN
Sunderland	37	D-	Average	No	37	D-	SAME
West Ham	37	D-	Average	No	37	D-	SAME
Liverpool	26	E	Lower than average	No	26	E	SAME

Everton	18	F+	Low	Yes	18	F+	SAME
Stoke City	17	F+	Low	Yes	2	F-	DOWN
Chelsea	10	F	Low	Yes	10	F	SAME
Middlesbrough	7	F	Low	Yes	7	F	SAME
Bolton Wanderers	5	F	Low	Yes	5	F	SAME
Newcastle United	5	F	Low	Yes	12	F	UP
Aston Villa	2	F-	Low	Yes	10	F	UP
Fulham	2	F-	Low	Yes	20	E-	UP
Wigan Athletic	2	F-	Low	Yes	2	F-	SAME
Hull City	1	F-	Low	Yes	1	F-	SAME
Portsmouth	0	F-	Low	Yes	2	F-	UP

Source: Equifax.

7. WHO ARE POPULAR OWNERS/FINANCE PROVIDERS?

Roman Abramovich is football’s well known owner in the English premiership football. However, recent takeovers at Manchester City and Portsmouth by Abu Dhabi United Group and Dr. Sulaiman Al-Fahim respectively, has ensured that there are now new arrivals in football with deeper pockets than even Chelsea's billionaire owner. Sheikh Mansour Bin Zayed Al Nahyan is the son of the founder of the United Arab Emirates and his family has an estimated potential wealth of £500bn compared to £13.2bn for Abramovich (Wilson, 2008). Dr. Sulaiman Al-Fahim is believed to be wealth as he plans to bring in new players, strengthen the club academy and set up relationships with clubs across the globe.

American businessmen are also popular in football business. Manchester United owners, Malcolm Glazer family borrowed money to finance takeover of the club in 2005. The family itself paid £284m in cash and the remained £559m were borrowed from their bank, JP Morgan and other three hedge funds namely, Citadel, Och-Ziff and Perry Capital (Conn, 2007). The money from the hedge funds was given at a very high interest rate. The club has been able to service the loan regardless of high interest rates and losses generated by their parent company, Red Football Joint Venture Limited. The club paid interest of £45.5m and the parent company confirmed loss of £44.8 for the year ended 2008. However, United’s profits are relatively high that has enabled the club to run smoothly by bringing in new players of sufficient playing talent.

Liverpool co-owners, George Gillett and Tom Hicks borrowed money from Royal Bank of Scotland to finance acquisition of the club in 2007. Basically, the club had £44.8m debt when they took over in 2007. The owners have been in difficulties servicing the loan due to high interests and losses generated by their US-based parent company, Kop Football

(Holdings) Limited (Kelso and Smith, 2009). In actual fact, the club paid interest of £36.5m and the parent company suffered £42.6m loss for the year ended 2008. As the case, the owners have been in negotiations for further loans with RBS and Wachovia, the US-based bank. Recently, RBS has promised to extend credit facilities because the club is financially healthy and able to meet its debt obligations comfortably from cash flow generated by its playing and commercial activities. Other popular owners are Mohamed Al Fayed and Dave Whelan who have injected "soft loans" in Fulham and Wigan respectively.

8. CONCLUSION

We should all comprehend that, football clubs have long had difficulty borrowing. Why all this come about regularly? The answer to this question is speculation to win trophies. We heard scandal of Leeds United the way things went wrong. In reality, most premiership clubs spend too much in playing talent hoping to achieve success in trophies that brings sturdy financial situation in their accounts. However, not all clubs speculating will win titles, some yes and some no. Speculation itself is not a bad thing but poor acquisition strategy is. It is anecdotal to identify when a player is at his peak, but it is objective to identify when a player is at his best. In actual fact, buying a player at his best is a bad thing because is similar as buying a stock when there is a run of good news. Players bought at their best performance are too expensive and demand high wages that brings more costs to the club. This is the main oversight done by clubs.

Another problem that seems to bring burdens to clubs is leveraged takeover strategy. Leveraged buyouts are legally accepted but had a number of drawbacks. The assets of acquired company are used as collateral for the borrowed funds and if not satisfactory, the assets of the acquiring company too. Manchester United and Liverpool are relevant examples of leveraged buyouts where most of their revenues are paid out as interest expense to service the loans taken during acquisitions. In fact, debt costs money and the more you have the more it costs. Fans who are customers of the football business are sceptical with leveraged buyouts. In plain terms, they associate high ticket prices with high interest payments rather than the credit crunch. It is too early to argue that leveraged buyouts are unsustainable in the football sector but the actual situation will soon be known.

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