Possible Pitfalls in the Regulation of Equity in Norwegian Football

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Aim

The last decades, the paradoxical situation with operating losses and financial distress, despite large and increasing revenues have characterized European football. Challenges related to financial distress have in turn fueled the need for intervention from regulatory bodies, both at the national level (e.g. distribution of collective revenues from sale of media rights and club license) and the international level (e.g., UEFA Financial Fair Play Regulations (FFP)). Although financial regulation systems are important and useful, the effectiveness of these are contingent upon adaptations made by football clubs.

The aim of this study is to look at football clubs' room for actions and adaptations in a financial regulation system and to what extent clubs take advantage of possible loopholes in the requirements. In order to do so, we focus on one key requirement inherent to the financial reporting system, namely the requirement for positive equity. We investigate to what extent financial reporting systems may be counter-productive in that they help promote adaptations that are in contrast to the intention of the overall goals of the reporting system by hampering financially stable football clubs (rather than promote financially stable football clubs). More specifically, the research question is what extraordinary financial possibilities are available and used by the clubs to fulfill the positive equity requirement in the club license? It should be noted that possibilities primarily refer to adaptations that are legal, but not necessarily in line with the overall intentions of the reporting systems.

Theoretical Background and Literature Review

Previous studies on financial reporting systems in European football have focused on the effectiveness of reporting systems (e.g. FFP) and the implications on competitive balance in European football leagues. However, the study conducted by Dimitropoulos et al (2016) shows how football clubs may adjust their accounting policy, if necessary, to fulfil financial requirements. Theoretically, this study draws on the peculiarities in professional team sport (Neal, 1964), the relationship between pay and performance (e.g. Szymanski and Smith, 1997) and soft budgeting (e.g. Storm and Nielsen, 2012).

Research Design

This study uses data from the Norwegian top division, which represents a typical European football league outside the "big-five" leagues. Because the license requirements are based on accountings, this paper apply empirical data from annual financial statements, from the 16 clubs that participated in the top division in 2016. Equally important, the financial statements provide information about limited companies affiliated with the football clubs. Although the study is mainly based on numbers for 2016, annual financial statements for 2014 and 2015 are also included. In total, this means more than 150 financial statements. Notably, Norwegian football clubs are membership organizations, but they may also cooperate with limited companies. Moreover, some clubs are affiliated to TPO companies as well. The annual financial statements are analyzed for two purposes. For one, they are drawn upon to give the financial status of the Norwegian top division as a whole (by drawing on descriptive statistics). More importantly, the annual financial statements are employed in order to identify cases in which questionable adaptations in the context of this study have been made.

Findings and Discussion

Overall, the study identifies three main findings. First, injections of external capital contribute to increased revenues end equity. In the 2015 and 2016 seasons, more than half of the clubs received external capital, either from private persons, limited companies or local government. Interestingly, the largest capital injections were done ex post, which can be considered as capital injected to save or rescue clubs from financial distress. Secondly, external investors through third party ownership (TPO) finance player transactions. Hence, both cost and financial risk is transferred from the club to the external investor company. Lastly in situations where the clubs struggle to achieve the inevitable requirement for positive equity, the regulations also includes subordinated debt in the equity share. In other words, the governing body (Norwegian FA) offers the clubs a possibility to loan more money to compensate for the negative equity. Here, the study discusses the duality of interests a national football association has to satisfy.

Conclusion and Implications

To sum up, the increased focus on financial health and sustainability in European football has forced the clubs to change their way of doing business. This paper discusses not only how Norwegian football clubs' exploit pitfalls in the financial regulation system, but also whether these kind of regulation systems are effective to its aim. As football club prefer sporting performance before financial performance, they may have incentives to be creative in their financial reporting to fulfil the financial requirement without compromising their sporting ambitions

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