The Financial Crisis and English Football: The Dog That Will Not Bark[1]

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Abstract: This paper considers the financial crisis of 2008 and its likely impact on English football, notably the English Premier League. It mostly examines the history of financial instability and sporting stability, in the sense of club survival, that is characteristic of English football and possibly much of football in the rest of the world. The paper suggests that while shareholders often lose money, clubs seldom disappear. It also suggests that while clubs are not immune to economic cycles, the impact is likely to be limited. The reasons for the financial instability of particular clubs and stability and success of the English leagues are discussed.

Keywords: financial crisis, football clubs

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Introduction

In September 2008, the investment bank Lehman Brothers collapsed. At the time the bank employed 26,000 people worldwide. In September 2007 the company has an income of $59 billion, profits of $6 billion and a market capitalisation of $34 billion; by September 2008 the amount of bad debt on the company's books made it worthless. Manchester United in 2007 had income of $400 million, profits of $120 million and, had its shares been traded in the market, they would probably have been values at around $1.5 billion; in other words, Manchester United was financial midget compared to Lehman's in 2007, but in 2008 Lehman's ceased to exist, while Manchester United lives on.

There are a number of paradoxes here. First, over the last decade more ink was spilt worrying about the financial stability of football than the banking sector, and the dire consequences of a banking collapse are now plain for all to see: were we worrying about the wrong things? Second, there seems to be a public perception that sport in general and football in particular are inherently unstable from a business perspective, but in fact they are some of the most stable businesses in the world.

The stability of English football

In 1923 the Football League consisted of 88 teams organised in four divisions of 88 teams. In the 2007/08 season:

- 85 still existed (97%)
- 75 remained in the top four divisions (85%)
- 48 were in the same division as they were in 1923 (54%)
- Only 9 teams (10%) remaining in the top four divisions were two or more divisions away from where they were in 1923 (poor Notts County were in the first division in 1923 but had sunk the fourth tier by 2007)

Of the thirteen teams that had left the four divisions since 1923, seven had disappeared before the second world war. Of the ten teams still playing today under the same name, only four had experienced any interruption to their existence. Bradford Park Avenue folded in 1974 but were immediately revived as a Sunday afternoon team while Durham City disbanded in 1938 but reformed in 1950. Halifax Town were the first club to be relegated from the League twice but survived until 2008/09 when they collapsed financially, only to be reformed immediately as AFC Halifax Town, while Newport County were declared bankrupt in February 1989 but the name was revived in July of the same year and the team continue to play in The Conference South. The only teams that no longer existed in any form by 2008 were Aberdare Athletic (disbanded 1928), Merthyr Town (dissolved 1934) and South Shields (who were taken over by Gateshead in 1930, although there have been two subsequent reincarnations of South Shields FC, the most recent of which was promoted to the Northern League Division One in 2008).

Overall, this is a remarkable history of stability. If you were to make a list of leading English companies in 1923, you would find today that a very large fraction no longer existed. In other words, compared to any other business, football is incredibly stable. To make a comparison, the economic historian Les Hannah compiled a list of the top 100 companies in 1912, and identified what had become of them by 1995. Only twenty remained in the top one hundred and a further thirty one lay outside it; in other words, only half of the top one hundred firms survived. Of the remainder, only five had gone bankrupt and shut down entirely, while six had been nationalised. Of those who didn't survive, the majority (37 firms) had been acquired by other firms. Being taken over does not necessarily mean that the business disappears altogether, but often production is relocated and local traditions are lost. In many cases a takeover only occurs because the firm is on the verge of collapse, and following takeover the old firm is more or less closed down. Moreover, even among the businesses that survived, many have developed major new lines of business and moved to new locations.

Performance, finance in English football and contest incentives

There exists a stable relationship between what teams spend, their performance in the league and the revenues that they generate (see for example Szymanski and Smith (1997) or Forrest and Simmons (2002)). This relationship is based on relative rather than absolute spending- teams that spend relatively more on players are more successful in the league and teams that succeed. Figures 1 to 4 show that this relationship has existed for the last decade, but previous research shows a similar picture going back to the early 1970s.[2] Similar relationships have been identified in other European leagues- Italy, Spain, Germany (e.g. Szymanski (2003)). By contrast, the relationship has been shown to be weaker in the 1950s in England when the maximum wage meant that total wage payments were effectively capped, so that all clubs spent the same amount (see Szymanski and Kupyers (1999)).

The significance of relative rather than absolute spending is a consequence of the contest-type nature of league football. Winning a gold medal depends not on the absolute speed of the sprinter but the speed relative to rivals. Likewise, in team sports the success of the team depends not on the absolute quality of the players but their quality relative to rivals.

Relative quality in sport is also easily observable – after all, that is why we call it "spectator sport". This means that it is possible to place a reasonably reliable price on the value of an athletes' contribution. Market prices reflect relative values and hence the correlation between spending and performance. Fans are also motivated by success, and teams that are more successful tend to attract more fans, charge higher ticket prices and sell more merchandising. Thus the relationship between performance and relative revenues.

From this argument it is apparent that the absolute level of spending should make no difference to the outcome of the championship, which is the essential characteristic of any contest. However, the profitability for the participants depends crucially on absolute levels. Since the path-breaking work of Tullock (1980) economists have speculated about the nature of the equilibrium of a pure contest. Does the equilibrium entail

(a) zero profits (rents are dissipated in the contest, entry and exit ensures zero profits)
(b) negative profits (in which case, why do the contestants play?)
(c) positive profits (in which case, why is there not entry into the contest?)

American sports league appear to have resolved Tullock's problem by creating closed franchise leagues which ensure positive profits by agreeing to a variety of competitive restraints (e.g. salary caps, roster limits, revenue sharing) and restricting entry. An apparent by-product of these restraints is that there is also a weaker correlation between pay and performance (although arguably, innovations such as those identified in Moneyball (Lewis (200?) are beginning to compete away some of these inefficiencies).

European football leagues are characterised by more or less free entry through the mechanism of promotion and relegation and the absence of competitive restraints (I have argued elsewhere that this combination is not accidental, in the sense that wealthy clubs will be unwilling to accept restraints that can make their poorer rivals competitive since this might increase significantly the probability that the wealthy clubs eventually face relegation (e.g. Szymanski and Valletti (2005)). As Stefan Késenne has long argued clubs also seem to act as win maximisers (e.g. Késenne (1996)), implying that they spend all available resources on winning. If all competitors had equal access to resources, then an equilibrium would exist in which each team spent an identical sum of money, and the outcome in any given year would appear random (so there would be no correlation between spending and performance). If successful teams generated higher revenues, then in some years clubs would earn profits and in others they would make losses, but over the long term all profits would be dissipated.

Equal access to resources does not seem like a sensible description of reality. Some clubs have greater resources, accumulated through experience, reputation as well as location, which makes the contest unequal in any given year. This produces

(a) relative stability in rankings (there are perennial winners and perennial doormats- although as Roger Noll (2002) has shown, there is a surprisingly high degree of mobility from year to year)

(b) significant change in ranking requires substantial investment, but can be achieved if someone is prepared to invest (the case of Roman Abramovitch and Chelsea is just the most egregious example of this phenomenon).

The impact of shocks

Within this context, what is the impact of an economic shock? First, at the aggregate level, football is not independent of the wider economy. There is, for example, a weak but positive correlation between changes in consumption at the aggregate level and attendance at football matches (the correlation coefficient between UK real consumption[3] and total league attendance in England between 1948 and 2007 is +0.16). Not surprisingly, attendance will decline when consumption is falling.

We can also observe a correlation of consumption between total revenues and total wages.[4] If we consider clubs in the top division over the same period, the correlation of real consumption with total real revenues is +0.245 and with total real wages +0.379. In the second tier the correlations are +0.141 and +0.219 respectively. Thus negative shocks are expected to depress both revenues and wages in aggregate.

Can we read anything into the higher correlation of wages than revenues? If clubs spend what they earn, while earnings capacity is driven by macroeconomic conditions, we should expect to see a perfect positive correlation between the macroeconomic indicator and both wages and spending. If wages adjust more than revenues, this means that the financial position of clubs taken would in fact improve in the downturn. It may be that at the individual levels clubs with relatively healthy finances adjust less in a recession than clubs that are, say, heavily indebted, and this accounts for the aggregate picture. Traditionally most clubs have operated an overdraft with the banks, who have been major creditors. It might be that in recession banks tighten these facilities. Clearly there is further work to be done here.

Despite the expressions of deep concern that are voiced, football clubs are remarkably resistant in the face of recession. During the Great Depression attendance and income at Football League clubs fell by 12% (between 1929 and 1931),[5] but by 1932 they were rising again, even though the UK economy didn't start to grow again until 1934 (see figure 5). Moreover, while the impact the Great Depression fell unevenly on businesses and communities – bankruptcies and mass redundancies brought some parts of Britain to the brink of starvation - few football clubs were affected. The Depression itself was mostly felt in the old industrial centres of the north, while the south was relatively unaffected; the Football League had always been dominated by clubs from the north, and there clubs such as Middlesbrough, Blackburn, Bolton, Burnley, Preston and Oldham had significant falls in attendance, but there was no question of collapse. True, there were one or two casualties. Merthyr Town, after failing to be re-elected to the League in 1930 (their average gate was 2,500 in their last season), folded a few years later, victims of economic hardship in the valleys (as well as competition from the far more popular rugby union code). Even more dramatically, Wigan Borough approached the League Management Committee in September 1931, twelve games into the season, to reveal debts of £20,000 and request a subsidy. They were turned down and the directors were forced to declare bankruptcy and to withdraw the league leaving their remaining fixtures unplayed, one of only two cases in the history of the English leagues (the other case was Aldershot in 1992- ironic given the fact that they were elected to the League in 1932 to fill the gap left by Wigan)[6].

More recently, league football clubs survived the "Thatcher recession" of the early 1980s (see figure 6)[7]. During this period increasing oil prices had caused a global economic slowdown, the flow of oil from the North Sea had turned sterling into a highly valued "petro-currency" and the government's targeting of inflation by controlling the money supply had raised interest rates as high as 16%. This combination of factors raised costs, made exports uncompetitive and as a result large swathes of British industry were bankrupted and unemployment spiralled from one million to three million (and once again the effects were felt more strongly in the north of country than in the south). Thousands of businesses vanished. The effect on league attendances was also significant, falling from 24.6 million in the 1979/80 season to 18.8 million in the 1982/83 season, a drop of almost 25% over three seasons. Individual clubs experienced severe financial pressures and warnings of financial collapse including Bristol City, Hereford, Hull, Bradford City, Wolves, Derby, Swansea, Middlesbrough, Hartlepool, Southend, Tranmere, Halifax, Newport and Rotherham. These were mostly "smaller" clubs, the ones that had traditionally struggled to make ends meet, but now questions were raised about the indebtedness of "big" clubs such as Chelsea, Nottingham Forest, Manchester City, Leeds United and Aston Villa. An Arthur Andersen Report published in 1982 found that the total match receipts for that season for all 92 League clubs totalled £35m, generating a £6m operating loss.

Yet while some clubs went into receivership (e.g. Hull City, Bristol City), most clubs found other ways to meet to their deficits. Some, such as Preston, Wolves and Leeds solved the crisis by selling their ground to the local authority. Clubs with attractive locations were able to sell land for redevelopment (Hull, Crystal Palace, Bolton, Brentford, Bournemouth and Tranmere). Some clubs which did not own their own their grounds were forced to relocate due to an inability to pay the rent (e.g. Bristol Rovers and Charlton). However, during this severe crisis no one "did an Accrington Stanley" and resigned from the league.[8]

One important feature of the survival of clubs has been the willingness of better off rivals to support the cause. This is a case of enlightened self interest- a team cannot operate with competitors against which to play, and so unlike most businesses, the collapse of a rival is not a cause for celebration. When Orient found themselves in financial difficulties in 1931 Arsenal wrote them a cheque for £3450 to tide them over (in that season 160,000 people attended Orient's home games, and the ticket price was one shilling, so the cheque equaled the income that an addition 69,000 fans would have generated). Arsenal subsequently offered to acquire the club and use it as feeder, a move that was blocked by the Football League.[9] While this is an extreme example, there were many cases of clubs lending support to each other. In more recent times, as players wages rose and the player's union became a wealthy organization it too offered financial support- several clubs in the recession of the 1980s owed their survival to a "sub" from the union.[10] This too is enlightened self-interest: a club's debts are almost always a reflection of being unable to pay player wages (generally about 60% of a club's costs) and ensuring that a club survives is better for the union than seeing its members become unemployed. In fact, unlike most businesses, football clubs can easily survive by paying lower wages and competing at a lower level, and this is what usually happens to a club in financial difficulties.

Imagine other businesses could do this: suppose Ford could lay off skilled workers and hire unskilled workers to produce a lower quality of car, or British Airways could lay off all their pilots and replace them with pilots who weren't as well qualified to fly planes. In most cases product quality is regulated by government to make sure that the consumers will not come to any harm, but even if this is not the case, consumers are intolerant of inferior quality products. Football clubs survive crises because, unlike most businesses, some of their customers seem willing to stick with them no matter how lousy the product. Calling this brand loyalty is not quite respectful enough to the sentiment involved- it is a form of communal attachment, a form a community spirit which is found in few areas of modern life.

If it is this ultimate loyalty that ensures the long term survival of so many clubs, there is something else that ensures short term failure is not fatal. Many fans complain bitterly about the commercialism of football and the inappropriateness of capitalism in the world of football, but arguably it is capitalism that keeps most football clubs afloat, not because it creates income (although it may do so) but because it allows financially dead businesses to be reborn under a new guise. The point is this: a business fails when (a) it has creditors that it cannot pay and (b) the value of assets is less than the value of the liabilities (otherwise assets can be sold to pay the liabilities). Historically, businesses were run by individuals who were entirely liable for their debts and the law took a dim view of bankrupts (people who could not pay their debts), usually putting them in jail and throwing away the key. Not surprisingly, this had a chilling effect on entrepreneurial spirits- running a business could be a dangerous thing. However, from the middle of the nineteenth century (since the Joint Stock Companies Act of 1856 in the case of the UK) those who invested in a business as shareholders had only limited liability. Hence individuals could start up enterprises knowing that if they failed they would not end up in debtor's prison. Of course, the creditors- unpaid employees, suppliers, bank lenders, the taxman – suffered a loss; but on balance, the spur to enterprise greatly outweighed the downside of losses due to insolvency. Football clubs were some of the earliest beneficiaries of this system. From the 1880s onward football clubs converted themselves from member associations, where members paid a subscription and an elected club committee made decisions, into limited liability companies with shareholders and a board of directors to take decisions (although confusingly they continued to call themselves clubs) . The reason for this was investment. The clubs wanted to build large stands to accommodate the rapidly increasing number of fans wanting to attend the games, but to build them they needed to borrow form the banks. Had the club committee done this, its members would have been personally liable for the debts, but by converting themselves into directors of a limited liability company they could invest without exposing themselves to all of the risk. And thanks to this, the forty English clubs in the Football League on the eve of the First World War were able to accommodate a total of 12 million fans in a season.

Companies that fail completely are liquidated- all their assets are sold, creditors receive their share of what is raised, and the business is no more: and all the skills, knowledge, contacts and experience that is associated with business is usually lost. This is a draconian solution, and seldom the right one for a business that is insolvent. A better solution is to wipe the slate clean and start again, and in most countries the law recognizes this, although the rules differ. In the UK an insolvent business can enter a process known as administration, which is aimed at finding a way to repay creditors as far as is possible, but then to allow the business to restart itself if it is commercially viable. This is the route taken by most insolvent football clubs nowadays. As mentioned above, forty English league clubs have been subject to insolvency proceedings since 1992:

AFC Bournemouth (twice), Aldershot, Barnet, Barnsley, Boston United, Bradford City, Bury, Cambridge United, Carlisle United, Chester City, Chesterfield, Crystal Palace, Darlington (twice), Doncaster Rovers, Exeter City, Gillingham, Halifax Town (twice), Hartlepool United, Hereford United, Huddersfield Town, Hull City, Ipswich Town, Leeds United, Leicester City, Lincoln City, Luton Town (twice), Maidstone, Millwall, Northampton Town, Notts County, Oldham Athletic, Oxford United, Portsmouth, QPR, Rotherham United (twice), Scarborough, Swansea City, Swindon Town (twice), Wimbledon, Wrexham, York City.[11]

This is an impressive list – almost three clubs per season. All of these clubs owed more than they could pay, yet in every case the football club survived- indeed, survival was never really in doubt. No doubt the fans would complain that their teams suffered relegation and lower quality football, but few would have swapped places with the creditors who lost money. And, when Leeds United flew too close to the sun in trying to win the Champions League[12], how many fans would have tried to dissuade the club directors from their reckless course of action? The point here is not that one should feel any particular sympathy for the creditors (usually the players and the taxman) but that the economic system has allowed the directors who run the football clubs to take risks without jeopardizing the existence of the clubs themselves (if only the same had been true of the banks in 2008).

Built-in stabilisers

Most industries are not stable and the reasons are not hard to find. Businesses constantly face competition, and survive only if the products they sell are better or cheaper than the alternatives. There is such a thing as brand loyalty, but when a better product turns up most people switch sooner or later. Thus businesses find themselves on an innovation treadmill- unless they can keep ahead of the competition they are likely to fail. Failure comes in many forms: failure to keep up with competitors offering similar products, shifts in tastes that mean consumers lose interest, shifts in technology that render the whole industry obsolete, low cost competition from countries with lower wage rates, government regulation, overinvestment leading to financial failure, recession or just simply bad luck. Football clubs are immune from almost all these effects

- Clubs can see their income drop substantially in a recession, but it is always possible to adjust to a lower income

- Failure to keep up with the competition may mean relegation, but it is always possible to survive at a lower level

- Some fans lose interest, but clubs always have geographical roots- an unsuccessful club may find its natural catchment area shrinking, but never disappear completely

- The “technology” of football can never become obsolete because the technology is the game itself, which could become less popular relative to other sports, but this is not the same as obsolescence

- Low cost rivals cannot enter the market and offer to supply football at a lower price. In fact, the rules of football protect domestic clubs from foreign competitors who cannot play in the domestic territory without the explicit permission of the national association

- In theory the government could nationalise football, and some radicals have argued this would be a good, but in practice it is extremely unlikely

- Clubs can overinvest, but this almost never destroys the club, only the wealth of the investor. Thus financial disaster may affect the level that the club plays at, but not its existence

This is not to say that football clubs never get into financial difficulties as the discussion has shown. Lots of shareholder capital has been lost and insolvency proceedings are commonplace, but there almost no instances of a club being liquidated. Insolvency simply means a club cannot pay its debts, insolvency proceedings (administration) is caused by the creditors demanding a settlement; that settlement will almost always involve the survival of the club, since the creditors are far more likely to get their money back if the club survives than if all the assets are sold off and the club shut down (this calculation usually relies on the local planning authority refusing to allow any land owned by the club being used for redevelopment). Even on the rare occasion where the club is pushed into bankruptcy, as happened with Aldershot FC in March 1992, supporters usually start a new club which is almost exactly the same as the old one (Aldershot Town AFC in this case, whose badge shows a phoenix rising from the ashes).

Is the current crisis different?

Following the financial crisis of 2008 concern has been expressed about the owners of some of the big clubs rather than smaller ones. When Bjorgolfur Gudmundsson, an Icelandic businessmen whose main asset was a bank bought West Ham in 2006 fans seemed relatively comfortable with their new owner, especially in the light of some of the alternatives that had been touted. But when it turned out that Icelandic banking was little better than the Icelandic football team, fans started to worry that Gudmundsson would become a forced seller. In the event Gudmundsson was removed by his creditors and by the beginning of 2010 the club remains in Icelandic hands, although there have been many rumours of outside buyers.

Concerns were also raised about the financing deals which had allowed American owners to acquire Manchester United and Liverpool, while the owners of Newcastle decided they wanted to sell some time in 2008 but by the beginning of 2010 had still failed to find a buyer. But even if a big name club did fall into administration, there is still no question of a club being liquidated, and it will be guaranteed to be reborn under new ownership. It might even be argued that it would be no bad thing if a bigger club went through a period of financial hardship, and so give some of the smaller clubs a chance to compete.

Prognosis

This paper has suggested that the current financial crisis is not a serious threat to the health and stability of English football, even if it does threaten the wealth of many prominent football clubs owners and may entail bankruptcy and restructuring of many clubs. Harsh as this may be for the owners of capital, the fans themselves, who are so often the object of public policy concerns are unlikely to suffer anything more than a loss of dignity.

A more serious concern is that the other European leagues might start to catch up with the Premier League, which has in recent years attracted the lion's share of the world's footballing talent. This is something that the Bundesliga, Serie A and La Liga might ardently desire, not to mention UEFA and FIFA, who are concerned about the increasing economic dominance of the English league. Commentators have suggested that the decline of sterling against the euro may undermine the capacity of English clubs to offer large salaries, while Britain's like slow growth in the future might mean that it attracts fewer foreign investors interested in owning a football club. However, the European leagues are unlikely to catch up any time soon. The Italian clubs, which dominated Europe until only a few years ago, are still in a long term financial crisis of their own, not helped by the fact that they are unable in most cases to set their own ticket prices and increase their incomes. In Spain it continues to be the case that only Real Madrid and Barcelona have real financial muscle, the rest of the clubs struggle to compete, and most clubs have significant debt exposure.

The Bundesliga is probably the greatest threat to English dominance, with a much larger population and significant financial potential, but German clubs are constrained by their anti-capitalist governance structure. Firstly, clubs are membership clubs; they can raise capital by selling part of the club to an investor, but the members must retain control (50% of the votes + 1). Wealthy individuals are generally unwilling to invest because they cannot control the club in the manner of a Roman Abramovitch. Secondly, the league controls the spending of the clubs through a system of licensing – each club must submit their investment plans to a league board which will only agree to them if they are deemed financially sound. This may sound financially prudent, but it may also be holding back German clubs from competing effectively in European competition. Between 2002/3 and 2008/9 a German club reach the quarter finals of the Champions League only four times and never progressed further, while the more profligate Spanish, English and Italians continued to dominate. If the financial restraints were removed, the expansion of German clubs might threaten the commercial dominance of the English Premier League.

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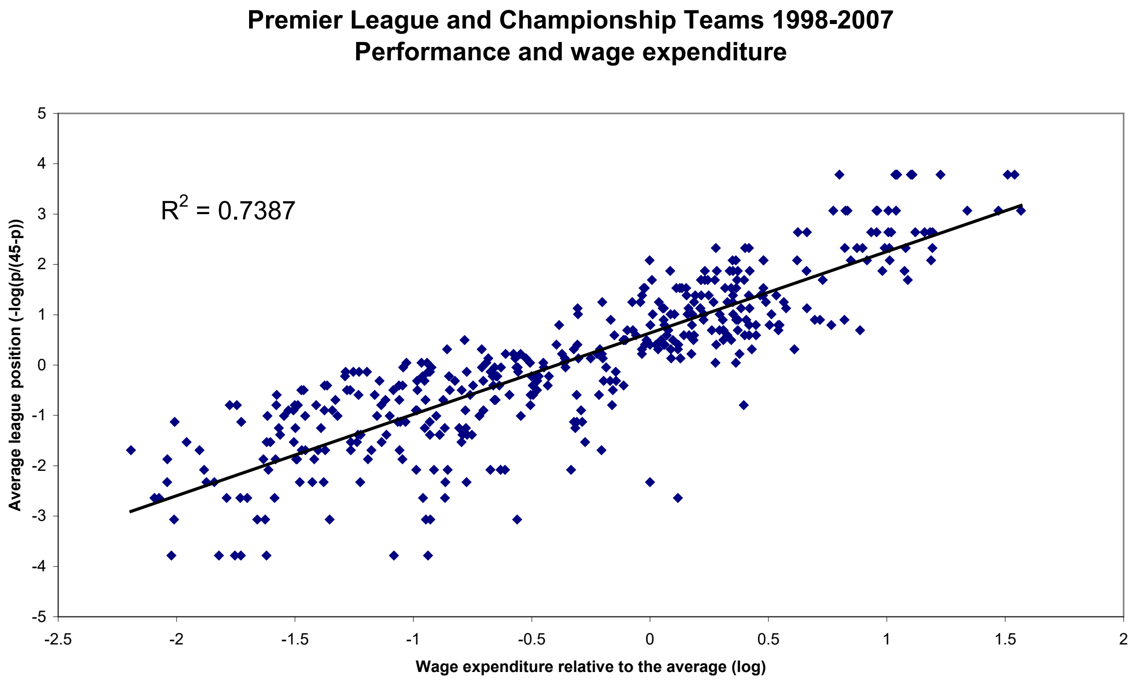

Figure 1

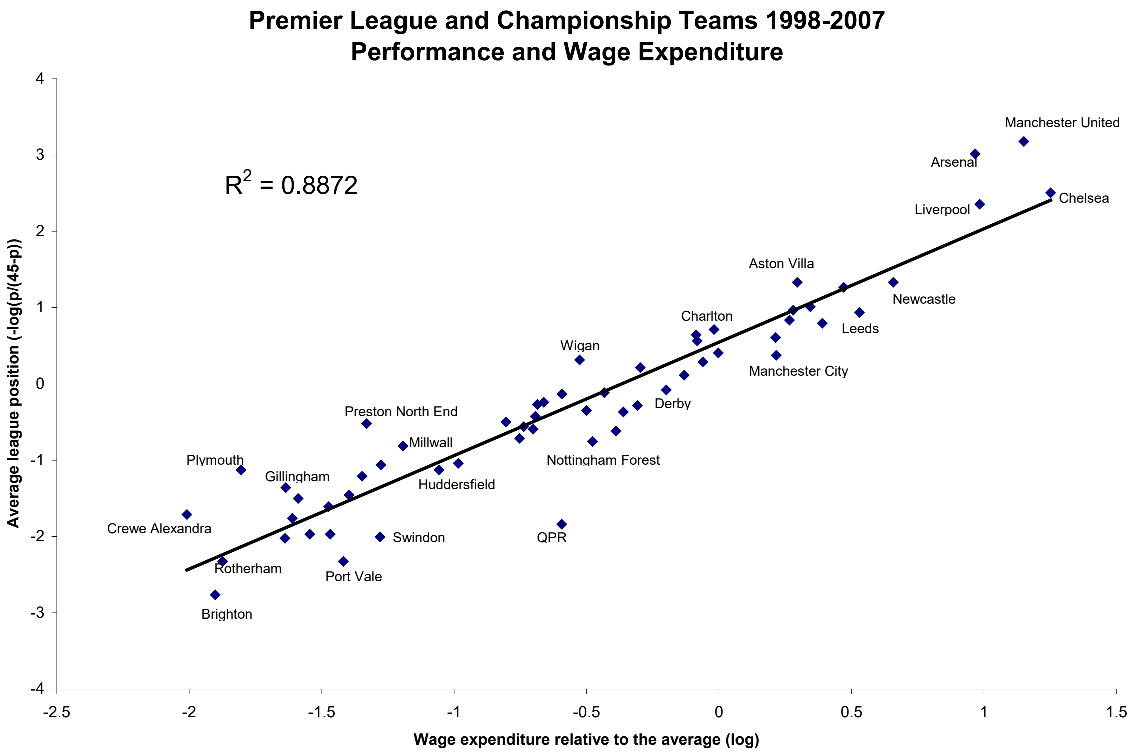

Figure 2

English Premier League and Championship Teams 1998-2007: Revenue and performance

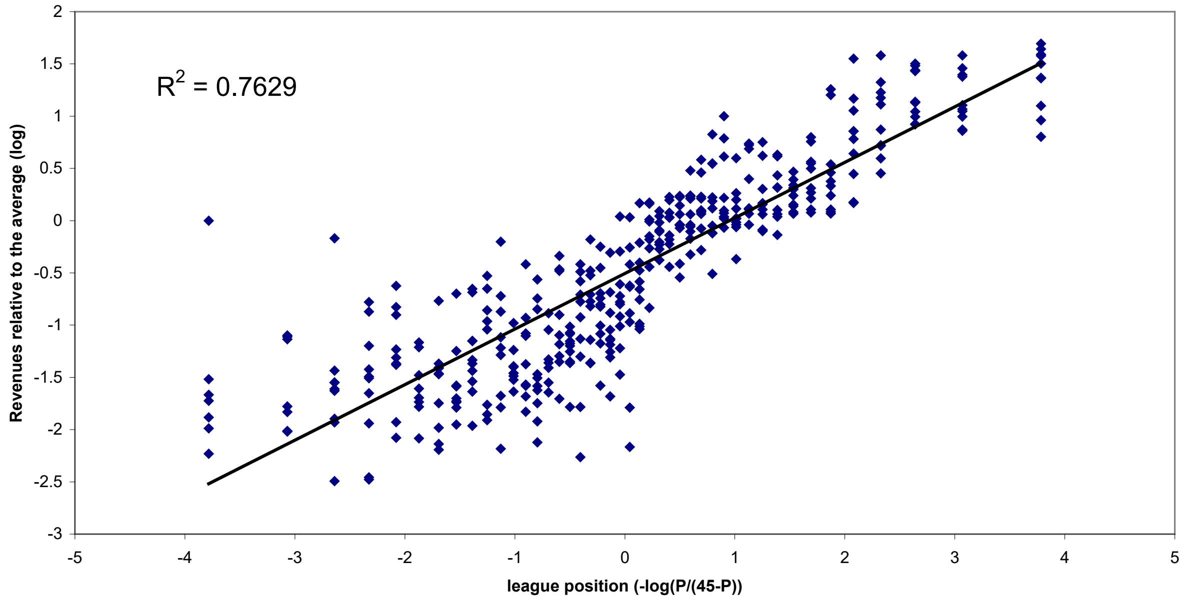

Figure 3

English Premier League and Championship Teams 1998-2007:
Revenue and performance

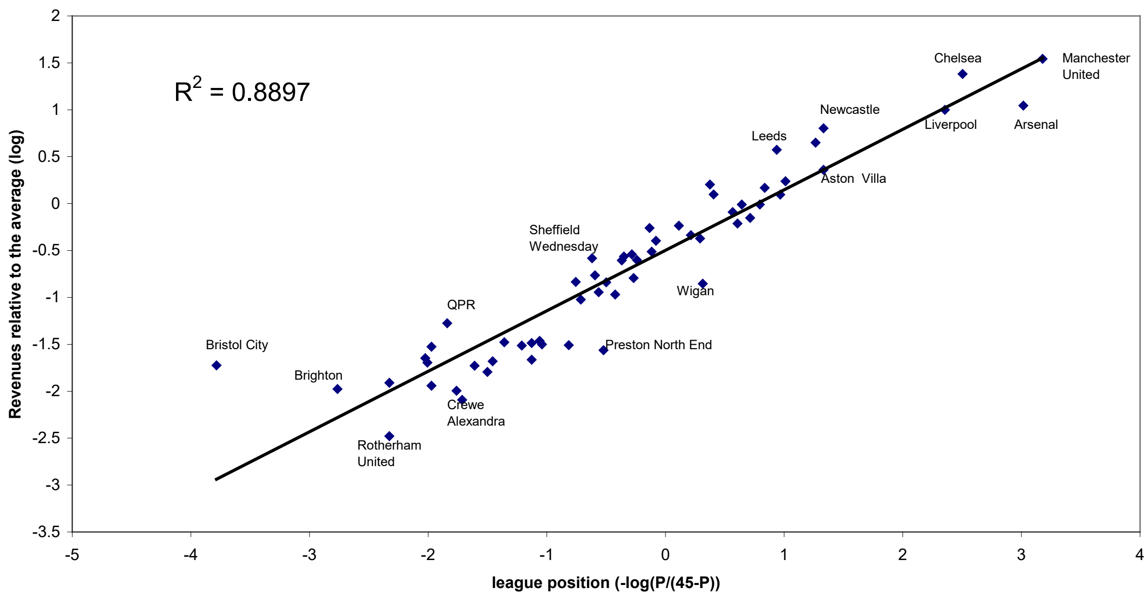

Figure 4

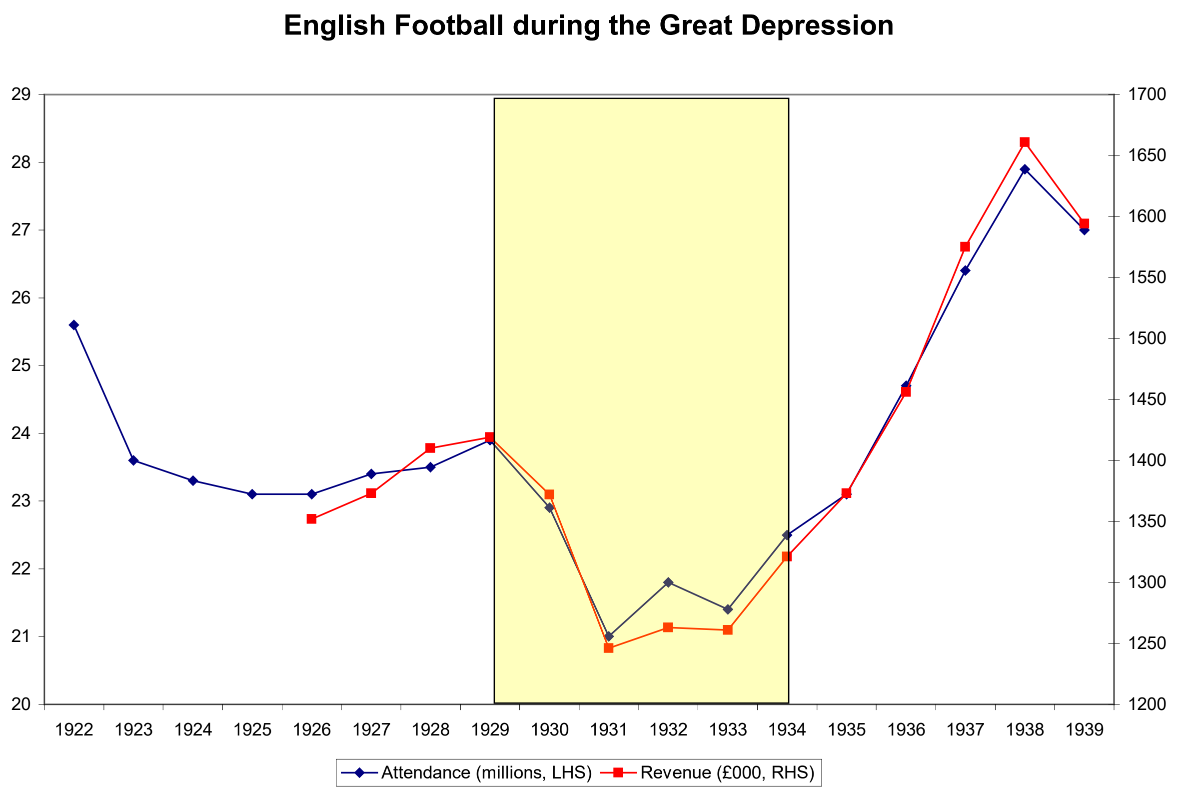

Figure 5

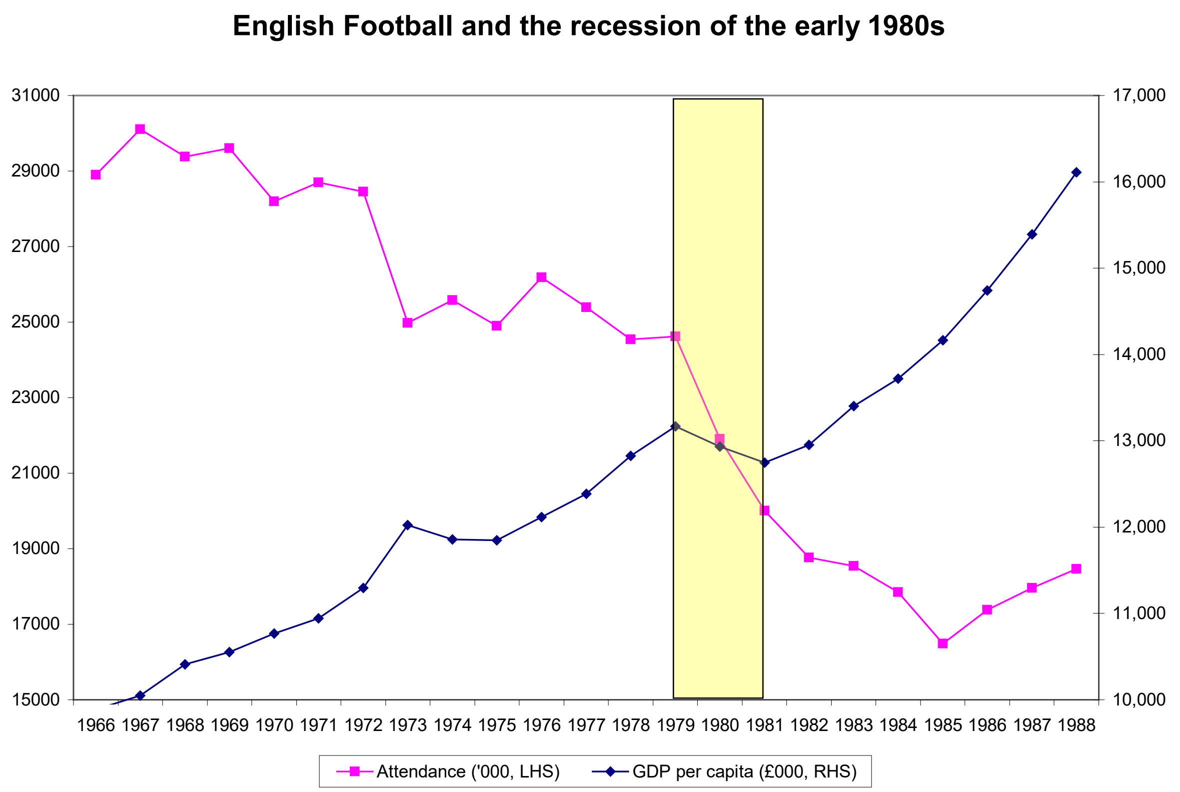

Figure 6

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[2] The financial data on which these charts are based can be obtained from the Deloitte Annual Review of Football Finance.

[3] Data on consumption was obtained online from http://www.statistics.gov.uk , the series used is Household final consumption expenditure: National concept CP NSA and is deflated by the Retail Price Index, also available from this source.

[4] Data until 1991 is taken from Szymanski and Kuypers (1999), post 1991 data is taken either from the online FAME database (http://fame2.bvdep.com/version-20091224/Home.serv?product=fameneo) or from various issues of the Deloitte Annual Review of Football Finance.

[5] The attendance data is taken from Taylor (2005), the revenue data from Szymanski and Kuypers (1999)

[6] See Inglis (1988) for this and other stories of how league clubs survived the Depression.

[7] Real GDP per capita data is derived from ONS data deflated by the RPI, revenue data from Szymanski and Kuypers (1999).

[8] See Inglis (1988) again for details. The Football League's Chester Report of 1983 also provides some interesting perspectives on the financial crisis.

[9] Reported in Inglis (1988).

[10] Harding (1991) discusses some specific cases.

[11] Deloitte annual Review of Football Finance, 2008. See also Beech et al (2008) for a very useful discussion of football club insolvency.

[12] Leeds United invested heavily in acquiring a superstar squad at the end of the 1990s, on which the club placed a book value of £198 million in 2001. However, failure to qualify for the Champions League in 2002 led to a cashflow crisis, the forced sale of all the stars (for little more than £50 million), and relegation, eventually to the third tier.