All Party Parliamentary Football Group

Inquiry into English Football and its Governance

Memorandum of Written Evidence

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1. Executive Summary

1.1. A football club has a dual role – it is both a limited company and a community institution. The role of the football authorities is to regulate the company and penalise instances of poor corporate governance in order to protect the value of the community institution, the integrity of the industry, the value of sporting competition, and to address the consistent lack of football club profitability which threatens the sustainability, indeed survival, of clubs. It is important therefore that the football authorities discipline the owners of the company for any financial mismanagement, rather than the club's supporters.

1.2. Since 2003 the implementation of a stronger regulatory framework in English football, characterised by the introduction of a number of new governance mechanisms, is evidence that the football authorities place significant importance on increasing accountability, transparency and financial awareness amongst football clubs. Their progressive moves in this area deserve to be recognised and applauded.

1.3. Administration is the process whereby failed companies which are unable to meet their financial obligations are given protection from their creditors whilst being "administered" by an insolvency practitioner until such time as they are re-structured; this often means that they pay only a fraction of their non-football-related debts. Football related debt must be paid in full if membership of the leagues is to be maintained in the future. Sporting sanctions (points' penalties for clubs that enter administration) were introduced by both the Premier League and Football League because of a perceived abuse of the administration process. The most notable case was Leicester City who entered administration in October 2002, wrote off in excess of £30 million of debt, kept their best players, and were promoted back to the Premier League at the end of the 2002/2003 season; whilst promotion rival Nottingham Forest, who continued to meet the payments on their debt, did not go into administration, and narrowly avoided promotion, were perceived to have been disadvantaged as a result. To this extent sporting sanctions represent a welcome development by demonstrating the willingness of the Football League and the Premier League to address seriously the problem of poor, or even opportunistic, financial management practices.

1.4. However, sporting sanctions can also have a negative impact on the community institution as a club may enter into a spiral of financial crisis, as is currently the case with both Luton Town and Rotherham United both of whom have been in administration on more than one occasion and have suffered multiple points penalties. This arises as multiple points penalties undermine the capability of clubs to recover on the field of play, thus undermining their ability to generate financial revenue through increased ticket sales etc. They also undermine the principle of sporting integrity of fair competition as clubs lose points not on sporting merit but due to financial mismanagement by owners. Of course it is legitimate for leagues to take a decision to use the sanction of sporting sanctions where they believe a major deterrent against financial mismanagement is required. However, it is important to recognise that this measure does have downsides, and is something of a blunt instrument. The critical question is whether such a measure might be rendered redundant by the exercise of other corporate governance powers at an earlier stage which are focused on prevention of financial mismanagement rather than punishment. It is our contention that there are significant measures that the football authorities might adopt which could assist in this regard (see paragraphs 1.6 and 1.7 below).

1.5. Despite the progress made in relation to club-level governance over the course of the last five years, it is our contention that the football authorities must consider that further regulation is necessary to improve the financial performance of football clubs. It is crucial that the football authorities seek to impose tighter regulation and penalise the owners and those responsible for the governance of football clubs when financial mismanagement occurs, rather than the clubs' supporters, so that the value of the community institution is not undermined.

1.6. The first key recommendation is the need for a more rigorous fit and proper process to which individuals are subject when declaring an interest in the ownership of a football club. This procedure could require that an individual state their motivations for ownership, their business credentials, present a business plan to the football authorities, and show a commitment to community engagement. It could also ensure that those with a previous history of involvement at a football club which has suffered severe financial mismanagement are excluded from involvement in the football industry for life. There is a precedent for this; in 2003 the FA banned from football for life Tony Lazarou, a one-time owner of Enfield FC, a club that enjoyed a long and successful history up to Conference level. Enfield FC went into liquidation in 2007, in large part as a consequence of actions taken during Lazarou's stewardship. In 2001 the majority of Enfield FC's supporters had left to form their own supporters' trust owned club, Enfield Town FC, in protest at the mis-management of Enfield FC by Tony Lazarou.

1.7. The second key recommendation is to pursue a salary cost management scheme, similar to the one currently in place on a mandatory basis within League Two and a voluntary basis in League One. Such a system needs to be further implemented within the Championship and the Premier League. However, for this scheme to be accepted within the Premier League it is necessary to phase it in gradually and for UEFA to take the lead and implement a similar scheme at the European level through the UEFA Club Licence.

2. Introduction

2.1. The Birkbeck Sport Business Centre is a specialist sport business research and consultancy centre based in the Management Department at Birkbeck, University of London. Geoff Walters and Sean Hamil are two of the members with particular expertise in corporate governance of the football industry.

2.2. This document represents the written evidence of the Birkbeck Sport Business Centre to the inquiry of the All Party Parliamentary Football Group into the governance of English football.

2.3. While it is the responsibility of individual football clubs to implement internal structures and controls relating to key areas of corporate governance, the purpose of this document is to consider the regulatory role of the football authorities in relation to club-level corporate governance.

3. Financial Performance in the Football Industry

3.1. Since the formation of the Premier League in 1992, the football industry can point to many positive developments. Attendances have increased at clubs in the Premier League and Football League, revenue growth has been extremely strong, and facility development has ensured that English football stadia are amongst the best in the world. Moreover, the work undertaken by football in the community departments, Community Trust organisations, and organisations such as the Football Foundation and Kick it Out demonstrate a commitment within the industry to develop community engagement initiatives.

3.2. However, during this period there has been increasing concern related to standards of club-level corporate governance, particularly with regard to poor financial performance at many professional football clubs. Although the clubs in the Premier League maintain strong revenue growth, largely due to the rise in value of broadcasting rights, pre-tax losses in the 2006/2007 season reached a new high of £285 million[1]. In addition, total debt in the Premier League reached £2.47 billion[2], with some clubs, notably Manchester United and Chelsea, maintaining especially high levels of debt. This is a particular cause for concern. The pre-tax losses of the 72 clubs in the Football League were also significant totalling £86 million[3], while aggregate debt levels of the 24 clubs in the Championship totalled £289 million[4].

3.3. Although Premier League clubs are loss making, owners are willing to sustain these losses and as such, they are more stable than clubs in the Football League. For example they are at least profitable at the operating level (before transfers) making a cumulative operating profit of £1,312 million in the 15 seasons to 2006/2007. By contrast, in 2006/2007 the cumulative operating losses of the 72 clubs in the Football League in the 15 seasons up to 2006/2007 were £932 million. In other words Football League clubs do not even break even before transfer spending. This can be explained by the fact that they spend a much higher proportion of their income on wages. In 2006/2007 the wages-to-turnover ratio for the Premier League was a record 63%; whilst the comparative figures for the Championship, League 1 and League 2 were 79%, 74% and 67% respectively. The wages-to-turnover ratio in the Championship in the ten seasons form 1997/98 to 2006/2007 has never been below 71%, and was as high as 101% in 2000/2001 as clubs geared up to spend anticipated revenue from the ITV Digital broadcasting deal (see paragraph 3.5 below).

3.4. While there has been a history of financial instability at clubs in the Football League, prior to the 1990s financial crisis was often averted due to the intervention of local businessmen, with few cases of administration or insolvency. Between 1992 and 2008, however, the financial problems at many football clubs in the Football League resulted in 47 cases of administration.

3.5. Notwithstanding the effect of the collapse of the ITV Digital broadcasting company (which having secured the rights to broadcast Football League

[1] Deloitte Annual Review of Football Finance (2008)
[2] ibid
[3] ibid
[4] ibid

football for three years collapsed after one year of the contract in 2002 with clubs loosing £131.5 million in expected broadcasting revenue having committed themselves to longer term player contracts in anticipation of these broadcasting receipts) in general it is fair to say that football clubs in the Football League have been poorly governed. Many have overspent on player wages to achieve sporting success, while clubs in the Championship have been committed to unaffordable player contracts upon relegation from the Premier League. Sustained operating losses in the Football League have served to increase debt levels.

3.6. Improved standards of corporate governance within the football industry are therefore critical to ensure that in the long-term football clubs can continue to operate successfully. It is not the case that football clubs should necessarily look to maximise profit – sporting success is critical. However, sustained poor financial performance will ultimately threaten the long-term sustainability of a football club within its community. So for example, Rotherham United are currently seeking to relocate from Rotherham to Sheffield's Don Valley Stadium as a temporary measure after over 100 years tenure at their Millmoor stadium due to a financial crisis. When a club loses its ground it often sets in train a prolonged period of instability and decline, as was the case after Wimbledon FC's Plough Lane ground was sold without any suitable alternative being made available, leading ultimately to the *cause celebre* relocation to Milton Keynes and reformation as MK Dons and the establishment of the supporters' trust-owned AFC Wimbledon currently thriving in the non-league football pyramid.

4. The Regulatory Response of the Football Authorities

4.1. While football clubs have a responsibility to implement internal structures and controls relating to key areas of corporate governance, poor financial performance within the football industry has also brought into question whether the response of the football authorities to the need for the implementation of effective regulatory measures to improve standards of club-level governance has been far-reaching enough.

4.2. During the 1990s a series of reports expressed concern that the football authorities were under-performing in their regulatory role including the Labour Party *Charter for Football* (1996) the Football Task Force (1999), and the Smith Report (1998).

4.3. These reports made a number of recommendations, including the creation of a Financial Compliance Unit with the remit to ensure the long-term financial stability of clubs; the need for a fit and proper person test for club directors; an independent scrutiny panel to independently assess governance at football clubs; the development of an 'Ombudsfan' that would look into individual complaints and report to the independent scrutiny panel; and a compliance and monitoring unit with statutory power to monitor finances, deal with appropriate complaints and investigate serious financial irregularities.

4.4. Despite these recommendations, the football authorities were reluctant to implement regulatory change. As a compromise, the Financial Advisory Unit (FAU) was created at the FA in 1999, while the football authorities agreed to the creation of the Independent Football Commission (IFC) in 2001 to oversee the performance of the football authorities.

4.5. The role of the FAU is to promote financial awareness and improve financial and governance procedures at football clubs. It does this through the development of advisory guides that are intended to help clubs with specific issues including advice on VAT, PAYE, National Insurance and the national minimum wage, whilst also undertaking financial reviews of clubs from the Football League, Football Conference, Isthmian League, Southern League and Northern League. However, the FAU is an advisory body and does not possess statutory authority. Like the FAU, the IFC operated in an advisory capacity and did not have the statutory authority to ensure that the football authorities comply with its recommendations. The IFC was wound up in June 2008 and its work incorporated into the office of the new Independent Football Ombudsman (IFO).

4.6. Since 2003, the football authorities have been more pro-active and have introduced a number of mechanisms designed to improve club-level governance. It is important to recognise the developments made by the football authorities since the 1990s in terms of club-level regulation.

4.7. The FA introduced the Financial Advisory Committee (FAC) in 2003 to improve strategic co-operation between the football authorities on issues relating to club-level governance. Membership of the FAC included representatives from the Premier League, Football League, Football Conference, Southern League, Northern Premier League and Isthmian League.

4.8. The FAC was responsible for overseeing the redesign of the FA's 'Form A' (the FA Annual Return) and the development of Director Certificates. The FAC was also originally responsible for the development of a fit and proper person test, while in 2005 it developed a Guide of Governance to assist clubs with issues relating to corporate governance. In 2007 the FA also introduced new football player agent regulations.

4.9. In 2005, the FA was subject to a major report into its own governance and regulation by Lord Terry Burns (2005), the Burns Review. As well as leading to a significant restructuring and re-organisation of the FA, the review also led to the creation of the Football Regulatory Authority, a semi-autonomous division of the FA with responsibility to carry out the regulatory functions.

4.10. The Premier League has been responsible for implementing an Annual Director's Report; for developing and administering a fit and proper persons test, which also applies to shareholders owning more than 30 per cent of shares; a Chairman's Charter; and a nine-point sporting sanction for entering into administration. Member clubs also have to declare share ownership to the Premier League, while the Premier League commissioned a corporate intelligence firm to examine 362 individual transfers over a two-year period between 2004 and 2006 due to perceived breaches of transfer regulations.

4.11. The Football League has arguably been the most proactive of the football authorities. Since 2003 it has implemented a number of measures including a fit and proper person test; a ten point sporting sanction for entering into administration; and a Salary Cost Management Protocol that clubs in League Two voted to adhere to on a mandatory basis, and which clubs in League

One accepted on a voluntary basis. The Football League also introduced a regulation stating that player contracts have to include levels of remuneration related to divisional status. The Football League also publicly report agent fees paid by member clubs every six months to increase transparency at member clubs.

4.12. The financial performance in the Football League in the three years following the implementation of the governance measures showed some improvement. In 2003, pre-tax losses totalled £165 million, while in 2004, 2005 and 2006 pre-tax losses were £67 million, £82 million, and £68 million respectively (though they increased again in 2006/2007 to £86 million[5]). It can be argued that the implementation of a tighter regulatory framework by the Football League went some way to reducing operating losses.

4.13. UEFA has sought an increasing regulatory role through the implementation of the UEFA Club Licence. This requires that clubs must meet certain standards relating to sporting, legal, infrastructure, administrative and financial criteria. Clubs competing in UEFA competitions are required to be more transparent with their finances, which UEFA hopes will improve the financial position of the clubs and enable UEFA to monitor financial fair play to avoid 'financial doping'; a situation in which the owners of a club are willing to sustain an unusually high level of debt, as a result of which the club gains a sporting advantage (this debt may be underwritten by a private businessman, by a state authority in some countries, or not at all in some cases where reckless lending decisions have been made leaving creditors exposed in the event that a club becomes bankrupt and unable to meet interest payments).

5. Key Issues

5.1. Despite the proactive approach to club governance, there are a number of concerns that can be raised in relation to some of the recent governance initiatives.

5.2. Sporting sanctions were introduced because of a perceived abuse of the administration process. Some clubs, notably Leicester City, were perceived to have utilised the administration process to clear debts and re-emerge in a stronger position to compete on the field of play than those clubs who attempt to manage their affairs in a businesslike way (see paragraph 1.3 above). To this extent sporting sanctions represent a welcome development by demonstrating the willingness of the Football League and the Premier League to address seriously the problem of poor financial management. However, this mechanism does represent something of a blunt instrument which has unintended consequences in terms of its ability to send clubs into a spiral of decline (see paragraph 1.4 above). It should be utilised only as one part of a range of mechanisms to improve financial management.

5.3. The first issue with the current format of the fit and proper person test of the FA, the Premier League, and the Football League is that it does not fully protect football clubs from potentially unscrupulous owners. For instance, it does not take into account breaches of company law or whether individuals have been involved with a number of company insolvencies.

[5] Deloitte Annual Review of Football Finance (various years)

5.4. The second issue with the fit and proper person test is it does not address the motives of people that take over football clubs and the plans for that club. This has been a key concern regarding one of the recent (ultimately unsuccessful) bids to takeover Mansfield Town, where the individual involved - despite declaring purely financial motivations and having been involved in a number of companies which have been struck off the companies register or have become insolvent[6] - would pass the fit and proper test.

5.5. The third issue with the fit and proper person test is that it does not prevent a takeover that might not be in the best short, medium and long-term interest of a football club. The takeover of Manchester United by the Glazer family in 2005 is a case in point. They bought Manchester United in a deal leveraged on a high level of debt against the club's revenues, which has resulted in high (and given the current "credit crunch" crisis possibly unsustainable) annual interest payments, a significant increase in season ticket prices, in addition to a mandatory obligation that season ticket holders purchase tickets for all cup competitions. Similar concerns have been directed at the takeover of Liverpool by Tom Hicks and George Gillett. Both cases raise questions about the potential financial stability of clubs purchased as part of highly geared leveraged buy-outs which carry significant interest payment demands.

5.6. The introduction of the FA Guide of Governance to identify key principles and some basic operational commitments that clubs can adhere to is a step in the right direction. However there is a question mark over the self-regulatory nature of the Guide. To what extent do football clubs actively use or apply principles from within the Guide? How is the FA monitoring the extent to which clubs use (or fail to use) the Guide? Given that it is the responsibility of the clubs to implement best-practice measures contained within the Guide means that it might have a limited impact.

5.7. To what extent does the Football Regulatory Authority at the FA (see paragraph 4.9 above) operate semi-autonomously and have statutory authority? There has been concern over the influence of the professional game within the FA; despite the proposals for the semi-autonomy of the Football Regulatory Authority, is it able to operate independently of the FA executive and do the leagues and clubs recognise its authority?

5.8. Despite regulatory improvements, recent financial performance illustrates that clubs in the Football League continue to make substantial financial losses. In 2006/2007, the pre-tax losses of the 24 clubs in the Championship were £86 million[7]. The net debt of £289 million of the 24 clubs in the Championship has led some commentators to conclude that, in general, only promotion to the Premier League or the introduction of owners' equity can reduce debt levels in the short to medium term at clubs in the Championship[8].

5.9. Despite strong revenue growth in the Premier League, the financial results in 2006/2007 show that pre-tax losses have reached a new high of £285 million, with total debt for the 20 clubs in the Premier League of £2.47 billion[9]. Moreover, wage levels increased by 13 per cent with the wage/turnover ratio in the Premier League the highest since 1992/1993 at 63% - the year the

[6] Conn, D (2008)
[7] Deloitte Annual Review of Football Finance (2008)
[8] ibid
[9] ibid

Premier League was formed[10]. These figures illustrate that Premier League clubs continue to be unprofitable at the pre-tax level.

5.10. These figures suggest that despite the proactive approach taken by the football authorities, the impact of the measures that have been implemented have had a limited impact and there is a need for the football authorities to continue to pursue a good governance agenda to improve standards of club-level governance.

6. Recommendations

6.1. Despite the progress made in relation to club-level governance over the course of the last five years, it is clear that the football authorities must consider that further regulation is necessary to improve the financial performance of football clubs and to ensure long-term sustainability.

6.2. However, certain examples of regulation, whilst not completely without merit, such as the deduction of points when entering administration, can have a negative impact on the community institution, while those responsible for running the football club are not penalised. Clubs such as Scarborough have been irreversibly damaged, having become insolvent; whilst Luton Town is currently in a spiral of financial crisis having suffered a number of periods in financial administration and points penalties. The deduction of points and compulsory relegation, whilst sometimes necessary, obviously goes against the principle of sporting integrity through fair competition on the pitch. It would be preferable for preventative measures to be implemented that would make such sporting sanctions redundant.

6.3. It is therefore crucial that the football authorities seek to impose tighter regulation and penalise the owners and those responsible for the governance of a football club, rather than the club's supporters, so that the value of the community institution is not undermined.

6.4. The first key recommendation is the need for a more rigorous fit and proper process to which individuals that are looking to takeover a football club are subject to. At present there are three versions of the fit and proper test administered by the FA, the Premier League and the Football League, none of which are robust enough.

6.5. This procedure could require that an individual state their motivations for ownership, their business credentials, present a business plan to the football authorities, and show a commitment to community engagement. It could also ensure that those with a previous history of involvement at a football club which has suffered severe financial mismanagement are excluded from involvement in the football industry for life.

6.6. As was outlined in paragraph 1.6, there is a precedent for exclusion from involvement in the football industry. In 2003 the FA banned Tony Lazarou, a one-time owner of Enfield FC, a club that enjoyed a long and successful history up to Conference level, from football for life. Enfield FC went into

[10] ibid

liquidation in 2007, in large part as a consequence of actions taken during Lazarou's stewardship.

6.7. The second key recommendation is the need to pursue a salary cost management scheme currently in place on a mandatory basis within League Two and a voluntary basis in League One and further implement it within the Championship and the Premier League. In this regard some valuable lessons might be learned from the application of the Approved Playing Budget (APG) scheme that is applied in the Conference National division, the fifth division of the English football pyramid.

6.8. It is recognised that there would be difficulty in persuading member clubs to accept it. For this scheme to be accepted within the Premier League it is necessary for the scheme to be pursued by UEFA at a European level so that English clubs do not become disadvantaged when competing in European competition. The UEFA President, Michel Platini, has recently suggested that the UEFA Licence could be used to introduce a salary cost control scheme as well as address the issue of excessive debt. We would support such a measure.

6.9. It would be necessary to phase such a scheme in gradually. The wage/turnover ratio could be introduced at 70% and reduced to 60% over a five-year period. The implementation of a salary cost control scheme is one scheme that will go some way to addressing the consistent lack of profitability in the football industry.

6.10. There are other key issues related to the implementation of a salary cost control scheme such as who would be responsible for monitoring club budgets? Would this be the remit of UEFA, the FA or the leagues? What would be the penalty for exceeding the wage/turnover ratio? The salary cost control scheme is an area in which further research is needed relating to the practicalities of implementing a scheme to contribute to the ongoing debate regarding standards of club-level corporate governance.

7. Critical Conclusions

7.1. Since 1992 the 92 clubs in the Premier League and the Football League have enjoyed spectacular growth in financial turnover of, on average, 16% and 12% per annum respectively.

7.2. During that period the 92 clubs have never cumulatively made a pre-tax profit.

7.3. Whilst clubs in the Premier League have managed to avoid financial collapse on the back of increasing turnover from TV revenues in particular, there have been 47 instances of financial administration out of 72 Football League clubs over this period.

7.4. Each administration involves a restructuring of clubs in which a range of creditors both from the private sector and the public sector, most notably HM Revenue & Customs, are paid only a fraction of the monies owed. In effect this represents a public subsidy to footballs' financial administrative weakness.

7.5. Historically this position has been tolerated. However with the country on the brink of a recession and also as a consequence of the credit crunch in the financial markets, this is unlikely to be a sustainable position in the medium to long-term.

7.6. The football authorities need to address the challenge of endemic lack of profitability and financial instability by, in the first instance, introducing a more robust Fit and Proper Test and some form of Salary Management Protocol. Prevention is better than cure.

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