House of Commons Culture, Media & Sport Committee Enquiry 2011: The Governance of Football

Memorandum of Written Evidence – January 2011: Mr Sean Hamil & Dr Geoff Walters

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Introduction

1. The Birkbeck Sport Business Centre (BSBC) is a specialist sport business research 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. This submission will begin by first summarising our key recommendations[1]. It will then summarise our response to each of the six key questions raised by the Committee, indicating wider background supporting documentation where appropriate.

Executive Summary of Recommendations

2. The authors recommend:

   (i) It is legitimate for football clubs to be treated differently by government regulators in recognition of the "peculiar economics" of the sport industry, and the special social function of sport in society, but in return the professional football industry must operationalise "special" reciprocal obligations via mechanisms such as "solidarity" payments to the grassroots.

   (ii) The Football Creditors Rule can no longer be justified as a "fit-for-purpose" regulatory device and should be abandoned.

   (iii) The English football authorities should wholeheartedly implement the UEFA Financial Fair Play (FFP) initiative and apply its principles throughout the football pyramid. The FA, as the governing body of English football should play the lead role in driving its implementation.

   (iv) The full implementation of the Burns Enquiry (2005) recommendations for reform of the FA should be re-visited as a solution to English football's fragmented governance structure.

   (v) Tax incentives should be introduced to incentivise supporter trust investment in clubs. Government should offer financial support to the work of Supporters Direct.

Should football clubs in the UK be treated differently from other commercial organisations?

3. Football is not purely a business. This is because football is structured as a pyramid of which the top professional level is just the apex. English professional football

[1] By way of additional background to this submission see: All Party Parliamentary Football Group - Inquiry into English Football and its Governance. *Memorandum of Written Evidence - Dr Geoff Walters & Mr Sean Hamil*, Birkbeck Sports Business Centre, Birkbeck, University of London, July 2008 - http://www.sportbusinesscentre.com/governmentenquirysubmissions.

draws on grassroots not-for-profit structures of participation, not only as a training ground for future players for both clubs and the national team but as a source of future spectators. The interdependency between the professional and grassroots game is explicitly recognised through the funding mechanism of the Football Foundation, a key investor in grassroots football infrastructure, which is funded by the government, the Football Association (the FA) and the Premier League.[2] So through the principle of sporting "solidarity" professional football in England quite correctly redistributes significant revenues to football's grassroots. In this regard professional football performs a "social" function, and it is legitimate that, when performing this "social" function, its activities be treated differently to mainstream business activity, for example through the provision of tax relief etc.

4. It is also the case that the operation of successful sports leagues embodies "peculiar" economic characteristics which require exceptional treatment.[3] Notably it is the competition itself that is the product, not the individual clubs. It is widely recognised that it is legitimate for sports' league organisers to centrally negotiate some commercial activities on behalf of their member clubs, in order to redistribute income more equally amongst them to more evenly balance labour market spending power to ensure a reasonable level of competitive balance/uncertainty of outcome. The Premier League, the Football League, and the UEFA Champions League and Europa League, all employ centralised selling and redistribution of broadcasting revenues. This also allows league organisers to maximise broadcasting revenues through more coherent branding of their competitions. It facilitates financial stability amongst participating clubs by providing a more balanced distribution of revenues; allows competition organisers to centrally divert funds for "solidarity" redistribution to sport's grassroots. Collective selling would be regarded as an illegal cartel in mainstream business. Its legitimacy in the sport broadcasting field has now been recognised by both the European Union and the UK competition authorities.

5. However, whilst there are clearly "specific" characteristics of the sport/football industry which demand that it be treated differently by government economic regulators, this should not amount to a blanket exemption. One such example is the Football Creditors Rule, the football industry rule whereby where a football club has collapsed into financial administration, in order for it to re-enter the league, the new owners must pay all football industry creditors 100% of outstanding debt. Other non-football creditors then receive proportionately less. Given there have been 53 incidences of administration in the Premier and Football Leagues between 1992 and 2010[4] additional losses endured by non-football creditors have been significant, as a reading of the April 2010 administrator's report [5] for Portsmouth FC demonstrates. Creditors include Her Majesty's Revenue and Customs (HMRC) (for a multi-million tax debt) and a host of local small businesses and public agencies including South Central Ambulance Service (£19,535) and St John's Ambulance (£2,701).

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[2] See: http://www.footballfoundation.org.uk/about-us/

[3] The seminal academic paper setting out the key "peculiarities" of the economics of sports leagues is: Neale, W (1964). "The peculiar economics of professional sports". *Quarterly Journal of Economics*, 78:1-14.

[4] Deloitte (2010). *Annual Review of Football Finance*. Manchester: Deloitte. Appendices, page 13.

[5] See: UHY Hacker Young (turnaround & recovery) (19th April 2010). *Portsmouth City Football Club Ltd (In Administration).* Report to Creditors pursuant to Paragraph 49 of the Insolvency Act 198, Appendix B - http://www.portsmouthfc.co.uk/LatestNews/news/Portsmouth-Football-Club-Statement-875.aspx

6. The Football Creditors Rule is justified by the football authorities on the grounds that it protects well-managed football clubs from the poor financial decisions of failing clubs. However, in reality the opposite is achieved as it serves to encourage inflation in the football player transfer market by allowing clubs with clear financial difficulties to trade players as selling clubs know that, under the current rule, they will still be paid their transfer fee even if the buying club collapses, at the expense of non-football creditors. This does not encourage a responsible attitude to risk management in the operation of the player labour market by either buying or selling clubs.

7. Given English professional football's endemic loss-making (see discussion below) insolvency is now a regular occurrence. HMRC has decided to challenge the legality of the Football Creditors Rule. This is hardly a surprise as non-payment of taxes is essentially a hidden public subsidy to a private industry. It is the view of the authors that the rule can no longer be justified given its extreme consequences for non-football creditors, and because of the negligent attitude to risk management it encourages in the transfer market. The football authorities should recognise this, and move to abolish the rule rather than be forced to by any future court decision.

Is there too much debt in the professional game?

8. Whilst the English Premier League is widely admired as being the world's most successful national league in terms of income generation, on the most critical financial indicator of all – pre-tax profit, English football's performance is deeply problematic. The table below, drawing on statistics from the authoritative Deloitte *Annual Review of Football Finance*[6], demonstrates the chronic lack of profitability of English football.

English Football - Pre-Tax Profitability (£ sterling)

	2006/2007		**2007/2008**		**2008/09**	
	Pre-tax profit	**Turnover**	**Pre-tax profit**	**Turnover**	**Pre-tax profit**	**Turnover**
Premier League	*-£285m*	*£1,530m*	*-£298m*	*£1,932m*	-£275m	£1,981m
Championship	*-£62m*	*£329m*	*-£80m*	*£336m*	-£160m	£375m
League One	*-£20m*	*£102m*	*-£18m*	*£125m*	-£43m	£123m
League Two	*-£4m*	*£63m*	*-£6m*	*£65m*	-£10m	£68m

Source: Deloitte (2009; 2010)

9. Chronic loss-making has been endemic since the inception of the Premier League in 1992, since when there has never been a season where the clubs in the Premier and Football Leagues have, collectively, made a pre-tax profit. The individual clubs that do, notably Arsenal, are the exception. The key reasons for the poor financial performance has been that football clubs consistently over-spend on (and go into debt to finance) player wages to achieve sporting success. For example, in 2008-09 the percentage of turnover spent on wages was 67 per cent, 90 per cent, 80 per cent and 72 per cent in the Premier League, Championship, League One and League two

[6] Deloitte (2009 & 2010). *Annual Review of Football Finance*. Deloitte.

respectively: a figure of 60 per cent is the considered benchmark for wage/turnover ratios. Over spending on player wages, leading to sustained pre-tax losses, has driven total net debt in the Premier League from £950m in 2005 to £3,301m in 2009 (Deloitte, 2010, page 59). In the Championship, total net debt levels for the 24 clubs increased from £327m in 2008 to £406m by 2009 (Deloitte, 2010, page 65).[7]

10. Added to this is the phenomenon of clubs like Manchester United, and until recently Liverpool under the ownership regime of Tom Hicks and George Gillett, where the clubs were plunged into losses, in Liverpool's case unsustainable losses, due to the cost of the interest on the debt acquired to purchase the clubs. In these cases the leveraged buy-out financial techniques employed simply serves to extract revenue from English football in order to pay for punitively priced loans.

11. These debt levels can only be managed in two ways. Owners must cover losses from their own resources, making the owner-benefactor model the norm in English football. Or clubs shed debt through the financial administration process. An associated problem is that this financially contrary business model significantly reduces the market for high quality investors in English football clubs. It should be of concern to the football authorities when investors like Delia Smith at Norwich City, and Sir John Madejski at Reading FC, both highly regarded for their stewardship of their respective clubs, have publicly stated their desire to sell on their ownership due to a quite reasonable unwillingness to cover indefinitely the ongoing losses that owning an English professional football club entails. This leaves open the prospect that increasingly the market for ownership of English football clubs will only be of interest to owners with an excessive appetite for, and highly speculative attitude towards, financial risk. The experience of the poor financial stewardship of Manchester City by former Thailand Prime Minister Mr Thaksin Shinawatra, now banned from entering the UK by the Foreign Office, is salutary. Mr Shinawatra used Manchester City's Premiership status prestige as part of a wider political power struggle in Thailand.[8]

12. It is the view of the authors that the only realistic way to resolve English football's chronic lack of profitability and related debt problems is for the English football authorities to wholeheartedly embrace the implementation of the Financial Fair Play (FFP) initiative of UEFA (the governing body of European football).[9] English football operates within the context of the wider European football pyramid in which its football clubs are highly successful participants in UEFA club competitions. It has been argued that if the English football authorities were unilaterally to adopt more stringent financial regulations this would disadvantage English clubs in European competitions by constraining their flexibility in financing player acquisitions. The fundamental principle underlying the FFP initiative is that clubs should not be able to spend more than they earn on player salaries and transfer

[7] For a fuller analysis of the key structural drivers of English football's financial model see: Hamil, S. & Walters G. (2010). "Financial Performance in English Football; An Inconvenient Truth". *Soccer & Society.* Vol. 11, No. 4, July 2010, 354–372.

[8] For a fuller discussion of Mr Shinawatra's poor financial stewardship of Manchester City see: Hamil, S. & Walters G. (2010). "Financial Performance in English Football; An Inconvenient Truth". *Soccer & Society.* Vol. 11, No. 4, July 2010, pages 364-365.

[9] For details of the UEFA Club Licensing regime and the planned implementation of the UEFA Financial Fair Play Initiative see: UEFA.com (2011). *Club licensing benchmarking report: Financial year 2009.* UEFA.com - http://www.uefa.com/MultimediaFiles/Download/Tech/uefaorg/General/01/58/53/46/1585346_DOWNLOAD.pdf

fees (whilst providing incentives to invest in home-grown player development). Its effective application will create a more favourable environment for all clubs seeking to compete in European competitions who wish to manage their finances on a sustainable basis. The FFP initiative is finding favour with owners of some Premier League clubs, notably the new owner of Liverpool FC Mr John Henry who has publicly acknowledged that its imminent introduction was an influential factor in his decision to buy Liverpool FC.[10]

13. If the FFP initiative is applied successfully by Premier League clubs, it will then become feasible to implement a version of the regime through the league pyramid, tailored for each league's special circumstances. In the view of the authors it is the FA, as the governing body of English football with a remit for promoting sporting good health and sustainability at all levels of the pyramid, which should play the lead role in implementing FFP principles, in collaboration with the respective leagues.

Are football governance rules in England and Wales, and the governing bodies which set and apply them, fit for purpose?

14. It would be unfair and inaccurate to assert that in their totality the football governance rules and football governing bodies are not fit for purpose. The Premier League and the Football League organise four very successful leagues. The Premier League is widely regarded as the world's leading national league in terms of global fan interest. The Football League Championship was itself Europe's fourth best attended league in the 2007/2008 season The FA executes a highly effective administrative function across a host of critical activities, including: (1) organising and regulating a vast structure of grassroots participation involving several million participants; (2) administering English football's disciplinary system, from the Premier League down to the lowest park league, efficiently and with integrity; (3) efficiently administering key elements of financial regulation including the player transfer system; and (4) organising what is still the world's most iconic club knockout competition – the FA Cup. Before attempting to critique the shortcomings of English football's three main regulatory bodies it is first necessary to acknowledge their many achievements; and in particular the extraordinary turnaround in the reputation and performance of English football since its nadir in 1989 in the aftermath of the Hillsborough stadium disaster. In the case of the FA in particular it is clear that it has served as a lightening rod for media criticism because of its exposure to the vagaries of the national team sporting performance, which has served to obscure the many achievements of the organisation and its staff.

15. However, there are two fundamental weaknesses in English football's model of governance that need to be addressed. Firstly there is a problem of uneven application of regulation across the industry given there are essentially three regulatory bodies, all competing to fill the regulatory space. So there is a lack of an over-arching strategy for dealing with the industry's chronic financial loss-making and its consequences. And secondly, and following on from this, regulatory initiatives tend to be reactive and piecemeal, rather than proactive and strategic.

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[10] Hunter, A. (18th October, 2010). "Liverpool's new owners provide welcome contrast to their predecessors". *The Guardian.*

16. It is the view of the authors that, as the governing body of English football it is the FA that should take the lead role in co-ordinating a strategy for the governance of English football[11], but obviously in active consultation and co-operation with the Premier League and the Football League (who, through the FA Professional Game Board and representation on the FA Board, have significant institutional opportunities to influence FA policy). The primary role of the latter is to organise successful competitions, not to regulate the game as a whole, but over time a process of regulatory "mission creep" has been manifested by the leagues as they adopt an increasingly proprietorial approach to regulatory policy. The resulting tensions regarding exactly where key regulatory and governance responsibilities lie were discussed in detail in the submissions to the All-Party Parliamentary Football Group's enquiry into English football governance in 2008-2009[12].

17. These tensions have been seen most obviously in the structure of the FA Board which is composed of five members representing the professional game (the Premier League and the Football League), five members representing the national game (the grassroots), the FA Chairman, and the FA General Secretary. This structure has simply served to entrench the sometimes competing interests of the two key stakeholder groups, making it difficult for the FA Board to devise a consistent and over-arching strategy for the governance of the game as a whole. The comprehensive review of the FA's governance by Lord Terry Burns in 2005[13] identified reform of the FA's board structure as a key objective. Critically, he proposed the addition of between two and three non-aligned "independent" directors, in line with best practice corporate governance guidelines for UK stock market quoted companies[14]. This would assist the FA Board to take a broader view of its remit. These recommendations were never implemented, but in the authors' view should be revisited.

18. The lack of a clear strategy for the governance and regulation of English football is reflected in the wider approach to policy development, which is essentially reactive. So, for example, in 1999 the FA, Premier League and Football League articulated their attitude to demands for a more interventionist approach as follows: "*the football authorities do not believe that the overall well-being of the game will be helped by new layers of regulation or bureaucracy*"[15]. But four years later all three bodies introduced points penalties for clubs that entered into financial administration following what was widely regarded as the unfair advantage over

[11] A recommendation also made in the: All Party Parliamentary Football Group (2009b, April). *English Football & Its Governance*. All Party Parliamentary Football Group - http://www.allpartyfootball.com/APFG_Report_on_English_Football_&_Its_Governance_April_2009%5b1%5d.pdf
[12] All Party Parliamentary Football Group (2009a). *English Football & Its Governance:* Overview, *transcriptions [of evidence submissions), written evidence and report.* All Party Parliamentary Football Group - Overview, transcriptions [of evidence submissions), written evidence, and report -http://www.allpartyfootball.com/inquiry8.htm.
[13] A full outline of the Burns Review terms of reference, submissions, and conclusions can be viewed at: Burns, L. (2005) *Structural Review of the FA- Conclusions*. – http://www.thefa.com/TheFA/WhoWeAre/NewsAndFeatures/2005/~/media/Files/PDF/TheFA/BurnsReview/StructuralReviewConclusions.ashx/StructuralReviewConclusions.pdf.
[14] For best practice governance recommendations for London Stock Exchange-listed companies see: Financial Reporting Council (FRC) (June 2010). *The UK Corporate Governance Code*. Financial Reporting Council - http://www.frc.org.uk/documents/pagemanager/Corporate_Governance/UK%20Corp%20Gov%20Code%20June%202010.pdf.
[15] The Football Association, The FA Premier League, The Football League. (1999) *Commercial Issues: Football's Report to the Football Task Force* - The 'Minority Report'. Department of Culture, Media & Sport: The Football Task Force. Page 127.

clubs running prudent budgets achieved by Leicester City in achieving promotion to the Premier League at the end of the 2002/2003 season having shed significant debt through the administration process. There are many similar examples of such reactive responses. The authors believe strongly that the football authorities, led by the FA, need to take a more proactive, holistic, approach to regulatory policy, and that the implementation of the UEFA Financial Fair Play initiative in English football offers the opportunity to achieve this.

What are the pros and cons of the Supporter Trust share-holding model?

19. Since its foundation in 2000, Supporters Direct[16][17], the national representative body for supporters' trusts (co-operative societies), has formed over 170 trusts which have in turn gone on to act as key, and constructive, mobilising vehicles for supporter interests who wish to invest in their local clubs and help them to embed more effectively in the local communities from which they sprung. In this regard supporters' trusts are a very good example of a modern, progressive, social movement for community benefit, motivated by the fundamental principle of self-help. Headline examples of successful trust-owned clubs which not only participate successfully in their respective leagues but act as hubs for community activity are AFC Wimbledon and Enfield Town FC. But there are many more, and also many more where trusts play an active role as minority shareholders in their club.

20. Supporters' trusts have also served as a buyer of last resort at many insolvent clubs, and effectively saved those clubs from extinction. For example, there are a number of Football League clubs, for example Chesterfield and York City, where a supporters' trust acquired the club, reconstructed it financially, but were then forced to sell the club back to a new private owner as the pressure of managing on a balanced budget basis whilst all around them, based on the owner-benefactor model, were spending to excess, became impossible. This process, whereby supporters' trusts served as effectively financial "accident & emergency" facilities, reconstructing club balance sheets with the use of supporter donations and unpaid voluntary labour, only to have to sell the club because a balanced budget approach to club management rendered its team uncompetitive on the sporting field of play, represents an indictment of the dominant prevailing owner-benefactor model of English football. Financial virtue does not currently have its own reward in English professional football.

21. The authors believe that the government should review the tax incentive regime covering investment by not-for-profit, social benefit, co-operatively structured, supporters' trusts in order to make it more efficient for them to invest effectively in their own local football clubs.

22. The authors believe that the work of Supporters Direct represents excellent value for money and should be a candidate for an appropriate level of funding by government agencies in order to provide it with the necessary stability to continue its good work.

Is Government intervention justified and, if so, what form should it take?

[16] See: www.supporters-direct.coop/

[17] Please note that one of the authors, Mr Sean Hamil, was an elected director of Supporters Direct from 2002 – 2008.

23. It should not be forgotten that English football's recovery following the Hillsborough stadium disaster in 1989 was initiated by government legislation following the recommendations of the Taylor Report.[18] This compelled clubs to provide safe stadia regulated by the Football Licensing Authority (FLA) (via the Football Spectator Act in 1989), a body responsible for monitoring local authorities' supervision of stadium safety including the issuing of safety certificates. The FLA also oversaw the move to all-seater stadia, which created an environment that encouraged professional football clubs to make significant investment in stadia modernisation, and led to the opening up of the game to a wider football audience. This investment was rewarded by increased attendances. This investment was supported by a significant subsidy from the Football Trust through a levy on the football pools gambling product. So there is a very clear precedent for successful government intervention in the governance of football where the industry was correctly perceived as being incapable of reforming itself following a decade of stadium disasters.

24. Similarly, the government regularly introduces legislation relating to the football, and wider sporting, industries often following lobbying by the sport sector, on issues as diverse as countering ticket-touting and the facilitation of the Olympic Games for London 2012. In other words there is a legitimate place for government intervention in football, particularly where such legislation emerges after a period of intensive consultation between the two parties. As was outlined above, the sport/football economic system does embody "peculiar" characteristics, and for example, successful consultation on the issue of the legitimacy of the collective selling of broadcasting rights has led to a sensible solution which recognises the special context of sport and the need to allow collective selling in that context.

25. However, it would be much more preferable if the football industry is able to develop effective systems of self-regulation, or that it is able to negotiate government regulation through a process of effective stakeholder engagement which recognises the legitimate interests of both parties. The governing bodies of football should be in the optimal position to assess what is in the best interests of their key stakeholders. However, this is also why it is critical for the football industry to be able to recognise in advance that historical practices such as the Football Creditors Rule should be withdrawn voluntarily without the threat of direct intervention by government agencies. The defence of outmoded practices serves to undermine their credibility when arguing for exceptional treatment on more legitimate issues.

Are there lessons to be learned from football governance models across the UK and abroad, and from governance models in other sports?

26. As a general principle the authors would state that there is a very strong case for the promotion of a more structured sharing of experience in addressing governance and regulation challenges by all the UK's major sporting organisations as a matter of best practice. This might be most effectively co-ordinated by a respected third party organisation such as the Sport & Recreation Alliance (SRA).[19]

[18] See Hamil, S. (1999) 'A Whole New Ball Game?: Why Football Needs a Regulator', in: Hamil, S., Michie, J. & Oughton, C. (Eds.) *A Game of Two Halves: the business of football*. Edinburgh: Mainstream, pp. 23-39.
[19] See: http://www.sportandrecreation.org.uk/.

27. The experience of the Rugby Football League (RFL) in implementing a licensing system[20], and the experience of the Rugby Football Union in implementing an eight year strategic plan – 2008/2009-2015/2016 – which includes a very clear strategy for balancing the interests of the domestic elite professional clubs with those of the national team[21], offer two clear demonstrations of management practice that that the three football authorities might learn from.

28. The English football authorities could usefully learn from the application of club licensing schemes by other UEFA member national associations. Particular lessons might be learned by the pioneering club licensing system in the German Bundesliga league structure. The Bundesliga is Europe's most profitable, solvent and well attended league and has never experienced a club insolvency.

[20] See: http://www.therfl.co.uk/about_the_rfl/annual_report.
[21] See: http://www.rfu.com/AboutTheRFU/StrategicPlan.aspx.