UEFA Financial Fair Play – The Curse of Regulation

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1 Situation in European Club Football
2 Financial Fair Play Concept
3 Methodology
4 Selected Results
5 Conclusion
Revenues of the “big five” European leagues doubled in the last ten years from € 4.2bn (2000) to € 8.4bn (2010) (Deloitte, 2011)

YET: Club spending has increased even more rapidly than revenues → aggregate net losses of € 1.6bn in 2010 for top division clubs (UEFA, 2012)

Running as “normal“ companies, many top-flight clubs would already be bankrupt! (cf. A.T. Kearney, 2010)
WHY DOES THIS NOT HAPPEN?

→ “too big to fail“-phenomenon

many loss-making clubs are constantly bailed out by different benefactors:

correlation between sporting success and relative expenses for player salaries

Financial Doping:

“financial means not earned by a club directly or indirectly through its sporting operations or supporter reputation, but rather provided by an external investor, benefactor or creditor“

(Müller, Lammert & Hovemann, 2012)

Sources: Storm, 2012; Szymanski, 2003
Basic Games Theory: Prisoner’s Dilemma

How Game Theory Works

The Game Tree

Player One

Player Two

FIRST MOVE

CONFESSION

DON'T CONFESSION

SUBGAMES

CONFESS

DON'T CONFESSION

CONFESS

DON'T CONFESSION

CONFESS

DON'T CONFESSION

1= 20 years

2= 10 years

3= 5 years

4= Go free

OUTCOMES

1 4

3 3

http://science.howstuffworks.com/game-theory3.htm
Basic Games Theory: Prisoner’s Dilemma

http://ingrimayne.com/econ/IndividualGroup/PrisDilm.html
Basic Games Theory: Prisoner‘s Dilemma

In its simplest form the PD is a game described by the payoff matrix: satisfying the following chain of inequalities:

<table>
<thead>
<tr>
<th></th>
<th>C</th>
<th>D</th>
</tr>
</thead>
<tbody>
<tr>
<td>C</td>
<td>R, R</td>
<td>S, T</td>
</tr>
<tr>
<td>D</td>
<td>T, S</td>
<td>P, P</td>
</tr>
</tbody>
</table>

satisfying the following chain of inequalities:

PD1) $T > R > P > S$

http://plato.stanford.edu/entries/prisoner-dilemma/#Sym2t2PDOrdPay
Clubs are trapped in Prisoner’s Dilemma

<table>
<thead>
<tr>
<th>MY STRATEGY AS CLUB</th>
<th>STRATEGY OF ALL OTHER CLUBS</th>
</tr>
</thead>
<tbody>
<tr>
<td>Expensive Player ($E_p$)</td>
<td>Expensive Player ($E_p$)</td>
</tr>
<tr>
<td>Expensive Player ($E_p$)</td>
<td>Cheap Player ($C_p$)</td>
</tr>
<tr>
<td>Cheap Player ($C_p$)</td>
<td>++</td>
</tr>
</tbody>
</table>

→ Rationality trap leads to over-indebtedness of clubs

Aims:

“[…] introduce more discipline and rationality in club football finances […] to protect the long-term viability and sustainability of European club football”

(UEFA, 2010)

Core element: break-even requirement

→ “relevant expenses” of each individual club are not allowed to exceed the club’s “relevant income”

Basic relevant expenses:

→ cost of sales, employee benefits, cost of player transfers (not: expenditure on infrastructure and youth development)

Basic relevant income:

→ gate receipts, sponsorship, broadcasting rights, commercial activities, profit from player transfers

monitoring period includes previous three years; acceptable aggregate deviation of € 5 million
Game model (basic assumptions):

(1) Two teams \((T_1 \text{ and } T_2)\) are engaged in an upcoming match against each other and have made a player buying decision.

(2) The two teams are assumed to be perfect clones. Hence, the probability of a victory for any team before the talent acquisition is \(1/2\).

(3) Both teams can choose from the same two-dimensional strategy space \(\{E_p, C_p\}\). \(E_p\) means buying an expensive player, while \(C_p\) means buying a cheap player. Buying an expensive player while the other team buys a cheap player leads to a probability advantage/increase of \(\varepsilon > 0\) of winning the match.

(4) We assume that the “buying markets” of the two teams are non-connected – the prices of the players \((cE, cC)\) are exogenously given.

(5) The playing strength and price of each of the expensive players and each of the cheap players are identical (cloned in pairs).

(6) The team winning the single decisive match receives a pay-off of \(R\) (common for both teams), the losing team receives a pay-off of zero.

(7) Teams are assumed profit maximizers, maximizing the expected pay-off.

(8) Simultaneous game with complete information.
<table>
<thead>
<tr>
<th></th>
<th>Team 2</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>$E_p$</td>
</tr>
<tr>
<td>Team 1</td>
<td>$E_p$</td>
</tr>
<tr>
<td></td>
<td>$C_p$</td>
</tr>
</tbody>
</table>
the concept comes into force...
Assumption: clubs try to bypass FFP regulations, resulting in extra cost $\gamma$

<table>
<thead>
<tr>
<th>Team 1</th>
<th>Team 2</th>
</tr>
</thead>
<tbody>
<tr>
<td>$E_p$</td>
<td>$E_p$</td>
</tr>
<tr>
<td></td>
<td>$E_p$</td>
</tr>
<tr>
<td>$M_p$</td>
<td>$\frac{1}{2} - [\epsilon - \hat{\epsilon}] R - C_M$</td>
</tr>
<tr>
<td></td>
<td>$(\frac{1}{2} + [\epsilon - \hat{\epsilon}]) R - C_E - \gamma$</td>
</tr>
<tr>
<td>$C_p$</td>
<td>$\frac{1}{2} R - C_M$</td>
</tr>
<tr>
<td></td>
<td>$\frac{1}{2} R - C_M$</td>
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<tr>
<td></td>
<td>$\frac{1}{2} R - C_M$</td>
</tr>
<tr>
<td></td>
<td>$\frac{1}{2} R - C_C$</td>
</tr>
<tr>
<td></td>
<td>$\frac{1}{2} R - C_C$</td>
</tr>
</tbody>
</table>

$\rightarrow$ if $\frac{1}{2} R - c_E - \gamma > \left( \frac{1}{2} - (\epsilon - \hat{\epsilon}) \right) R - c_M$ is satisfied, the clubs will buy expensive players in equilibrium.
Strong incentive to bypass the FFP regulations for the clubs due to the situation of being in a Prisoner’s Dilemma

→ Adding to inefficiency through additional costs for clubs (cover-up) and UEFA (monitoring & enforcing)

Additional costs and risk of conviction might deter smaller clubs with less financial capabilities from trying to bypass the regulations

→ Ossifies dominance of rich clubs by enabling financial doping
→ Competitive Balance on national level decreases

BUT:
long term governance project, initial problems inevitable;
initially the power of sugar daddies and the “total dependency culture” will be reduced
Thank you!

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