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Nielsen, Klaus and Storm, R.K. (2017) Profit maximization, win optimization and soft budget constraints in professional team sports. In: Nielsen, Klaus and Wagner, U. and Storm, R.K. (eds.) *When Sport Meets Business: Capabilities, Challenges, Critiques*. London, UK: Sage, pp. 153-166. ISBN 9781473948044.

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# **Profit Maximization, Win Optimization and Soft Budget Constraints in Professional Team Sports**

## **Introduction**

The business of professional team sports is not an ordinary business. The competitive environment and the character of the product are indeed peculiar, which explains why consumers and producers behave differently from economic actors in other industries. In a ground-breaking article, Neale (1964) identified the need for uncertainty regarding the outcome of sporting contests as the reason for the many peculiarities of North American professional team sports, which takes place in closed leagues organized by monopolies. However, the peculiarities of team sport business in North America compared to the normal business enterprise are not related to different motivations and different underlying goals. The owners of team sport franchises are profit maximizers as other enterprises.

In Europe, the business of professional team sports is equally peculiar when measured by the yardstick of the typical business enterprise. However, it is radically different from North American team sport businesses in terms of competition and regulation. In at least one respect, the European context is even more peculiar than its North American equivalent in the sense that profit maximization does not appear to be the ultimate motive of enterprise behavior. Rather, the pursuit of 'win maximization' seems to determine the decision making of the professional European team sport enterprise. The pursuit of the best possible sporting results is superior to any other motives in all team sport clubs independent of whether it is a non-profit voluntary organization or a for-profit business enterprise. The professional team sports club in Europe is perceived to maximize its wins under a break-even constraint. As long as costs do not exceed revenues, clubs are doing whatever they can to be as successful as possible in its respective leagues.

There is much empirical evidence in support of this view. European team sport clubs do not seem to be motivated by profit. They normally do not earn profits and they definitely do not maximize profits. They rather seem to do what is seen as required for

sporting success independent of profit implications. However, does that mean that they maximize wins under a break-even, or zero deficit constraint? This is often not the case. Many professional team sport clubs seem to pursue sporting success without bothering about any budget constraints. Their accounts show persistent deficits and growing debts. Despite these problems, the clubs have an abnormally high survival rate. When in financial trouble, the vast majority are bailed out, saved by rich individuals ('sugar daddies') or the government or its private creditors. The expectation of being saved in case of financial problems affects the behavior of professional team sport clubs. They behave as if there is no need to balance the books. They act as if it is not a threat to the survival of the company to operate financial losses. In other words, their budget constraints are soft. They do not seem to care about profits but maximize sporting success within budget constraints, which are soft in the sense that they expect that expenditures in excess of revenues can be covered in various ways *ex post*.

The phenomenon of soft budget constraints exists at all levels of professional team sports. However, paradoxically, the phenomenon prevails more often when clubs are rich. Often, the higher revenue streams the clubs earn, the higher are the deficits. The phenomenon is particularly evident in top-level European professional football. The richest leagues operate the largest accumulated losses. This chapter mainly refers to football but the phenomenon of soft budget constraints also exist in other professional team sports in Europe, such as basketball, ice hockey, handball and rugby.

Why are the budget constraints of professional team sport businesses often soft? Why is the degree of 'softness' different in different contexts? What are the mechanisms that explain the phenomenon of soft budget constraints? Why do saviours save loss making sport clubs from financial collapse? How prevalent is the phenomenon?

This chapter attempts to answer these questions. The chapter is structured as follows: The first section outlines the background for the prevailing win optimization theory. The second section presents evidence, which indicates that something different from win optimization under a break-even constraint is at play. The third section is a general presentation of the syndrome of soft budget constraints, which is followed by a

discussion of the institutional preconditions and the social and emotional attachment in European professional team sports. The next section provides examples of six different forms of ‘softness’, which is followed by two case studies and a concluding section.

### **Win optimization rather than profit maximization**

For-profit business enterprises normally not only try to survive but also attempt to earn a profit. In case of no profits or lower profits compared to alternative uses of capital, the investor is expected to withdraw from the firm in favour of investing in another. This means that in order to survive the firm will have to maximize profits, and in economic theory businesses are assumed to behave in such a way that their profits are maximized. Real-life business enterprises do not always follow this behavioural rule. They may instead prioritize growth of market share, or they may ‘satisfice’ rather than optimize (Simon, 1979), which means that they do not pursue optimal but rather satisfactory solutions. They may be non-profit social enterprises who primarily pursue social aims and invest surpluses back into the business itself. They may also aim for shared value, i.e. a combination of profit maximization and the creation of societal value beyond what the effects on the company’s balance sheet (Porter and Kramer, 2011).

Increasingly, European professional team sport clubs have become business enterprises with capital injections by owners and sometimes flotations on stock markets. Arguably, this has caused major changes in the functioning of the clubs. They have become commercialized in practice and in rhetoric (Horne, 2006; Storm, 2010). Focus has shifted to give priority to maximization of revenue streams such as sponsorships, media rights, merchandise, luxury seating, branding and diversified services. Professional management and labour markets have emerged, and corporate governance has become a hot topic. Further, new economic and managerial discourses of club management linked to commercialization have emerged. However, profits are seldom and in any case insignificant. Increasing revenues lead to similar or even larger increases in expenditures. If maximization of profits is what motivates and guides owners of professional team sport clubs they are not very successful and it is difficult to understand why anybody would want to invest in such an unrewarding line of business.

These phenomena have puzzled sport economists. Some advocate direct application of mainstream economic theory including an assumption of profit maximizing club owners (Dobson & Goddard, 2001; Sandy, Sloane, & Rosentraub, 2004). However, others conclude that “*owners are just as likely to be win-maximizing sportsmen*” (Vrooman, 2007, 353). Indeed, a consensus seems to have emerged that clubs rather behave according to a win optimizing motive (Garcia-del Barrio & Szymanski, 2009). Club owners are assumed to disregard return on capital and rather give priority to doing whatever is needed to become as successful in the relevant sporting contests as possible. If this means zero profits so be it. However, it is assumed that club owners do not want to lose the invested capital so win optimization with a zero deficit constraint is seen as prevalent.

Fort (2000) disagrees with the argument. He maintains that European professional football clubs are in fact profit maximizers. However, there is ample evidence that win optimization rather than profit maximization characterizes European professional team sports (Garcia-del Barrio & Szymanski, 2009).

Comparisons with North American major leagues have contributed to this emphasis on the European peculiarities (Andreff, 2011). The North American leagues are closed with no relegation and promotion whereas European leagues are open. The North American leagues are local monopolies with strong entry barriers. They impose limits to player mobility and have measures designed to level out the competitive strength of individual clubs such as a reverse-order-of-finish draft. They redistribute income by pooling TV rights sale at the league level. The leagues are cartels exempted from the American anti-trust regulation. These conditions are favourable for profit maximization whereas the competitive structure of open leagues in Europe encourages win optimizing behaviour.

There are obvious historical reasons for this contrast. Whereas major leagues in North America were pure market phenomena from the start, the European context is radically different. Professional team sport originates from voluntary organizations in civil society who have maintained an influence on league structures. The contemporary structures have emerged gradually and still reflect the influence of their emergence, the

overall competitive structure is still heavily influenced by its past and the major European leagues are still more or less linked to the inherited civil society organizations.

### **Persistent losses but high survival rate<sup>1</sup>**

Arguably, the assumption of win optimization is highly valuable in attempts to understand the business of professional team sports and explain the behaviour of club owners in Europe. It explains why increasing revenues result in equivalent increasing costs. Or, as Tottenham Hotspur's former owner Alan Sugar famously expressed it when commenting on a new windfall Premier League TV rights deal: "It is like prune juice. It will go in one end and out the other" (<http://www.bbc.co.uk/sport/football/31391778>).

However, it does not explain why win optimization behaviour often persists without any break-even constraint. In their pursuit of sporting success, owners often accept deficits leading to debt and loss of capital. This is reflected in persistent losses in professional European team sport clubs.

According to UEFA's club licensing benchmarking report (UEFA, 2010), more than 50% of all top division clubs in Europe have operating losses. In 28% of the clubs salaries alone constitute more than 120% of revenues.

The situation is much worse in the major European leagues. The English Premier League is the richest and most popular league in Europe. It has experienced phenomenal revenue growth rates following the unilateral decision of clubs in pre-division one in 1992 to break away from the Football League. The Premier League has since taken advantage of increasingly lucrative television rights deals and experienced a growth in revenues of more than 900% in the period between 1992 and 2007. Even so, the business has not been profitable (Hamil & Walters, 2010). All of this increased revenue, and still more, has been used on players' salaries or transfers, leaving no profits. In fact, there has in this period not been one single year in which the Premier League has

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<sup>1</sup> This section is based on Storm & Nielsen (2012).

generated an aggregate pre-tax profit for the Premier League clubs (Hamil & Walters, 2010).

There are similar trends in other European countries. Italian football is a prime example of financial chaos and poor management (Morrow, 2006; Szymanski & Zimbalist, 2006). There have been persistent and increasing operating losses in all Serie A clubs. From 1996/1997 to 2006/2007 the accumulated losses of Italian Serie A clubs amounted to a total of €1.4b, even before transfer deficits were taken in to account (Hamil et al., 2010). The player's salaries increased more than 700% in the top 6 clubs from 1996 to 2002 alone (Baroncelli and Lago, 2006).

Spanish football is another case of persistent deficits (Garcia & Rodriguez, 2003; Boscá et al, 2008). The first tier league has experienced large and strongly growing revenues similar to the English Premier League. However, the clubs are spending even larger amounts on player salaries and transfers, resulting in rising levels of debts. In spite of the booming revenues, several Spanish clubs have been threatened with closure due to overspending. Almost half of the clubs in the first and second divisions are in serious trouble when measured on factors such as indebtedness, capacity to refinance debts, and expenditure on players seen in relation to operating revenues (Barajas & Rodriguez, 2010). For instance, in 2008, the aggregate losses in the two top tier leagues were a staggering €2.8m (Andreff, 2007). 90% of the clubs operated with an aggregate loss, with nine clubs being technically insolvent. Total salaries were 99% of revenues in the top tier and 98% in the second tier (Barajas & Rodriguez, 2010). This situation is not a novel phenomenon. In Spain, accumulated operating results have always been negative, and more than half of the clubs are operating in the red each and every year (Boscá et al, 2008).

The situation in France is less serious although aggregate operating losses also characterize French football (Andreff, 2007). In the period 1997-2007, the aggregate losses in the top tier French football league was €298 m.

Germany is the exception. The Bundesliga is clearly the most profitable of the major European football leagues and player's salaries constitute a much lower share of revenues than in the other major leagues (Deloitte, 2011). This has no doubt to do with the specific ownership structure in German football. Apart from a few exceptions where companies own the clubs (VfL Wolfsburg, Bayer Leverkusen and TSG 1899 Hoffenheim), all German top clubs have 51% member ownership.

However, despite the economic hardships outlined above, the history of European football is also a history of extremely high survival rates (Kuper & Szymanski, 2009; Szymanski (2009) compared with business firms in general. Despite the chronic deficits, there have been only three cases of tier 1–4 insolvency in English football since 1985 (Beech et al, 2010). In 1923, the Football League consisted of 88 teams organized in four divisions. 97% of them still existed in the 2007/08 season, and 54 % were in the same division as they were in 1923 (Kuper & Szymanski, 2009). In comparison, only 20 of the top 100 English companies in 1912 remained in the top 100 in 1995 (Szymanski).

The survival rate of Italian football clubs is also extremely high. Of the 60 clubs playing in the top Italian League from its inauguration in 1929 until 2010, 58 clubs are still in existence. It is remarkable that 20 of the 36 top two tier league teams in 1929 are still playing in the two best tiers. In recent years, some Italian top clubs have been relegated due to financial collapse. However, it is noteworthy that all of them have reemerged after being reconstructed.

Spanish football clubs have also had high rates of survival, although not as high as in the English and Italian leagues. In total, 13 of 20 clubs (65%) playing in the best or second best tier in 1929 were playing in one of these tiers in 2009 which arguably indicates a high rate of survival.

Why is the survival rate so extraordinarily high among professional European football clubs, who almost always operate with operating losses and accumulates debt? We propose that the paradox can be understood as a consequence of the prevalence of soft budget constraints in the sector. This argument is developed in the following sections

with a brief introduction to the concept followed by an account of the prevalence of soft budget constraints and a discussion of the conditions that lead to soft budgets in the European professional team sport clubs.

## **Soft budget constraints – theory and practical relevance**

What is a soft budget constraint? The concept was originally developed by the Hungarian economist Kornai in order to understand the phenomena of widespread shortage and inefficiency in socialist economic systems, and, in particular, the failure of attempts to reform the system (Kornai, 1980; Kornai, Maskin and Rolland, 2003). Later, Kornai applied the approach in efforts to understand the post-socialist transition economies (Kornai, 2001), and the concepts have been used to explain a multitude of phenomena in capitalist economies as well (Kornai, Maskin and Rolland, 2003). The soft budget constraint phenomenon describes a situation in which firms survive even when they repeatedly run a deficit from their operations. Environmental economic actors more or less systematically bail them out.

However, it is not the phenomenon of bail outs in itself that constitutes the syndrome of soft budget constraints. The *ex post* act of saving a firm from collapse is often sensible when seen in isolation and this does not in itself constitute a problem unless it has *ex ante* behavioral implications. The phenomenon of soft budget constraints constitutes a syndrome if firms expect that they can rely on external financial support if they run into financial trouble. If this is the case, they will not bother much about profits or even about balancing the books. They will pay less attention to efficiency, and hoard scarce resources as it will practically be costless to accumulate too much, and focus on strengthening the relationship with the supporting organizations rather than properly manage the resources of the firm. In the classic socialist system, managerial incentives to be efficient or create innovative products were heavily distorted due to institutionalized *ex ante* expectations of *ex post* support if the firm in question failed to meet its planned financial goals.

In contrast to socialist societies, Kornai (1986) argues that, in general, the capitalist economies are dominated by hard budget constraints, in the sense that firms operating in

a free market environment cannot generally rely on survival through bailouts from external supporters. Instead, they will face bankruptcy if they do not ensure efficient and optimized operations and do not curb spending in case of deficits. In other words, capitalist firms can only survive in the long term if they seriously master the relationship between their sales and costs and pay utmost attention to efficiency.

In an ideal sense, hard budget constraints ensure creative destruction of inefficient organizations and a high level of innovation and high quality of products.

Kornai outlines five main criteria for assessing whether firms face hard or soft budget constraints. Firms are facing hard budget constraints when the following conditions are met: (H1): The firm is a price-taker for both inputs and outputs; (H2): The firm cannot influence the tax rules and no individual exemption can be given concerning the volume of tax or dates of collection; (H3): The firm cannot receive any free state or other grants to cover current expenses or as contributions to finance investment; (H4): No credit from other firms or banks can be obtained (all transactions are made in cash); and (H5): No external financial investment is possible, i.e. investments are dependent on retained profits.

If all of these conditions are fulfilled, the firm in question is constrained on its budget in a hard way. However, this extreme situation only exists in exceptional circumstances. Generally, H4 and H5 are not fulfilled in monetary economies with developed financial systems. Further, H1 presupposes absence of firms with market power, i.e. capacity to influence the market price. There are many exceptions to H1 in capitalist economies. In practice, the efficiency driving budget hardness in capitalist economies is seen as linked to hardness in relation to H2 and H3. In general, firms are unable to influence their tax payments and will not be able extract negotiated subsidies from the state contrary to powerful state-owned companies in socialist economies. Paradoxically, an extreme case of ideal-type hardness existed in the former socialist economies where the household sector experienced hardness in relation to all five criteria with absence of consumer credit in addition to hardness with respect to the other criteria.

In fact, there are numerous examples from capitalist economies of firms facing relaxations on several of the conditions of hardness listed above including H2 and H3, thus showing that the soft budget constraint syndrome is not a phenomenon found exclusively in socialist or post-socialist economies. In capitalist economies, large scale (usually public) organizations such as the military, public transport, hospitals, and also the banking sector, is shown to be facing significant relaxations of hardness. Generally, if an organization is seen as ‘too big to fall’ by its stakeholders there is a strong motive to save it in case of trouble and the behavior of the organization then reflects an expectation of bail outs.

### **Soft budget constraints in European professional football**

Even though some European clubs behave as win maximizers subject to a break-even constraint, many are facing environmental conditions that effectively result in a high survival rate despite continuous financial problems (Storm and Nielsen, 2012, 2015). Bankruptcies are seldom and only seem to occur for clubs in the second or lower divisions. Normally, state bailouts and sugar daddies come to the rescue and/or creditors accept debt arrears and non-payment of debt.

Using Kornai’s (1986) framework, we distinguish between six types of softness. Soft pricing (S1), soft taxation (S2), soft subsidies (S3), soft credit (S4) and soft investment finance (S5) represent relaxations of each of Kornai’s five conditions of hardness. We add another category: Soft accounting (S6). In the following paragraphs, we will present a range of examples that illustrate the different mechanisms of softness in European professional football.

**Soft pricing (S1)** takes place when a public stadium and/or training facility is made available to football clubs at below market fees and when governments or city councils buy naming rights to stadia at above market prices (see case 3 below). This has happened in many countries, including Spain, Italy and Denmark.

**Soft taxation (S2)** takes the form of tax exemptions and non-payment of taxes, non-enforcement or amnesty of tax debt. There are numerous examples of soft taxation in

Spain (Barajas & Rodríguez, 2010) and Italy (Foot, 2006). For instance, Lazio was saved from collapse in a major rescue operation in 2015 by means of a relaxation of its tax obligations. The club reached an agreement with the Italian tax authorities of paying a €140m tax liability over an extended period of 23 years to avoid the club from immediate closure (Foot, 2006, 491-499)

**Soft subsidies (S3)** come in either open or hidden forms provided by governments or rich ‘glory seekers’ to reduce deficits and pay off debts to keep clubs running in situations of severe financial problems. This has happened often in English (Grant, 2007) and French football (Andreff, 2007), but there are also numerous examples in other parts of Europe. Other subsidies take the form of access to guaranteed income-generating schemes such as football pools, inflated sponsorship deals and other indirect subsidies.

**Soft credits (S4)** are reflected in the acceptance of overdrafts, unpaid bills and non-enforcement of repayment arrangements with routine postponement and rescheduling of debt. Often the most prominent clubs enjoy very soft forms of credit (Ascari & Gagnepain, 2006).

**Soft investments (S5)** exist, for instance, when the government or other sponsors pay for a part, or perhaps all, of the costs when clubs build new stadia or other revenue-boosting infrastructure.

Finally, **soft accounting (S6)** takes the form of discretionary, and even illegal, praxis, with the purpose of bypassing rules and creative fulfillment of legal conditions and credit criteria to fool the creditors. This is often accepted or even, at least in Italian cases, encouraged by the government who has also in some cases changed legislation to facilitate softer accounting (Foot, 2006, 491-499). A recent study shows that the introduction of the UEFA Financial Fair Play rules has been followed by a reduction in the quality of financial statements of European football clubs (Dimitropoulos, 2015); the employment of earnings management, conditional accounting conservatism and auditor switching are used as indicators for accounting quality, and a study of 84 clubs

for a four-year period (2009–12) shows a decline in accounting quality in all three dimensions. Massaging of accounting is seemingly applied as a means to avoid FFP-induced penalties without changing behaviour and actual financial outcome.

According to Kornai, the soft budget constraints syndrome is an effect of vertical relationships between the state and economic micro-organizations. This reflects his primary focus on socialist and post-socialist economies. As a broader interpretation, a soft budget phenomenon can be said to reflect a relationship between an organization and its environment (Kornai et al, 2003).

In the application of the soft budget constraint concept in the context of this chapter, the perspective is widened. The focus on vertical relations characteristic of a classical supporter-supported relationship is stretched to grasp a more complex situation where many types of stakeholders - not only public supporters, but also private investors, creditors or alike - in a firm are perceived by the firm as potential supporters, whereby expectations of ex post support can grow even though a vertical supporter-supported relationship does not exist ex ante in a formal sense.

In the classical case, the organization experiencing soft budget constraints has an important societal role that serves or affects a large number of people. This has the effect that the supporter considers the organization as 'too big to fall' which translates into expectations of ex post support. Many European professional team sport clubs are similarly seen as 'too big to fall' by their stakeholders.

By taking such an approach, it becomes possible to understand the paradox of European football. Several stakeholders, private and public, play from time to time the role as supporters of their respective clubs, thus establishing the conditions for development of the SBC syndrome in a sector normally perceived as capitalist and embedded in a horizontal environment but rather functioning as a supported firm in a vertically organized sector.

Storm & Nielsen argues (2012) that the emergence and institutionalization of the soft budget constraints syndrome in European football is due to two main factors: 1) the institutional mechanism of the European football market and 2) the specific emotional logic of sport focused on winning. We will touch upon the two in turn below.

## **Institutions and social and emotional attachments**

The institutional framework regarding competitions is part of the reason for the existence of soft budget constraints in European professional football. The severe financial problems are at least partly due to the ruining conditions of competition in the European league structures enforced by: a) the open league structure; b) the unequal distribution of the league revenue; c) growing inequality between the first and second divisions in the domestic leagues; and d) an additional exogenous prize (e.g. participation in international competition) awarded to the winner of the domestic championship (Dietl, Franck and Lang, 2008).

The problem of open leagues is well recognized in the sports economic literature. It represents a threat that pushes the (lower performing) clubs to invest in player talent in order to avoid relegation, which in turn exclude the clubs from the high revenues in the best league(s). Conversely, promotion increases revenues significantly. For clubs at the higher end of the sporting ladder, remaining in the top positions often induce investment in players to remain competitive in relation to lower level clubs. In addition, the existence of an exogenous prize in the form of participation in the Champions League, with promises of a significant hike of income, provides further incentives for investments by the top level clubs

According to Dietl et al(2008), polarization between the clubs within and between leagues increases clubs willingness to gamble on success. A ‘bidding to bankrupt’, ‘zombie<sup>2</sup>’ sporting arms race on players is the result, thus increasing the risk of deficits among the majority. In expectation of ex post support, weak performances -or a threat of relegation - are not met with reduced costs, but the opposite. In such a competitive environment, all club profits are easily competed away.

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<sup>2</sup> See: Franck (2013).

Such institutional mechanisms of the football market certainly create problems for the clubs. However, without the existence of significant softness it could not continue. It would break down the entire sector.

The soft budget constraints syndrome helps to explain how the sector prevails despite growing debt and deficits. Or, put differently: If the clubs in general were facing hard budget constraints - with the consequences of failure when gambling on success in the sporting arms race - they would very likely curb their expenses thus finding their position in the league hierarchy with (at least) a break even budget constraint. The persistent overspending indicates the softening of budget constraints.

A second main factor contributes to the syndrome is social and emotional attachments to sport. Football clubs are often markers of identity in their respective localities, not only for hardcore fans but also for citizens, in general, and politicians. The effects are often significant, because the clubs serve as a common flagship of reference and branding in the local context, which provides the club with resources to counter the threat of collapse, which is significant due to the ruining conditions of competition in the sector.

The prestige attached to being part of European football also contributes to explaining the high survival of the clubs. Some investors are attracted to the sector because they see a professional team sports club as a kind of consumer good or because it put themselves in the spotlight of one the most media exposed popular sports. This constitutes another type of identity making.

### **Case 1: Soft budget constraints and rescue operations in Spain**

The soft budget constraint syndrome is more entrenched among football clubs in Spain than in any other European country. In Spain, the popularity of football has resulted in several rescue operations to help financially distressed clubs.

In 1985 public authorities decided to help reduce debts in Spanish League clubs, which then exceeded €124m, through subsidies poured in from public football pools. A few years later, in 1992, when the Spanish clubs faced a new economic crisis, €192m of debts to the government were cancelled (Barajas & Rodríguez, 2010, 53).

The local governments frequently steps in to bail out troubled clubs. The clubs are heavily backed by their respective regions, i.e. local governments and financial institutions (Barajas & Rodríguez, 2010, 53). Some of the regional governments sponsor the local club or buy their stocks in order to support it. In other cases stadiums have been sold to a willing City Council for large profits. In addition, local Spanish governments are aiding financially troubled clubs by buying or renting out stadia at subsidized prices. These examples of support from local and national state authorities - in the form of subsidies or cancellation of debts - support the notion that Spanish top clubs seem to be immune to financial downturns. If the clubs cannot make it themselves others will fix the problem, either by providing the necessary credit (through the bank sector) or by injecting public subsidies into the clubs.

In response to a question asked in the Spanish parliament in July 2013, the Government was obliged to disclose the amount of unpaid tax owed by professional football clubs in the country's top two divisions. The sum was a staggering €663m (The Independent, 2013). This should be seen in the context of the benefits from potential a European Union bailout potentially worth as much as €100bn and a government plan the year before for amnesty of football club debt to the state, which was blocked by Germany (EU Observer, 2012).

The amount of unpaid tax did not include the tax debts of four clubs that are exempt because they were not obliged to reconstitute themselves as public limited companies and could continue to be owned by their members. Those four clubs are Real Madrid and Barcelona, who also take around 50 per cent of La Liga's total television revenue for themselves, as well as Athletic Bilbao and Osasuna.

However, the privileged status of the four exempted clubs is under threat from a European Commission investigation. The European Commission has opened three distinct in-depth investigations to verify whether various public support measures in favour of seven Spanish clubs, including Real Madrid and Barcelona, are in line with European Union state aid rules (European Commission, 2013).

## **Case 2: Soft pricing and subsidies in Denmark - The case of Viborg FF**

Then evidence presented above indicates that softness mainly prevails in the largest European Leagues. However, smaller European football nations also face softness of budget constraints. The case of Viborg FF, a Danish professional football club currently playing in the best Danish league, shows how subsidies through soft pricing (S1) can be used to soften the budget constraints of football clubs.

In 2008, Viborg FF was relegated to the second tier of Danish football and found itself in financial problems shortly after, and in 2010, the club was in close to collapse. The football club is located in a municipality that prides itself of the achievements of its football and handball teams. The clubs serve an important role as markers of local identity. In addition, in the part of where Viborg is located there is an intense competition among second tier cities to prevail in the Superliga, i.e. the top division of Danish football. The relegation and the subsequent deficits implied a threat of a decisive setback in this competition in case of reduced investment in player talent in order to reduce the deficit. In 2010 the football club was in need of an injection of a significant amount of cash (3m DKK) to balance the books.

The local politicians were eager to find a way to help the club. The dynamic mayor was instrumental in developing and implementing a solution. It happened in a way which was by Danish standards pretty sophisticated. It took the form of indirect subsidies following two interconnected steps.

- Viborg municipality sold the naming rights of the municipal stadium to Viborg FF for a period of five years at a price of 50.000 DKK

- Viborg FF then resold the naming rights to the municipal energy company, Energy Viborg (owned 100% by Viborg municipality) for 3m DKK for a period of three years.

The transactions did the trick and Viborg FF received the support it needed. It happened through an indirect transfer of taxpayer money. Energy Viborg also subsequently suffered from the costly acquisition of the sponsorship.

No doubt the mayor and his political allies would have preferred a lack of publicity regarding the transactions but this did not happen. Political opponents in the municipal council and among the board of directors of Energy Viborg exposed the deal in the media and sought clarification of the legality of the deal. In 2014, the Danish state administration concluded that the deal was a conscious attempt to subsidize a private business by illegal means.

## **Conclusion and further perspectives**

European professional team sports suffer from the soft budget constraint syndrome. The Financial Fair Play (FFP) initiative of UEFA reflects a political awareness of the negative impacts on the management of clubs and the unfair effect on the terms of competition between clubs. The FFP is designed to institutionalize a break-even constraint which will make it harder, and in the long run impossible, to operate with deficits and soft budget constraints (Franck, 2013; Pieper, this volume). The first data of the effects on the clubs in the English Premier League indicate that FFP has the desired effect (Cohen, 2015). Maybe, soft budget constraints are a thing of the past or at least a phenomenon of declining importance.

There are many reasons why this is hardly the case. UEFA has experienced significant opposition and has diluted some of its regulation in response. Further, the long-term effects are uncertain. In addition, human imagination is borderless and successful attempts to counteract the intended effects of regulation will no doubt dampen the effects.

As far as the prevalence of soft budgets, a comparison with the North American major leagues may be useful. Storm & Nielsen (2015) identify similarities between European and North American professional team sports when seen through the prism of the soft budget constraint theory. The study shows that expectations of rescue in case of financial trouble and the associated effects on firm level efficiency do not prevail in the USA and Canada. However, American major leagues experience softness of budgets in ways that are remarkably similar to the European experience and with similar distortion of resource allocation. North American leagues receive ex ante support which are in many ways similar to the ex post support representing the six types of softness.

## Recommendations

The following contributions are essential for the understanding of the soft budget constraint approach and how it can be applied in order to understand professional team sports:

- Andreff, W. (2015): Governance of professional team sports clubs: agency problem and soft budget constraint, in W. Andreff (Ed.), *Disequilibrium Sport Economics: Competitive Imbalance and Budget Constraints*, Cheltenham: Edward Elgar.
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