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Soft budget constraints in professional football

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Professional football in Europe is characterized by persistent deficits and growing debts among the majority of the top league clubs. Despite these problems, the clubs have an abnormally high survival rate. This paper focuses on this apparent paradox and poses the question: Why do only very few European professional football clubs go out of business even though they operate chronically on the edge of financial collapse? The paper argues that the paradox can be explained by the fact that professional football clubs operate within soft budget constraints in a way which is similar to the role of large companies in socialist economies – a phenomenon which was first identified by the Hungarian Economist János Kornai.

Keywords: soft budget constraints; European professional football; economics of sport

Introduction

The peculiar logics of professional football have puzzled economists for years. In their classic papers on the specificity of sports business, Rottenberg (1956), Neale (1964), Davenport (1969) and Sloane (1971, 1980) took the first steps toward what has become a distinct, established discipline of sports economics. Academic knowledge of the sport business sector has been continuously enhanced and refined. However, contemporary scholars examining the economy of professional football have failed to develop a satisfying understanding of the paradox that seems to be a fundamental and distinctive trait of the sector: Why do European professional football clubs chronically operate on the brink of insolvency without going out of business? Why is the survival rate so high when the football business perpetually generates losses?

It is important to conceptualize this paradox properly in order to better understand the particular mechanisms of decision-making and change in such organizations. This paper contributes such a conceptual and theoretical framework by means of an application to the sports economics literature of the concept 'Soft

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Budget Constraint (SBC) Syndrome'. The concept was developed by Kornai (1979, 1980a, 1980b, 1980c, 1985, 1986, 1998, 2001) and Kornai, Maskin and Roland (2003) as a means to understand the inefficiency of enterprises in socialist or post-socialist economies. This paper documents the ubiquitous prevalence of the SBC Syndrome in professional football and shows how the application of the concept can significantly enhance our understanding of the apparent paradox.

The paper is structured as follows: First, it reviews evidence on the economics of European professional football, focusing on the paradoxical co-existence of persistent losses and extreme stability. The data are from the three top leagues (England, Italy, and Spain). Second, it demonstrates how the application of the concept of SBCs may enhance our understanding of the peculiar logics of professional football. Third, it outlines the 'irrational' outcomes of the behavioral logics originating from the SBCs of professional football clubs, and concludes by discussing the current UEFA efforts to promote financial fair play which is in effect an attempt to harden budget constraints. The paper refers specifically to European professional football but the argument is seen as having relevance to professional team sports clubs, in general.

Persistent losses

One of the inconvenient truths about European football is its lack of profitability and poor financial management. The 2010 UEFA club licensing benchmarking report (UEFA, 2010) covers figures from the most recent financial statements of 90% of all top-division clubs in Europe. The report shows that more than half of the European top clubs reported losses, with 28% reporting significant losses equivalent to spending 120% or more of income.

The situation in the major leagues is even worse. Although the income of the top five major leagues has risen significantly over the last decade (see, Deloitte, 2006, 2007, 2008, 2009, 2010a; Deloitte & Touche, 2000, 2001, 2002, 2003, 2004, 2005), financial trouble have followed suit. Evidence shows that not only are profits generally absent in European football clubs, they even incur significant and persistent losses.

In their analysis of Europe's most popular league, the English Premier League, Walters and Hamil (Hamil & Walters, 2010; Walters, 2007; Walters & Hamil, 2008) find no evidence of any profit-orientated behavior. Despite significant revenue growth rates – more than 900% in the period between 1992 and 2007 – the business has not been profit-making. All of this increased revenue, and more still, has been used on players' salaries or transfers, leaving no profits. In fact, since the foundation of the highly lucrative Premier League in 1992, there has not been a single year in which the business has generated an aggregate pre-tax profit for the Premier League clubs (Hamil & Walters, 2010, p. 354). On the contrary, the clubs usually operate way down in the red. A recent study of EU football sustainability identifies an extremely low ratio of equity to assets and a high negative rate of return on assets in the English Premier League, and concludes that under normal conditions it would be only one year from bankruptcy (Kearney, 2010). Recent research on English football clubs' numerous financial difficulties reaches similar conclusions (Beech, Horsman, & Magraw, 2008).

Other studies identify broadly the same trends in other European countries. Morrow (2006, p. 106), Szymanski and Zimbalist (2006, p. 140) and Hamil, Morrow, Idle, Rossi, and Faccendini (2010) see Italian football as a prime example of financial chaos and poor management. Baroncelli and Lago (2006, p. 20) point at the co-existence of an extreme increase in players' salaries – more than 700% in Juventus, Milan, Inter, Roma, Lazio and Parma from 1996 to 2002 – and persistent operating losses in all of the *Serie A* clubs, increasing from an aggregate €144.3 m in 1996/1997 to €982.2 m in 2001/2002. From 1996/1997 to 2006/2007 the accumulated losses of Italian *Serie A* clubs amounted to a total of €1355 m, even before transfer deficits were taken into account (Hamil et al., 2010, p. 391). This is clearly a business that has for long been on the brink of bankruptcy if seen through the lens of normal business logic.

Garcia and Rodriquez (2003) and Boscá, Liern, Martínez and Sala (2008) show that Spanish football is another case of severe financial distress. The Spanish first tier league experiences large and strongly growing revenues. The current aggregate club revenue is close to €1.5 b (Deloitte, 2010a, p. 11) and FC Barcelona and Real Madrid top the Deloitte Football Money League[1] (Deloitte, 2010b). However, Spanish clubs are spending still larger amounts on player wages and transfers, resulting in rising levels of debts. Spanish football has had major financial injections, to cancel their debts, the first in 1992 from public Spanish football pools and a second, five years later, from new television deals. In spite of the booming revenues, several Spanish clubs have been threatened with closure due to overspending (Barajas & Rodríguez, 2010; Garcia & Rodriguez, 2003, p. 253; Lago, Simmons, & Szymanski, 2006). Almost half of the clubs in the first and second divisions are vulnerable when measured on factors such as indebtedness, capacity to refinance debts, and expenditure on players seen in relation to operating revenues (Barajas & Rodríguez, 2010, p. 57). Furthermore, as much as 89% of these clubs had operational losses in 2008, with nine clubs being technically insolvent, and thus, due to regulations in Spanish law, operating under administration (Barajas & Rodríguez, 2010, p. 53). This is not a novel phenomenon. In Spain, accumulated operating results have always been negative, and even though some clubs have generated positive results from time to time, a breakdown of these data reveals that more than half of the clubs are operating in the red each and every year (Boscá et al., 2008, p. 170).

Stability despite economic hardships

Despite the economic hardships outlined above, the history of European football is also a history of extreme stability. Szymanski (2009b) and Kuper & Szymanski (2009) show that the football sector is very stable when it comes to survival.

Compared with business firms in general, the survival rate of football clubs is extremely high. In 1923, the English Football League consisted of 88 teams organized in four divisions. In the 2007/2008 season, 85 of them (97%) still existed, 75 remained in the top four divisions (85%), and 48 (54%) were in the same division as they were in 1923 (Kuper & Szymanski, 2009, p. 88f). In comparison, only 20 of the top 100 English companies in 1912 remained in the top 100 in 1995, 50 survived, seven were liquidated, six were nationalized, and 37 had been acquired by other firms (Szymanski, 2009b). Beech et al. (2008) have studied insolvencies in all tiers of English football and found that whereas the total number of insolvencies from 1986

to 2008 was 68, only six clubs were liquidated and out of the ashes of all six emerged new clubs with new ownership and investments.

The survival rate of Italian football clubs is also extremely high. Of the 60 teams playing in the top Italian League from its inauguration in 1929 until 2010, only two (Legano and A.C. Ancona)[2] are out of business today. Although in recent years, some Italian clubs have been relegated due to financial collapse, it is noteworthy that almost all of them have been reconstructed.[3] Moreover, nine of the 18 (50%) clubs playing in the top league during the 1929 season were also playing in the best league in the 2010 season. Furthermore, 20 of the 36 clubs playing in the top two leagues in 1929 (56%) are still playing in the two best tiers.

Spanish football clubs have also had high rates of survival, although not as high as in the English and Italian leagues.[4] The vast majority of the 59 teams having participated in Spain's first tier league since its inception in 1929 are still operating today. Seven out of ten (70%) teams that played in the first tier league in 1929 are also playing in this league in the current season (2010/2011).[5] 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.

Explaining the paradox

Why is the survival rate so extraordinarily high among professional European football clubs, who almost always operate with zero profit – and often with losses, in particular in the major leagues?

The most popular theoretical explanation among scholars within sports economics is the utility, or winning, optimization approach.[6] In contrast to the profit-orientated American leagues, the clubs in European football leagues are seen to maximize utility, or winning percentage, usually subject to a break-even constraint. This theory has contributed significantly to a better understanding of the behavior of European football clubs but it does not, in our view, provide a satisfactory framework for understanding the paradox. In particular, the assumed break-even constraint makes it difficult to understand the logic behind the persistent losses.

This paper proposes that the paradox can be understood as a consequence of the prevalence of SBCs in the sector. More generally, it is claimed that the application of the idea of soft budgets constraints contributes valuable new insights to sports economics. The argument is developed below, giving an introduction to the concept followed by a discussion of the conditions that lead to soft budgets in European professional football.

Hard and soft budget constraints

Kornai introduced the concept SBC to describe a situation in which loss-making firms or enterprises are bailed out by public authorities or creditors (Kornai, 1979, 1980b). Kornai saw the SBC as a significant factor in explaining certain characteristics of socialist economies, especially the phenomenon of ubiquitous shortage and inefficient (state) enterprises (Li & Liang, 1998, p. 104). The concept is best understood when contrasted with its counterpart, the 'Hard Budget Constraint'

(HBC), which according to Kornai, is the dominant form of budget constraint in capitalist economies.

According to Kornai, the HBC is a form of economic coercion where 'proceeds from sales and costs of input are a question of life and death for the firm' (Kornai, 1980b, p. 303, 1979, p. 806). The budget constraint is hard if, ultimately, it has to cover its expenses out of the proceeds it receives from selling its output. A firm will not be able to survive if it is unable to earn enough revenues to cover its costs, and its investment activity is fully dependent on the profitability of past activities and on the profit it expects to earn in the future (Kornai, 1979, p. 807).

For existing firms the following five conditions need to be met in order to guarantee 'perfect hardness' (see, Gomulka, 1985, pp. 2–3; Kornai, 1980b, pp. 302–303, Kornai, 1980c, pp. 233–237; Kornai et al., 2003, pp. 1097–1098):

H1: The firm is a price-taker for both inputs and outputs;
H2: The firm cannot influence the tax rules: these rules base taxes on observable and measurable criteria; 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;
H5: No external financial investment is possible, i.e. investments are dependent on retained profits.

The conditions of 'perfect hardening' are theoretical constructs. They seldom exist in actual economic systems although they do prevail in budgets of households and the formal and informal private business sector in socialist economies (Kornai, 1980b, pp. 311–312, 1980c, p. 237). A more empirically relevant case is the 'Almost HBC' where the conditions H2 and H3 remain fixed. There is no discretionary state redistribution among firms by means of subsidies or taxes. However, the other conditions are relaxed. Discretionary price setting exists but within narrow limits. In addition, credits and external financial investment purposes can be obtained on hard conditions (Gomulka, 1985, p. 3; Kornai et al., 2003, p. 1102). This does not mean that interest rates are high but rather that the principles used in granting credits are orthodox and conservative (strict enforcement of adherence to credit agreements, external financial investment only for technical progress and expansion and not for the purpose of surmounting short-run financial difficulties). In such cases, the firm's will always fulfill its obligations and take appropriate steps to adapt to changing environments as in the theoretical state of perfect HBCs.

In contrast, 'perfect softness' is a state of affairs where differences between proceeds from sales and costs from production are *not* a matter of life and death (Kornai, 1980b, p. 308), where the growth of the firm is not tied to its present or future financial situation, and the firm 'survives even when investment entails grave losses' (Kornai, 1979, p. 807). In other words, 'perfect softness' occurs when all of above factors are relaxed. Of course, one can find intermediate stages between (almost) hard and soft constraints (Kornai, 1980b, p. 310; Kornai, 1980c, p. 237). In general, the relaxation of several or all conditions from H1 to H5 is signs of softness that are typical of companies in socialist and post-socialist economies.

Budget constraints can be more or less soft and there are various means by which they can be softened. Some of these means are fiscal. They take the form of subsidies from the state budget or tax concessions (remission, reduction, or postponement of tax obligations). Kornai applies the prefix 'soft' to characterize such means: soft subsidies and soft taxes. This means that the amount of the subsidy is subject to bargaining rather than at a level explicitly laid down and adhered to for a longer period. Where taxation is soft, the obligations to pay taxes are not set according to stable, uniform principles, but are rather subject to prior and/or subsequent bargaining (Kornai, 1992, pp. 141–142). Budgets can also be softened by means of soft credit. This implies discretionary credit contracts that do not follow general, uniform principles. It also means that the bank does not insist on full adherence to the credit contract and its schedule. Contract fulfillment becomes the subject of bargaining. Kornai identifies a fourth form of softening: soft administrative pricing (Kornai, 1992, p. 142) which is mostly relevant in socialist economies although it is also relevant in relation to internal pricing in the public sector and regulation of private utilities. Other indirect methods of support are identified in Kornai et al. (2003, p. 1102), such as tariff increases or administrative restrictions on import to ease budget constraints on the revenue side.

Where do SBCs exist?

The early literature on the SBC phenomenon focused almost exclusively on state enterprises in socialist economies. Since the collapse of communism in Eastern Europe the concept has been applied extensively in analyses of the post-socialist economies, where the problems associated with hardening of budget constraints in privatized enterprises are crucial in the transition process (Blanchard, 1999, pp. 439–440; Gomulka, 1985, p. 1; Kornai, 1980b, p. 314, 1986, 1998, p. 12; Kornai et al., 2003, p. 1119). However, the SBC phenomenon is not only restricted to such economies. There are plenty of examples of SBCs in capitalist economies (Kornai et al., 2003, p. 1097; Röller & Zhang, 2005, p. 48). SBCs prevail in institutions within the public sector and for private institutions which have been contracted to perform public tasks. The public health care sector in Europe is a prime example (Duggan, 2000; Tjerbo & Hagen, 2009). In general, non-profit organizations such as schools, universities, hospitals and social insurance institutions are not permitted to go bankrupt and are being bailed out when they spend more than their budgets. The same is the case with local government authorities (Kornai et al., 2003, p. 1097).

The SBC syndrome also applies to the banking sector and financial intermediaries in general (Bergløf & Roland, 1995; Du & Li, 2007; Mitchell, 2000). It only rarely happens that a large bank in financial trouble goes out of business. It is normally bailed out by the government or taken over by another bank. Historical examples include the US government bailouts following the Savings and Loans crisis in the early 1990s and the Long-Term Capital Management Crisis in the late 1990s (Maskin & Xu, 2001). Also the collapse of the East-Asian banking sector in the 1990s can be understood as an effect of the SBC syndrome (Kornai et al., 2003, p. 1095). In the most recent financial crisis one major bank (Lehmann Brothers) was allowed to collapse and the huge knock-on impacts illustrate why bailouts and takeovers almost always occurs in such cases. This happened in other cases of

financially troubled large American and European banks where bailouts and takeover were made in order to prevent a fundamental collapse of western economies.[7]

One of the knock-on effects of the huge costs of the rescue actions primarily funded by the taxpayers have been the sovereign crises in Greece, Ireland, and Portugal where rescue packages from IMF and EU have bailed out governments who would otherwise be forced to default on their debts. This is another example of the SBC syndrome.

Ex ante expectations

The fact that state enterprises, non-profit organizations, banks, and whole governments are being rescued ex post is not in itself what makes the SBC syndrome an important phenomenon. It is the effect of ex ante expectations on the behavior of the supported organizations that matters (Kornai, 1980b, p. 309f; Kornai et al., 2003, p. 1104).[8] The SBC syndrome is likely to appear when a firm faces the possibility of negotiating refinancing, credits or subsidies *ex post* (Kornai et al., 2003, p. 1100). The syndrome refers to the behavior guided by expectations of such a future scenario by a decision maker in a firm standing in a principal-agent relationship to a financing (governmental) institution (Kornai, 1980c, p. 240, 1985, p. 50, 1986, p. 4; Tjerbo & Hagen, 2009, p. 337). In short, decision makers and managers expecting bailouts or support in case of financial trouble ex post have strong incentives to increase expenditure above the initial budget, leaving the additional costs, that is firm deficits, for the principal to pay, thus resulting in a softening of their budget constraints. If the expectation of ex post support does not exist ex ante, then a given project will most likely not be undertaken by the firm, when the firm is not sure it can finance it out of its own current or future income.

The classical case of the SBC syndrome is the situation in socialist or post-socialist economies where a clear supporter–supported relationship exists. It is clear how expectations of ex post support can take hold in these firms or organizations. The organization is producing a welfare good which is seen as important to the government and is thus initially established with public subsidies. This becomes a dynamic commitment problem for the supporter organization, that is it will be unable to commit itself not to provide additional financial support when a given project exceeds its projected costs in the future. The same mechanisms exist when non-profit or private organizations perform public tasks and when private organizations are seen as 'too big to fall' because of the known-on effects in the economy if they go bust.

Motivational factors behind organizations' decisions to support vary. Paternalistic factors are relevant in many cases (Kornai, 1979, p. 806, 1980b, p. 561ff, 1985, p. 50; Pun, 1995, p. 335). Kornai et al. (2003, pp. 1098–1099) identify a wider set of motivations including (un-)employment issues (see also, Li & Liang, 1998, p. 108; Schmidt, 1996), fear of political unrest, spillover effects, and corruption.[9] In some cases, the motivation is self-interest, such as reputational (political) incentives (se also, Robinson & Torvik, 2009; Schmidt, 1996, p. 51). It may also be in the business interests of the supporter organization to extend credit or invest more capital in order to avoid that sunken investment or loans will be lost.

In other words, certain structural and cultural factors seem to be a prerequisite for the emergence of the SBC syndrome. Thus, it is not a solely financial matter but rather a socio-economic one (Kornai, 1986, p. 8). According to Kornai, the syndrome is primarily an effect of vertical relationships between the state and economic micro-organizations (Kornai, 1998, p. 13). More broadly, a soft budget phenomenon can be said to reflect a relationship between an organization and its environment (Kornai, 1980b, p. 321; Kornai et al., 2003, p. 1107).

Does the SBCs syndrome exist in the context of professional football?

In the application of the SBC concept in the context of this article, the element of vertical relations characteristic of a 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 – of a firm (or organization) are perceived by the firm (or the organization) 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 SBC case, the organizations have important societal assignments that serve or affect a larger 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 football clubs are similarly seen as 'too big to fall' by their stakeholders and their behavior reflects similar expectations. Actually, football clubs are not at all big business from a financial point of view. In 2008, the total revenue of the richest club on earth, Real Madrid, was less than half of the revenue of the lowest ranked company on the top 500 list of US companies (Kuper & Szymanski, 2009, p. 76). When football clubs are seen as 'too big to fall', it is because they are seen as socially 'big'. They have particular characteristics that facilitate and sustain the SBC syndrome, such as social attachments and emotions. This is because football clubs serve as identification markers in their respective local communities or larger regions. This can also be seen as an example of externalities. Fans pay for tickets and merchandise, and for watching their team play on pay TV but their valuation is much higher. Football clubs are incapable of internalizing a big part of the actual demand and satisfaction generated by the primary product, the football match (Kuper & Szymanski, 2009).

By taking such an approach it becomes possible to understand the paradox of survival in spite of persistent losses in 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 functioning, in effect, as a supported firm in a vertically organized socialist economy.

European football provides ample evidence of all the different forms of softening budget constraints identified in the literature on the SBC syndrome. Soft subsidies are given by 'sugar daddy' owners in the form of additional cash and capital in cases of looming insolvency. Other stakeholders also contribute additional equity and sponsorships and so on in such cases. This is the functional equivalent of renegotiated additional subsidies for state enterprises in socialist economies. Soft taxation is common in the context of professional football clubs. Many league

football clubs routinely fail to pay taxes and the tax authorities have often little incentive to enforce payments through the legal system. Furthermore, when clubs enter administration and are reconstructed tax arrears are almost always among the debt obligations that are not being met. Banks, local governments and other stakeholders often provide clubs with soft credit. When football clubs fail to meet their credit obligations to banks credit contracts are often renegotiated, repayment schedules are extended and the debt burden reduced (Buraimo, Simmons, & Szymanski, 2006; Hamil et al., 2010). Local government support may similarly take the form of loans without expectation or enforcement of repayment. Furthermore, soft pricing is a phenomenon which is not only relevant in socialist economies although it takes other forms in capitalist economies. It exists when football clubs buy, sell and rent facilities at subsidized prices. For instance, the local government buys the training ground from the club at a price much higher than the market failure and rent it back at a fee much lower than the market fee. In other countries, where the local governments own the stadiums, the fee paid for renting the facilities is often heavily subsidized.

The emergence and persistence of the SBC syndrome in professional football is due to two main, interconnected factors: (1) the institutional mechanism of the football market and (2) the social attachment to the clubs linked to the specific emotional logic of sport focused on winning. We will deal with the two main factors in turn, and then describe their interconnectedness.

The institutions of the European football market

According to Dietl, Franck and Lang (2008, p. 366) European football clubs are facing severe financial problems due to the ruining conditions of competition in the European league structures enforced by: (1) the system of promotion and relegation; (2) highly unequal distribution of the league revenue; (3) increased inequality between the first and second divisions in the domestic league; and (4) an additional exogenous prize (e.g., participation in international competition) awarded to the winner of the domestic championship.

The problem of promotion and relegation is well recognized in the literature as a threat which places ever-increasing pressure on clubs to invest in player talent to avoid being relegated, excluded from the market, and thereby placed in a dire financial situation. Conversely, promotion increases revenues significantly (Gammelsaeter & Ohr, 2003, p. 4; Solberg & Haugen, 2010, p. 337; Szymanski & Zimbalist, 2006, p. 4). An increasingly unequal distribution of revenues and the increasing polarization between the first and second tiers amplifies the incentives to gamble for success.

Research findings have documented that these mechanisms are actually at work in European football leagues (Barros, Ibrahímo & Szymanski, 2002, p. 7; Football Governance Research Centre, 2005, p. 21; Morrow, 2003, pp. 15–16; Storm, 2009, p. 21; Szymanski & Smith, 1997, p. 148; Szymanski & Zimbalist, 2006, p. 193). This creates strong incentives to overspend. Typically, weaker performances or decreases in demand are not met with downward adjustments in costs (hardening) but the opposite: in order to be able to compete and raise performances, football clubs buy players, which indicate a softening of budget constraints.

In professional football there is a general notion that sporting success can be achieved by hiring better players or a better manager, and that this is the precondition for gaining substantial income (Kuper & Szymanski, 2009; Szymanski & Kuypers, 2000; Szymanski & Smith, 1997). The football clubs expect that if expenditure is high enough the investment will pay off because of the huge financial rewards of becoming successful on the field. However, although there is some correlation between winning and increasing revenue, there is only a limited – if any – connection between winning and profit-making (Kearney, 2010; Sperling, Nordskilde, & Bergander, 2010; Szymanski & Kuypers, 2000). All profits are typically competed away. The problem is that expectations of increasing revenue and profit, at the level of the individual football clubs prove to be illusionary for the majority of the clubs. It all adds up to a destructive sporting arms race at the aggregate level when the majority of clubs strive to make it to the top. The result is a bloated demand for players and subsequently too high expenditures for all competitors involved. This can be seen as a case of micro rationality leading to aggregate irrationality (Barry & Hardin, 1982).

As this sporting arms race is further enforced with an exogenous prize as the top level clubs compete for participation in the Champions League, where the income can be tremendous, it can be understood why the institutional mechanism of the football market contribute to the softening of clubs' budget constraints.

However, even if high spending may have the potential of huge rewards this does not in itself explain why football clubs overspend. If such behavior would carry a huge risk of failure and collapse this would no doubt curb the excesses. In order to explain why this is not so we have to look at the behavior of the stakeholders who act as the supporters similar to the role of governments in socialist economies.

Social attachment and emotions

Does the winning optimization approach explain the seemingly irrational behavior in European professional football? Fort (2000) disagrees with the argument. He maintains that European football clubs are in fact profit maximizers, because it is not rational for them to optimize winning percentages. He believes that the clubs are maximizing profits in terms of a rational calculation of their 'real' or potential player talent set in relation to their financial capabilities. As the clubs know that the sum of winning percentages is constant, and that not all clubs can win a league championship or qualify for the Champions League in a single year, the argument is that the clubs will find their place in the league hierarchy based on their financial strength and adopt a profit maximizing approach based on these premises. They are seen to do so by only hiring the player talent that is necessary to reach the given profit maximizing optimum (Fort, 2000, p. 444).

Fort could be right if the clubs were willing to accept a sporting hierarchy among themselves which would restrict the ruining forms of competition in the sector. What Fort overlooks, however, is that the game of overspending (e.g., the existence of softness of budget constraints) in professional football is caused by (realistic) expectations of bailouts due to the second main factor in European professional football: social attachments and emotions. This factor establishes professional football clubs as markers of identity in their respective communities/regions, thereby making supporters willing to provide them with resources to overcome the impacts of

the ruining competition in the sector on their survival (Borland & Macdonald, 2003, p. 479). Football and other team sports provide 'people with common interests, loyalties and enthusiasm, thus serving as a way to unite diverse groups within a community against outsiders' (Chen, 2007, p. 38).

Previous academic studies present evidence and explanations of such distinct characteristics of professional football. For example, a study by De Ruyter and Wetzels (2000) found that the intentions of supporters to buy shares from their clubs to provide assistance in times of financial need was not motivated by an economic return but rather by the social norm of reciprocity. The personal attachment to the clubs provides them with feelings of indebtedness and obligation to help the club without regard for the financial return.

Bailouts in European football

When viewed from an economic perspective football clubs seem incompetent but this is because they can afford to (Kuper & Szymanski, 2009, p. 90). There is (almost) always someone – a bank, an investor, fans, public authorities, etc. – who is willing to step in and bail them out or find another (financial) solution to the problem (Grant, 2007; Lago et al., 2006, p. 6).

The prestige of being part of European football is significant, which has the effect that investors willing to risk their own money are likely to be attracted to this sector. This is particularly evident in the case of English football. For example, Russian oil billionaire Roman Abramovich has invested £700 million in the Chelsea Football Club since he took it over – money that will be practically impossible to get back (Hamil & Walters, 2010, p. 364). Investment in football clubs can to some extent be seen as an indirect investment, in the sense that it is a means to boost the reputation and goodwill of the owner and thereby, indirectly, a means to increased political influence, better credit conditions, and increased profits from other investments. However, such effects hardly justify the size of owner funds sunk in football clubs, and often ownership is more of a consumer good than an investment.

Moreover, according to Buraimo et al. (2006, p. 41), the cultural significance of football in England has led even the hardest creditors into creating what Kornai would label as 'expectations of softness': 'English football has managed to sustain persistent losses that in other industries would have invited creditor reaction. The patience of banks, Inland Revenue, and other creditors is partly due to a reluctance to call in overdrafts and unpaid bills in recognition of community disapproval that would follow' (Buraimo et al., 2006, p. 41).[10]

Clear cases of the SBC syndrome are also found in Italian football, where the cultural and political significance of the game is reflected in numerous examples of close connections between public authorities, politicians and clubs leading to permanent overspending, massive borrowing and searches for other financial 'solutions' to secure club survival.

The Lazio case in Italy is a prominent and interesting example of a club relaxing the H2 factor (described above). Around 2005 Lazio's managers reached an agreement with the Italian tax authorities of paying a €140 m tax liability over an extended period of 23 years to avoid an immediate collapse of the club. The current Italian Prime Minister Silvio Berlusconi, who is also the owner of AC Milan, explained the rationale of the deal: 'We are talking about a team that has a huge

number of supporters and there could have been public disorder and grave consequences' (Morrow, 2006, p. 105). The mayor of Rome, Walter Veltroni, also supported the agreement: 'S.S. Lazio (is) a (...) national heritage for the sport and deserved to be bailed out simply on that account (...) the tax authorities were wise to help S.S. Lazio because the club had gone under it would have been a major blow to Italian sport' (Hamil et al., 2010, p. 393).

In Italy, the SBC syndrome was institutionalized by the Salva Calcio ('save football') decree that was introduced by the Italian parliament in 2002 (Hamil et al., 2010, p. 374). The decree was designed to soften the requirements in relation to financial reporting for Italian football clubs, and in relation to licensing and other regulations as well, thus legally spreading the SBC syndrome to the overall football environment in Italy. For example, the Salva Calcio decree allowed the Italian clubs to amortize players' transfer rights over a period of 10 years instead of their respective lengths of contract, thereby improving the reported financial position and performance (Hamil et al., 2010, p. 393) in order to secure clearance from the Italian licensing agency, Co.Vi.Soc.

The Salva Calcio decree is a clear example of softening of budget constraints, which was motivated by the weaving together of Italian professional football's (political) reputation and cultural matters. In this sense, some Italian clubs turn the horizontal relationship characteristic of the SBC-syndrome upside down. According to Hamil et al. (2010, p. 387) many Italian football clubs are owned by powerful families capable of exercising power in various social and political areas, and their survival can be seen as a result of simultaneous paternalism from the state and a perceived paternalistic care for the wider social welfare of the Italian people who stand alongside the football clubs' owners. In Italy the DNA of football is part of politics and power and vice versa.

With regard to Spain, the public interest in football has resulted in several rescue operations designed to help financially distressed clubs. In 1985 public authorities decided to help reduce debts in Spanish League clubs, which then exceeded €124 m. A few years later, in 1992, when the Spanish clubs faced a new economic crisis, the league organization (LFP) closed a deal with the Superior Sport Council in Spain that meant that €192 m of debts to the government were cancelled (Barajas & Rodríguez, 2010, p. 53).

In Spain, as in the case of Italian clubs, the local governments frequently steps in to bail out troubled clubs. For example: '(...) there is no chance that Real Madrid or Barcelona would ever be allowed to go bankrupt, whatever the financial problems of these big-spending clubs' (Barajas & Rodríguez, 2010, p. 64; Lago et al., 2006, p. 8). Similar mechanisms are in play for lower-spending clubs. As the clubs represent ethnic, geographical and cultural values (Ascari & Gagnepain, 2006, p. 77), and their fans and local communities take pride in that, the clubs are heavily backed by their respective regions, that is governments and financial institutions (Barajas & Rodríguez, 2010, p. 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.

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 other words, conditions H3 and H4 are relaxed and budget constraints are softened.

Concluding remarks and perspectives

This paper has applied Kornai's work on the SBC syndrome in order to understand the peculiar logics of professional football. It has shown that, with few exceptions, European football clubs in all three major leagues are operating with losses under conditions that can be understood as SBCs. The evidence presented in the article are from football clubs but probably the conditions are quite similar in other professional team sports, as indicated for instance, by evidence from Danish team handball (Storm, 2008a, 2008b; Storm & Brandt, 2008).

Generally, the phenomenon of SBC is strongly associated with economic inefficiency because the market is prevented from sweeping out inefficient firms when they are being subsidized by willing supporter organizations. Hardening of budget constraints is the obvious cure. However, in the sports business neither this diagnosis nor the cure is as obvious as in other contexts of SBCs.

European professional football has many characteristics in common with firms in socialist or post-socialist economies, and even banks in capitalist economies. They are also seen as 'too big to fall'. They are all facing a situation with investors, public authorities, and banks that are willing to bail them out or support them at times of financial trouble. However, it is specific for professional football clubs that this willingness originate from the way in which these clubs serve as central markers of identity in geographical regions or local communities to which the stakeholders are socially and emotionally attached to such a degree that the environment supports their survival – often no matter the economic costs. The expectation of such bailouts, coupled with the lure of winning championships and trophies and the fear of relegation, result in the seemingly irrational behavior.

However, the behavior of professional football clubs is not irrational if seen in a microeconomic perspective within the specific institutional environment of professional team sports. Of course, it is not rational if the objective is seen as maximization of club profits. The behavior of the clubs may to a certain extent be seen as rational in relation to alternative objectives such as utility maximization, that is maximization of winning percentage within a break-even constraint. However, whereas utility maximization may to some extent explain financial distress, it cannot explain the survival of clubs in spite of the sustained prevalence of losses and the mountains of debt. It offers no satisfactory explanation of the bailouts and the seemingly irrational willingness of stakeholders to absorb the losses and refinance the clubs.

We argue that the application of the SBC concept provides a better way of understanding of peculiar economic logic of professional football. It explains the paradox of extremely high survival rates in spite of huge deficits and increasing debts. Furthermore, it makes it possible to reconstruct the economic, political, and emotional logic of the behavior of the clubs and their stakeholders which explains the irrational outcome at the societal level. The situation represents, yet, another case of 'rational man and irrational society' in addition to the variety of cases presented in Barry and Hardin (1982).

The micro behavior is not irrational if the specific institutions of the football market and the specific preferences of the sectoral actors are taken into account. However, the overall outcome is irrational and unfair because the bill is not only payed by wealthy owners but also by others who contribute unwillingly to finance the excesses of the sector. Wealthy owners may have their own agenda. Their investment may be a vehicle for increased goodwill, prestige and power. They may willingly accept short-term operational losses if they believe that economic gain can be achieved in the longer run, for instance by continuous rising revenues from television contracts. Their behavior may also in some cases be a deliberate purchase of an expensive consumer good. Others, however, may end up unwillingly supporting the clubs, directly or indirectly. Fans and supporters willingly play their part in promoting the irrational outcomes but they also carry some of the costs as targets for revenue boosting activities of the clubs. More problematic is the role of the ordinary bank clients, and, most of all, the taxpayers who unwillingly contribute funds to loss-making football clubs.

There is another issue of fairness within the sports business sector itself. The sporting competitiveness of professional football clubs is dependent on the degree of softness of their budget constraints. The clubs who are able to sustain huge losses have a clear competitive advantage. The financial problems are problems of moral hazards. Many European clubs gamble, more or less irresponsibly, with money they do not have in order to stay competitive. If such actions are not sanctioned, then clubs making an effort to balance their books are punished in terms of their results on the playing field whereas at least some poorly operating clubs are rewarded for being economically irresponsible because overspending enhances their chances of being successful.

The UEFA Financial Fair Play Program is intended to counteract such behavior and to provide a more sound operational grounding of professional football. In the future, European football clubs will be met with demands to operate within their means and a potential threat of being excluded from participation in the European club if they do not follow the new rules.

UEFA's initiative is inspired by the recent developments in Germany and France. Judged from the experiences in Germany, where a strictly enforced licensing system has been in place for several years, results of tighter control are positive. Besides growing interest from spectators and TV audiences, the clubs in the German Bundesliga are now reducing their debt portfolios, increasing their revenues and some clubs even making small surpluses (Kearney, 2010). It is argued that the phenomenon of financial crisis is not absent but takes a hidden shape in French football (Andreff, 2007). Others argue that the French League is operating under sustainable condition, for example, Kearney (2010).

The sporting competitiveness of German league clubs in European competitions has decreased in recent decades, and despite a German comeback in the UEFA Country Rankings in 2011, German and French clubs still seems to face a lack of financial strength to challenge the dominant English, Spanish and Italian leagues. This is partly an effect of the unequal competition caused by different degrees of softness of budget constraints. The huge prize of unequal competition provides an incentive to circumvent UEFA's new rules if possible, and the willingness and capabilities for circumvention may become a new competitive asset. According to the UEFA website, all major football clubs in Europe have indicated that they will back

up the UEFA initiative.[11] However, it remains to be seen whether the regulators can and will stand up against the economic power of the major clubs and the media in case of conflicts.

Furthermore, one should not underestimate the creativity that will be mobilized in future efforts to boost the competitiveness of clubs by means of imaginative new forms of softening budget constraints. Inflating the value of sponsorship deals may be one such new form of softening as evidenced by the £400 m sponsorship deal by Etihad Airways with Manchester City (Taylor, 2011).

Application of the idea of SBCs opens up a field of interesting questions as part of a promising research agenda. Below are a few issues for further research. First, some clubs are not bailed out in situations of financial distress, and it is important to understand why most clubs are rescued while others are not. Second, the forms of rescue vary dependent on the specific circumstances, and a better understanding of the causes for the variety of forms may enhance our knowledge of the actual processes significantly. Third, a systematic stakeholder perspective in analyses of actual processes may further clarify motivations and explain behavior. Fourth, a thorough comparison with the North American model of team sports may further clarify the institutional preconditions for SBCs in professional team sports.

Notes

1. FC Barcelona and Real Madrid have income streams of more than €400 million each in 2010.
2. Another team in Ancona, however, has taken over their logo, identity and plays under the name US Ancona.
3. Clubs that have been relegated due to financial collapse are: Fiorentina (2002), Allessandria (2003), Como (2005), Perugia (2010), Venezia (2005 & 2009), Pisa (1994, 2009), FC Pro Vercelli (2010), Pescara (2003, 2008), Legano (2010), Ancona (2010), and Aurora Pro Patria (2009).
4. The following Spanish clubs have been relegated due to financial trouble: CF Extremadura (2008), Real Oviedo 2003/2004,Granada CF (2002/2003), SD Compostela (2002/2003, 2003/2004), CP Merida (2000) were reconstructed as Merida UD (still operating), Real Burgos CF (folded in 1983 but was replaced by its reserve team; now operating under the name Burgos Club de Fútbol), CD Logrones (2000, 2004, and folded in 2009, but reconstructed as SD Logrones).
5. Today the Spanish first tier consists of 20 teams.
6. On the contrast between the American profit maximization approach versus the European winning optimization please refer to: (Ascari & Gagnepain, 2006, p. 77; Barajas, Fernández-Jardón, & Crolley, 2010; Barros et al., 2002, p. 2ff; Cairns, Jennett, & Sloane, 1986, p. 10; Downward & Dawson, 2000, p. 27f; Downward, Dawson, & Dejonghe, 2009, p. 196; Hamil et al., 2010, p. 401; Kesenne, 2007, p. 4; Lago et al., 2006, p. 5; Sandy, Sloane, & Rosentraub, 2004, p. 11; Sloane, 2006; Solberg & Haugen, 2010, p. 331; Szymanski, 2009a, p. 70f; Szymanski, 2010, p. 32; Szymanski & Zimbalist, 2006, p. 132; Zimbalist, 2003, p. 504).
7. One can also point to the bailouts of the Finnish and Swedish banking system in the early 1990s (Kornai et al., 2003, p. 1123).
8. Kornai treats the terms "support", "rescue" and "bailout" as synonymous actions to avert financial failure (Kornai et al., 2003, p. 1097).
9. It should be pointed out here that one instance of bailout alone does not make the SBC phenomenon appear. According to Kornai (1979, p. 807, 1980b, p. 568, 1998, p. 14), only if successive instances of support happens – for instance, if other organizations are being bailed out in the same sector or previous examples of support exists – expectations of future bailouts or support can grow.

10. See Hamil et al. (2010, pp. 360–361) for a similar argument.
11. http://www.uefa.com/uefa/footballfirst/protectingthegame/financialfairplay/index.html

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