



**LUND UNIVERSITY**  
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# **Financial Fair Play in European Football**

Consequences on the competitive  
balance in the short- and medium-term

*Author:* Victor Millien

*Tutors:* Pontus Hansson  
Jerker Holm

## Abstract

This thesis deals with the matter of competitive balance in European club football. Its starting point is UEFA's new set of regulations known as Financial Fair Play. These new rules officially started to be active for the season 2013-2014. The ground rule for FFP as I will call it further on, is the so-called "break-even" criterion, and cancels the possibility for clubs to make losses at the end of each season.

This new regulation is important since it cancels the possibility for so called "sugar-daddy" club owners to make money injections into the club as a mean to buy players and pay high wages. This should impact well-known clubs such as Manchester City or Paris Saint-Germain for example, at least theoretically. The purpose of this study is to analyze whether or not these regulations will have a real impact on the competitive balance within and between leagues, in terms of fairness of the competition means. I first consider the consequences for the competitive balance in the short-term to then analyze consequences in the medium-term.

Since these regulations have only been active for a few months my study is presented in the form of a prediction and reflects the expected outcome. This outcome shows that FFP will indeed improve the competitive balance between clubs. Especially because clubs will compete with similar and fairer means after FFP is introduced.

However, big clubs will still have an advantage on smaller clubs mainly because of a bigger market size. But the fact that FFP will force clubs towards better management incentives should benefit the smaller ones that already focused on "healthy" and "smart" management before FFP came into force. In the end those two effects might compensate each other.

*Key words: Financial fair play, football, competitive balance, fairness, win maximization, market size, moral hazard.*

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# 1- Introduction

In this section I will present the background surrounding the subject of research in this paper, alongside some key parameters. After what I explain the purpose of the paper, its results and its delimitations.

## *1.1- Background*

At the end of season 2009-2010 professional football clubs from first divisions in Europe had an aggregate loss of 8,4 billion euros from which 5,5 came from bank loans (Drut, 2013). These huge numbers symbolize an alarming situation where overspending has become a normality for numerous clubs in Europe as a mean to reach sportive success.

This is not a sustainable situation for European football since it has lead to several problems such as the inflation of salaries and transfer fees for example and also cases where some clubs could not pay their players anymore. Moreover there has been a proliferation of the so-called “sugar-daddies” that refer to very wealthy club owners that are willing to inject enormous amounts of money into their clubs so as to maximize success on the field.

Even though money injections can be positive, these have been said to lead to a somehow unfair competition in regard to the fact that some clubs are not owned by so-called “sugar-daddies” (Lang et.al., 2011), also referred to as benefactor owners. The Federation of International Football Association (FIFA) has therefore come up with a solution to solve this problematic situation. This solution is a new set of regulations known as the Financial Fair Play, which I will further on refer to as the FFP.

## *1.2- Key parameters*

The cornerstone of the FFP is the so-called “break-even criterion” which states that clubs’ relevant expenses cannot exceed their relevant revenue. I will further on explain what is meant by “relevant”, but money injections from “sugar daddies” are not considered as relevant revenue.

It is also crucial to understand that professional sports leagues and clubs are not classical businesses and that they have a few specificities. The most important one might be professional clubs' goal of win maximization instead of profit maximization, as normal businesses would normally have. Which basically means that clubs' utility functions are maximizing win ratios under a certain budget restriction (as I show later this restriction is not equal for all clubs). Most clubs as one will see prefer to reach success on the field than making profits (they even make losses in some cases), which is very central in this paper.

### *1.3- Purpose*

The purpose of this paper will be to analyze whether or not FFP will have an impact on the competitive balance between and within European leagues. More specifically I will try to understand if FFP rebalances the competition between clubs and makes the terms of competition fairer for everybody.

### *1.4- Results*

The main result in this paper is the fact that FFP should improve the competitive balance in European football in the sense that it will make the competition fairer between all clubs. The playing strengths of all teams might not be equitable but all of them will at least compete with similar tools. Which was not the case before FFP. I also express the belief that FFP will also lead to better managerial incentives and new income sources for the clubs. The final thought of this paper is the fact that FFP will be positive as a whole for European professional football as it will lead to a healthier and more stable environment.

### *1.5- Delimitations*

To simplify this analysis I will make the assumption that all clubs concerned by the FFP will actually follow its new regulations and will not try to find any dishonest solutions to accommodate. In this regard I will ignore questionable sponsorship deals that clubs might use in the future as a mean to increase their incomes. Also I will ignore the fact that there are significant differences in tax

policies between countries in Europe, which gives a big advantage to some clubs compared to others. Taking into account those two parameters in the paper would have made it far too complicated. Moreover FFP does not influence on tax policies, which makes it irrelevant to include them in the analysis.

## *1.6- General outline*

After thoroughly defining the term competitive balance in section 2, I will in section 3 present all the specificities that apply to the world of professional sports since clubs are different to classic businesses. I will also carefully explain the different parameters of the Financial Fair Play regulation. At the end of section 3 I will also present an economic model describing the situation of overspending in European football. I then concretely analyze the short-term effects of FFP on the competitive balance in section 4, grounding my reasoning on different sports economic studies. In section 5 I focus my analysis on the FFP's medium-term effects and present a few solutions for small clubs to increase their competitiveness. I close the discussion in section 6 with the idea that FFP could actually lead to better and healthier managerial incentives for all clubs, which in the end should benefit the football industry as a whole.

## 2- Competitive balance

It is quite obvious that the FFP will have certain consequences since it does not allow clubs to make losses anymore. Also, it cancels the possibility for wealthy owners to cover those losses or inject money to buy new players and pay high wages for example. Which is exactly the case in several leading European clubs today.

A possible consequence of the FFP could then be an impact on the competitive balance within and between the European leagues. The term competitive balance can have different meanings but can be referred to as a situation in which no business of a group of competing businesses has an unfair advantage over the others ([www.dictionary.cambridge.org](http://www.dictionary.cambridge.org)). Specifically applied to professional sports leagues it can be referred to as the degree of equality of the playing strengths of teams (Owen et.al., 2005).

The second definition seems to me less relevant than the first one for my study because of two reasons. The first one is the fact that it would be highly subjective to evaluate the teams' "playing strengths" so as to calculate the degree of equality between them. There is no actual ranking of all the players and I myself, could not create one that would be sufficiently reliable. The second reason is simply the fact that there will always be differences in the level of playing strengths within the leagues. And I do not think it would be realistic or desirable to wish for twenty teams of the exact same level in the same league. Beside it is not what the UEFA is striving for with FFP. According to Vöpel (2013), the UEFA's objectives with FFP are to insure the long-term viability and sustainability of European club football and the integrity of the UEFA club competitions.

I believe that these objectives of viability and integrity express the UEFA's will to recreate a "fairer" competition between all teams. Not more equitable but fairer. It is important to understand the difference. Money injections from sugar daddies are positive in the sense that they bring more money into the football world. Nonetheless they are unfair in regard to the fact that they give some clubs a huge advantage on the others, just because these are "lucky" enough to have a wealthy benefactor owner. And the notion of fairness is very important, in my

opinion, to make all clubs feel that they compete with the same tools and have theoretically the same chances of winning. Those tools might not be as powerful for each and every one of them, but at least none of them would feel the unfairness of not having access to a tool that other teams have access too (a benefactor owner in this case). In that sense it might not be equitable that some clubs have much higher gate revenues than others because of a greater fan base, but it is not unfair. All the clubs have the tool “fan base” and can try to make it as powerful as possible.

To better picture the situation that the FFP is supposed to solve, just imagine two stores located next to each other and selling the same products. One store has to put prices in accordance with its budget constraint. A billionaire for whom it is only a hobby owns the other one. He wants to own the most popular store but does not really care about making profits. For that reason he lowers his prices to a level that will make sure all customers choose his store instead of the other. This would be regarded as unfair towards the other store. Let’s now imagine that the second store is forced (by law) not to make any losses. It would force it to readjust its prices to a more rational level and make the situation fair again. This does not mean both stores have equitable chances to succeed (the billionaire might use his money to build a brand new store to attract the customers) but at least the competition is not unfair anymore.

That is why I have decided to concentrate my study on the effects of the FFP on the competitive balance in terms of fairness of the competition.



## 3-Football industry and financial fair play

I am not expecting that people reading this study are very acquainted with the game of football in general and even less with the rules of Financial Fair Play. However it is crucial for the reader to get a deep understanding of those two parameters if he wants to understand the logic behind my analysis. This is why I will in this section carefully explain the economic specificities applying to the world of football. I will explain the most important parameters of the FFP rules as well so as to make it easier to understand how these rules might impact the football industry. At the end of this section I will also present an economic model illustrating the situation overspending in the football industry, which should give the reader a solid ground for my following reasoning in section 4 and 5.

### *3.1- Specificities of professional football*

In what way are football clubs different than “normal” businesses? As mentioned earlier it is important to understand those differences to better understand the factors that led to the problematic financial situation in today’s European football. And eventually to better understand FFP’s meaning for all the clubs concerned by the regulation.

#### *3.1.1- Win maximization*

A first important question that has to be answered is what professional football clubs’ main objective is? What is the main goal for the team, the coach, the manager and more importantly the owner?

The main objective for firms is usually to maximize profits. Over the years it has been shown that such is not the case for professional football clubs though. A few decades ago it was believed that clubs either maximized profits or maximized their win ratios (Dietl et. Al, 2011). But it was then widely recognized within sports economics that clubs are win maximizers rather than profit maximizers (Szymanski, 2012; Peeters and Szymanski, 2012; Késenne, 1996, 2000). And so, empirical data actually shows that clubs trade-off profits and

wins, by accepting smaller profits (or losses) if greater win ratios are reached (Garcia-del-Barrio and Szymanski, 2009). This win maximization objective is central when it comes to understand football clubs' specificities. It will be a critical factor for this study since it drives clubs to make somewhat questionable investments in some cases. Finally this win maximization drive is also reinforced by the relegation and promotion system between the leagues. And so, in almost every European league the three last teams are relegated to a lower division and the three best clubs are promoted to a higher one. Which of course involves differences in price money, as I will mention further on.

### *3.1.2- Zero-sum game and positional competition*

Even though it appears that clubs do not necessarily worry about making profits, one can still wonder why several of them are making losses on a regular basis. No matter how you look at it, clubs need to have a certain amount of money to pay for basic costs like salaries for example. So what is it that makes them so obsessed about winning on the field that they somehow leave aside the financial side?

One of the answers is one of the central characteristics in football, the so-called zero-sum game. Anyone's win always means another one's defeat, in contrast to a normal industry where competitors don't actually compete in a "frontal" battle. Another answer is the fact that football competitions have sometimes been described with the terms "positional competition" or "rat-race" meaning that there can only be one "number 1", one "number 2" and so on. In other words, each place of a ranking can only be assigned once, regardless of how well teams play in absolute terms (Vöpel, 2011). This then implies biased incentives for participants to take too high of a risk since only winning counts at the end (Vöpel, 2013). This rat race is one of the main factors that led to the situation that FFP is supposed to improve.

### *3.1.3- Spiral of success*

It is also interesting to look at how profitable it is for clubs to actually win on the field. As I just explained each position in the competitions can only be assigned once. It is then relevant to wonder how much of a difference it makes to finish a competition as number 4 or 5 for example.

Well in all domestic and European competition, sportive success is usually followed by the gain of prize money. This extra income gives the already winning team a chance to buy better players and become an even better team that will probably win again and so on. Moreover prize money does not only concern the number 1 team but also other final rankings. For example it is the first four teams in the English league that qualify for the European Champions League. The prize money for participating to the group stage in that competition is for example 9 million euros. In this case it is then easy to understand the financial importance of participating to the Champions League for all clubs. Especially when you know that the winning team usually gets around 50 to 60 million euros in prize money. I want to underline the importance of this spiral of success often described such as “success breeds success” (Vöpel, 2013). It directly impacts the clubs’ decision-making when making investments (see the biased incentive I mentioned in the previous paragraph), in an attempt to reach the rankings allowing the gain of prize money.

### *3.1.4- Uncertainty of outcome*

The growing influence of sugar daddies in European football has led many actors in the football industry to express a concern for the competitions’ because of the unfair dominance of a few clubs. Meaning that the clubs owned by sugar daddies might have an economic advantage too important to be challenged by the others.

This spiral of success could then be problematic in the long run since it could lead to the constant dominance of these few clubs over the rest of the league. Problematic according to the uncertainty of outcome theory, which is a very important determinant of demand for football (Szymanski, 2001). And so, the more uncertain the outcome of a game is, the bigger the interest from fans will be. For that reason the risk with the spiral of success is that the dominance of

only a few clubs could lead to a decrease of interest from fans, medias and sponsors. Which is something the UEFA wants to avoid. In my opinion the UEFA then considers that the unfair advantage given to a few clubs by their benefactor owners, is not a fair considering the unchallenged dominance it leads too. Which in turn justifies the implementation of FFP.

### *3.1.5- Associative competition*

The fact that the UEFA is concerned about preserving a somehow fair competition between the clubs also symbolizes a specificity of professional sports leagues in the way that both the interest of all the individual clubs and the league as a whole need to be taken into account.

This problematic situation can be expressed as associative competition. According to this theory there is indeed an inherent conflict between the interest of the individual clubs and the leagues as a whole. Individual clubs want to be as successful as possible regardless from others' success and the leagues want to keep a balance among the competitors since uncertainty of outcome is, to a certain extend, a necessity for the popularity of the game (Vrooman, 1995). This parameter shows once again the complexity of the football industry where several interested parties all need to be treated fairly.

### *3.1.6- Market size and glory hunter phenomenon*

After taking a look at some of the main parameters making the specificity of the football industry, there is one last dimension that needs to be explained. Hence it is important to understand what makes a football club economically successful, if we assume that we disregard from the possible gain of prize money. This is a central question when looking at the problematic of competitive balance, or the fairness of competition as I see it in this study.

An answer to this question can be found in several sports economics studies in which it is claimed that clubs' economic- and sports results are closely related to one another. For example, Dietl and Franck (2005) argue that there is interdependency between economic and sportive outcomes. Drut (2013), Pedace (2008) and Kuypers/Szymanski (1999) also believe that sports results are

positively correlated to the level of wages for clubs in the long term. To put it simply, the bigger financial power a club has and the easier it will attract good players to its team by offering them high wages. Which in the end should lead to improved results on the field. This is the reason why I will later on in this paper analyze what determines a club's potential revenues and how this potential can be improved. One of the main factors mentioned in different studies is the club's market size, which basically refers to a club's revenue potential that is positively dependent on the club's historical success. This mechanism is sometimes referred to as the *glory hunter phenomenon* (Sass, 2012). This dimension shows in my opinion that there might be an intrinsic inequality between clubs regarding their revenue potential. However I do not see those differences as unfair since they result from past successes or differences in market sizes, two factors that are also present within classic industries.

### *3.2- Financial fair play explained*

Now that the specificities applying to the football industry have been presented, it is vital to also thoroughly explain the rules and requirements coming along with the introduction of the FFP. To better understand why the UEFA decided that FFP was a necessity, let's first list some numbers symbolizing the clubs' tendency to overspend and make financial losses.

At the end of 2010 first division professional clubs in Europe had an aggregate indebtedness of 8,4 billion euros from which 5,5 billions was due to bank loans. (Drut, 2013). For the financial year 2011 European top division clubs reported an amount of 1,7 billion euros in aggregate net losses 2011 which is an almost tripled number compared to the financial year 2007 (UEFA 2013). European top-division clubs reported a net non-profit-related equity increase of 1,279 billion euros in the financial year 2011. According to Franck (2013, p. 17) this last number "gives an estimate of the ad hoc capital injections (new equity, write-off loans or revaluations) provided by first division club owners in order to cover the losses and liquidity shortfalls of their clubs".

In the first 14 months after taking over their club, the "sugar daddy" owners of Chelsea, Manchester City and Paris Saint-Germain (Roman Abramovich , Sheik

Mansour and Qatar Investment Authority) respectively spent €283,6 M, €234,3 M and €212,6 M (Bairner, 2012). Finally the following table presents the revenues and profit/losses of twenty of the leading European clubs. Note that thirteen out of twenty had an aggregate loss from the seasons 2009-2010 and 2010-2011 (“chiffre d'affaires” stands for “turnover” and “résultat net” stands for “net profit”).

	Chiffre d'affaires		Résultat net		
	2009-2010	2010-2011	2009-2010	2010-2011	Aggrégation
Real Madrid	438,6	479,5	24,0	31,6	55,6
FC Barcelone	398,1	450,7	-79,6	-9,3	-88,9
Manchester United	349,8	367,0	-32,2	11,3	-20,9
Bayern Munich	323,0	321,4	2,9	1,3	4,2
Arsenal	274,1	251,1	74,4	13,9	88,4
Chelsea	255,0	249,8	-86,5	-74,9	-161,4
Milan AC	235,8	235,1	-9,8	-69,8	-79,6
Inter Milan	224,8	211,4	-69,0	-86,8	-155,8
Liverpool	225,3	203,3	-24,3	-55,4	-79,6
Schalke 04	139,8	202,4	5,2	4,9	10,1
Tottenham	146,3	181,0	-8,1	0,8	-7,3
Manchester City	152,8	169,6	-148,0	-218,6	-366,6
Juventus	205,0	153,9	-11,0	-95,4	-106,4
Olympique Marseille	141,1	150,4	-0,4	-14,7	-15,1
AS Roma	122,7	143,5	-22,0	-30,8	-52,8
Borussia Dortmund	105,2	138,5	-2,8	9,5	6,7
Olympique Lyonnais	146,1	132,8	-35,1	-28,0	-63,1
Hamburger SV	146,2	128,8	ND	-4,9	-4,9
FC Valence	99,3	116,8	0,2	0,2	0,4
Naples	95,1	114,9	0,3	4,2	4,5

Source: Deloitte (2011,2012) – calculations by Bastien Drut

All of the above numbers concretely underline the seriousness of the situation among European football clubs and somehow give credit to UEFA’s decision to regulate the football industry through introducing the FFP. At least these numbers give a good background to the reader and emphasize the magnitude of the situation.

### *3.2.1- Break-even requirement*

The situation presented above explains why the UEFA introduced FFP in European professional football. According to them it was a necessity. As Gianni Infantino (UEFA's general secretary) explains, "a few of the biggest clubs can afford it (overspending), but the vast majority cannot. They bid for players they cannot afford, borrow money or receive it from their owners, but this is not sustainable because only a few can win" (swissramble.blogspot.co.uk).

Infantino refers here at the end of his statement to the zero-sum game parameter that I mentioned earlier. In other words, one of the problems that FFP is intended to solve is the fact that some of the richest clubs drive up players' salaries and transfer fees which in turn forces smaller clubs to over-stretch their budgets to compete (swissramble.blogspot.co.uk).

The main component in the FFP supposed to solve the problematic situation explained by Infantino is the so-called "break-even" requirement. According to this, an individual club's "relevant expenses" cannot exceed its "relevant income" (UEFA, 2012). To put it simply, clubs are not allowed to make losses anymore. They are forced to break-even and compete within their means. Note that starting with season 2013/2014 clubs will have to fulfill the FFP requirement to obtain a license, which is the precondition for participating in the UEFA competitions such as the Champions League and the Europa League (UEFA, 2010).

### *3.2.2- Relevant income and expenses*

However, you could ask yourself how that will really change the situation. If clubs have to break-even, "sugar-daddies" (Lang et.al., 2011) could still inject money into their clubs to reach a break-even and the situation would remain the same. That is why FFP introduces the notion of "relevant" incomes and expenses in its break-even requirement. The UEFA precisely defines what can be counted into relevant incomes and expenses and what cannot.

Relevant incomes are the sum of incomes coming from gate receipts, sponsorship and advertising, broadcasting rights, commercial activities, other operating income, profit or revenue from player sales, excess proceeds on

disposal of tangible assets and financial income (UEFA, 2012). Relevant incomes do not include incomes from non-football operations and external money injected by the owner for example is then no longer accepted.

Relevant expenses are the sum of expenses coming from cost of sales and material, employee benefits expenses, other operating expenses, amortization and impairment of player purchases or loss of player sales, finance costs and dividends (UEFA, 2012). It is very important to note that investments made into youth development activities or infrastructure (stadiums for example) are not included in relevant expenses, which means that sugar-daddies are still able to make injections intended for that purpose.

By introducing this notion of relevant incomes and expenses the UEFA cancels the possibility for sugar daddies to make money injections into clubs as a mean to buy players and pay high wages. It can then be expected that this regulation should theoretically solve the vicious circle in which small clubs overstretch their budgets to compete with a few big clubs for the best players.

### *3.2.3- Monitoring period*

I stated earlier that clubs, in accordance to FFP, are no longer able to make any losses at the end of each season. This is not entirely true and I need to elaborate on that statement. The calculation of the break-even requirement is not only based on one season's number but instead on the aggregated incomes and expenses over three seasons. As UEFA puts it, the break-even requirement is assessed for a three-year period, being called the "monitoring period" (UEFA, 2010). Thus, the calculation of the break-even requirement for season 2014-2015 will be based on the three previous seasons 2013/2014, 2012/2013 and 2011/2012. With this notion UEFA acknowledges the fact that like in any other businesses football clubs could sometimes have "a bad year" making a loss, which explains the three-year monitoring period. A loss can be made during one of those years but has then to be balanced by profits from the other years. This ensures a continuous positive trend but allows for some leeway in case a club's management would make any bigger investment from one year to another (Vöpel, 2011). Finally note that for the starting season 2013-2014 during which



FFP officially comes into force, the monitoring period will exceptionally be of only two years. Meaning that the break-even requirement will be calculated on the basis of season 2011-2012 and 2012-2013 only. The following seasons will thereafter always have a monitoring period of three years.

### *3.2.4- Acceptable deviation*

Another central parameter in the FFP that needs to be underlined is the notion of “acceptable deviation”. According to this notion, clubs can have an acceptable aggregate deviation from the break-even requirement. The amount of the deviation varies depending on if it is covered or not. If not covered, the deviation can be of 5 million euros only each season. If covered by related parties or equity participants such as sugar daddies, the deviation can actually reach 45 million euros for the seasons 2013-2014 and 2014-2015 if (UEFA, 2012). The acceptable “non-covered” deviation will always be of 5 million euros. The acceptable “covered” deviation on the other hand, will be reduced to 30 million euros for seasons 2015-2016, 2016-2017 and 2017/2018, and will thereafter be reduced even more to an amount that has not been communicated by the UEFA yet (see following table for more precisions). This allowed deviation from the break-even requirement is used to help out clubs that are primarily financed by private investors such as sugar daddies and forced to change their management policy because of FFP (Vöpel, 2013). Doing so they will adapt to the new set of regulations as soon as possible, without facing a possible ban from European competitions already after the first year.

The table below summarizes the notion of acceptable deviation in a very clear way.

<b>Acceptable Deviation Levels</b>						
Monitoring Period	Number of Years	Years Included			Acceptable Deviation (€m)	
		T-2	T-1	T	Covered	Not Covered
<b>2013/14</b>	<b>2</b>	<b>N/A</b>	<b>2011/12</b>	<b>2012/13</b>	<b>45</b>	<b>5</b>
2014/15	3	2011/12	2012/13	2013/14	45	5
2015/16	3	2012/13	2013/14	2014/15	30	5
2016/17	3	2013/14	2014/15	2015/16	30	5
2017/18	3	2014/15	2015/16	2016/17	30	5
2018/19	3	2015/16	2016/17	2017/18	<30	5

Source: [www.swissramble.blogspot.co.uk](http://www.swissramble.blogspot.co.uk)

### *3.2.5- Scale of sanctions*

Of course the FFP regulations would not have any persuasion power if there were no sanctions for clubs that will not accommodate to these new rules. The worst possible sanction is, as mentioned earlier, the case where clubs would not be awarded a license from the UEFA that is needed to participate in European competitions.

Although, there is a wide range of sanctions that could come into force before this critical point is reached. Those sanctions could be the following: a simple warning, fines, point deductions, the withholding of revenue from UEFA competitions, the prohibition to register new players for UEFA competitions, restrictions on how many players a club can register for UEFA competitions and finally the disqualification of a competition in progress or exclusion from future competitions (UEFA, 2012).

### 3.3- Economic modeling

I have so far presented the specificities applying to the football industry and the foundations of FFP. To finalize the better understanding of what the situation looked like in the football industry before FFP entered into force, I will now present an economic model that expresses the club's tendencies to overspend and explains the reason for this. This will show that one of the main reasons for some clubs to overspend is their lack of consideration for long-term consequences of their investments. The following model is based on the so-called contest theory (see <http://www.eco.uc3m.es> for more precisions about contest theory).

If I consider the simple case with only two teams, let  $G_1$  and  $G_2$  be the amount of money spent respectively by each club in transfer fees. The letter  $V$  stands for the value of the profit (if you actually do win the championship) and the probability of winning is given by:

$$p_1 = \frac{G_1}{G_1 + G_2} \quad (1)$$

The expected profit for team 1 through investing  $G_1$  is then:

$$\pi_1 = \frac{G_1}{G_1 + G_2} V_1 - G_1 \quad (2)$$

(We assume the profit equals zero if the team does not win). If I now assume that the costs are not valued correctly and instead discount them because of the fact that teams have myopic preferences regarding these costs, I can then let  $\alpha$   $\alpha \in [0,1]$  represent this myopia (or I could call it moral hazard tendency) and the closer the value is 0 the more short-sighted teams are.

The expected profit for team 1 through investing  $G_1$  is now:

$$\pi_1 = \frac{G_1}{G_1 + G_2} V_1 - \alpha G_1 \quad (3)$$

To find the Nash-equilibrium I partially derive with respect to  $G_1$  and set it equal to zero so that I get the first order condition:

$$\frac{1}{G_1 + G_2} V_i - \frac{G_1}{(G_1 + G_2)^2} V_1 - \alpha = 0 \quad (4)$$

$$V_1 \left( \frac{1}{G_1 + G_2} - \frac{G_1}{(G_1 + G_2)^2} \right) = \alpha$$

$$V_1 \left( 1 - \frac{G_1}{G_1 + G_2} \right) = \alpha(G_1 + G_2)$$

$$V_1 \left( \frac{G_2}{G_1 + G_2} \right) = \alpha(G_1 + G_2)$$

$$V_1 = \alpha \frac{(G_1 + G_2)^2}{G_2} \quad (5)$$

Let us now study the symmetric solutions to this problem which means that in optimum  $G_i = G_j = G$  and furthermore let the valuations of winning be the same so that  $V_i = V_j = V$

We then get:

$$V = \alpha \frac{(2G)^2}{G} = 4\alpha G \quad (6)$$

To solve for the equilibrium investment we get:

$$G^* = \frac{V}{4\alpha} \quad (7)$$

If the individual does not express any myopia, then  $\alpha = 1$  and the expected profit in equilibrium  $V/4$  and both have equal chances of winning. If on the other hand  $\alpha$  is sufficiently low, the clubs will make expected losses. I also want to find the critical value of  $\alpha$  where the expected profit turns to a loss. If I assume

that there are  $N$  teams participating, the expected profit in the symmetrical Nash equilibrium is given by:

$$\pi^* = \frac{V}{N} - \frac{V}{2N\alpha} \quad (8)$$

The condition for the expected profit to be positive is then  $\pi^* > 0$ , which is equivalent to  $\alpha > 1/2$

This simple model shows that modeling these competitions with the equilibrium parameter is possible but shows also why you can make losses in this type of competitions.

Finally the equilibrium with  $N$  clubs should then be expressed by:

$$G^* = \frac{V}{2N\alpha} \quad (9)$$

The important parameter in this economic model is alfa ( $\alpha$ ). It expresses clubs' tendency to make shortsighted and myopic investments, which often lead to economic losses. The cause for these biased investment incentives can be found in the pattern of "positional competition" (also referred to as rat-race) that football leagues demonstrate and that I explained in the section "Specificities of professional football". Since the final ranking of each team has a huge impact on the amount of prize money they get, club managers have a tendency to prioritize shortsighted investments to win this rat-race. And as shown in the model, the more managers are inclined to make such investments (this tendency being represented by a lower value of alfa) the higher the probability will be that those managers' clubs make losses.

This tendency for shortsighted and myopic investments expressed by alfa will be a key parameter for this paper. As I will show further on, the difference in clubs' tendency for such investments will, in my opinion, be a crucial factor for how well they respond to the FFP's restrictions. In most cases, clubs owned by sugar daddies will express very low values for alfa whereas smaller clubs usually express much higher ones, allowing for more profitable investments.

## **4- Short-term effects on competitive balance**

The previous section was intended to give the reader a solid ground about the football industry's specificities and how these impact the sector's economy, as well as a technical understanding of the main parameters that constitute the Financial Fair-Play. Since it can be difficult for a person not acquainted with the game of football to automatically understand the distinction between professional clubs and classic businesses, I wanted to clarify this technical sports-related knowledge for any potential reader of this study.

Based on this theoretical background I will now in the following two sections take a closer look at how FFP will concretely impact the competitive balance in European professional football. The difficulty lies in the fact that FFP is such a new set of regulations, which makes it too early to actually analyze any empirical data. However, some trends can already be observed since this ongoing season's break-even requirement is based on the two previous seasons, as mentioned, which forced clubs to start preparing themselves for FFP in advance. Also, several studies have been made within sports economics where the authors try to catch the future effects of FFP. In addition to a wide set of research within general sports economics, I then believe it is possible to build a hypothesis of what the FFP's effects on competitive balance will be. In this case I define the term competitive balance as the level of fairness regarding the terms of competitions between all teams.

My belief is that during the first years after the implementation of FFP, the main consequence for most clubs will be a reduction of their cash flow. That is why I will in section 4 strictly focus on the short-term effects of FFP and try to define how these reduced cash flows will affect the clubs' win probability and in turn, the competitive balance. Notice that I consider this short-term perspective as representing a period of approximately five years after FFP enters into force.

## *4.1- A fairer win probability*

In this next paragraph I want to start by analyzing whether or not FFP should impact each club's chances of winning. As one can easily understand there are many factors influencing the real outcome of sports results (such as the players' condition, the opponent's value, luck, the weather etc...) but at least let's evaluate how club's theoretical win probability will be affected by FFP.

The first thing that comes to my mind when getting acquainted with the rules of FFP, is the fact that it should theoretically put and end to the era of sugar-daddies as witnessed during the last eight or nine years. The amount of money spent by benefactor owners such as Abramovich (€283,6 M during the first 14 months after taking over Chelsea F.C.) as a mean to quickly put a club on top of the hierarchy should not be realistically possible in the future. At least not amounts of that range and not in such a short period of time. If I now consider equation (1) in the economic model of contest theory presented earlier, it appears that the probability of winning is positively correlated to the amount invested on transfer fees. Grounded on that assumption, it seems to me that if sugar daddies are not able to freely inject money into their club anymore, it should bring more equity in the competition between clubs. The investments made by clubs owned by sugar daddies on transfer fees will probably decrease because of FFP, which in turn lowers their win probability. At least, the unfair advantage of clubs owned by a sugar daddy over clubs that are not, will disappear. At this point it could then appear that FFP will actually improve the competitive balance by canceling an unfair advantage of a few teams. Which exactly refers to the definition of competitive balance quoted in the introduction and that I chose to ground this analysis on.

Once this first assumption has been made, let's now consider other consequences for the competitive balance.

## *4.2- FFP as a soft salary cap*

After looking at how the reduction of investments in transfer fees impacts the win probability, I now want to analyze how this probability is affected by investments in player salaries instead.

This might be important since one of the main differences between clubs owned by sugar daddies and clubs that are not is that the first ones usually spend huge amounts on player salaries, which gives them an advantage to attract the best players. If somehow FFP rebalances the clubs' respective "salary power", it could mean that it will impact the clubs' win probability. As I mentioned this win probability is positively correlated to the investments made on transfer fees, in accordance to the economic model. But I could also assume that investments in transfer fees can be replaced in the model by investments in player salaries. If it appears that FFP impacts the salaries one could then conclude that this will also affect clubs' probability of winning.

Well as Franck (2013) expresses it, FFP does not define a uniform level of expenses for all clubs since it only forces them to break-even on the contrary to the system used in the American NBA (National Basket Association), where teams actually have the same allowed level of expenditures on salaries. What makes it possible to use such a system though, in contrast to European football leagues, is the fact that the NBA is a closed league. The same teams compete again each other year after year and there is no system of promotion and relegation.

Although, FFP can still be considered as some kind of soft salary cap, since it actually does define a limit for each club's expenditure on salaries. But in contrast to the NBA's salary cap, this limit is set by each club's level of revenues, and not by a uniform limit applying for every one of them.

In addition to the effects I just mentioned, most of the sports economists agree that FFP should, in the short-term, put downward pressure on players' salaries. However, many disagree on the effect caused by this general decrease in salaries. If I assume that FFP is viewed as a salary cap then Késenne (1999) argues that it should have similar effects to those observed in the NBA, meaning an improved competitive balance and a more effective distribution of player salary. Peeters



and Szymanski (2012) on the other hand, claim that FFP limits the competition in the player market (because of the impossibility to use external money for smaller clubs) and puts downward pressure on salaries, but that these effects are not compensated through benefits from an increased competitive balance, as one can observe in the NBA. The reason for that being primarily the fact that a uniform ceiling is not set by FFP, giving the possibility for a few clubs to have higher levels of expenses and revenues.

A hard salary cap as we find in the NBA would have been a fairer solution in my opinion, in the sense that all clubs would have had the same ceiling for salary expenses. But this is not possible in football leagues for the reasons mentioned above. However I believe this soft salary cap brings more fairness to the terms of competition since clubs now have to rationalize their salary levels and index them to their revenues. Which cancel the possibility for some of them to use external money so as to offer salaries much higher than the market price, in order to attract the best players. Considering the economic model of contest theory (according to which win probability is positively correlated with investments in player salaries) I can then assume that this will level out clubs' probability of winning; smaller differences in the amounts spent on salaries will thus decrease the differences in win probabilities which indeed makes it fairer for all clubs.

### *4.3- Market size*

In the two previous paragraphs I considered that FFP would improve the competitive balance since the break-even requirement should force clubs to decrease their investments in transfer fees and player salaries, which in turn diminishes the differences in win probability. But even though the economic power of sugar daddies is diminished by FFP, clubs will still exhibit different economic powers. This economic power is often defined by each club's market size and I now want to clarify how much these differences in revenue potential will impact the competitive balance.

As I underlined, the main difference with the salary cap used in the NBA is the fact that FFP only forces clubs to match their revenues with their expenses and

does not define an exact salary cap. Allowing for very different levels of salaries for example, if the clubs have different levels of revenues. It is the use of an identical salary cap for all teams that, in my belief, brings the increased competitive balance to the NBA.

However, even though NBA teams have a similar salary cap, there are differences in the economic power between all clubs. Just like for football clubs. This economic power or revenue potential refers to the market size described earlier. A team from Los Angeles will have a bigger market size than a team from a town in Minnesota for example, just like a team from London would have a bigger market size than a team from Gothenburg in Sweden. Which in the end allows them to have higher revenues.

Furthermore, several authors claim that competitive balance depends on the distribution of player talent among clubs (Késenne, 2000; Pawloski et.al., 2010). The distribution of player talent in turn, depends on the level of wages in each club since the ones being able to pay high salaries will attract the best players. If I take into account both notions of market size and distribution of player talent, my belief is that big clubs will still have an advantage on smaller ones in the short-term. Despite FFP, they will still earn higher revenues and in consequence, be able to pay higher salaries than small clubs to attract the best players and also prevent them from moving to another club. These mechanisms are known in the literature as the “adverse selection” and the “labor turnover” explanations of the efficiency wage theory (Akerlof & Yellen, 1986). According to this theory, a player will be willing to make an extra effort if he considers that he is getting paid a higher salary than in another club.

This assumption of course, worsens the competitive balance in terms of playing strengths in favor of those clubs that are able to pay high salaries. But the fairness of the terms of competitions between clubs is here preserved. Grounding my reasoning on the economic model, I can argue that differences in revenues because of different market sizes will allow for higher paid salaries and higher win probabilities. But this does not make it unfair in the sense that those differences are intrinsic to the clubs’ history and environment (on the contrary to the unfair situation where revenue differences are caused by sugar daddies).

For that reason I believe that the competitive balance in terms of fairness is here still improved by FFP.

Although as I will now explain, it appears that several authors within the sports economics world believe FFP might have other negative effects on the competitive balance

#### *4.4- FFP as a barrier of entry*

The assumption expressed in the previous paragraphs of this section is that neutralizing sugar daddies' financial power should be positive as it makes it fairer for clubs that do not have access to these sources of external money. But one can also look at this from another perspective and consider that small clubs are negatively hit by FFP since they also lose the hypothetical possibility to use external money (whether it comes from a bank or a new sugar daddy).

And so logically, the most common argument that I found among the studies dealing with FFP is that it will indeed cancel the possibility for smaller clubs to make big investments in an attempt to catch-up with the leading clubs. If I relate this assumption to the economic model this now means that their win probability would be harder to increase, because of the impossibility to make big investments. According to this argument, the negative effect of small clubs not being able to use external money is greater than the positive effect of sugar daddies not being able to make big investments in the clubs they own, as I mentioned above.

Franck (2013) points out that, because of those reasons, several authors consider the effect of the FFP as an actual barrier of entry for smaller clubs. Peeters and Szymanski (2012) for example, state that FFP will reduce the competitive balance because small clubs lose the possibility of breaking the big clubs' dominance with external money. Their argument is reinforced when they underline the fact that smaller clubs usually have lower revenues than the big ones (remember the different market sizes), which emphasizes the unfairness of not being able to use external money in their case.

I agree that from this perspective FFP can be seen as unfair if it works as a barrier of entry, although I believe this assumption needs to be questioned. I personally consider that forbidding the use of external money leads to a fairer

competitive balance since the amounts spent by the big clubs are usually much bigger than for small clubs (which basically means that the marginal cost of not being able to use external money would be higher for big clubs than for small ones). If I once again relate to equation (1) in the economic model, this would mean that big clubs' value of  $G$  would proportionally decrease more than the small clubs' value of  $G$ . Which in turn would mean that the differences in clubs' win probabilities would be reduced, meaning that the competitive balance in terms of fairness is still improved.

#### *4.5- A Freeze of the hierarchy?*

I now wonder how FFP will concretely affect the hierarchy between clubs?

Based on the arguments encountered so far, it seems to me that FFP should lead to a change of the competitive balance in European football in the sense that the terms of competitions between clubs will be fairer. This can mainly be explained by the impossibility for sugar daddies to directly inject money into clubs so as to buy players and pay high wages. However, this new parameter should not lead to a drastic rebalancing of the competitive forces on the field among clubs since big clubs will still have an advantage in revenue levels compared to smaller ones. In other words, even though the differences in clubs' win probability are reduced, the big ones will still have an advantage because of their higher revenue potential.

As one can see in the table below, there are significant differences in revenue levels coming from three main sources, and this even between the leading European clubs. The column "Match day" represents the gate revenues emanating from the stadiums (match tickets, restaurants etc...). "TV" represents the revenues coming from TV- and broadcasting rights and "Commercial" refers to revenues coming from all commercial products such jerseys, souvenirs and so on. Real Madrid for example generates almost twice as much gate revenues from its stadium as Bayern Munich does.

Deloitte Football Money League (2010/11 Results)								
£ mlns	Rank	Match Day	TV	Commer- cial	TOTAL	Match Day as % of Total	TV as % of Total	Commer- cial as % of Total
<b>Real Madrid</b>	<b>1</b>	<b>112</b>	<b>166</b>	<b>156</b>	<b>433</b>	<b>26%</b>	<b>38%</b>	<b>36%</b>
<b>Barcelona</b>	<b>2</b>	<b>100</b>	<b>166</b>	<b>141</b>	<b>407</b>	<b>25%</b>	<b>41%</b>	<b>35%</b>
<b>Man United</b>	<b>3</b>	<b>109</b>	<b>119</b>	<b>103</b>	<b>331</b>	<b>33%</b>	<b>36%</b>	<b>31%</b>
<b>Bayern Munich</b>	<b>4</b>	<b>65</b>	<b>65</b>	<b>161</b>	<b>290</b>	<b>22%</b>	<b>22%</b>	<b>55%</b>
Arsenal	5	93	87	46	<b>227</b>	41%	39%	20%
Chelsea	6	68	101	57	<b>226</b>	30%	45%	25%
AC Milan	7	32	97	83	<b>212</b>	15%	46%	39%
Internazionale	8	30	112	49	<b>191</b>	16%	59%	26%
Liverpool	9	41	65	77	<b>184</b>	22%	36%	42%
Schalke 04	10	34	67	82	<b>183</b>	18%	37%	45%
Tottenham	11	43	83	37	<b>164</b>	26%	51%	23%
Man City	12	27	69	58	<b>153</b>	17%	45%	38%
Juventus	13	11	80	48	<b>139</b>	8%	58%	35%
Marseille	14	23	71	42	<b>136</b>	17%	52%	31%
AS Roma	15	16	82	31	<b>130</b>	12%	64%	24%
Dortmund	16	25	29	71	<b>125</b>	20%	23%	57%
Lyon	17	17	63	40	<b>120</b>	14%	52%	33%
Hamburg	18	38	24	55	<b>116</b>	32%	21%	47%
Valencia	19	25	60	21	<b>106</b>	24%	57%	20%
Napoli	20	20	52	32	<b>104</b>	19%	50%	30%

Source: [www.swissramble.blogspot.co.uk](http://www.swissramble.blogspot.co.uk)

It is then much plausible that differences will be even more important compared with smaller clubs that generate less money, mainly because of a smaller market size. And since the competitive balance in terms of playing strengths in professional sports leagues is believed to be predominantly dependent on the market size (Sass, 2012), the competitive balance in that sense should not be improved by FFP. But once again, this does not make the situation unfair as it is regarding sugar daddies' influence in clubs. Differences in revenues based on clubs' market sizes cannot be, in my opinion, hold as unfair.

FFP might then allow for a similar situation that we are witnessing right now, the only difference being that the inflation of wages and transfer fees caused by sugar daddies should decrease. This has led many authors to believe that, not only will FFP be inefficient to drastically increase the competitive balance, but it will also lead to a "freeze" of the hierarchy in European football. In other words, the barrier to entry created by FFP should freeze the clubs' position in the hierarchy (Vöpel, 2011 and Sass 2012) since small ones lose the possibility to compete through big external investments.

I personally do not think the above argument is very powerful. Differences in economic power have been and will always be a reality in sports leagues, because of different market sizes. Alongside the fact that I believe FFP is more

restricting for the bigger clubs than for small ones, it appears to me that the new situation should not be more conducive to a freeze of the hierarchy than it was before FFP. Which means that the fairness of the terms of competitions is here preserved as well.

#### *4.6- Conclusion on short-term effects*

Concluding this section on FFP's short-term effects, it appears important to me to underline the fact that FFP should reach one of UEFA's main objective with this regulation, which is to introduce rationality in clubs' finances and to decrease the inflation of player salaries and transfer fees (UEFA, 2010).

As a whole, it is clear that FFP will not have a pronounced effect on the competitive balance in terms of playing strengths. On the other hand, it appears to me that it should improve the competitive balance in terms of fairness. The impossibility for sugar daddies to directly inject money into clubs so as to buy players and pay high wages actually rebalances the competition (reducing their win probability) and makes it fairer in regard to small clubs that are not owned by benefactor owners.

The assumption that FFP might work as a barrier of entry since the impossibility to use external money is also one less tool for small clubs in order to break the big clubs' dominance is according to me, not relevant. The reason for this being that the marginal cost for not being able to use external money is much higher for clubs' owned by sugar daddies than it is for small ones.

Many authors expressed a concern about a possible risk for FFP in the short-term to "freeze" the hierarchy because of the effects mentioned above. I do not believe this argument is relevant either since the situation after FFP enters into force is not more conducive to a freeze of the hierarchy than it was before FFP. Differences in economic power will always exist and they will solely be a consequence of clubs' different market sizes instead of being a direct consequence of the sugar daddies' influence. As a whole I therefore consider FFP brings more fairness into the competitive balance.

This section focused on short-term effect. I will now analyze if FFP's effects will be as positive on a long-term perspective.

## 5- Medium-term effects on competitive balance

The effects of FFP on the competitive balance described in the previous section were based on a short-term perspective and focused on the reduction of cash flows. I will now instead focus on differences in management incentives and show how the fact that some clubs' exhibit myopic preferences could impact the competitive balance.

It is my belief that, past the first years after the introduction of FFP and the shock of reduced cash flows, clubs will face other kinds of problems over the medium-term. Most clubs, in my opinion, should succeed to reach levels of revenues equal to the ones before FFP after the first years of adaptation to the regulation. However, most of them will also probably exhibit the same type of biased management incentives as they had before FFP, the only difference being that such behaviors will now lead to sanctions from the UEFA. This is why there might be differences in how well they respond to FFP, between clubs owned by sugar daddies that developed very weak management skills and incentive and smaller clubs, that were not able to count on huge money injections from their owner and had to become very efficient with their limited means.

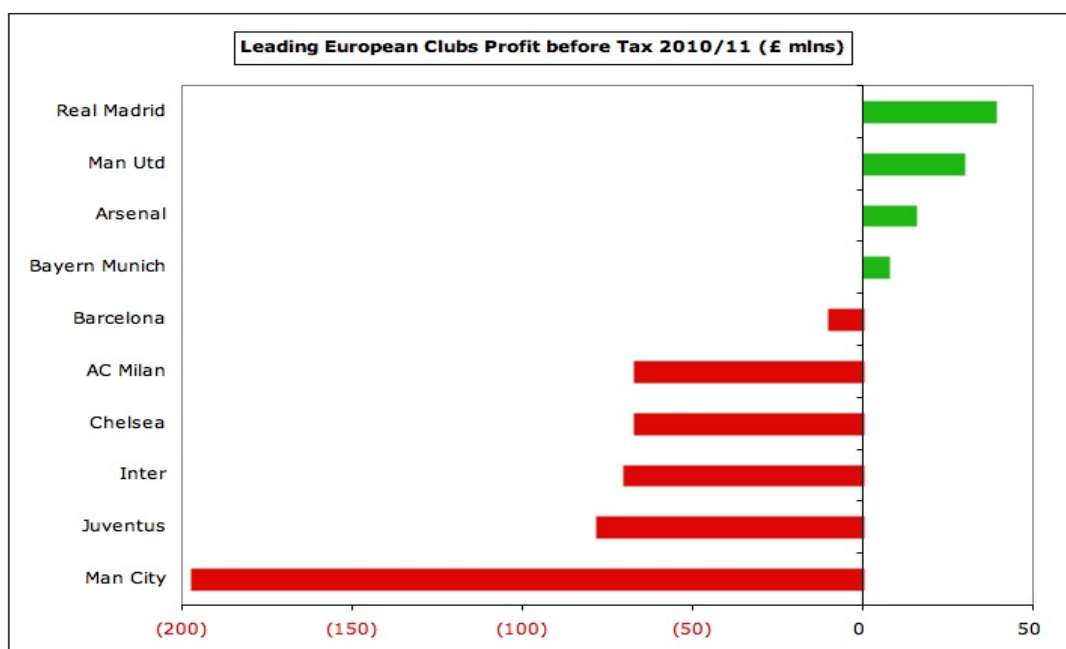
After taking the hit of the restrictions (such as the impossibility to use external financial sources) small clubs should, in a second phase, benefit from their management skills that are in my opinions better adaptable to FFP than some of the bigger clubs', especially because of the fact that the first ones exhibit less myopic preferences regarding their investments.

In section 5 I will then look at FFP's effects over the medium-term only and focus on how clubs' biased investment incentives (represented by  $\alpha$  in the economic model) will affect the competitive balance. I do not focus on the long-term since I believe that whatever advantages the small clubs have in the medium-term, those will eventually be acquired by the bigger ones in the long-term as all clubs should tend to make less shortsighted investments and find less result-related sources of income.

### 5.1.1- Sugar daddies: selfish consumption motives

My goal in the following paragraphs of section 5 is to discuss how well club's management incentives fit the new restrictions coming along with FFP. And that way analyze which ones will actually benefit from FFP and which ones will not. Which might allow for changes in the competitive balance.

A common argument among people that believe FFP will worsen the competitive balance is the fact that the regulation still allows sugar daddies to make long-term investments in areas such as youth development and infrastructure. Which gives those clubs an advantage on those that are not owned by a benefactor owner (Drut, 2013). However, this parameter in the FFP regulation might not necessarily lead to an advantage for clubs owned by a sugar daddy. Franck (2010, p.117) argues that "benefactor motives are pure selfish consumption motives, analogous to race horse ownership". According to this idea, sugar daddies owning a football club behave in a similar way to horse owners. They too, buy the club to gain a consumption benefit that might be the thrill of the match day, the happiness of seeing their team win or the excitement of meeting high-quality opponents (Madden, 2012). And just like racehorse ownership, this consumption motive usually leads to negative financial benefits (Gamrat and Sauer, 2000) in clubs owned by sugar daddies.



Source: [www.swissramble.blogspot.co.uk](http://www.swissramble.blogspot.co.uk)



This can be observed in the above graph, showing that three clubs owned by benefactor owners (Chelsea, Manchester City and Inter Milan) made huge losses for the season 2010/2011, mostly because of investments that did not pay off as they were expected to.

For example, a club could choose to buy and pay a player a very high salary (with money injected by the sugar daddy), expecting to get a high return on investment thanks to good sportive results that this new player would enable. But in the case of worst sportive results than expected the initial investment could lead to a huge loss since the player's transfer fee and high salary would not be compensated by the gain of price money.

This phenomenon is expressed in equation (3) and (5) of the economic model. Equation (3) expresses the fact that teams with myopic preferences do not value the costs of investments correctly and therefore expect too high of a profit. The myopic tendency is represented by  $\alpha$  in the equation and the lower the value of  $\alpha$  is (which means that the team has very high myopic preferences) the higher is the expected profit. Which is in fact a miscalculation from the team (because of its myopic preferences) since equation (5) shows that the lower the value of  $\alpha$  is, the more negatively impacted is the actual profit. Which means that the actual profit will turn out to be much lower than the one the team was expecting.

Finally the motive that lies behind sugar daddies' decision to buy a certain club, a selfish consumption benefit in most cases, might actually be an obstacle for long-term investments. Assuming that, benefactor owners might not have the patience or the desire to invest in something less "glamorous" than football superstars such as infrastructure or youth development. I then consider that the impossibility for benefactor owners to directly inject money to buy players and pay them high wages is actually not compensated by hypothetical bigger investments in infrastructure and youth development. And this in turn, preserves the idea of an improved competitive balance regarding the fairness of the terms of competition. The reason for that being that bad management leading to losses will not go unpunished any longer, which values smaller clubs' healthy management.

## *5.1.2- Moral hazard tendency*

If it actually appears that moral hazard tendency is a disadvantage, I need to understand why clubs owned by sugar daddies are more inclined to exhibit this characteristic than smaller clubs.

The economic model presented in section 3 points out moral hazard (or myopic preferences as I have described it so far) as one of the main components explaining clubs' overspending tendencies. These overspending are in turn the consequence of miscalculated costs of investments and incorrect expected profits. The explaining factors for that moral hazard tendency leading to biased investments incentives is the rat-race phenomenon witnessed in football leagues. That is why I want to analyze why big clubs are more inclined to exhibit a moral hazard tendency than small clubs since this represents an advantage for the small ones in regard to how well they will adapt to FFP in comparison to the big ones.

Well according to Késenne (2006, p.426 ) "heavy losses of most European football clubs are generally believed to be caused by poor management and the reckless overpayment of professional players, whose performances are staying far behind the expected or predicted levels". This reality relates precisely to the problem of moral hazard in football, where the presence of sugar daddies can lead some managers to demonstrate a certain negligence and lack of consideration for how serious some economic situations actually are (Kornai, 1986). Once again this also refers to the value of  $\alpha$  expressed in the economic model. A low value of  $\alpha$  means that clubs miscalculate the costs of investments and the expected profits, which often leads to financial losses such as mentioned above by Késenne. This moral hazard phenomenon is I believe, very accurate for clubs owned by sugar daddies, in the way that their managers have somehow lost touch with reality and over-investments have become very common (Vöpel, 2013). The fact that they have the support of their benefactor owner makes their behavior and decision-making much less influenced by real matters of efficiency and profitability that smaller clubs have to face (at least in the sense that those will probably try not to make losses).

The FFP will automatically bring clubs down to earth since a same level of moral hazard would keep them from meeting the requirements of FFP and get the required license to participate in European competitions. In the medium term, that is why small clubs should have an advantage because of the fact that their decision-making is more “down-to-earth” and thus more FFP-compatible compared to clubs owned by benefactor owners. This results in the increase of the competitive balance in terms of fairness since all clubs have now to face a wide set of sanctions if they stick to management incentives polluted by moral hazard, which was not the case before FFP.

### *5.1.3- Managerial rent-seeking*

I want to follow the idea that management incentives (in the sense of economic management) should be a very important factor for how well clubs will manage to compete with each other in consideration to FFP’s restrictions. And just like moral hazard tendencies, clubs will be sanctioned because of FFP’s restrictions if they cannot erase some of the managerial rent-seeking behaviors that can be witnessed among their managers.

Kornai (1986) for example, states that sugar daddies actually lead clubs to have an almost perfectly soft budget constraint where their own price-elasticity of demand is zero. Moreover he believes “allocative efficiency cannot be achieved when input-output combinations do not adjust to price-signals and that within the firm there is no sufficiently strong stimulus to maximum” (p.10). Finally he also states that if “ a rent-seeking behavior is rewarded in soft budget constraint organizations, their managers invest less effort and energy in developing the business by improving quality, cutting costs, introducing new products or new processes” (p.10). This rent-seeking phenomenon can be described as “when a company, organization or individual uses their resources to obtain an economic gain from others without reciprocating any benefits back to society through wealth creation” ([www.investopedia.com](http://www.investopedia.com)). Applied to football clubs, this can refer to managers asking the sugar daddy for some money to buy a “star player” that will presumably bring success to the club. The manager’s action becomes “managerial rent-seeking” when his goal is to please the sugar daddy so as to

secure his own job, rather than investing in this player because he truly believes it will lead to a sportive and economic success. Which often does not.

The reason why I quote Kornai so carefully is because the situation he describes is in some cases, exactly what can be witnessed in clubs owned by sugar daddies. And this can again be related to the value of  $\alpha$  in the economic model, showing that the bad management incentives expressed by  $\alpha$  (in this case rent-seeking) will eventually lead to economic losses. And on the other hand, the opposite is true among smaller clubs restricted by hard budget constraints and for which the value of  $\alpha$  is very high. And since FFP is actually forcing clubs to have a constraint (set by the level of revenues), the clubs used to work with a hard budget constraint should have an advantage on the ones that were basically not restricted by any kind of budget. Managers used to work with no budget constraint could then tend to be less innovative and have a less entrepreneurial mindset than the others.

Moreover, according to Franck (2013) more money will be generated through better management decisions. If we assume that, just like in any other business, a change of the management policy in clubs owned by sugar daddies will take some time, their revenues will probably not increase through this mechanism in the medium-term. Which is another disadvantage in comparison to smaller clubs that might rebalance the competition. Finally this shows in my opinion that the fairness of competition is emphasized since only the clubs realizing that they need to bring more rationality into their investments and management decisions will avoid sanctions from the UEFA.

#### *5.1.4- Youth development and asymmetry of information*

I finally want to underline one last factor that should I believe, emphasize some advantages of the small clubs over the big ones and improve the fairness of the terms of competition brought by FFP. This factor lies in the clubs' asymmetric information regarding the discovery and training of young talents.

The search and development of young players will probably become more and more important in the future since the best players will be harder to buy, at least compared to the situation before FFP came into force. And even though financial investments into youth academies can be regarded as an advantage for sugar daddy-owned clubs (benefactor owners can still invest limitless amounts of money into youth development) there are several other parameters that are not impacted by financial means that give smaller clubs with a strong experience in youth development a significant advantage.

One of these parameters can be regarded as the asymmetry of information on the player market. Vöpel (2011) believes that this asymmetry of information could work as an equalizer between clubs with small financial means and the bigger ones. Money does help buying some of the best players of course. However, this money is sometimes useless when it comes to finding the young talented players and potential future stars. And some clubs have learned to master the art of discovering unknown prodigies. Examples are Arsenal in England, Dortmund in Germany, but also much smaller clubs like Lorient and Auxerre in France. The ability to see young players' talent and the art of maximizing their potential is nothing you learn from one day to another. And although I have to admit that Arsenal and Dortmund are not considered as small clubs but the examples of Lorient and Auxerre show that some of the small clubs' expertise in this area might be crucial as a mean to be more competitive against the big ones.

In my mind this definitely reinforces the improved competitive balance in terms of fairness of the competition. The clubs' knowledge about youth development will now be a much more competitive asset than it was before FFP, in the sense that their knowledge could be overshadowed by other clubs' financial power. Rich clubs could often "bid" on many young talents and hope that at least one of their investments would turn out to be a star. And in most cases these young talents could be attracted by lucrative contracts. These types of investments can here also relate to the value of  $\alpha$  in the economic model since these clubs "gamble" on young players and have incorrect expectations about their future payoff for the club. And so, as I explained, knowing that this type of management often leads to economic losses which are sanctioned by FFP,

I can assume that clubs will be much more cost-efficient in regard to their investments in young talents. In that sense smaller clubs that are much more knowledgeable about youth development will gain an advantage over the big ones.

The competitive balance in terms of fairness of the competition is then here improved since the knowledge of youth development is truly reinforced as a strong asset for a club to have, once FFP entered into force.

### *5.3- Conclusion on medium-term effects*

As I expressed above I believe that smaller clubs should benefit from FFP's restriction on a medium-term perspective since the non-financial assets that they possess (healthy and long-term oriented management incentives as well as youth development knowledge among others) will give them an advantage on bigger clubs. At least those assets will be more useful than before FFP entered into force, since the financial power of big clubs could sometimes overshadow the smaller clubs' technical expertise in specific areas (since young players could choose the most lucrative contract in a bigger club for example, instead of a club's youth development abilities). Bad management incentives, as I explained, often lead those big clubs to make losses. But since FFP sanctions losses, "sugar daddy clubs" will now be forced to be much more longsighted and careful with their investments.

The fairness of the terms of competition is then improved in regard to the fact that smaller clubs' technical and managerial expertise (their human capital one could say) is no longer overshadowed by the big clubs' financial power in the same proportions as before FFP.

## 6- Long-term effects on football industry

After focusing on FFP's short- and medium-term effects on the competitive balance, I now want to analyze how those effects will impact the football industry as a whole over the long-term. In my opinion, the advantage that small clubs benefited from in the medium-term should disappear over the long-term since all clubs will eventually migrate to healthier and more efficient management incentives. Which, as I will show, should benefit European professional football as a whole through allowing for a healthier and more stable economy.

### *6.1- FFP as better management incentives*

Although some people are skeptical about the possible positive effects of FFP on the football industry, it is a reality that clubs will have to accommodate to tighter restrictions and new levels of expenses. Clubs supported by a sugar daddy will no longer be able to spend regardless of any budget constraint but will have to stick to amounts that are not exceeding their revenues. Clubs using a little bit more rationality in their investments and management should therefore be rewarded in the long run.

Clubs that did not have the support of a benefactor owner had to be much more realistic and creative when trying to avoid financial losses and finding solutions within their means to improve the team. This difference of management skills and incentives was expressed in the previous section where big clubs often suffered of a moral hazard tendency in their decision-making. I believe that in the long-term all clubs should realistically learn from their mistakes and evolve towards more long-term investments and management decision-making. Following this idea and grounding my reasoning on the economic model from section 3 I can then assume that improved managerial incentives would be expressed by a higher value of  $\alpha$  in equation (5). Which in turn should allow for higher actual profits in the case of a winning team. As a general effect, the improved management incentives brought by FFP will then lead in the long-run to more profits for the football industry as a whole and a healthier economy.

## *6.2- Increased market size, a key objective*

A key effect of FFP on all clubs will be that the constant stimulation of their ability to find and develop new income sources. Either to be able to keep the same level of expenses they had before FFP (in this case mostly the sugar daddy-owned clubs) or to actually increase their revenues as a mean to improve their competitiveness (mostly smaller clubs).

I know that the main determinant of clubs' potential revenues is their market size. As mentioned before a club's market size is one of the most crucial factors determining its competitiveness and as Sass (2012) emphasizes, an increase in a club's market size will lead to an increase of its revenues and allow more talent units that will in the end enable a higher win percentage. Most of the big European clubs, as a consequence of their past successes, might have already benefited from the positive economic effects of an increased market size. At least, the marginal benefit of investing so as to increase the market size might be much smaller for the big clubs compared to the smaller ones. That is why there is certainly an important potential for revenues that all smaller clubs need to maximize, and that would bring a new wave of incomes to the football industry. And the key for a club to increase its market size (or revenue potential) is in my opinion to increase the number of fans it attracts. To achieve that I see one main approach for the clubs, which is becoming the owner of its stadium as a mean to increase the gate revenues and ensure less result-related revenues.

## *6.3- Stadium ownership*

It is clear that finding income sources for the clubs will be even more crucial than it ever was before the introduction of FFP. As FFP will sanction the consequences of management incentives exhibiting moral hazard tendency and leading to financial losses, all clubs will need to find healthier and more stable sources of income. They will need new tools to either increase their market size (finding more customers=fans) or to fructify an already increased market size (make the new customers "consume" as much as possible so as to increase revenues).

And so one of the most efficient ways for clubs to increase revenues in the future will be, in my opinion, the revenue potential surrounding football



stadiums. Let me explain myself. According to the UEFA (2013) there were in 2011 only 24% of European clubs that actually owned their stadiums, and only 33% owned their training facilities. This number concretely shows that there is a huge potential for future revenues. Thus, owning its own stadium generates much more revenues for a club compared to a situation where the stadium is owned by the municipality or the state. The reason for that is because the club keeps all the generated revenues in the first situation while it usually has to share them with the city in the second case, or with a third part if it's a multiple ownership for example.

According to the UEFA (2013), clubs owning their stadium generated 23% and 11% of their total revenue from gate receipts and commercial activities compared to just 14% and 7% for those clubs who rent their stadium. As Franck (2013) argues, clubs should then invest their money in stadiums, infrastructures and youth academies instead of constantly buying players, since it will generate more sustainable relevant income. New stadiums with higher capacity could bring higher gate revenues of course. The table below shows how big of a difference there can be between clubs, regarding the match-day revenues. Manchester United earns for example almost 3 million pounds more than Aston Villa per match. This is a huge difference, and smaller clubs will need to generate more gate revenues as a mean to keep competing with the leading ones.

<b>Match Day Revenue 2010/11</b>					
<b>£ mlns</b>	<b>Stadium</b>	<b>Capacity</b>	<b>Match Day Revenue</b>	<b>No of Matches</b>	<b>Revenue per Match</b>
Manchester United	Old Trafford	76,000	108.6	29	<b>3.7</b>
Arsenal	Emirates	60,400	93.1	28	<b>3.3</b>
Chelsea	Stamford Bridge	41,800	67.5	27	2.5
Tottenham	White Hart Lane	36,300	43.3	27	1.6
Liverpool	Anfield	45,400	40.9	27	1.5
Manchester City	Etihad	47,800	26.6	29	0.9
Newcastle United	St. James Park	52,400	24.3	20	1.2
Aston Villa	Villa Park	43,000	21.4	23	0.9

Source: [www.swissramble.blogspot.co/uk](http://www.swissramble.blogspot.co/uk)

Owning its own stadium or even build a new one are some of the solutions for that. However, clubs need to increase the match attendances if they actually want to use the stadiums' potential for revenue generation. The solution can be

found in postmodern arenas that offer not only the football game as a core product, but also supplementary services such as restaurants, conference facilities, VIP boxes and so on...(Buraimo et.al., 2008).

The technique of bundling could then be a solution in my opinion, so as to attract new people to the stadium even though they might not be real football fans. If they could buy a package that included a ticket for the game, a lunch at a restaurant in the stadium and a discount voucher for the club store for example, more people might be interested in coming to the stadium. The key for clubs is to offer an enhanced match-day experience, where the game as a core product is improved by supplementary services.

Moreover, it will be crucial for clubs to use stadiums so as to generate less result-related incomes. Renting out the stadium for concerts and offering conference possibilities for example would then be the perfect way to do so. The question though, is whether or not small clubs might be better skilled to achieve this than bigger ones. Or at least take it to another level since this phenomenon of enhanced match-day experienced is already used in many stadiums. The assumption that smaller clubs have better management skills regarding football related questions, as mentioned before, might not fit here since owning your stadium and develop it requires investments. Investments that could be made by sugar daddies since those types of investments are allowed by FFP for long-term purposes. However, loans made by a smaller club to invest in infrastructure would also be accepted by FFP, which then equalizes every club's possibilities and would allow for a generalized trend in the maximization of gate-revenues. Resulting once again in a general increase of the revenues in the football industry.

## *6.4- Conclusion on long-term effects for the football industry*

It appears to me that FFP should definitely benefit the football industry as a whole over the long-term. The hypothetical advantage of small clubs in the medium-term should disappear since all clubs will be forced to adapt their decision-making and management in regard to FFP's restrictions. The rationality

and long-term philosophy that this will bring to the clubs should lead to the finding of new income sources and less result-related revenues through the stadiums for example, and thus allow for more stable finances. This would in the end, mitigate the negative effect of the rat-race phenomenon in the football world since clubs would no longer be negatively impacted by the quest for prize money in the same proportions as they were before.

## **7- Final Conclusion**

The main goal of this study was to analyze what impacts FFP will have on the competitive balance regarding the fairness of the terms of competition, on a short- and medium-term perspective.

On a short-term perspective it seems that the competitive balance should be improved, mainly because of the fact that the reduction in clubs' cash flows caused by FFP should be more restricting for clubs owned by benefactor owners than for smaller ones. This improvement in the competitive balance would be expressed in smaller differences in win probabilities between clubs.

On a medium-term perspective the effect caused by cash flow reductions should disappear since all clubs will probably manage to reach their revenue levels pre-FFP once they have taken the hit from the first years after FFP enters into force. However this would also mean that clubs owned by sugar daddies will still exhibit bad management incentives and express a tendency for moral hazard (also mentioned as myopic preferences) and managerial rent-seeking. Since this type of behavior usually leads to economic losses, which is sanctioned by FFP, it can be assumed that those clubs will have difficulties to adapt to FFP and will not keep the same level of competitiveness. On the contrary to smaller clubs that will gain advantages on the bigger ones in regard to some non-financial assets they possess, such as their expertise in youth development or their cost-effective and long-sighted management skills.

Despite these positive effects it is important to underline that FFP will probably not have a pronounced effect on the competitive balance in terms of playing strengths. The important point here is that the competitive balance in regard to the fairness of the terms of competition is improved. This means clubs will now

compete with similar tools and make their theoretical win probabilities fairer. Which was not the case before FFP with the unfair financial advantage of the clubs owned by benefactor owners. FFP will then make sure that all clubs feel that they now have a fairer chance to compete against each other. This will not lead to equal playing strengths on the field since it is not FFP's goal with the regulations. To quote Jean-Luc Dehaene, chief enforcer of the UEFA's FFP, "the FFP rules will not be enough to help smaller clubs on their own, much will still depend on how they organize themselves. And there will always be a difference between clubs like Bruges and Barcelona, because of TV rights and the number of fans. But the differences can be smaller" ([www.bbc.com](http://www.bbc.com)).

All of the above effects should have a positive impact on the football industry as a whole since it should force all clubs to adopt healthier and more long-sighted management incentives. Which will be translated in the search for new and less result-related income sources through the revenue maximization of the stadiums for example. Leading to increased revenues and a more stable economy for the football industry as a whole.

Finally if the need for an enhanced competitive balance in regard to the playing strengths on the field was desirable, there might be a few possibilities to enable that. The use of a luxury tax such as in the NBA has proved to be efficient in improving this competitive balance. Having the clubs that overstretch the salary cap to pay a tax, which is then redistributed to the other teams, is definitely a system improving the competitive balance. Another much more restrictive solution might otherwise be the use of an asymmetric financial policy. The restrictions of FFP could then only apply for the "big" clubs and the smaller ones would be free to still use external money. However this solution would be difficult to implement because of the difficulty to categorize clubs between small and big and because of the fact that small ones might probably turn out to exhibit some of the negative tendencies observed with the big ones today.

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