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Professional sports: strategic approaches to investment attractiveness formation

Abstract

The unstable financial condition of sports clubs combined with negative cash flows and losses can cause the collapse of the entire football industry. Thus, the total losses of top division clubs in 2011, when their maximum level was observed, amounted to 1.7 billion Euros, which is largely due to the European model of sports activities, when the main principles of building a business and financial efficiency go by the wayside. However, the introduction by UEFA in 2011 of «financial fair play» rules, designed to make the financial policies of clubs more rational and disciplined, led to an annual reduction in losses from the activities of the football industry and stimulated long-term investments in the development of youth sports and infrastructure.

The article is devoted to the search for an effective business model for the further development of the professional sports industry, taking into account modern requirements of market economy. The study was conducted based on a review of the experience of English and Danish clubs whose stocks are traded on the stock market. As a theoretical basis of the research, a value-oriented model is used, which consists in determining the reaction of the stock market to the management efficiency of a sports club.

The results showed that the most financially stable are clubs that have chosen the American approach to the sports business as their development model. Therefore, one of the ways to optimize the financial stability of professional sports entities can be the implementation of measures to increase the share of tangible assets in the overall structure of non-current capital through the construction of a developed sports infrastructure, as well as diversification of activities via development of related and non-core areas, which will generate income in addition to participation of clubs in sports competitions, due to the synergistic effect of commercial activities under a brand of a well-known sports team, making the parent organization less dependent on the sports component, which will ultimately increase the investment potential of the football industry as a possible area for investing private capital.

Keywords: Investments; Professional Sport; Football; Assets; Value; Business Model; Efficiency; Infrastructure; UEFA; English football clubs; Danish football clubs

JEL Classification: Z23; L83; E22

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Професійний спорт:

стратегічні підходи до формування інвестиційної привабливості

Анотація. Нестійкий фінансовий стан спортивних клубів у поєднанні з негативними потоками грошових коштів і збитками можуть стати причиною краху всієї футбольної індустрії. Сукупні збитки клубів вищих дивізіонів у 2011 році, коли спостерігався максимальний їх рівень, склали 1,7 млрд. євро, що багато в чому пов'язано з європейською моделлю здійснення спортивної діяльності, коли в прагненні отримати спортивні результати на другий план відходять основні принципи побудови бізнесу й фінансова ефективність. Введення УЄФА в 2011 році правил «фінансової чесної гри», покликаних зробити фінансову політику клубів більш раціональною та дисциплінованою, призвело до щорічного скорочення рівня збитків від діяльності суб'єктів футбольної індустрії та стимулювало довгострокові інвестиції в розвиток дитячо-юнацького спорту й інфраструктуру.

Наша стаття присвячена питанням пошуку ефективної бізнес-моделі для подальшого розвитку індустрії професійного спорту з урахуванням сучасних вимог ринкової економіки. Дослідження проведено на основі розгляду досвіду англійських і датських клубів, чії акції представлені на фондовому ринку. В якості теоретичної бази дослідження використовується ціннісно-орієнтована модель, яка полягає у визначенні реакції фондового ринку на ефективність менеджменту спортивного клубу.

Результати показали, що найбільш фінансово стійкими є клуби, які обрали своєю моделлю розвитку американський підхід до ведення спортивного бізнесу. Одним із напрямків оптимізації фінансової стійкості суб'єктів професійного спорту може бути здійснення заходів щодо підвищення частки матеріальних активів у загальній структурі позаоборотного капіталу за допомогою будівництва розвиненої спортивної інфраструктури, а також диверсифікації діяльності шляхом розвитку супутніх і непрофільних сфер, що дозволить генерувати дохід додатково до участі клубів у спортивних змаганнях, за рахунок синергетичного ефекту від здійснення комерційної діяльності під брендом відомої спортивної команди, роблячи головну організацію менш залежною від спортивної складової, що в підсумку підвищить інвестиційний потенціал футбольної індустрії як можливої сфери вкладення приватного капіталу.

Ключові слова: інвестиції; професійний спорт; футбол; активи; вартість; бізнес-модель; ефективність; інфраструктура; УЄФА.

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Профессиональный спорт:**стратегические подходы к формированию**

Аннотация. Неустойчивое финансовое состояние спортивных клубов в сочетании с отрицательными потоками денежных средств и убытками могут явиться причиной крушения всей футбольной индустрии. Совокупные убытки клубов высших дивизионов в 2011 году, когда наблюдался максимальный их уровень, составили 1,7 млрд. евро, что во многом связано с европейской моделью осуществления спортивной деятельности, когда в стремлении получить спортивные результаты на второй план уходят основные принципы построения бизнеса и финансовая эффективность. Введение УЕФА в 2011 году правил «финансовой честной игры», призванных сделать финансовую политику клубов более рациональной и дисциплинированной, привело к ежегодному сокращению уровня убытков от деятельности субъектов футбольной индустрии и стимулировало долгосрочные инвестиции в развитие детско-юношеского спорта и инфраструктуру.

Наша статья посвящена вопросам поиска эффективной бизнес-модели для дальнейшего развития индустрии профессионального спорта с учетом современных требований рыночной экономики. Исследование проведено на основе рассмотрения опыта английских и датских клубов, чьи акции обращаются на фондовом рынке. В качестве теоретической базы исследования используется ценностно-ориентированная модель, заключающаяся в определении реакции фондового рынка на эффективность менеджмента спортивного клуба.

Результаты показали, что наиболее финансово устойчивыми являются клубы, избравшие своей моделью развития американский подход к ведению спортивного бизнеса. Одним из направлений по оптимизации финансовой устойчивости субъектов профессионального спорта может являться осуществление мероприятий по повышению доли материальных активов в общей структуре внеоборотного капитала посредством строительства развитой спортивной инфраструктуры, а также диверсификации деятельности путем развития сопутствующих и непрофильных сфер, что позволит генерировать доход помимо участия клубов в спортивных соревнованиях, за счет синергетического эффекта от осуществления коммерческой деятельности под брендом известной спортивной команды, делая головную организацию менее зависимой от спортивной составляющей, что в конечном итоге повысит инвестиционный потенциал футбольной индустрии как возможной сферы вложения частного капитала.

Ключевые слова: инвестиции; профессиональный спорт; футбол; активы; стоимость; бизнес-модель; эффективность; инфраструктура; УЕФА.

1. Introduction

After the Union of European Football Associations introduced the rules of financial discipline, a new stage in the development of the football industry began. In 2017, football clubs for the first time reported a total profit of more than 600 million Euros, while a few years earlier the total losses of the clubs, representing the top European football divisions, were amounted to 1.7 billion Euros. This fact indicates a possible change in the investment attractiveness of the sports clubs. The goal of this article is to identify, whether the increase in the profitability of the football industry is connected with a change in the approach to conduct of sports business and to draw a conclusion about the effectiveness of a business model. The study is based on the information obtained on the analysis of official statistical sources, including a comparative UEFA report for 2017 on the licensing of «Landscape of European Club Football» (UEFA, 2019), normative legal acts, regulating public relations in the field of professional sports, publications in periodicals and on the Internet, illustrating practice and problems of professional sports development.

2. Brief Literature Review

The issues of economic and financial processes occurring in professional sports, as well as the problems of strategic management of sports subjects, were considered in a large number of

studies that made an important contribution to formation of the theoretical and methodological foundations of the field study. The basic works that reveal the economic and social aspects of the sports industry development include the researches of the following scientists. These authors had significant impact on the definition of the sports industry development. Features of business process management on the example of the professional sports subjects are revealed in scientific works of following authors: S. Altukhov (2015) [1], A. Trokhov (2017) [12]. The problems of transformation of the economic foundations of professional sports and the features of the formation of stakeholder relations in sports devoted to the works of A. Pochinkin, I. Dimitrov and S. Visheyko (2018) [8], P. Garcia del Barrio and S. Szymanski (2009) [5]. Methods of applied statistics in sports are set forth in S. Antonova and G. Evdokimova (2015) [3], A. Vorobyev, E. Zarova, I. Solntsev, N. Osokin and V. Zhulevich (2016) [13]. Problems of diversification of tourism and sports in the conditions of the digitalization are revealed in the publications of S. Ziyadin, O. Litvishko, M. Dubrova, G. Smagulova and M. Suyunchaliyeva (2019) [14]. Features of implementation of investment projects in the field of professional sports are considered in the works of M. Zolotov (2015) [15], V. Titov and R. Veynberg (2015) [11]. Legal regulation of the sphere of professional sports and implementation of the rules of financial fair play in European football, addressed in the articles of T. Peeters and S. Szymanski (2014) [7], N. Dermitt-Richard, N. Scelles and S. Morrow (2017) [4]. Economic and financial models of professional football clubs are revealed in scientific works of I. Solntsev, N. Osokin and A. Vlasov (2019) [10], N. Scelles and W. Andreff (2017) [9]. Furthermore, in the scientific works by W. Andreff and S. Szymanski (2006) [2] two approaches to the professional sports development were considered. The first approach, which is typical for Anglo-Saxonian countries, aims to maximize the profit. Sport results in such case are considered as a profit tool. According to the second approach, which is typical for the European countries, the main priority is the competition and results, while financial efficiency is a secondary concern. In our research, we would like to combine these two approaches in order to create a new one, which may have advantages of both and no disadvantages.

3. The purpose of this article is to determine the most optimal approach to management of a sports club, which will increase its attractiveness as an object of investment.

4. Methodological Framework

The authors in their study are based on the presence of correlation between high sports efficiency and profit obtained. If the sports club administration strives to minimize the costs related to recruiting qualified athletes in their team, possible sports success will be limited, and potential profit from realization of the sports product with such approach will be limited with low demand. Increase of such costs will provide better results and more spectacular team performance, higher game attendance, interest by sponsors and mass media, resulting in profit increase. Yet, such correlation lasts until the certain moment when achieving another sports goal fails to give required profit to cover all costs related to achieving a higher level in sports hierarchy, forming a curve on the line of profit level and sports success is presented in Figure 1.

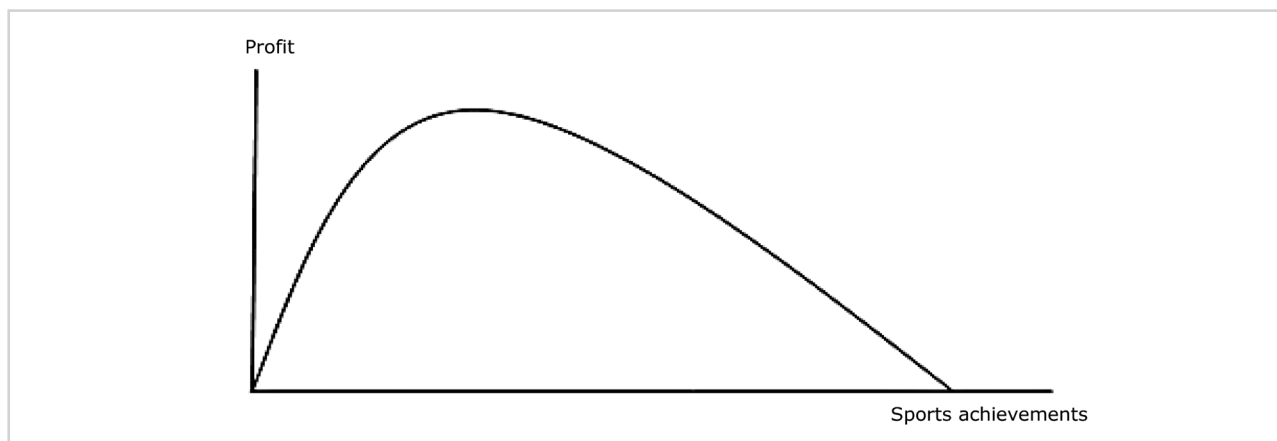


Figure 1:
Correlation between profit and sports achievements of sports club
Source: W. Andreff & S. Szymanski (2006) [2]

Figure 2 uses indifference curves, representing multiple combinations of resources equally useful for the club, to depict two completely different approaches for sports activities. Flat indifference lines are typical for a club that aims to the profit maximization (PM); with such approach, the sports result is not the main priority but a tool to achieve the main goal. Curved indifference lines are typical for a club that aims to maximize the sports results (UM). With such approach, the club administration is ready to refuse from potential profit increase: e. g. refuse selling club rights for an athlete if it can impair the team performance. High team performance covers non-received profit resulting in curved indifference line.

Considering interdependence between the club profit and its sports achievements, we can determine efficient business strategy in terms of the 1st and the 2nd models. Figure 3 represents determination process of a balance point for profit maximization and productivity models. If the 1st approach is applied, the club administration stops at the crossing with highest flat indifference line with coordinates $(\pi(PM), S(PM))$. Crossing of indicator correlation and indifference curves in the point $(\pi(U), S(U))$ will be the most beneficial in achieving the sports result.

The main task for the sports club management is to determine a balance between profitability and successful sports performance of the team. Aiming to maximize the profit, the club

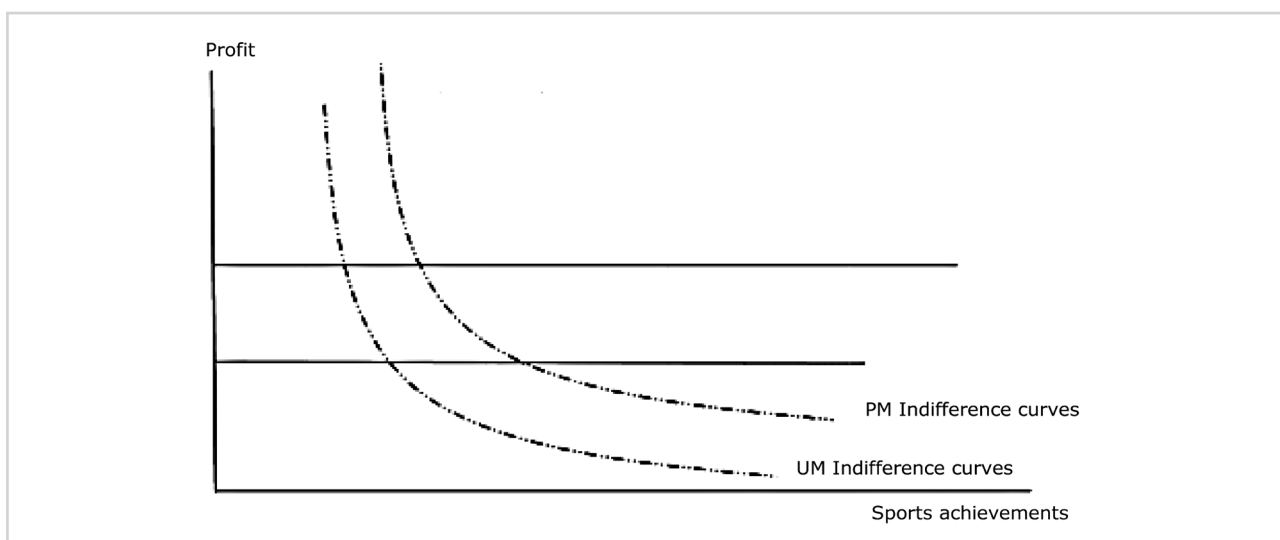


Figure 2:
Indifference curves for profit maximization (PM) and sports results (UM) models
Source: W. Andreff & S. Szymanski (2006) [2]

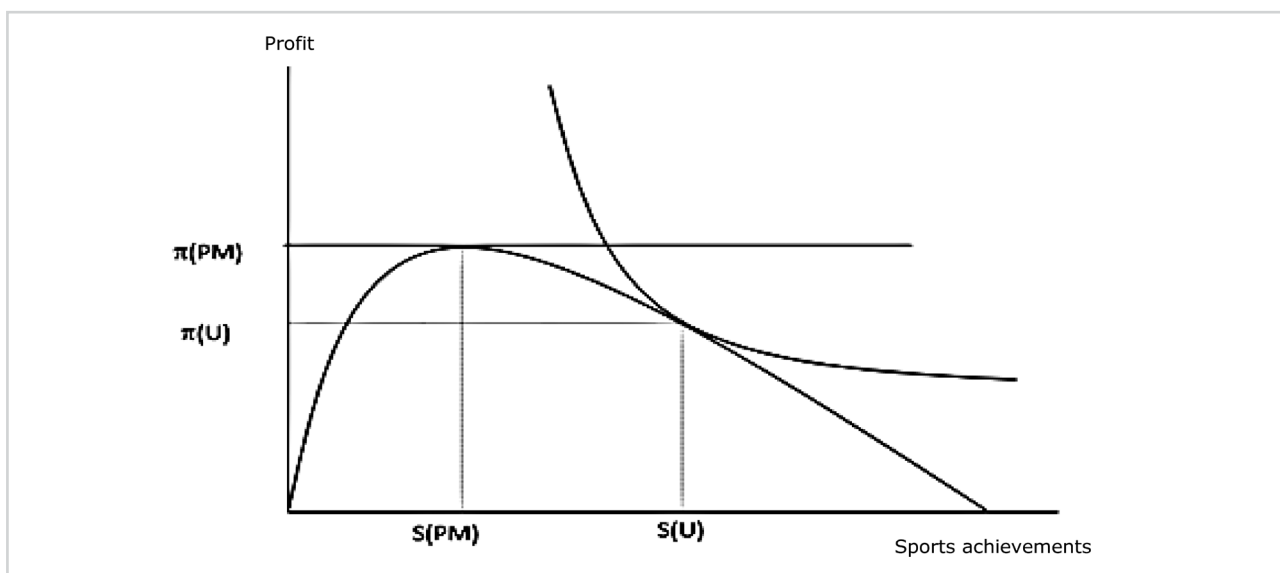


Figure 3:
Balance point for profit maximization (PM) and sports results (UM) models
Source: W. Andreff & S. Szymanski (2006) [2]

management often expects to receive quick one-time profit from selling and leasing rights for the athlete registration, as well as advertisement contracts and club merchandise sales. If a club utilizes «sports result maximization» approach, it aims for continuous long-term profit from successful tournament performance and it will make contracts with qualified athletes while the maximum benefit of sports success is higher than maximum cost of the labour contracts. Considering mentioned above, the difference between these two approaches is mechanism of incoming and outgoing cash flows allocation.

Regardless of the regulatory form and function model of the organization, the financial result is an important indicator of efficiency in a certain development phase; it is also an indispensable condition for further growth of commercial activity in production and financial area that increases marketability of an economic entity.

5. Results and Discussions

In football business, market processes started to emerge earlier than in other sports: purchase and sale of athletes registration rights, TV and radio game broadcasts rights, using sponsor brands as an advertisement, club funding. Active commercialization of European football began in 1992, when major business projects started, such as UEFA and Premier League. Members of the football business started earning big profits which made them attractive to professional investors, the clubs got a new method of attracting investments for their development: entering the financial market.

Anglo-Saxon market model considers initial public offering (IPO) as a mechanism to improve corporate management by making managers comply with discipline of financial markets. In case of poor management company capitalization decreases and managers can get fired. Yet, this rule does not always work for football clubs. For instance, in England, where IPO has become a popular mechanism of capital raising in the football business, sports achievements improved after the clubs entered the market, but they were also followed by significant financial losses and reduced quotations.

The reason is that initial purpose of IPO for clubs was stadium construction or renovation and other club infrastructure improvements, so the funds rose at the financial market were used to acquire more qualified athletes and pay their salaries, which resulted in short-term increase of sports achievements but gave no opportunity for long-term development. If a company does not invest into its development, it starts «eating itself» at certain moment, which ends up with bankruptcy in regular market economy [6].

Table 1 shows sports and financial achievements of English football clubs. It reflects average annual revenue (loss) before taxation 5 years prior the IPO and 5 years after it. For the same period, average values are given for such indications like team's position in tournament bracket, relative salary costs and club profits. Furthermore, in 11 cases out of 14, average position of the

Table 1:
Comparative analysis of English football clubs before and after the IPO (£ mln), the period from 2010 to 2015

Aston Villa	Birmingham City	Bolton Wanderers	Charlton Athletic	Chelsea	Leeds United	Leicester City	Newcastle United	Nottingham Forest	Queens Park Rangers	Sheffield United	Southampton	Sunderland	West Brom Albion	Average value	Change, %
Income (loss) before taxation															
162.4	25.6	-32.0	-73.6	101.7	189.2	-3.9	-642.9	-65.0	105.1	7.3	122.9	-47.3	-24.3	-12.5	
679.6	-262.6	-513.4	-80.9	48.0	-164.4	-314.0	-568.4	-649.7	-671.9	-323.4	-57.6	170.8	19.5	-192.0	-93.5
Tournament bracket position															
8	43	38	32	12	6	25	15	13	9	20	16	40	44	23	
7	25	22	17	5	5	12	10	28	37	31	13	15	30	18	+21.7
Salary costs relative to average value (1 is average league value)															
2.10	0.97	0.74	0.69	1.78	2.23	1.26	2.21	2.07	1.46	1.12	1.36	1.06	0.71	1.41	
2.21	0.83	1.17	1.15	3.70	2.78	1.98	2.97	1.37	0.94	0.83	1.27	1.68	0.61	1.68	+19.1
Profits relative to the average value (1 is average value in the league)															
2.25	0.81	1.07	0.50	2.00	2.48	1.33	2.88	2.44	1.19	0.73	1.51	1.59	0.76	1.53	
2.79	0.78	1.02	1.14	3.51	3.38	1.91	3.77	0.98	0.71	0.49	1.27	1.23	0.58	1.68	+9.8

Source: Compiled by the authors based on data of UEFA Club Licensing and Financial Fair Play Regulations (2018) [16]

teams in tournament bracket improved due to hiring higher-class athletes and resulted in salary costs increase in 8 cases out of 11. The club manager expected that teams profit will increase together with sports achievements with respect to average league value. As it can be observed in Table 1, it only happened in 6 cases, and average salary costs growth rate (+19.1%) was higher than the club profit growth rate (+9.8%).

By analyzing the profit (loss) value before taxation, it can be concluded that after entering the stock market, profitability of sports organization decreased significantly (by 93.5%). While total loss of sports clubs were £ 174.8 mln 5 years before the IPO, 5 years after the IPO they were £ 2 688,4 mln already. It indicates that the clubs did not switch from «achievements maximization» to «profit maximization» strategy as they entered the stock market.

Denmark is another country where sports organizations use IPO market mechanism to attract investments for their activity. Since the first IPO by the football club in 1987, members of sports business raised about DKK 2 billion with this mechanism.

In terms of determining how efficiently the clubs use the funds raised, it is reasonable to calculate the shareholder cost (VC) created/increased by them since offering shares at the stock market. We will use the following formula:

$$VC = CG - EO + D, \quad (1)$$

where:

CG is accretion to the capital ($CG = MC - NS * SP$);

MC is current market capitalization of the sports club;

NS is stock amount before the IPO;

SP is share cost at offer;

EO is funds raised by initial and subsequent equity offering;

D is total dividends paid to investors;

T, T + 1 ... T + 4 are periods after the IPO (years). Calculations are given in Table 2.

As it can be observed in Table 2, only Parken S&E could make profit for its owners from all the reviewed clubs while the rest lost their shareholder value. It is due to the reason that intangible assets, including labour obligations for athletes, are the biggest part in structure of active Danish clubs. Value of intangible assets, same as club profitability, is strongly related to sports

Table 2:
Influence of business model to financial performance in the Danish football clubs (DKK mln.),
the period from 2010 to 2015

Club	VC	Indicator	T	T+1	T+2	T+3	T+4	Average
Aalborg (AaB)	-200	Model	DIV	DIV	DIV	DF	DF	
		Profit	6.630	-7.732	36.681	-87.007	-42.647	-18.815
		ROE, %	5.18	-4.14	21.17	-76.71	-104.94	-31.89
		FL	0.28	0.45	0.90	2.28	8.89	2.56
Brøndbyernes (BIF)	-150	Model	FS	FS	FS	FS	FS	
		Profit	71.940	-23.998	-18.920	2.063	-34.920	-0.77
		ROE, %	18.47	-4.19	-3.43	1.24	-8.41	0.74
		FL	0.87	0.75	0.62	0.72	0.54	0.7
Aarhus (AGF)	-85	Model	DIV	DIV	DIV	DF	DF	
		Profit	-3.225	-7.511	0.084	-43.473	-25.314	-15.89
		ROE, %	-23.47	-31.67	0.19	-81.31	-79.58	-43.17
		FL	3.65	6.24	5.34	1.56	1.47	3.65
Copenhagen (Parken S&E)	+105	Model	DIV	DIV	DIV	DIV	DIV	
		Profit	57.685	161.905	46.631	-246.840	63.172	16.51
		ROE, %	9.16	19.64	6.10	-1.36	5.13	7.73
		FL	1.79	2.58	4.80	8.14	2.28	3.92
Silkeborg (SIF)	-158	Model	FS	FS	MS	MS	MS	
		Profit	0.748	-0.185	-6.485	-9.738	0.129	-3.11
		ROE, %	3.57	-0.87	-2.75	-4.37	0.05	-0.87
		FL	0.45	0.58	2.01	2.23	2.26	1.51

Note: Business models used by the sports clubs: Focus strategy, FS; Diverse focus, DF; Middle strategy, MS; Diversification, DIV.

Source: Calculated by the authors based on data of UEFA Club Licensing and Financial Fair Play Regulations (2018) [16]

achievements, because the bad results decrease value of intangible assets and revenue. Given that there is a high competition in professional sports, the risk of failing season tasks is high enough which can result in serious losses and decrease of market price of the sports club shares.

Stability of Parken S&E financial performance is mostly due to the business model selected.

We can determine four business models used by the sports clubs:

- *Focus strategy, FS*. The club concentrates solely on its core business as the only profit source.
- *Diverse focus, DF*. The club puts emphasis on its core business, but the model also includes other accompanying activities providing additional profit.
- *Middle strategy, MS*. Besides its core business, the club performs activity in other business area which is an important source of profit.
- *Diversification, DIV*. In this strategy, club's revenue of sports activity takes only a small part among other activities in overall profit structure.

Efficiency of the specified business models was determined by studying the Danish football clubs. Table 2 that includes economic efficiency indicators of 5 most successful Danish football clubs utilizing various business models shows that DIV-based strategy provides more stability and bigger profit which is due to activity that is not affected by risks typical for sports. Parken S&E club utilizes such model and has the biggest return of equity (ROE) among other clubs mentioned. Yet, in order to raise resources for business expansion and establish required infrastructure, the clubs must increase the financial lever (FL) which impairs their financial stability.

Parken S&E owns state-of-art football stadium with closing roof allowing maintaining comfortable temperature within the stadium and using it all year round. Besides football matches, Parken S&E also hosts concerts, exhibitions, conferences, forums and other large events at its stadium. Also, the club receives significant income from letting the office premises and area around the stadium for rent to commercial companies. In total, only 40% of total profit is football matches, the rest 60% come from other activities.

6. Conclusion

Stabilization of the assets value and club profitability means increasing material resources in overall non-circulating assets structure and diversification of business and development of supplementary business which would allow to generate stable profit aside from the main activities, thus decreasing dependence on sports events outcome. This position is also reflected in UEFA policy on financial recovery of football business and in the concept of «fair financial game» approved in 2011. Furthermore, the compulsory requirement of football clubs profitability does not include relevant costs that are considered when calculating efficiency indication, fixed assets depreciation, youth football development costs and other social programmes, which cost of funding directly correlating with building-up intangible assets. This being said, the clubs are free to invest into stadiums, schools, academies and training camps, enabling development investments and providing long-term stability for the European clubs. This strategy yields its fruit now: since introduction of new financial discipline rules, net total losses of the European football clubs were reduced by 84% and net club liability were reduced from 65% of gross income to 35%.

In conclusion, the DIV model, being the most efficient with regard to sports clubs profitability can be used by the Russian professional sports entities in order to increase investment attractiveness. In order to implement such model in Russia, sports infrastructure that was built due to large-scale international competitions should be transferred to the sports organizations that use these sports sites as training ground and place for official competition, allowing a synergistic effect from business activity under the brand of a famous team finding market investment source from the activity which is not directly related to sports and make Russian clubs more financially stable and attractive for investors.

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