French Football

A Financial Crisis Rooted in Weak Governance

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This article contends that a French football exception is not an absent financial crisis but its hidden shape because of undisciplined club behavior and a lack of transparency and disclosure. French football is characterized by a lax financial management and a soft-budget constraint at the club level. The latter results from a weak governance structure in the league and clubs. Shareholders behave as non-profit-seeking investors or patrons. The arms race to enroll the most efficient players fuels wage inflation that is hardly balanced by newly emerging sources of finance. The more a club is able to attract broadcast revenues, the more likely it is to be in the red. Policy recommendations include strengthening the governance structure, restoring financial discipline, and defining compulsory thresholds for some clubs' financial ratios.

Keywords: *budget constraint; disclosure; finance; football; governance*

Any assessment of French football is right when it stresses specific regulation measures as an exception compared with other national football leagues in Europe (Gouguet & Primault, 2006). Does this mean that the response is definitely no to the question "Is there a crisis?" raised in a subtitle of the aforementioned article? I would contend that the French exception is not to be found in an absent financial crisis but rather in the peculiar and partly hidden shape of such crisis revealing that it is deeply rooted in governance issues that have not been phased out despite club supervision by an auditing body (DNCG, Direction Nationale de Contrôle de Gestion). Because the French football league has been in the red for 7 of the past 8 years, the only question is not whether the observed financial troubles reflect a crisis of the contemporary model of professional sport finance or not but how it is occurring in the French-specific context. One of the latter's features is that some top clubs are facing a soft-budget constraint because of bad governance practices that trigger financial mismanagement.

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BEHIND METHODOLOGICAL TRICKS: A NAKED FINANCIAL CRISIS

Gouguet and Primault (2006) argue that French League 1 total losses are smaller than were deficits of a single foreign club such as FC Barcelona, AC Milan, or Lazio Roma in 2003-2004. The argument is somewhat faked because when you aggregate the whole league's accounts, the largest French clubs' deficits are partly compensated by profits of those clubs that are in the black. Nevertheless, it remains true that PSG and AS Monaco, in terms of financial deficits in 2003-2004 (respectively, €60 million and €15 million), were far behind major Italian and Spanish clubs or Leeds United (€74 million) and Borussia Dortmund (€164 million). In 2004-2005, no French club exhibited a deficit higher than €18 million (PSG) or €11 million (Marseille). By the same token, this raises the question of accounting transparency (see below).

Whatever the expectations for 2005-2006 (Table 1), the French League 1 accumulated a €332 million deficit from 1997 to 2005, and League 2 accumulated a €61 million deficit. Is not a nearly €400 million cumulative deficit during 8 years enough to talk about an overt—or at least a creeping—financial crisis? The latter would have seemed even deeper had not we taken into account the League 2 net transfer fee balance (+€126 million). Transfer fees are not a major factor of financial deficit because they explain only 6.3% of the overall deficit in League 1 from 1997 to 2005. The French football financial crisis is basically because of the current operation deficit of both leagues (and clubs). The expectations for 2005-2006 seemingly dwell on a strategy relying on players' "net export" to equilibrate the financial balance.

Coming out from this financial deficit accumulation, PSG and AS Monaco had, respectively, €179 million and €81 million in debt as of June 2004, which is less than the debt of some of the most indebted European clubs (FC Barcelona = €230 million, Leeds United = €95 million, Borussia Dortmund = €281 million, Lazio Rome = €281 million, Inter Milan = €281 million, AS Roma = €224 million). However, a debt crisis is in the making in French football if we consider the amount of League 1 banking and other debts (Table 2) and the asset-debt ratio, which usually starts to be of concern for a lending banker when it falls below a 25% threshold and becomes a major concern at 8%. In 2004-2005, in League 1, the asset-debt ratio was roughly 0% for SC Bastia, 0.2% for AS Monaco, 4% for Olympique de Marseille, 5% for FC Girondins de Bordeaux, 6% for FC Istres, and 8% for RC Strasbourg.

Table 2 shows that after a substantial investment in both leagues in 2001-2002, shareholders reduced their assets in 2002-2003. The overall debt fell in 2003-2004, and shareholders invested again, so that the asset-debt ratio markedly improved in League 1, followed with a reversed move in 2004-2005. The same ratio deteriorated in League 2 from 2002 to 2004, but investors stepped in again in 2004-2005. French football finance is relieved by non-profit-seeking

TABLE 1: Pretax Accounting Balance of French Professional Leagues (Millions of Euros)

	1995-1996	1996-1997	1997-1998	1998-1999	1999-2000	2000-2001	2001-2002	2002-2003	2003-2004	2004-2005	2005-2006[a]	1997-2005
League 1	14.9	6.8	−7.6	−7.2	2.2	−53.6	−46.3	−151.2	−35.9	−32.5	19.1	−332.1
League 2	0.0	1.3	−1.5	3.0	1.4	−14.2	−20.2	−15.8	−8.0	−5.5	3.9	−60.8
Total	14.9	8.1	−9.1	−4.2	3.6	−67.8	−66.5	−167.0	−43.9	−38.0	23.0	−392.9
Of which, net transfer fee balance												
League 1	18.9	25.1	51.1	65.9	8.1	−19.3	−68.1	−100.2	17.9	23.6	80.0	−21.0
League 2	2.7	3.7	8.8	23.6	19.5	26.0	21.0	10.3	15.5	1.2	4.5	125.9
Total	21.6	28.8	59.9	89.5	27.6	6.7	−47.1	−89.9	33.4	24.8	84.5	104.9

Source: Professional Football League.

a. Forecast based on expected transfer fees.

TABLE 2: Financial Liabilities Structure of French Football Leagues 1 and 2 (Millions of Euros)

	1998-1999	1999-2000	2000-2001	2001-2002	2002-2003	2003-2004	2004-2005
League 1							
1. Assets (owned)	84	89	84	143	93	139	112
2. Service charges	49	123	101	60	50	37	37
3. Banking debts	108	231	320	228	233	128	116
4. Other debts	276	360	424	416	344	297	404
5. Total liabilities	517	803	929	847	720	601	669
Ratio 1/3 + 4 (%)	21.9	15.1	11.3	22.2	16.1	32.7	16.7
League 2							
1. Assets (owned)	10	12	12	19	6	5	21
2. Service charges	4	5	6	6	6	4	5
3. Banking debts	1	12	11	20	10	8	12
4. Other debts	34	38	38	46	49	52	51
5. Total liabilities	49	67	67	91	71	69	89
Ratio 1/3 + 4 (%)	28.6	24.0	24.0	28.8	10.2	8.3	23.6

Source: Professional Football League.

shareholders who cope with debts, but this may explain a lax financial management and eventually a soft-budget constraint at the club level.

IS ALL THE FINANCIAL MISMANAGEMENT PREVENTED BY AUDITING?

French football is no more saved than other football leagues in Europe from financial misdoings such as false invoicing, hidden honoraria, fake club accounting and book cooking (despite DNCG audits), embezzlements, rigged matches and referee bribing, the use of "black bags" when transferring overseas players, fictitious player transfers hiding undisclosed money transfers, and abuse of social benefits (Andreff, 2000). Besançon RC, demoted from League 2 in 2004-2005 because of a supposedly fixed match, has lodged a complaint in court. Several clubs' chairmen have been sued and then sentenced in the past 10 years or so. In February 2005, the French Ministry of Finance carried out 19 searches in five football clubs and connected TV channels, football marketing companies, the Professional Football League (LFP), the French Football Federation, and the UNFP (Union of Professional Football Players). The investigation is all about unfair competition and its financial outcome.

At the time of writing, two former heads of Olympique de Marseille have been sued for 14 irregular player transfers (including black bags and overinvoicing), and former CEOs of PSG and Canal Plus (a TV channel that was the PSG core shareholder)[1] are under investigation for abuse of social benefits achieved through about 100 player transfers at rigged prices between 1998 and 2003. The Nike-France financial manager has been sued for fake accounting and suspicious contracts signed with PSG that enabled the club to evade the payment of social contribution when paying extra wages to top players. Thus, what is meant by a French football financial crisis is not only confined to the emergence of lasting financial deficit and indebtedness, which is only the tip of the iceberg.

The financial situation of French football had been believed to be serious enough to be the core issue of a governmental report presented to the parliament (Rapport, 2000), focusing on finance and juridical issues. Thereafter, Senator Yvon Collin was committed to write up a longer and deeper report after a 1-year inquiry (Collin, 2004). His report shows that football clubs' deteriorating accounting balances have been financed through new investments from shareholders (€203 million from 1997 to 2002) and through advances in their current accounts (€255 million from 1997 to 2002). The report concludes that the overall clubs' debt has been growing at an unsustainable pace and calls for a brake to be put on drifting financial charges in French football.

THE CLUB'S SOFT-BUDGET CONSTRAINT

The senator's report points to three complementary factors to explain financial troubles. First, a weak governance structure at both league and club levels is

a driving force for managerial lax financial behavior (reluctant data disclosure characterizes weak governance structures). Shareholders do not efficiently supervise managers in a weak corporate governance structure, and this leads to a second factor: Shareholders behave as non-profit-seeking investors, patrons, or tycoons. This behavior obviously softens the club's budget constraint and relaxes financial discipline over managers. A third factor is the arms race among football clubs eager to enroll the most efficient players, which fuels wage inflation. Such a self-reproducing process explains the unimpeded nominal wage bill increase and requires a proportional growth in new sources of finance. Indeed, top French clubs are drawn to spending more than their budget to attract much efficient players, and afterward, they beg patrons and tycoons to bail them out. Financial mismanagement, tycoon and patron paternalism, or, in more theoretical terms, a soft-budget constraint (Kornaï, Maskin, & Roland, 2003) do not financially maintain top French football clubs' viability in the long run.

French football is a TV-dependent industry (Andreff & Bourg, 2006). The underlying economic analysis of the senator's report refers to the coexistence of two models of professional sports finance in European and French football, in line with Andreff and Staudohar (2000), that is, the so-called SSSL (spectators, sponsors, subsidies, local) and MCMMG (media, corporations, merchandising, markets, global) models. In the former traditional SSSL model, gate receipts are the primary source of revenue for a professional sports league, usually enhanced by advertising and sponsoring revenues and (in French football) public subsidies from municipalities. In the past decade, a second contemporary MCMMG model has emerged. Its major pillars are the financial godsend derived from TV broadcasting rights, then merchandising. From one auction to the other, LFP has been able to significantly raise the amount of TV rights gained from pooling the championship and cups broadcasts for sale. In 1999, professional football TV rights were auctioned for €375 million per season for 2001 to 2004 to two channels, Canal Plus (€300 million) and TPS (€75 million). LFP has earned 60% more in auctioning TV rights to Canal Plus alone, at an exclusivity price of €600 million per season from 2005 to 2008. This will soften the clubs' budget constraint even further. Is it really good news? Certainly, it is not once it is admitted that the financial crisis is fuelled by weak governance under a soft-budget constraint, all the more so if the TV rights godsend for 2005 to 2008 is felt by club managers as an opportunity to raise wages and prolong the arms race. In the background of the TV financial godsend stands the monopolistic strategy of the league, but the whole thing is fragile because any possible decrease in the league monopoly power would undermine the major pillar of French football finance. Big clubs are increasingly claiming individual club ownership over TV rights instead of pooling.

Moreover, there is a great divide between League 1 and League 2 in terms of revenues, despite the overemphasized TV rights redistribution (Gouguet & Primault, 2006). In 2003-2004, with both leagues containing 20 clubs, the ratio

between League 1 and League 2 turnovers was 4.8. A conclusion immediately springs up: Both demotion and promotion, from one league to the other, are financial shocks in French football. Demotion deteriorates a club's budget because revenues shrink overnight. Promotion compels a club to attempt to multiply its turnover by nearly 5 and creates expectations of new revenues; if expectations are not met, the club will have to borrow money from banks and increase its debt.

SUSTAINABILITY REQUIREMENTS FOR THE FRENCH FOOTBALL MODEL

A sharper increase on the expenditure than revenue side of the accounts was witnessed from 1995 to 2001 in both leagues. The expenses inflation was triggered by growing gross wage cost (wage + social security contribution). Labor cost was primarily drifting in League 1's biggest clubs and was assumed to be the most significant determinant of leagues' and clubs' accounting deficits that emerged since 1997-1998. In the early 90s, a financial stabilization program had been curbing a wage bill no longer compatible with the hardening budget constraint of clubs hemmed in by the limited sources of finance in the SSSL model. The proportion of wages to overall expenses came down to 48% (excluding social security contributions) in 1993-1994 and to 45% in 1997-1998. A second policy was to look for fresh money from new sources of finance: TV rights and merchandising. Such a two-tier policy suggests the assumption that the MCMMG model is financially sustainable as long as a sensible proportion is maintained between wage increase and the growth of new sources of funds (Andreff, 2005). In other words, when nominal wages increase, TV rights must grow more or less at the same pace to maintain the wage-turnover ratio in the range of 60% or so. Otherwise, a financial crisis is likely to burst out.

Therefore, in the French context, the MCMMG model would be sustainable if (a) new sources of finance were to reach about 60% of turnover and (b) the latter approximately recoups overall expenses. The first sustainability requirement is fulfilled in League 1 (the ratio of TV rights + merchandising to turnover has been slightly 60% since 1999), whereas the second one (a nonnegative accounting balance) was met only in 1999-2000. The League 1 financial crisis is more because of excess expenditure than inadequate distribution between revenue sources, the major pillars of finance nearly covering the major causes of expenses (gross wage). In League 1, French football is facing more a crisis of financial mismanagement (deficit) within the MCMMG model rather than a financial crisis of this model itself. In League 2, the new sources of finance have reached about 55% of overall finance, a percentage lower than the gross wage-overall expenditure ratio (about 65%). On the other hand, the gross wage–turnover ratio in French League 1 is one of the highest in European football, fluctuating around 60% since the 1991-1992 stabilization plan. The only national league among the five biggest leagues in Europe in which the wage-turnover ratio is

higher is the Italian league. The comparison is all but flattering. The heavy weight of gross wages in the French league is often explained by the advantageous social protection system, whose price is paid for by a high social security contribution charged on employers (clubs). Nevertheless, the steadily increasing trend in the wage-turnover ratio in French League 1 tells another story: The booming turnover, backed by skyrocketing TV rights, has been translated by most club managers into booming wages to attract star players. Again the soft-budget constraint!

TRANSPARENCY AND DISCLOSURE: THE SAFE FOUNDATIONS OF GOOD GOVERNANCE PRACTICE

The senator's report states, "Information about individual clubs' financial data usually is not disclosed and this must be denounced" (p. 90). It also states, "Information (published by DNCG) encompasses a number of deficiencies, namely due to their aggregation at the league level . . . . The disclosure obligation is often circumvented or is not enforced at all" (p. 11). When I looked to achieve an econometric test about the explanatory variables of wage growth in French football—the only significant variable is the amount of TV rights, at a 1% threshold (Andreff, 2005)—I attempted to gather clubs' accounting data, which started to be disclosed by DNCG for both leagues no earlier than 2002-2003. However, I was not able to get 80 sets of individual club data (i.e., 40 clubs × 2 years). Some clubs are still reluctant to have their accounting data released, and the DNCG does not disclose them. One reads on the DNCG Web site, "Those individual club accounts that are published here are under the clubs accountability so that they can be different from the ones aggregated into DNCG financial statistics." Consequently, I could avail only 60 sets of individual club data.

From this very simple experience, we can derive an important lesson about the French football financial crisis. For example, look at the League 1 pretax accounting balance (Table 1) in 2002-2003: It exhibits a €151.2 million deficit. Aggregating the accounts of the nine available League 1 clubs in 2002-2003, we find a €936,000 surplus! The conclusion is that those clubs that are in the red are reluctant to disclose their accounts. One has to know that these clubs are fined for absent disclosure, but they do prefer to pay a fine rather than having their accounts transparent to anyone (except DNCG). One major aspect of the financial crisis in French football is that it remains partly hidden by such undisciplined club behavior. In 2003-2004, the League 1 deficit was €35.9 million. Aggregating the data from those 13 available clubs, the deficit reached only €19.7 million. Again, nearly half the deficit remained undisclosed. One can reasonably suspect those clubs with undisclosed accounts (PSG, Bordeaux, Auxerre, Nantes, Rennes, Sochaux) to have substantial deficits, adding to those disclosed deficits exhibited by Lens, Marseille, and Monaco. Most are top French football clubs!

The propensity to hide financial accounts appears to be high among top clubs earning sizeable TV rights, namely those qualifying for European competitions. Econometric testing (Andreff, 2005) confirms this because it reveals a very significant relationship, with a negative sign, between a clubs' accounting balance and their TV rights revenues. The more a club is able to attract from TV broadcasts, the more likely it is to be in the red, and vice versa: The lower the TV revenue, the higher the probability for a club to be in the black. Is it at odds with the MCMMG model? Not at all, because those clubs with high TV revenues are the top French clubs that spend a lot on wages because of the arms race and possibly a laxer financial management than smaller clubs, which do not often qualify for European competitions. In top clubs, there is a sort of vicious cycle between TV godsend and arms race that trickles most of these clubs down into a financial crisis. They feel less budget constrained thanks to the TV revenues, although the latter heavily depend on their qualification for European competitions (Andreff & Bourg, 2006). Here, the financial crisis thrusts its roots.

WHAT IS TO BE DONE?

First of all, the economic analysis of French football financial crisis must be further studied. Among the recipes put forward in the senator's report, we would pick up,

A. Strengthening the governance structure by reinforcing the inner audit (DNCG) over French football—that is, the monitoring role of DNCG in supervising management of professional clubs—which requires a full independence of the audit from the French football authorities in tune with the internationally acknowledged good practices in auditing.
B. Restoring financial discipline, in particular through the introduction of a salary cap (and thus dampening the arms race).

Regarding Recommendation A, we can only agree because our assessment is that the financial crisis is the outcome of mismanaging the MCMMG model in the French context. The DNCG should no longer comply with the request of some clubs not to disclose their accounts. The most urgently needed auditing good practice is not yet fully enforced in French football (i.e., an entirely transparent disclosure of accounting data). Clubs' stock flotation could be a tool for mandatory disclosure, but, whatever the European Commission advised, it might not be desirable in the French context, given its outcome in other countries (an issue that goes beyond this article).

As to Recommendation B, financial discipline is not just a question of curbing wage inflation, although it is basic. Some compulsory threshold must also be defined for what acceptable (sustainable) deficit-turnover and asset-debt ratios are; they should be under the mandatory supervision of DNCG. Both

recommendations could be implemented only with a reinforced independence of DNCG, which requires cutting the umbilical cord between the auditing body and the major stakeholders of the football business. We wonder whether DNCG should no longer have members nominated by football governing bodies (federations, leagues, clubs, trainers, players unions) and whether they should be replaced with only chartered accountants, financial experts, lawyers, and professional (sports) economists, as is usual in any industry.

Nowadays, to make the MCMMG model sustainable, relegation should be a regular sanction for any financial mismanagement practice. To end up with a provocative suggestion, Why not demote those clubs that resist disclosure of their accounting data?

NOTE

1. PSG was sold at an underpriced value by Canal Plus to two investment funds, the American Colony Capital and the French Butler Capital Partners, in April 2006.

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