Opportunity v Risk

The opportunity for football clubs to improve commercial performance through understanding financial risk.

WORDS: SAM WILLIAMS, DIRECTOR AND CO-FOUNDER OF ECONOMIC INSIGHT

For any commercial organisation, understanding financial risk is a key input into sound business decision-making. Put simply, understanding what financial risks you are exposed to, their likelihood and consequences allow management teams and Boards to make sensible trade-offs, balancing risks against potential rewards. The better you are at doing this, compared to your rivals, the more competitive you will be.

For football clubs, this issue has been brought into greater focus by the establishment of the Independent Football Regulator (IFR), which has an objective to promote "financial soundness" and will introduce financial regulation to the industry for the first time.

The IFR's financial regulation includes requiring clubs to: (i) submit Strategic Business Plans by November 2026, which contain sufficient financial information to inform an assessment of risk (as part of the Provisional License process); (ii) meet a 'Mandatory Financial Plan' license condition (including assessing how finances are impacted under certain stress scenarios); and (iii) meet the 'Appropriate Financial Resources' threshold (where the IFR will consider metrics relating to liquidity and solvency).

Rather than seeing the IFR's forthcoming financial regulation merely as a requirement to be complied with, it should instead be viewed as an opportunity for clubs to ensure they have class-leading information on risk, which in turn can deliver improved commercial performance (by achieving this, a side benefit would also be to comply with the IFR's requirements). The question this raises for football clubs is: how?

Figure 1: three elements of an approach to understanding risk

The answer has three parts.
Part 1 is to establish a clear framework for understanding and measuring risk, which reflects the considerable variation in business models across clubs. Part 2 is to embed robust analysis that allows the framework to be used in practice. Part 3 is to communicate the results clearly and simply, so that management teams and Boards can understand and act on them.

A framework for understanding risk
Because clubs' business models are diverse, there is no template for assessing financial risk that can be copy-pasted across them. Each club must develop an approach that reflects its own circumstances. This means: (i) identifying your material financial risks; (ii) defining the drivers of those risks (what events might cause them); and (iii) identifying interdependencies across them.

All clubs will be exposed to revenue, cost and liquidity-related risks, to some degree. Revenue risks include: matchday receipts; sponsorship/other commercial income; broadcasting income; and merchandise sales. Cost risks include: playing staff bills; other club staff bills; stadium operation and maintenance costs; and finance-cost related risks. Liquidity risks include: interest rates; inflation; debtor days; and transfer spending/receipts.

However, the materiality of these will vary considerably across clubs, depending on their circumstances and business models. For example, a Premier League club with limited spare stadium capacity will face little-to-no matchday receipts revenue risk, whereas for a lower league club, this could be a material risk item. A more diversified club will face lower overall revenue risk than a less diversified one. Similarly, all else equal, a more indebted club will face more liquidity risk than a less indebted one.

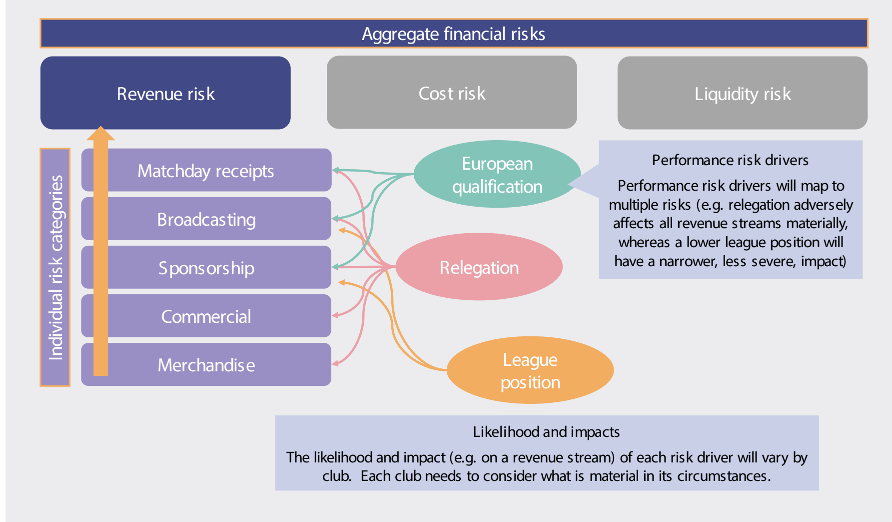

Figure 2: illustrating some dimensions of a risk framework

Having identified your material financial risks, the next step is to define their drivers – the events that could give rise to them. These will include: sporting performance (relegation, failure to qualify for certain competitions, or poorer league performance more broadly); operational (such as stadium closures); economic (a deterioration in the UK economy); and reputational.

Once the drivers are identified, you need to map them to the financial risk categories, in order to ensure the various interdependencies are captured. Most obviously, sporting performance impacts multiple financial risks on both the revenue and cost side.

Embedding robust risk analysis
Once you've established a framework that reflects the realities of your club, you need the analytical tools to implement it. The most important guiding principles should be to ensure any analysis is: (a) built around how the risk factors affect your club, so that its intuition reflects the real world; (b) draws on the best available evidence to understand the relationships between risk drivers and likelihoods; (c) recognises that the risks of multiple events occurring concurrently is not the same as the sum of their individual probabilities; and (d) is easy to explain (if the analyst cannot explain how their risk model works in plain English, something is wrong).

Principles (a) and (b) are especially important, because that is where the uniqueness of your club gets embedded (e.g. the probability and consequence of relegation, and its impact on revenues and costs, will be different for every club).

Conversely, risk analysis should avoid: (i) false precision, by seeking to overly specify relationships between risks, or probabilities of risks arising, when the underlying evidence to support these is not there; (ii) unnecessary complication (endless simulations built on sand); and (iii) copy-pasting modelling tools used in other industries/clubs.

In the real world, football club risk exists on a continuum, and so helpful analysis should produce outputs that reflect that, providing a distribution of potential financial outcomes with probabilities attached to them (not, "if this occurred, X would happen" – that's not real life).

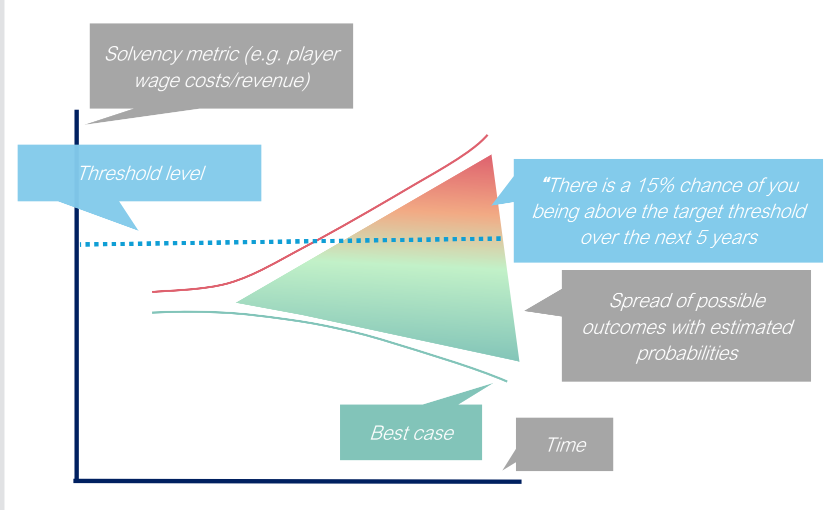

Figure 3: football club financial risk should be shown on a continuum

"Once you've established a framework that reflects the realities of your club, you need the analytical tools to implement it"

Clear communication
For any football club senior management team or Board, the obvious questions raised by any risk analysis should be: "If I believe this, what is it telling me?"; "Why should I believe it?"; and "What does it mean I should do?" No one cares about risk, or risk analysis, for the sake of it.

The output from any risk analysis should be designed with this audience in mind, so that the answers to the above questions jump off the page, without any need for lengthy explanation.

Based on our experience of supporting organisations in relation to risk, my overriding reflection is that clubs should not start with the IFR's requirements, but instead consider what is genuinely helpful to their decision-makers. If you get that right, you'll reap commercial benefits and the regulatory compliance will take care of itself.

For more information about Economic Insight, please email sam.williams@economic-insight.com