

Goodwill, Negative Margins and Results: Some Evidence from the Professional Football Industry

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Companies continuously produce an economic and a meta-economic performance, i.e. the company's ability to achieve social and environmental objectives, competitiveness, and so on. When examining deals that occur in some industries, the meta-economic impact seems to be particularly important, and it sometimes leads to enterprise values which diverge substantially from the value of capital that is implicit in the economic fundamentals. Our paper examines a number of recent deals in the football industry in Europe, and it suggests that: a) the meta-economic performance is significantly high in the football industry, where positive enterprise values co-exist with poor or feeble financial and economic results of the company acquired; b) turnover can be used as a preliminary proxy, in the above mentioned industry, for highlighting the meta-economic performance.

Field of Research: Business Valuation, Goodwill, Football Industry, Meta-economic Performance.

1. Introduction

As a general principle, we can say that companies continuously produce an economic and a *meta-economic* performance, defined in our paper as the company's ability to achieve social objectives (recognition, prestige, social support, the cultural promotion of the social system the company operates in, and so on), environmental objectives (for instance, reduction of environmental impact, improvement of the ecosystem) and competitiveness (ability to influence the markets, strengths with respect to customers, suppliers, competitors).

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Although the present paper is the result of the common effort of the two authors, section 1. and 5. have been attributed to Luigi Borrè, section 2. and 3. to Lorenzo Gelmini, while section 4. has to be jointly attributed.

Meta-economic performance may be translated into an economic-type performance, but this may occur: a) at a date much later than the time when the effective preconditions were created and b) involving parties other than the company (indirect advantages for the stakeholders that do not flow from the company). Yet, in some cases, meta-economic performance does not produce financial flows at any level and at any time. In any case, the value of the meta-economic performance becomes manifest in monetary terms when there is a passage of equity's ownership in the companies examined. At this stage, the price negotiated takes into account not only the cash flows produced by the company's economic performance, but also the flows of the meta-economic performance.

In effect, if we study the transactions that take place in certain business industries, obvious inconsistencies emerge with respect to their relative economic fundamentals. If meta-economic performance, as described above, is particularly important, the level of the prices of the transactions in these sectors tends to diverge substantially from the value of capital that is implicit in the economic fundamentals. In particular, it is assumed that the gap between the price and the economic value of the capital increases as a function of a company's ability to produce meta-economic results. In fact, poor or negative economic results can co-exist with positive meta-economic performance. Consequently, negative profits and/or cash flows can still lead to positive, not to say substantial, enterprise values and deal prices.

This paper is the first outcome of a broader research about the impact of the meta-economic performance, carried out with the aim to:

- a) analyse a number of deals in some industries, and check:
 - 1) if the meta-economic performance exists, and
 - 2) being that the case, if it could be measured in monetary terms (step 1);
 - b) measure the goodwill inducted by the meta-economic performance, and identify the main drivers which can act as "signals" of this performance (step 2).
- This paper is included in step 1 of our research, and it has been addressed to the professional football industry, as an example of an industry with material meta-economic impacts.

In fact, several deals involving shares in football teams are concluded at deal prices that are significantly higher than the values determined simply on the basis of an evaluation of the assets and liabilities at their current value, leaving aside premiums for majority control or minority discounts. Generally speaking, the above mentioned difference (between deal prices and values determined by evaluating the assets and liabilities at their fair values) is called "goodwill" in literature and it refers to results that outperform the average industry return. Accordingly, goodwill is the difference between prices and values, from a balance sheet point of view, which is generally associated to financial and economic results that are higher than the industry average, from an income statement point of view. Yet, the financial reports of most professional football teams show negative cash flows, negative margins and negative results, while deal prices are generally higher than the share of the current values of assets and liabilities.

This means that a poor or feeble economic performance could co-exist with goodwill, which measures in that sense the meta-economic performance. Our paper analyses a number of recent deals in the professional football industry in Europe, with a view to determining if the impact of the meta-economic performance exists. The remainder of the paper is as follows: section 2 reviews briefly the literature; section 3 describes the methodology adopted; section 4 shows the main findings and section 5 concludes.

2. Literature Review

While there is abundant literature about goodwill and a number of studies examine the relationship between goodwill and equity valuation (M. Bugeja, N. Gallery, 2006, and the prior literature cited in this study) little literature is available on how to determine and measure the economic value of sport players and teams (R. Tunaru, E. Clark, H. Viney, 2005). Several studies have, however, dealt with the subject of measuring the value of sportsmen and football players (G. Fiori, 2003; T. Onesti, M. Romano, 2004; Tunaru *et al.*, 2005). There is some evidence suggesting that the behaviour of turnover and player performance resembles correlated Brownian motions (Tunaru *et al.*, 2005).

Some authors have examined the market performance and the economic value of the English Premier League football teams (K.K. Haugen, A. Hervik, 2002; R.A. Zuber, P. Yiu, R. P. Lamb, J.M. Gandar, 2005), and suggest that there are reasons other than economic measurements – for example, *mere ownership* – to be considered when dealing with football companies. “Meta-economic performance” is the term used by some authors for identifying the performance of companies which is not related to measurements of profits and/or cash flows (L. Borrè, 2003, 2008).

Our paper suggests a slightly different point of view than previous literature, since:

- we adopt a “qualitative” approach, as we focus on the financials of football teams;
- we focus our attention on organisations (companies) and not on individuals (players);
- we try to explain the enterprise values of football teams as the result of underlying economic and meta-economic performances, which jointly influence the football team values.

In the steps of Borrè and Zuber *et al.*, we suggest that the meta-economic performance of football companies affects their enterprise value, and leads to a definition of goodwill which does not rely on strictly economic parameters.

3. Methodology and Research Design

This paragraph examines the following issues:

- research sources;
- research limitations;
- sample of deals chosen for the analysis.

Research sources

We have made use of the following sources:

- a) a database that gathers data about mergers and acquisitions, deals, etc. (*Zephyr*, 2007);
- b) a database that collects and revises company financials (*Amadeus*, 2007);
- c) independent sources for double-checking the financial data extracted by Amadeus, such as registered financial statements and the London Stock Exchange software (*LSE DataCenter*).

Research limitations

The research limitations are mainly constituted by the number of deals included in the sample and by the research tools used, which offer a preliminary support for our findings. See section 1. for appreciating this paper as the first output of a broader research and section 5. for future developments.

Sample of deals chosen for the analysis

Table 1 describes how the number of deals used for our research was extracted.

Table 1: the sample

(1) Total number of deals extracted by Zephyr	905
(2) Deals regarding holding companies	32
(3) Deals regarding sports other than football	99
(4) Deals regarding companies operating in the media industry, entertainment, etc.	423
(5) Deals regarding anomalous football companies	7
(6) Deals regarding football companies (1-2-3-4-5)	344
(7) Deals with no market data available from Zephyr database	207
(8) Deals with no financial data available from Amadeus database	12
(9) Sample of deals for the analysis (6-7-8)	125

The sample consists of 125 deals but, if financial data do not need to be taken into account, 137 deals have been considered. A brief explanation of lines 1 to 9 is now provided.

(1) 905 deals – chosen as “deals regarding US code SIC 7941”, *i.e.* “Professional sports club and promoter” – were extracted from Zephyr; period of time covered 2000-2007, Europe.

(2) 51 of these deals have been classified as “deals regarding holding companies”, *i.e.* companies operating in fields other than football. Only 19 of these were included in the sample, after the income statements of the football companies involved had

been analysed and it was found that a substantial majority of the revenues would come from the football business. This means that 32 deals - involving 5 football companies - were not included since the companies concerned operate as conglomerates or the financial data necessary for the assessment were not available.

(3) 99 deals relating to sports other than football were excluded.

(4) 423 deals relating to the media and entertainment industries and only indirectly to professional sports were excluded.

(5) 7 deals were excluded, as involving companies apparently classified in the sample as “football companies” but not relevant to the research project.

The 344 deals regarding football companies (line 6) were reduced to exclude deals with no market data (in the Zephyr database) or no accounting data (in the Amadeus database) available, thus finishing up with a total of 125 deals.

4. Discussion of Findings

The research was developed as follows:

- a) *deals data analysis*, that is, analysis of the deals data, available in Zephyr, regarding the sample;
- b) *search for possible correlations*, between deal prices (see point a) and accounting data (available in Amadeus);
- c) *some hypotheses for breaking down the sample*.

4.1. Deals Data Analysis

Table 2 shows information obtained from Zephyr regarding the deals examined in the study.

Table 2: description of the sample

Information	Statistics
Number of deals	137
Number of companies	47
Number of deals with both market and financial data available	125
Period	2000-2007
Share acquired:	
- 100%	9
- at least 50%	15
- less than 50%	<u>113</u>
	137

Zephyr also extracts some financial data, *i.e.* margins and results (EBITDA, EBIT and Profit after tax) obtained from the last financial statement prior to the deal; table 3 shows these data together with their sign – negative or positive.

Table 3: margins and results in the sample

Margins and results	Number	%
<i>EBITDA:</i>		
- Negative	47	35%
- Positive	89	65%
- Not available	<u>1</u>	<u>0%</u>
	137	100%
<i>EBIT:</i>		
- Negative	81	59%
- Positive	<u>56</u>	<u>41%</u>
	137	100%
<i>Profit after tax:</i>		
- Negative	73	53%
- Positive	58	43%
- Not available	<u>6</u>	<u>4%</u>
	137	100%

Table 3 provides support for our thesis, as most of the football companies involved in our research show *negative results* (at least in the year immediately prior to the deal) and *positive enterprise values* (as all of the 125 enterprise values are positive numbers). Afterwards, we decided to focus our attention on the multiples calculated by Zephyr. In detail, the multiples of some economic measurements (*Turnover, EBITDA, EBIT, Profit after tax*) on a “market measurement” like the *Estimated Enterprise Value* (EEV) were selected, since these multiples seem to be particularly suitable for the purpose of our research. Zephyr database measures the Estimated Enterprise Value by determining the Equity Value (*i.e.*, Deal Value in proportion of the share of capital acquired) plus total liabilities from the last available financials of the company, while the accounting data have been taken from the last income statement before the deal. Since the multiples express only positive measurements and the EEV is always a positive number, the multiples computed to negative margins and results, as shown in Table 3, have been excluded, with a reduction of the multiples to 65%, 41% and 43% (respectively EBITDA, EBIT and Profit after tax) of the whole sample. Taking this into account, table 4 shows some statistics relating the above mentioned multiples.

Table 4: statistics of the multiples

Multiple	Statistics
<i>EEV/Turnover:</i>	
- Minimum	0,08
- Maximum	83,11
- Average	3,77
- Median	2,54
- Variation	1,98
<i>EEV/EBITDA:</i>	
- Minimum	2,08
- Maximum	3.706,96
- Average	63,43
- Median	12,61
- Variation	6,14
<i>EEV/EBIT:</i>	
- Minimum	2,68
- Maximum	3.375,00
- Average	91,02
- Median	24,85
- Variation	4,88
<i>EEV/Profit after tax:</i>	
- Minimum	3,30
- Maximum	2.373,00
- Average	113,82
- Median	35,35
- Variation	2,83

As shown in table 4, the variation of every multiple (measured as the ratio between the standard deviation and the average) leads us to conclude that turnover is the most stable accounting measurement when compared with deal prices, since the variation of the related multiple (EEV/Turnover) is substantially lower than the others. If we consider turnover as a proxy for some meta-economic measurements (for instance, the visibility of a football team) - which are certainly more related to the turnover than to other accounting items like certain margins (EBITDA, EBIT, Profit after tax), since visibility, prestige and recognition directly affect turnover, whereas margins are more directly related to the economic performance – we can assume that the EEV/turnover multiple seems to embody both the economic performance and the meta-economic impact of the football teams, which does not emerge on its own but which can be indirectly appreciated through some “traditional” accounting measurements like turnover.

4.2. Possible Correlations between Deal Prices and Accounting Data

Section 4.1. has explained, generally speaking, that (i) the football industry shows positive enterprise values, when dealing shares of football companies, and negative margins and results, when looking at the income statement returns; (ii) turnover appears to be the most stable proxy, when comparing the variation of market data (like EEV) and accounting data. This is examined in greater detail in section 4.2

together with the possible correlations (measured with the Pearson coefficient) between:

- a) market data and income statement data;
- b) market data and balance sheet data.

The objective of this analysis is to understand whether these correlations can correctly explain the dynamics of the market data, or whether there is a hidden performance (the meta-economic performance) which does not emerge from the accounting data but which is considered by the dealing parties.

Market data and income statement data

For all EEVs in our deals sample, we have extracted averages of the following accounting measurements of economic performance: Turnover, EBITDA, EBIT, Profit after tax (data extracted from Amadeus). All measurements of performance have been calculated as a 4-year moving average, on the basis of the data for the 2 years prior to the deal, the data of the year of the deal and the data for the year after, in order to take into account past economic performance, current performance and forecasts. The use of a 4-year moving average reduces the number of deals from 125 to 76. The following correlations have been calculated:

- a) per deal, comparing the EEV with the moving average of accounting performance measurements;
- b) per company, comparing the average EEV for each company with the average of accounting performance measurements of the same company.

Table 5 presents the results.

Table 5: correlations between market data and income statement data

	Pearson coefficient	
	<i>Per deal</i>	<i>Per company</i>
EEV and Turnover	87%	85%
EEV and EBITDA	76%	51%
EEV and EBIT	54%	5%
EEV and Profit after tax	49%	(2%)

The main points in table 5 are as follows.

- (1) The correlation between market data and income statement data is always higher when comparing data per deal than when comparing per company.
- (2) There are no clear signs of correlation between economic margins and market prices.
- (3) Turnover is the best income statement item for highlighting the dynamics of market data; in fact, the relationship between EEV and turnover is strongly positive

both per deal and per company. Both assumptions (2) and (3) corroborate the findings of section 4.1., that positive enterprise values can be associated to negative margins and results, and that turnover is the accounting measurement that provides the best understanding of market trends.

Market data and balance sheet data

For all EEVs in our deals sample, we have considered the following balance sheet measurements of accounting economic performance: Liabilities, Working Capital, Cash and cash equivalents, Intangibles (data extracted from Amadeus). Balance sheet data have been computed at the end of the year immediately prior to the deal. We suggest, in fact, that averages of balance sheet data are less relevant than averages of income statement data; moreover, we assume that possible re-organisational operations on the capital of a company (for instance, capital increases) are more likely to be performed by the buyer of the shares immediately after the deal. Both EEV measurements and balance sheet measurements have been scaled to the amount of the Net Assets of the company at the end of the year immediately before the deal. The correlations have been calculated both per deal and per company (see the preceding paragraph).

The results are presented in Table 6.

Table 6: correlations between market data and balance sheet data

	Pearson coefficient	
	<i>Per deal</i>	<i>Per company</i>
EEV and Debt ratio	(18%)	(4%)
EEV and Working capital	15%	9%
EEV and Cash and cash equivalents	5%	32%
EEV and Intangibles	15%	20%

As shown in Table 6, there are no clear signs of a positive (or negative) correlation between market data and balance sheet data, and that confirms the difficulty of explaining certain market trends, in the football industry, with traditional accounting measurements like the balance sheet items shown in table 6. Yet, it should be taken into account that some intangibles – due to the accounting standards currently in force – are not allowed to be recognised as an asset in the balance sheet, and that accounting policy could reduce the “real” relationship between balance sheet numbers and deal prices.

4.3. Some Hypotheses for Breaking Down the Sample

We suggest in section 4.3. some preliminary, basically qualitative, hypotheses for breaking down the sample into small homogeneous groups. The breakdown was effected on the basis of:

- a) the percentage of capital acquired during the deal;
- b) the country the football company plays in.

Breakdown on the basis of the percentage of capital acquired during the deal

We looked for possible correlations between the EEV multiples computed by Zephyr and the share of capital acquired using the Pearson coefficient. The results are presented in Table 7.

Table 7: correlation between EEV multiples and share of capital acquired

	Pearson coefficient
EEV/Turnover	(6%)
EEV/EBITDA	18%
EEV/EBIT	(4%)
EEV/Profit after tax	13%

Table 7 shows that there is no sign of a strong correlation between market data (EEV), accounting data (turnover and margins) and share of capital acquired. Yet, that result gives rise to some perplexities and it could be examined, in the future, with a thorough research.

Breakdown on the basis of country

We looked for possible correlations between the EEV multiples computed by Zephyr and the country the football company plays in, dividing again the same multiples per country. Only two countries have been selected: Italy, as our research department is from Italy and England, as the majority of the deals examined in our paper took place in England. The results are shown in Table 8.

Table 8: average EEV multiples per country

	Sample	Italy	England
EEV/Turnover	3,77	2,63	2,88
EEV/EBITDA	63,43	11,45	18,80
EEV/EBIT	91,02	6,70	96,14
EEV/Profit after tax	113,82	92,84	122,38

EEV/EBIT in Italy appears to be statistically not relevant, with a single observation; yet, the main points that emerge from table 8 are as follows.

- 4 out of 4 multiples in Italy, and 2 out of 4 in England, are lower than in the sample, probably due to the fact that the sample involves some countries with a single deal and with anomalous data.

- Deals in Italy show multiples that are always lower than deals in England, even though it is unclear, without a further analysis, if the difference should be mainly attributed to the economic or to the meta-economic performance.

- The difference between turnover multiples in Italy and in England is smaller, when compared with other multiples, since turnover seems to act, in general, as a steady measurement of performance for the football industry.

5. Conclusion

Traditionally, goodwill has been associated to positive margins and results that outperform the average return of companies operating in the same field and which lead to an enterprise value that is higher than the value resulting simply from the valuation of assets and liabilities at their fair value (section 1 and 2). In the football industry there is evidence – broadly speaking – both for negative margins/results and for positive enterprise values, computed on the basis of deal prices (section 4). If the economic performance can not be interpreted as the source of goodwill in that industry, we suggest in our paper that there is room for the meta-economic performance to be considered by the practitioners and the dealing parties as the origin of goodwill (section 4).

This meta-economic source of goodwill directly affects deal prices, and it is not always clearly associated to financial measures; yet, we suggest that, in the football industry, turnover can be used as a preliminary proxy for highlighting the meta-economic performance, since it is positively correlated to the market data and it appears not to change abruptly when we breakdown the sample (section 4); moreover, our results appear to be solid in terms of the relationship between turnover and players' performance (see Tunaru *et al.* findings, 2005) Step 2 of our research project (see section 1) is in progress and it is directed – also with the use of different statistical techniques as, for instance, regression models – to identify a model for measuring, separately from the economic impact, the impact of the meta-economic performance, and to apply some models, used in literature for evaluating the media value of football players, to football teams.

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