

THIRD PARTY OWNERSHIP ARRANGEMENTS: AN ALTERNATIVE FINANCIAL INSTRUMENT FOR SPORTS COMPANIES APART FROM FOOTBALL?

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Abstract

Sports companies (equivalent to professional sport teams) are increasingly confronted with difficulties in raising capital. On the one hand, they have to fulfill league- and association-linked infrastructure requirements. On the other hand, they must ensure to be competitive in an increasingly demanding sportive and financial environment. However, future athletic success is highly uncertain (for example, because of players' injuries) and hence, associated cash flows are difficult to predict which makes it difficult to attract investors. An alternative financing option that has become more popular in recent years – especially in football - is Third Party Ownership (TPO). TPO is a way of investing in the player squad of a sports company and therefore reducing investment risks for sport companies. However, due to the wide usage in football and legal concerns about the usage of TPOs, the FIFA has forbidden the implementation of TPOs since 2015. But, the question rises, whether TPOs are still economic useful for sports companies in other sports? What are the reasons why TPO arrangements in football are so popular? What is their economic benefit for involved stakeholders? To answer these questions and to judge the appropriateness of TPOs for sports companies and the ban in football, a financing-theory-oriented view on the design and functional possibilities of TPOs is needed, but still missing. Our paper tries to fill this gap and, moreover, sets the economic basics for a profound legal and economic discussion on the use of TPOs in sports.

1. INTRODUCTION

Professional sports divisions of sport clubs are similar in many aspects to professionally managed business enterprises (for example, separation of ownership and control), and are focused on achieving both sportive and economic goals (Herberger, Oehler, & Wedlich, 2017; Fox & Weimar, 2014; Bühler, Gros, & Wallek, 2013; Küting & Strauß, 2010; Kupfer, 2006; Schewe, Gaede, & Kuchlin, 2005). However, the degree of similarity between both types of organizations depends on the degree of professionalization in the sports industry itself. Thus, the structures of professional sports divisions (e.g. in football, basketball and ice hockey) are more similar to professionally managed enterprises than in less popular sports like field hockey. While the concept of a football company has established itself in the context of professional football it can be transferred of course to other sports or it can be generalized (independently of a specific sport) called sports companies¹. This view supports the understanding in sports companies that they are – similar to other companies and business enterprises – mainly affected by the same issues (e.g. fulfilling its capital needs; profit orientation) and all corporate actions aim to maximize the companies' shareholder value.

In their daily economic life, sports companies are confronted with the task of financing their investment needs, e.g. the transfer of new players, the expansion of the stadium or the construction of a youth training center (Bühler et al., 2013). In this context, however, they are faced with the challenge that cash flows directly depend to a considerable extent on the sportive success (e.g. TV donations or sponsorship agreements depend on the league ranking at the end of a season) and are therefore difficult to predict. This uncertainty in forecasting cash flows makes planning for larger infrastructure investments more challenging (e.g., investments in a youth training center, training plants, or the playground infrastructure). The enormous increase in transfer fees² as well as the salaries of professional sportsmen (including huge variable payments when reaching previously agreed athletic and performance-related goals, e.g. a football players' number of scored goals per season or a championship) are evidence for an intense competition in some sports (in Europe i.e. in football). The top managements' task of sports companies needs to satisfy the capital requirements through external financing instruments. In this context, however, capital demands and investors must consider possible sports regulations as well as the capital market legal framework applicable to the respective financing instruments used (Haas, 2012; Schmech, 2005).

¹ That definition should be not confused with companies which produce sports goods or services (Herberger et al., 2017; Keller, 2005).

² The terms "compensation fee" or "compensation payment" are frequently used to the term "transfer fee" in the corresponding literature synonymously. In this paper we only use the term "transfer fee" for a consistent wording.

A financial instrument for sports companies, which has become popular in recent years – not only because of the critical discussion about it – are Third Party Ownership arrangements (TPOs). In the case of TPOs, an investor participates financially in the transfer payments during a player's transfer from one club to another before his former contract expires and therefore receives an amount of the compensation rights. In the case of a future player's resale before his contract expires, the investor will receive a certain part of the transfer cash flows in accordance with his share in the compensation rights. In this case, on the one hand, it is possible for sport companies to finance capital-intensive investments in their players' squad, while transferring at least a part of the investment risk to the investor. On the other hand, investors are offered the opportunity to invest in specialized human capital contracts, whereby an additional investment diversification potential can be obtained (Markowitz, 1952). This type of diversification is not yet possible with standardized financial instruments (e.g. exchange traded funds) and can benefit investors with diversification effect for their overall financial portfolios.

Despite the discussion on the legality of such financial contracts and a following FIFA ban in football since 2015, the interest of investors in such human capital contracts has grown in recent years not least due to the continuing low interest period on capital markets. We contribute to current literature by discussing TPOs from a finance-oriented perspective in a practical manner and try to fill this gap in literature. We also try to visualize the different TPO arrangements to provide a better understanding of stakeholders' interests in such arrangements.

2. THEORETICAL FINANCIAL FRAMEWORK FOR THIRD-PARTY-OWNERSHIPS

TPOs can be attributed at first glance to borrowing from the perspective of the relevant sports company (debt). On the one hand, from the legal point of view, investors of TPOs are not given any rights to ownership and control of the sport company. On the other hand, the contractual arrangement provides for a guaranteed interest rate, including (partial) repayment of the financial resources provided by the investor, in the event of a transfer at the usual end of contract (KPMG, 2013). Against the pure debt character of TPO, however, it can be argued that TPO investors can also profit from a performance-related return component when the player is resold. Therefore, they have similarities to partial loan constructions which, in addition to a (low) guarantee interest rate, additionally provide a performance-related bonus and can be allocated to mezzanine financing instruments that are related to debt capital. Furthermore, TPOs have a high degree of individualization (e.g. regarding the contract terms), which makes it difficult to distinguish whether TPOs are a classic debt financing instrument or a mezzanine

financing instrument. Ideally, an investor or investor pool³ finance a players' transfer fee and profit directly or indirectly from the obtained cash flows of the resale of the transfer rights. This would be the case when the player gets transferred before the contract expires (Guardian, 2014; Geey, 2014; Geey, 2013; Holzhäuser & Körner, 2009).

TPOs offer sports companies the opportunity to invest in its players squad with financial aid from an investor and thus, can share its related investment risks. Additionally, it is an opportunity for smaller sports companies with less financial resources (e.g. due to less sponsorships or income from TV contracts) to achieve a more well-adjusted competitive balance with wealthier sports companies. In return, the investor may profit from a potential rise in the players' human capital (e.g. an appreciation in the players' market value which results in a higher transfer fee in the future). However, it is uncertain whether the investor will realize a gain from a future player transfer and what his return is (depending on the transfer fee). Due to investors' uncertainty of the investment value, even after signing the contract, the investment can be characterized as a credence good in the terminology of information economy (Oehler, 2017; Oehler & Wendt 2017; Oehler, 2006; Oehler, 2005; Oehler, 2004). In return, the investor financially participates for his risk-taking depending on whether a transfer occurs before the contract ends. Moreover, TPOs are also common in the form of personal leasing contracts, where the investor lends a player to a sports company and gets a usage fee in exchange.

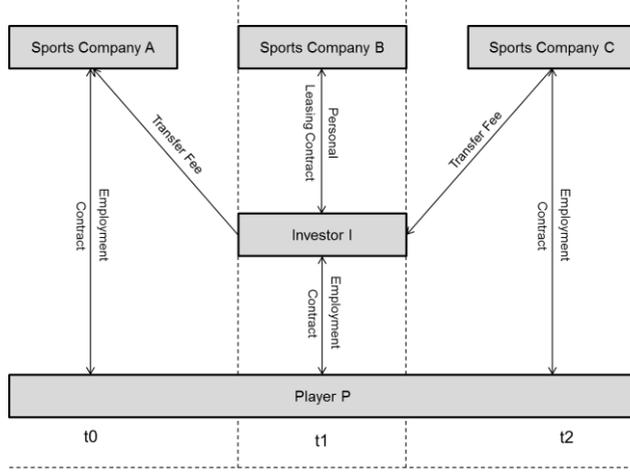
If the player is "lent" to another sports company during the season and a "rental fee" is due, the investor also benefits financially (at least in proportion to his share the compensation rights). Depending on the terms of the TPO contract, it is also possible that the investment must be repaid partially or entirely by the sport company after the end of the contract, irrespective of a potential player's transfer before the end of the contract. Additionally, it is possible that a fee (interest rate) has to be paid, if the player leaves the sports company after expiration of his contract and no transfer fee exists. With such contract terms, the investor tries to minimize his investment risk.

TPOs can be also compared with leasing or ABS constructions. Regarding the leasing form, TPOs are basically assigned to the area of personal leasing (see Figure 1). At t_0 , an employment contract between sports company A and player P exists. At the end of t_0 , player P is transferred to sports company B before the original contract ends. Therefore, investor I pays the transfer fee to sports company A for sports company B. Subsequently, an employment contract between investor I and player P exists at t_1 . A personal leasing contract will be established between investor I and sports company B simultaneously. Both contracts have the same duration. Investor I receives payments based on the

³ In the further course of the work, only "one" investor is spoken of for reasons of practicality, although the statements can, of course, also be transferred to an investor pool.

personal leasing contract and player P plays for sports company B. In addition, Investor I is the owner of the transfer rights and corresponding future cash flows from player P. If the player P is transferred to sports company C at t2 (before the original contract ending), investor I will receive a transfer fee and the leasing contract as well as the employment contract will be dissolved.

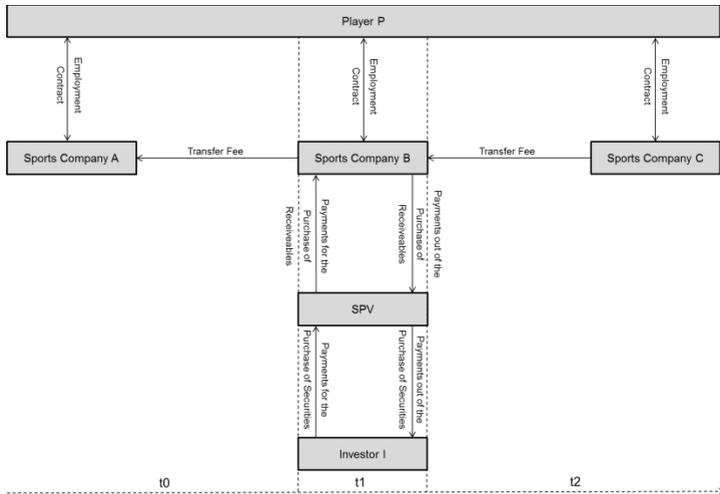
Figure 1. TPO based on a personal leasing contract



Note: Figure 1 shows a TPO as personal leasing construction. In t0, an employment contract between sports company A and player P exists. At the end of t0, player P is transferred to sports company B before the original contract ends. Therefore, investor I pays the transfer fee to sports company A instead of sports company B. Subsequently, an employment contract between investor I and player P exists at t1. A personal leasing contract will be established between investor I and sports company B simultaneously. Both contracts have the same duration. Investor I receives payments based on the personal leasing contract and while player P is playing for sports company B. In addition, Investor I is the owner of the transfer rights and corresponding future cash flows from player P. If the player P is transferred to sports company C at t2 (before the original contract ending), investor I will receive a transfer fee and the leasing contract as well as the employment contract will be dissolved.

However, a TPO can be also interpreted as an ABS. In this case, receivables from potentially future income related to a transfer (e.g. transfer fee) are sold to a special purpose vehicle (SPV) established for this purpose. The receivables are securitized and the related securities are sold to investors. This approach is particularly useful if (in addition to the transfer rights) further rights and related receivables (e.g. marketing rights) should be sold to the SPV and a wider circle of investors should be involved. Figure 2 outlines the relevant relationships between the stakeholders who participate in a TPO in the form of an ABS construction.

Figure 2. TPO based on an asset backed securities construction



Note: Figure 2 shows a TPO as an Asset Backed Securities (ABS) construction. In t_0 , there is a player's transfer from sports company A to sports company B, whereby a transfer fee of company B to company A is to be made, since the original contract between sports company A and the transferred player is not expired. In this transfer, investor I participates indirectly by providing a part of the transfer fee via the Special Purpose Vehicle (SPV) and thus financing sports company B. Therefore, in t_0 via the SPV, a payment is made from investor I to sports company B. In return, the investor receives securities from the SPV, whereby future receivables result from a potential future transfer fee and act as collaterals. In t_1 , player P is employed by sports company B. In t_2 , player P will be transferred from sports company B to sports company C before the employment contract ends. Investor I receives a part of the realized transfer fee resulting of the purchased securities from the SPV.

In t_0 is a player's transfer from sports company A to sports company B, whereby a transfer fee of company B to company A is made, since the original contract between sports company A and the transferred player is not expired. In this transfer, investor I participates indirectly by providing a part of the transfer fee via the SPV and thus finance sports company B. Therefore, in t_0 via the SPV, a payment is made from investor I to sports company B. In re-turn, investor I receives securities from the SPV, whereby future receivables result from a potential future transfer fee and act as collaterals. In t_1 , player P is employed by sports company B. In the t_2 , player P will be transferred from sports company B to sports company C before the employment contract ends. In return, investor I receives a part of the realized transfer fee depending on the basis of the purchased securities from the SPV.

Three types of TPOs can be differentiated depending on time horizon when the investor gets involved with the TPO contract:

- Financing TPO;
- Investment TPO;
- Club-to-Club Investment TPO (C2C Investment TPO / Club-Club Co-Ownership).

These three variants of TPOs are basically designed for the duration of the (remaining) time of contract of the TPO-financed player. While the investor acquires part of the transfer rights (usually 10-40% of the transfer value) – and the corresponding cash flows, when the player is already under contract by the sports company depending on the chosen construction (ABS or leasing), the investor acquires a share of the transfer rights (usually 10-50%) in TPO and club-to-club investment TPO only in the case of an upcoming player transfer. As a result, in a financing TPO the investor pays a contractually fixed sum for the acquisition of the transfer rights to the sports company in which the player is currently under contract, while in an investment TPO the investor provides a part of the transfer fee, which have to be paid by the acquiring sports company (KPMG, 2013). As an investor, for example, private individuals, specialized funds in human capital investments, other financial investors (e.g. hedge funds), but also sports company take part in such financing instruments. The latter, the Club-to-Club Investment TPO, is a special form of the investment TPO. A sports company, that has a claim on a player, let the player transferred, remain his stake in the player gets a part of the transfer fee in case of a possible further transfer. Therefore, the sports company that transfers the player would also act as TPO investor. This sports company becomes a TPO investor by abstaining from the transfer fee against the TPO initiating sports company. Instead, the releasing sports company will further hold a share of player's transfer rights and a corresponding claim on a potential transfer fee in the future. In this scenario the TPO investor speculates on a higher transfer fee for the player in the future than he would realize in the present.

The type of TPO depends on when investor participates. In the case of an investment TPO, a TPO investor participates during the transfer phase when the releasing sports company, the transferred player (and his advisor) and the TPO initiating sports company negotiate a transfer and the employment contract will be signed and closed. The maximum duration of the new employment contract between player and TPO initiating sports company is usually five years. The duration of the contract is usually equal to the financial engagement by the TPO investor. In the case of a Financing TPO, the player is already part of the team of the TPO initiating sports company and the TPO investor enters only during the contract phase of the player and therefore basically covers the remaining duration of the contract. This remaining period corresponds to the duration of the TPO. For all TPO variants, four termination outcomes can be distinguished (below, KPMG, 2013):

- 1) The player is transferred to another sports company after the regular end of his contract, which means that the new employer does not pay any transfer fee. Consequently, the TPO investor does not participate in a transfer fee payment. Depending on the specific contractual agreement, it is possible that the IPO investor will get back his investment sum plus a mini-mum interest rate from the TPO

initiating sports company. Thereby, the TPO investor could reduce his investment risk.

2) The player extends his contract with the TPO-initiating sports company. For the investor, no claim for compensation from a transfer fee payment can be derived from this. For such cases, the investor and the TPO-initiating sports company usually agree that the investor holds his respective transfer rights and a potential claim on a transfer fee payment until a potential transfer in the future will take place. Additionally, the TPO investor gets a minimum interest rate for his previous financial engagement

3) The player gets transferred before his regular contract ends. The TPO investor receives a part of the transfer fee depending on its share in the transfer rights. If the transfer fee payment (absolute sum) is lower than the capital sum originally invested by the TPO investor, the releasing sports company usually has to compensate the loss for TPO investor with its own financial resources and also have to provide him with a contractually agreed minimum interest rate. If the proportionate transfer fee payment is higher than the TPO investor's investment at the beginning of the TPO contract, the difference in the yield achieved for the investor is equal to its return on investment.

4) The player gets transferred before the regular contract between player and releasing sports company ends; the TPO investor, however, waives his right to claim the transfer fee payment and instead continues to hold pro rata transfer rights and corresponding payments for the player in the future. In addition, however, the investor receives a contractually agreed minimum interest rate on his capital engagement depending on the investment period by the sports company that releases the player. The new contract partner for the TPO investor is now the new employer of the player, whose transfer has been funded by a TPO. In the case of another player's transfer, the investor would have the opportunity to sell its claim on the future transfer fee payment. Since this is a second TPO (Investment TPO) construction, the TPO investor's interest and payment claims depends on the outcome (scenarios 1 to 3) and the agreements with the new TPO-initiating sports company.

3. DISCUSSION ON THE USE OF THIRD PARTY OWNERSHIP ARRANGEMENTS, THE CURRENT SPORTS-LAW REGULATION, AND THEIR APPROPRIATENESS FOR OTHER SPORTS

Especially TPO-funded player transfers have become more popular in a broader public due to very high transfer volumes and a resulting enormous public attention. As a consequence, these TPO funded player transfers will also be discussed more critical (Guardian, 2014; Wall Street Journal, 2012). The four main directions of criticism also interfere with each other and thus can not be considered as disjoint. Often, the four directions of criticism also occur together: (1) Possible conflicts of

interests, (2) influence and dependencies, (3) ethic reservations, (4) price distortions.

TPO arrangements are considered to be problematic if an investor is directly involved in a sports company (e.g. via equity) and also owns a stake in a player's transfer rights whose player is under contract for another sports company that is in direct competition with the sports company in which the investor is financially engaged.

From an ethic point of view, TPOs can also be criticized because players (or their human capital), who are the underlying of a TPO construction, can become a speculative object which "value" is largely influenced by investors. The risk is that these players may be influenced in their sporting future. E.g. they can not decide independently for which club they want to play (Bahners & Konermann, 2013). However, the player's decision-making independence in context of employment to a sports company, was strengthened by the Bosman Case and the corresponding judgment in 1995. This basic decision of the European Court of Justice states that a player can transfer to another employer at the end of his contract (without transfer fee for the released sports company). The player has become more independent and flexible in his decision to pursue his professional activities (assuming an interest of another employer exists)⁴. For players who are financed by TPOs there is therefore a risk that this gained independence and flexibility will be counteracted.

On the one hand, a minimum interest rate and securitization of repaying the invested capital are valuable components in a TPO from an investor's perspective. On the other hand, the TPO business model is mainly designed to gain returns for the case that a TPO-financed player is transferred before his regular contract ends and a transfer fee has to be paid for him. Therefore, the aim is to realize a player's transfer before the ending of a contract (UEFA, 2013). This increases the uncertainty regarding the fulfillment of the contract by a player who is financed by a TPO, as transfer fee payments are due only in case of transfers before contracts end. In addition, the increase in the turnover rate and the simultaneous inflow of financial resources from outside the circulation transfer pillar could trigger a spiral to ever-increasing transfer prices and distort prices on the players' transfer market. The development of price bubbles on transfer markets would also be raised (Bahners & Konermann, 2013).

TPO arrangements have become well known, especially in the professional football and are increasingly regulated at national and international level. UEFA argues that TPO structures undermine financial regulation e.g. the Financial Fair Play regulation. The core of this rulebook is the controversially discussed "breakeven-rule". That

⁴ The Bosman Ruling can only be applied for transfers in the EU and the European Economic Area. For further information about the Bosman Case and the consequences for professional football see Huwer, 2014; Binder & Findlay, 2012; Ericson, 2000.

standard determines that a soccer company is not allowed to spend more than the income of operative business (e.g. ticket sales, merchandising income etc.) over a period of cumulatively three reporting periods (Peeters & Szymanski, 2014; Müller, Lammert, & Hovemann, 2012; Dehesselles, 2011; UEFA, 2010).

The FIFA, which is responsible for the legal framework for players' transfer, followed the efforts of UEFA by regulating TPOs stricter. However, FIFA took also into account the economic interests of the Southern European and South American national associations and the interests of their football companies, which are highly dependent on TPOs (Geey 2014). In FIFA regulations according to players' status and transfer is presented in article 18^{bis}, that no sports company is allowed to enter a contract, in which the contract partner or a third party gets the opportunity to influence employment contracts, the basic sports company business strategy or the performance of the team. FIFA has the right in the case of misconduct to punish sports companies financially or sportive (FIFA, 2015).

Bahners & Konermann (2013) as well as Holzhäuser & Körner (2009) interpret the article 18^{bis} of FIFA that TPOs are not fundamentally forbidden by regulation, but rather restricted and are therefore permitted under certain conditions. In the case of an admissibility check of a TPO construction, based on the FIFA regulation, the transfer right have to be divided into the right to approval and the right to compensation. The right to approval of a player's transfer is exclusively held by the football company, where the respective player is under employment contract. However, the right to (financial) compensation grants the right get a compensation (transfer fee) if a player is transferred before the contract ends and can be sold to a third party. Only the transfer of the right to compensation is therefore allowed to an investor under the FIFA regulation Article 18^{bis}. In any case, the right to approval must remain by the respective football company. In practice, however, it is often difficult to prevent and prove an influence on the sports company by a third party. The national league associations are fundamentally aligned to the aforementioned FIFA regulations and implemented them in the respective national legal framework. However, some leagues (e.g. France and England) completely prohibit TPO designs (Geey, 2014; Bahners & Konermann, 2013; Abatan, 2012).

FIFA intensified regulation with article 18^{ter} since May 1, 2015 and completely prohibit TPO arrangements, although a study commissioned by FIFA did not come finally to the conclusion that TPOs should be compulsory banned, but that its frequency could be a potential risk for sports integrity (International Centre for Sports Studies, 2013). Neither sports companies nor players may enter into a contract with a third party which grants a third party a full or partial claim to compensation payments (transfer fee) or any other rights connected with a player's transfer, which is due in the case of a future player's transfer (FIFA,

2015). The prohibition does not apply to TPO constructions completed before 1 May 2015 (article 18^{ter}, paragraph 3).

However, circumvention strategies for the TPO prohibition can be observed. E.g. a minority participation of the investor in the TPO-initiating sports company can be initiated in order to break away from the role of "third party" (Transfermarkt.de 2017; Zürcher, 2016). It can also be argued that club-to-club investment TPO is still allowed because no third party is involved in the concrete transfer business from outside. If a football company transfers a player before the contract ends and a transfer fee would be paid to the releasing football company, it (partially) resigns the due transfer fee and secures instead a share of possible transfer fee payment in the future when the player will be transferred again. However, the aforementioned laws are undoubtedly a hurdle for a liquid TPO market and complicate to get TPO investors for professional football companies. In the future, TPOs are likely a rarely used and also hardly sustainable financing instrument for sports companies since potential investors can only participate indirectly in transfers and corresponding payments. The higher transaction costs for TPO contracts resulting from the fundamental ban and their reduced fungibility are detrimental to the profitability for TPO investors. A reasonable trade-off between risk and return seems at least questionable.

The rules in other sports concerning the use of TPOs are far less specific and it is often harder to find specific provisions for TPOs in the relevant legal framework. In handball, for example, the Articles of Association of the International Handball Federation (IHF) state that under the terms of Article 8 players make their own decisions independently and are not influenced by third parties. There are no specific statements on the influence of third parties in the context of players' transfer in the legal framework. Similarly, the statutes in other sports such as volleyball, basketball or ice hockey do not prohibit TPOs in general. More detailed, the statutes often do not provide any comments on TPOs. However, the discussed legal framework in football could have a signaling for other sports. Our provided financing-theory-oriented view of TPOs could contribute to a more profound legal and economic assessment of TPOs. E.g. it is evident that an investor has far less influence on a player through a TPO via an SPV than via a personal leasing contract.

4. CONCLUSION

The aim of the paper was to reveal practical designs and characteristics of TPOs in professional sports as well as their financial background. This issue is relevant to various stake-holders in sports, such as board members in sports companies, (future) investors of sports companies, but also regulatory institutions in sports federations to determine the meaningfulness and economic consequences of TPOs. Due to the legal

developments in professional football sport, it will be difficult for football companies and interested investors to initialize TPOs in the near future, but it is possible to implement a TPO arrangement e.g., if TPOs investors would commit with the football companies based on an equity engagement. The Southern European and American football companies, which have been heavily involved in TPOs in the past, are most likely to be affected by a rigorous ban financially (Geey, 2014), although there are strong advantages of TPOs from an economic, especially financial, perspective (e.g. another financial resource for smaller sports companies supporting the competitive balance).

Up to now, however, there are no signs of regulatory constraints in other sports. Therefore, other sports and sports companies could be interesting investment areas for TPOs, also due to the increasing degree of professionalization and, as a result of that process, an increased demand for investments. Our analysis provides indications that there are some basic economic arguments for the use of TPOs, both from an investors' and sports company' perspective. Instead of attempting to block such instruments rigorously and thereby promoting avoidance strategies, legal frameworks should be consistently applied and controlled (e.g. investors should not be allowed to invest in a sports company and simultaneously engage in TPO arrangements concerning the company's competitor). Moreover, players should be helped to make decisions independently apart from an investors' influence. The economic dependence from a player to certain investors should be diminished e.g. through legal restrictions that forbid payments between an investor and a player depending on a transfer. Additionally, the asymmetric information distribution between the different stakeholders in a potential TPO arrangement should be reduced. In order to avoid conflicts of interest, all property rights (especially transfer rights) in a player's human capital have to be recorded in a database at the responsible sports federation or league federation and should be available for all relevant stakeholders.

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