

**MUTUALITY FOR FOOTBALL CLUBS?  
LESSONS FROM THE FINANCIAL SECTOR**

**Andy Adams and Seth Armitage  
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**ABSTRACT**

The mutualisation of two English third division football clubs in 2001 and the creation of a number of supporters' trusts has offered hope to supporters of many larger clubs who see mutual status as protection from the vagaries of shareholder ownership and private control. This paper assesses whether mutuality would be of economic benefit for football clubs, drawing heavily on the experiences of mutuals in the financial sector. The economic case rests on the distinctive feature of customer loyalty to a club, which will usually be much stronger than loyalty to a financial institution. However, club members must expect to shoulder some financial risk.

# **MUTUALITY FOR FOOTBALL CLUBS? LESSONS FROM THE FINANCIAL SECTOR**

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## **Introduction**

Most British football clubs are constituted as companies, and several of the largest have been floated on the Stock Exchange, the first to do so being Tottenham Hotspur in 1983. The main objective of a company is the maximisation of shareholders' wealth and this objective is emphasised when a company is quoted on the Stock Exchange. Unfortunately, pursuit of wealth maximisation by a football club does not coincide with the interests of its customers (supporters) and tends to erode the emotional bond between the club and its supporters. Football supporters are particularly vulnerable to exploitation due to the loyalty and commitment they show to their club, and it is common for boards and supporters to be in open conflict over matters such as ticket prices and the price of replica kit. There have even been well-publicised cases of directors showing complete contempt for their supporters.

Many commentators argue for greater democratisation of club ownership and the government's Football Task Force 'majority report' recommended that supporters should be given more say in how their clubs are run. Michie & Ramalingam (1999) go further and suggest that full mutualisation 'would suit the culture, ethos and objectives of football clubs and should be encouraged to promote a diverse and modern economic system', though the authors stress that it may be difficult to raise the capital to buy out the shareholders.

Ownership of a football club by its supporters has obvious attractions. Through the principle of one member, one vote, members would have an equal say in important decisions, and could propose resolutions at general meetings of the club. The involvement of supporters would therefore be reflected in and reinforced through a mutual constitution, with no conflict of interest between owners and supporters. But would the mutualisation of a football club improve its economic prospects? Given that only a very few clubs are currently flourishing in

financial terms, with the majority operating on the edge of viability, this would seem to be an issue worth considering.<sup>1</sup>

In February 2001, Lincoln City Football Club changed its ownership structure to an industrial & provident society<sup>2</sup> and was purchased for £400,000 by a mutual consortium consisting of supporters, local businesses and the Co-operative Society. This followed many years of financial blight at the club. Then in May 2001, Chesterfield Football Club followed suit and turned itself into a mutual after the Chesterfield Football Supporters Society acquired a majority shareholding of the club. The club had run into serious debt and had been penalised by the English Football League for financial irregularities. After mutualisation, the club attracted financial support from many interested parties including the Borough Council.

The type of ‘community mutual’ at Lincoln City and Chesterfield Football Club has not been created simply to serve the economic interests of its members. The key relationship is between the club and the local community. As Jaquiss (2001) puts it: ‘The community is served by the mutual and owns it (through open membership) and controls it (through the elected and co-opted members of the Board).’ In many ways this is a return to the community-run, non-profit organisations that football clubs were when they were first established.

The mutual consortia at Lincoln City and Chesterfield were helped by the Supporters Direct organisation, which has its origins in the Football Task Force, and became operational in September 2000. Supporters Direct provides legal and practical advice to help football supporters form trusts and thereby become more actively involved in the way their clubs are run.<sup>3</sup> Ideally, this involves electing representatives to serve as directors on the board of the club. By December 2001, Supporters Direct had helped in the setting up of forty-two

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<sup>1</sup> Aggregate operating losses amounted to £59m for the ninety-two English professional football clubs in the 1999/2000 season. Operating losses of £112m for the seventy-two Football League clubs exceeded operating profits of £53m for the twenty Premiership clubs. Pre-tax losses amounted to £145m overall. (Deloitte & Touche, 2001).

<sup>2</sup> The constitution of an industrial and provident society requires that: the trust must operate for the benefit of the community that it serves; the members and officers will not profit from the trust; and all changes to the rules are monitored by the Registrar of Friendly Societies (Hamil *et al*, 2001).

<sup>3</sup> The first democratically run supporters trust was created at Northampton Town FC in 1992. The trust managed to obtain representation on the Board through the efforts of the local council who were in a position to exert pressure on the club because the club needed local council support for its ground development (Michie & Verma, 1999).

supporter trusts at British football clubs, around half of which have elected supporters' representatives on their boards (Supporters Direct, December 2001).

Under the terms of its funding from the Department of Culture, Media & Sport, Supporters Direct may only provide direct financial help to supporters groups in England and Wales.<sup>4</sup> Nevertheless, there has been considerable interest in greater democratisation of football clubs in Scotland and in September 2000, Celtic supporters formed an industrial and provident society, known as the Celtic Trust.<sup>5</sup> By the middle of 2001 there were nearly 200 members of the trust, holding in aggregate shares worth around 1% of Celtic PLC, although there is currently no representation for the trust on the board, which is causing some disquiet among the members.

Some argue that the long-term aim of a supporter trust should be to expand to the point where it gains control of the club and then to turn the club into a mutual organisation. This seems to be the view of David Burns, Chief Executive of the English Football League, who argues that: "Mutuality is not a thing of the past. Instead, as the establishment of Supporters' Direct has shown, it is very much part of the future for many football clubs in this country." (Supporters Direct, September 2001). But whether the supporters' trusts springing up all over the country can be regarded as an intermediate step to full mutualisation depends very much on the economic benefits of such a change in status.

Having established that there is serious interest in mutuality for football clubs, we now assess whether mutual clubs would be viable in the long term. We do this by drawing comparisons with the two types of business in which mutuals have been most prominent in the UK, namely mortgage banking and life assurance.

### **Why financial mutuals?**

The accepted explanation for why financial mutuals exist is Fama & Jensen's (1983) application of the agency perspective. They argue that, in the long run, the form of organisation that will survive is the one in which agency costs are minimised. Agency costs in

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<sup>4</sup> Supporters direct hopes to offer a semi-autonomous service in Scotland from April 2002 (Supporters Direct, December 2001).

this context are the extent to which managers fail to maximise the welfare of shareholders, or the welfare of members of a mutual, and the costs of ‘monitoring’ and ‘bonding’ mechanisms designed to promote welfare maximisation.

The agency perspective might appear to leave no room for mutuals. The major advantage of joint-stock companies is that the owners (shareholders) are better able to ‘discipline’ managers than are the owners (members) of a mutual. A quoted company is under scrutiny by investment analysts and professional investors, and if there is no ‘friendly’ shareholder owning a large block of the shares, it is vulnerable to a hostile takeover bid. Alternatively, a single owner can acquire a large stake or indeed own all of the shares, and can exercise direct control of the company. Thus, the managers can be steered towards maximisation of shareholder wealth either through stock market pressures or through direct intervention by a large shareholder. The aim of a mutual is to maximise the benefits of the organisation to its members. But the absence of stock market pressures, and the one member, one vote principle, mean that a mutual’s managers are less accountable to its members than are the managers of a company to its shareholders. The result is that agency costs, manifested in relatively undynamic management (or perhaps worse), are expected to be greater in a mutual.

To account for mutuals in the agency framework, Fama & Jensen argue that there must be special features of a particular business that give the mutual form an advantage to set against the lack of shareholders. In the case of mortgage banking, the nature of the product means that there is a direct link between member satisfaction and the size of the business. A building society in its purest form collects deposits and uses them to make mortgage loans (which is all they were allowed to do until the Building Societies Act 1986). Because deposit accounts and mortgages are products which endure over time, customers have an ongoing interest in the health of the product provider, but if they are dissatisfied, they can take their deposit or mortgage business elsewhere, and the mutual shrinks. Given this, the benefits of further ‘disciplining’ by shareholders may not be worth the costs of having an extra group of stakeholders with a claim on the business.

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<sup>5</sup> The origins of the Celtic Trust can be traced back to 1997 when the Heriot-Watt and Edinburgh University Celtic Supporters Club resolved to push for a more proactive role for supporters in the running of their club

Life offices are similar to building societies in that they collect savings and invest them to provide a return, but it is, or has been, notoriously costly to withdraw from a with-profits endowment policy once entered into. It is also very difficult for policyholders to assess how competitive their policies are in relation to others available. Arguably, therefore, product market discipline is weaker in the life sector than in mortgage banking, and there is more scope for managers to exploit policyholders in their own or shareholders' interests. Mayers & Smith (1981) argue that this explains contractual limits to dividend and investment policies in some US proprietary offices, which protect policyholders from excessive payments to shareholders and from imprudent investment of their funds. To the extent that customers are aware of the differences between mutual and proprietary offices, and know which office is of which type, it may also be more difficult for proprietaries to attract new business.

If agency problems are, in fact, no worse in mutuals than in their joint-stock competitors, the two types of organisation should display similar efficiency. The mutual will then be able to provide better-value products for its customers, assuming that over time a proprietary mortgage bank or life office pays out more in dividends than it receives through share issues. This is certainly a reasonable assumption in the long run. Even Microsoft will return cash to its shareholders one day.

However, joint-stock companies have an advantage in being able to raise fresh equity capital by issuing shares. Mutuals can only grow through retention of surpluses. This helps to explain why financial mutuals are found in less risky lines of business, such as mortgage lending, but not in lending to companies.

Many building societies and mutual life offices have converted to joint-stock status since the late 1980s, to the point where there is only one large building society and one large life office remaining. There is a real possibility that mutuality will disappear almost completely from the financial sector in the next decade, which naturally raises the question of whether there is something inherently wrong with the mutual constitution. The evidence suggests that mutuality has not failed on the grounds that it led to poor performance or more serious agency problems compared with companies in the same business (see Drake (1997) for building societies, and Armitage (1997) and Draper & McKenzie (1998) for life offices).

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(Carr *et al*, 2001).

If anything, mutuals have provided a better deal for customers, operated with lower cost ratios, and grown more rapidly. However, they carry the seed of their own destruction, or at least conversion. It is in the financial interest of most existing members to convert, whether via flotation on the stock market or via being taken over by a company. If existing members form the constituency whose financial benefits the mutual seeks to maximise, the mutual is acting in accordance with its objective in converting.

Conversion is in the interests of most members because for most of them the value of the shares and/or cash payment received on conversion is more than the likely loss they can expect as customers due to the profit which will henceforth be extracted from them. The reason is as follows. Part of the windfall on conversion represents the present value of future returns to shareholders expected from the current business. To this extent, the members as a group are merely compensated for the poorer deal they can expect in future as customers, assuming that joint-stock status does not lead to improved efficiency. But part of the windfall is the present value of returns expected from *new* business, which is a pure bonus for the existing members. The remaining financial mutuals are therefore vulnerable to pressure to convert unless they change their rules so that members would not receive the conversion windfall, as some building societies have done (though potentially their members could vote to remove such an ‘anti-conversion defence’). Thus, the losers from conversion are mainly future customers of the ex-mutual rather than ex-members.<sup>6</sup>

Capital constraint has also been a contributory factor in some decisions to convert, particularly amongst life offices. The decision regarding how much surplus to retain is awkward in a mutual. On the one hand, every pound retained is money that could have been paid out to members, for example through setting a higher deposit rate. Once retained, it is unlikely to be paid out later. On the other hand, retained surplus forms the capital base, which allows growth and absorbs losses. If the base is too small, survival is threatened. Equitable Life was forced to close in 2001 not only because of a House of Lords judgement that it must honour its guaranteed annuity contracts, but also because of its long-standing policy to operate with relatively little capital for its size, which left it unable to honour the contracts.

## **Mutuality for football clubs?**

The basic agency concern about a mutual football club is that the absence of a profit imperative may result in worse performance both on and off the field than if the club were a company. But the experience of financial mutuals suggests that the absence of shareholders is not associated with poor performance, provided that the mutual operates in a competitive market. Football clubs are likely to be similar in this respect; there will always be plenty of competition on the field. But is there a special feature of the football business that actually gives mutuality an advantage? We suggest that there is one: customer loyalty. This arises partly because of the geographic inconvenience of switching clubs for many fans, but perhaps more importantly because there is a clear sense in which the ‘product’ is unique. The experience of watching your side win is not one which another club can provide and, as with a financial mutual, the product endures over time and involves an ongoing relation between provider and customer. Loyalty means that a badly managed club will not lose all its customers, while the most successful clubs, with very large loyal followings, can charge near-monopolistic prices for its products. How might supporter loyalty provide a rationale for mutuality?

We noted above that a rationale for mutuality in life assurance is that a proprietary office might have difficulty selling its products due to mistrust on the part of would-be customers. In the life business, it is opacity of the product and of prices, which renders customers vulnerable to exploitation and potentially leads to mistrust. In football, it is supporter loyalty. Thus, mutuality can help a club attract new supporters on the grounds that, were the club to become more successful, price increases for match tickets and other products would be lower than if the club were a company. In addition, the greater involvement with a club implied by mutuality may enhance the experience of being a supporter, thereby enhancing the value of the club’s product. This would be reinforced if the club made a deliberate virtue of its mutual status, as the remaining financial mutuals have belatedly done, and as Lincoln City and Chesterfield football clubs appear to be doing.

In the case of a badly managed club, the fact that it is a football club makes its position somewhat different from that of most other businesses, including financial mutuals.

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<sup>6</sup> Michie (1999, p. 28) overstates the case when he writes that ‘demutualisation is ... just one more example of short-termism in the British economy.’ The point of calling a decision short-termist is that it is *not* in the interests

The normal market mechanism for ensuring that bad management does not persist is decline of the business and, ultimately, closure, or takeover by another management team. However, closure of a football club is much more of a last resort than closure of other types of business, because its product is unique. This means that the methods of dealing with poor management should be focused on intervention, for example replacing managers, rather than closure. It could be argued that a mutual constitution is superior to that of a company in the prevention and treatment of poor management. Loyal supporters are much closer to a football club than are institutional shareholders, and are in a stronger position to monitor managerial performance. It is the members who would employ the paid executives, entrusted with the efficient running of the club.

If a football club is in serious financial difficulties, a mutual constitution would make it harder to attract financial backing from a wealthy individual, who could not be ‘rewarded’ by outright control, or at least by ownership of a large block of shares. However, supporters and local communities have in the past often contributed money to bail out failing football clubs and a mutual status makes this more likely. Furthermore, it is possible that a change in status to a mutual could actually attract a charitable donation from a wealthy individual, as was the case with Lincoln City.

There remains the problem that, were today’s more successful clubs to be mutuals, they might well be under pressure to convert for the same reason that applies to financial mutuals. But here again, supporter loyalty, implying a continued wish to retain ownership of the club, could mitigate against the desire to cash in. This factor was largely absent in the case of financial mutuals. Most customers did not know the difference between a bank and building society until the conversions were under way. Whilst many customers had a vague attachment to building societies, this pales into insignificance in comparison with supporter feelings for a mutually owned football club. The form of mutual constitution adopted could also prevent conversion. The ‘anti-conversion’ measures taken by the remaining building societies have so far been effective.

A further potential problem is that the football business seems to have much more financial risk than mortgage banking or life assurance. Mutuals are not found in risky lines of

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of the decision-maker.

business in the financial sector. The members of many mutual football clubs, unlike the members of a financial mutual, would face a serious risk of being called upon to provide extra funds, the alternative being closure of the club. The reward for such an injection of capital would be the survival of the club and the prospect, were its fortunes to improve, of lower prices for match tickets and other products, than if it were a company.

## **Conclusions**

The consideration of financial mutuals in this paper clarifies both the case for mutuality amongst football clubs and the problems involved. The strongest argument for mutuality is that it removes the danger that the supporters will be exploited to make profits for shareholders. This danger arises because a club's product is unique, whereas the product of a building society or life office is not. A mutual constitution may therefore make it easier for clubs to attract and retain supporters. The fact that supporters could be genuine members of their club may also enhance the experience of being a supporter. The evidence from financial mutuals is that mutuality is not associated with inefficiency, and there is no obvious reason to expect mutual football clubs to be less efficient than proprietary football clubs. The one member, one vote arrangement could even lead to better monitoring and control of management than the shareholder alternative.

On the negative side, football is a risky business financially and mutuals are not found in risky lines of business in the financial sector. Members would face a high probability of being called upon for more funds, perhaps repeatedly. They would need to be a source of capital if a mutual club is to survive hard times.

The fundamental reason for the wave of conversions amongst financial mutuals is that the value of the windfall exceeds the costs to customers of the poorer deal they can expect after conversion. For the same reason, there might be pressure to convert if a club were mutual and became more successful. However, the emotional attachment factor which has already led to the mutualisation of two English third division clubs, combined with anti-conversion provisions, could mean that mutual clubs face much less pressure to convert. It is arguable that mutuality would add more value in the football business than it has in financial services. Whether the greater loyalty of a club supporter compared with a mortgage bank or

life office customer is sufficient to give mutuality a role in football is a question that may well be answered in the coming years.

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