

Introduction - New Research Pathways in the Soft Budget Constraints Approach

Rasmus K. Storm, Klaus Nielsen and Zsolt Havran

<a> Why a book on the SBC approach?

The influence of the Soft Budget Constraint (SBC) approach is significant in the social sciences, in particular economics (Mitchell, 2000). Developed by the late Hungarian economist János Kornai (1986, 1992), the approach has become institutionalized as a powerful tool for examining the problems of socialist and post-socialist economies (Kornai, 2001), especially the phenomenon of shortage (Kornai, 1980b, 1980a). A multitude of phenomena in capitalist societies, such as financial instability (e.g. Maskin & Xu, 2001) and the banking crisis (e.g. Jannik & Theocharis, 2016), have also been studied using the SBC approach.

This book aims to expand on existing research by developing the potential of the application of the SBC approach in the area of sports economics and management. Still relatively few such studies exist, although the body of literature is growing, showing the potential of Kornai's ideas.

<a> Prior applications of the SBC Approach in sports economics and management

The first references to Kornai and SBC in the sports economics and management literature appeared around 2005 with Andreff and Storm & Nielsen among the first to introduce and apply the approach more extensively (for a more thorough review, see the chapter by Andreff in this volume). Andreff (2007, 2015) and Storm & Nielsen (2012) outline the theoretical foundation for the application of the SBC approach to professional team sport leagues in Europe, where emotional attachments and prestige can prompt bailouts from sponsors, creditors, and even public authorities, thus distorting the normal capitalist connection between profits and survival.

Andreff (2015) uses the approach to analyze the managerial problems associated with running professional sports clubs facing SBCs. Storm & Nielsen (2015) argue that the approach has also relevance in the American context where a kind of inverse softness exists with support present ex ante instead of ex post resulting in a kind of inverse softness. Franck (2014) sees the problems of the financially unstable European football business as caused by the prevalence of soft budget constraints and argues that the problems can be solved through the implementation of the UEFA financial fair play (FFP) program, which hardens the budget constraints of the clubs. In line with Franck (2018), Pieper (2017) argues that FFP has already had a positive impact on the professional clubs' financial conditions.

The SBC approach is not endorsed by everybody in the field. For instance, Szymanski (2015) is critical of the relevance of the SBC approach in relation to European professional football and sees no need for hardening of budget constraints as proposed by some of the SBC advocates. Rather, the FFP break-even rule, which is central to the idea of hardening, is seen as a threat to competitive balance and as a means to protect the success of big clubs, thus freezing the existing league hierarchies (Peeters & Szymanski, 2014).

<a> Substance and Structure of the Book

This volume is based on the belief that the SBC framework can advance our understanding of crucial aspects of professional team sports. The contributions provide novel insight from empirical studies and theoretical reflections following Kornai's insights. This involves discussion of the potential and weaknesses of the approach in order to push the research frontier forward.

This book aims to develop the approach through theoretical enrichment as well as new empirical evidence. The framework is deployed in new contexts (more nations, more clubs). Further, thorough the analysis of problems such as financial (mis)management, competitive (im)balance and regulatory issues regarding professional leagues, new evidence will be revealed to the benefit of researchers and managers alike. The chapters in this volume are a testimony to this.

At hand is a comprehensive volume with contributions by established scholars in the field as well as papers written by young, talented researchers that have taken up the ambition of using the SBC approach on professional team sports. As the field of research is still in its initial stages of development, it is the hope that this book will inspire to broaden and deepen still more research in the area.

In the residual part of this chapter, we briefly introduce central aspects of the SBC-framework, while in parallel introducing each of the book chapters to put them into the context of the theories' central terms, aspects and substance. In this way, the reader will be able to follow how the various chapters uses and develops the framework while also specifying its appliance to sport management and economics.

<a> The SBC Framework: The Basics

What is a Soft Budget Constraint? In short, the SBC concept describes a situation where an organization, for example a public enterprise or a private company, is bailed out from financial distress or collapse (Kornai, Maskin, & Roland, 2003). Instead of facing a Hard Budget Constraint (HBC) – where *'... proceeds from sales and costs of input are a question of live and death ...'* to the organization (Kornai, 1980b, p. 303) – the bailout instils a softness in the budget constraint of the organization, thus keeping it alive.

According to the original understanding of the term, a HBC is (as is the case with a SBC) an environmental condition exercising a *"(...) form of economic coercion (...)"* restricting its potential survival when faced with financial difficulties and generally making it obey market competition in all potential dimensions (ibid.).

Originally, Kornai developed the SBC concept in order to understand shortage (Kornai, 1980b, 1980a). He saw the existence of soft budget constraints as a catalyst of inefficiency that prevailed in almost all sectors of society (except the space and the military industry) behind the iron curtain (Kornai, 1986). Borrowing the idea of the budget constraint from micro-economic theory, he helped to shed light on the core problems of planned economies.

Kornai outlines five conditions of hardness (Kornai et al., 2003; Maskin, 1999): H1: exogenous prices (where the organisation is a price taker of in- and outputs), H2: hard taxes (where the organisation cannot

obtain exemptions from tax rules or legislation), H3: hard subsidies (where direct or indirect public subsidies is not provided for the organisation), H4: no Credit (where no credit from other organisations – for example other firms or banks – can be obtained to help the organisation), and H5: no external investment (for running the organisation (except for its foundation). Storm & Nielsen (2015) add another condition of hardness (H6: no soft accounting practices) where no ‘creative’ accounting can be applied to help the distressed organisation from collapsing.

If all six H-conditions of hardness prevail, an ideal-type situation of ‘perfect’ hardness exercises a strict coercion on behavior. This situation is seldom found in practice but establishes a theoretical (bi)pole of analytical understanding. In contrast, ‘perfect softness’ can be said to characterise a situation where efficiency and sound financial operations is not a matter of “life and death” (Kornai, 1980b, p. 308) of the organisation, where the growth of the organisation has no link to its financial performance, or when the firm keeps surviving “(...) even when investment entails grave losses (...)” (Kornai, 1979, 807). This would usually be the case if all conditions of hardness are softened to various degrees but often only one or a few of the H-conditions of hardness needs to be softened to secure the survival of a given organisation in spite of losses.

According to the SBC theory, hardening the budget constraints of organizations is important because under conditions of softness, ex ante expectations of ex post rescue in case of financial distress develop within organizations. One of Kornai’s (2014) main observations was that when ex ante expectations of ex post support are institutionalized in organizations – i.e. when they face soft environmental conditions – managerial inefficiency becomes the order of the day. In this situation, management staff focus on pleasing the (vertical) supporter organization that are assisting the organization financially instead of optimizing production procedures, sales or management processes that are critical for survival and profit-making under hard budget constraints (Kornai, 1986; Maskin, 1999). The soft budget constraint facing an organization has impacts on behavioral patterns of the organization, and if such conditions prevail widespread hoarding of resources (in football, mainly players), overspending and inefficient use of such resources develop.

In short, if the creative destruction of capitalist societies (whose firms (normally) are facing relatively hard budget constraints) is prevented by successive bailouts or supporting initiatives, shortages start to

develop because little holds companies back from hoarding resources, and negotiation and bargaining takes precedence over market incentives and efficient allocation of resources (Kornai, 1992). In sum, perpetually failing organizations survive despite their substantial and successive losses, resulting in a significant overall loss to societal prosperity and wealth (Kornai, 2006).

<a> The Challenge of SBC - Introducing Chapters 2-3

In European professional football there is much evidence of SBCs with many instances of persistent financial problems but also rescues, bailouts and a high survival rate among the clubs (Storm & Nielsen, 2015). In the book's two first chapters, these characteristics are identified and dealt with in order to give a better understanding of their characteristics and to reflect on what can be done to deal with the problems.

One of the answers to the problem of overspending and financial mismanagement is regulation. Several ideas have sufficed with UEFA's Financial Fair Play program (FFP) as the most prominent and recent one. In Chapter 2 ('**Soft Budget Constraints and Institutional Logics in European Football**'), the authors take this idea further by suggesting an organisation that is external to the football business itself and modelled after the World Anti-Doping Agency.

Their suggestion is based on a thorough examination of European professional football using not only the SBC approach but combining it with institutional theory. They argue that two long-lasting paradoxical financial practices in European football is much better understood this way. One of these practices is the tendency of clubs to continue to overspend even when revenues are increasing. The other practice is that clubs rarely go bankrupt despite experiencing ongoing deficits.

The authors argue that two, often competing, but sometimes complementary institutional logics are underpinning the soft overspending and bailout practices: a dominant sporting logic and a weaker economic logic. Consequently, the two intertwined SBC practices constitute a self-destructive financial logic of European football. The vicious circle continues because clubs and leagues operate in ways that are individually rational, but collectively irrational. Finally, the authors discuss reasons why clubs have been

allowed to operate under SBCs and also comment on challenges that can make it difficult to establish an efficient regulation system that can harden the budget constraints in European football.

The difficulties of hardening budget constraints are also the centre of attention in Chapter 3 (**‘Hardening the Soft Budget Constraint in Professional Team Sports: Why It Is So Hard?’**). Digging deeper into the theoretical literature on SBCs, Andreff detects that its determinants have been analyzed as being macroeconomic (nationwide in socialist and transition economies), then microeconomic (softness of a firm’s budget), and finally meso-economic (at industry level or in the banking business). It is argued that hardening SBCs implies measures taken at macro-national, meso-industrial, and micro-entrepreneurial levels.

The contribution explores in forensic detail how the SBC in professional team sports could be hardened, and why it is so difficult to implement this in practice. At the club level the measures include handling fans’ pressures, tight financial management, transparent accounting (no slush funds, bungs, etc.), and improving the quality of club governance. At the meso level, i.e., the league, measures to harden the SBC pertain to a tight enforcement of league rules - in particular, regarding bailing-out benefactors, clubs’ external auditing, financial supervision by the league, including at the international (ex: UEFA FFP) level, and a change in the league’s bargaining TV rights revenues and their redistribution. At the macro-level the following is at stake: lax finance (subsidies, tax exemptions) by regional and national governments and financial institutions, tax arrears, social contribution arrears, mutual payment arrears, de facto exemption of sports clubs from bankruptcy law enforcement, and the enforcement of the (international) EU competition (anti-trust) law. The chapter concludes by suggesting some practical recipes and recommended policy measures for hardening the budget constraint.

<a> Variation and Dynamics of Budget Constraints in European Football - Introducing chapters 4-6

While there is evidence pointing to existence of SBCs in European professional football, there are also variations to how soft – or how hard – the environmental conditions are formed in the European leagues and even within each of the leagues.

Looked at from the point of view of the H-conditions of hardness, one might talk about a continuum ranging from (perfect) hard, over almost hard to soft, and extremely soft depending on the context the club in question faces. Over this continuum more and more of the H-conditions of hardness are softened. However, it is not clear from the SBC literature how one is to operationalize this continuum more specifically besides being a theoretical heuristic tool to understand specific cases. The variations and different dynamics regarding the institutionalization of SBCs is the theme in Chapters 4-6, all of which consider the dynamics of budget constraints in order to understand how they differ within leagues or across different nations.

Chapter 4 (**'Budget Constraints in French Professional Football League: Various situations'**) addresses the question related to French football. It aims to develop an empirically based typology for different degrees of softness –taking into consideration the specific context of professional team sports with dual objectives of the organizations, i.e., sporting as well as financial performance. The authors hypothesize that the character of budget constraints imposed on clubs is not uniform and that in French professional football, although some clubs operate within an SBC, others are subject to a much harder budget constraint. While much of the previous research have analyzed the leagues as whole, the chapter broadens the perspective and analyzes the French professional football league at the level of each of the participating clubs, with the aim of identifying different levels of budget constraints. It shows that only a few large clubs, owned by moguls with a patron's behavior, evolve within the framework of the SBC. These are the big European deficit-generating clubs often cited as examples in the literature on this issue. However, it also demonstrates that a lot of the clubs face harder forms of budget constraints. The contribution thus adds to existing research by nuancing the approach and the understanding of dynamics and existence of budget constraints in Professional Team Sports Clubs.

Much of the exiting research on SBC in European football have – paradoxically as it may seem – examined Western European leagues even though the theory originally were developed to understand a phenomenon institutionalized in Eastern European nations. In chapter 5 (**'Heterogeneity of Budget Constraints in Hungarian and Polish Football'**), the authors dig deeper down into two Eastern European

nations to look at how budget constraints manifest themselves in these contexts. The authors argue that thirty years after the change of political and economic regimes in Hungary and Poland, the transition of the sport systems in both countries is not yet completed. The sport organisations, despite their growing commercialisation and professionalization, are still to a varying degree dependent on ad hoc state aid. Similar to the situation in Western European football the expectations of managers that their organisations will get rescued ex post by an external agent in case of a financial distress impact their decisions and behaviors ex ante and lead to the SBC syndrome.

More specifically, the SBC phenomenon starts as a mental issue and the softness of the budget limit may be estimated by the probability of the rescue as perceived by managers. The chapter undertakes an empirical evaluation of the heterogeneity of the budget softness perceived by top managers of football clubs in Hungary and Poland. A survey is conducted among football clubs of the top two divisions in both countries, and its results are analysed with segmentation and profiling techniques. In general, the clubs evaluate the probability of their bankruptcy in a case of sudden and serious financial problems as low, and among external rescue options most hope is placed in the owner.

Chapter 6 (**'The Soft Budget Constraint Syndrome in Hungarian Professional Football from a Central and Eastern European Perspective'**) also aims to expand the research on SBC in professional football through an analysis of the characteristics of the operation of professional football in Central and Eastern Europe (CEE). To reveal the specificities of CEE football, the chapter is based on a thorough analysis of sporting and financial performance, revenue, spectators and social media interest in nine nations (Bulgaria, Croatia, Czech Republic, Hungary, Poland, Romania, Serbia, Slovakia and Slovenia) revealing significant differences in the structure and role of public funding. The analysis shows that Hungarian football provides a striking example being characterized by the combination of huge financial contributions and minimal sporting success. The special features of Hungarian football are outlined in order to understand how SBC obstructs the development of football.

<a> Is the SBC Framework needed? And are there Limits to Softness? - Introducing chapters 7-8

Connected to the question of variations in the softness (and hardness) of budget constraints – examined in the chapters introduced above – are the equally important questions of, first, whether there are fundamental flaws to the theoretical approach that misinterpret the situation and give a misleading understanding of how professional team sports function, and, second, whether there are limits to how much the environment can soften the budget constraint of professional team sports clubs and. In other words, are there limit(ation)s to the application of the framework in the context of professional team sports, and what are the limits to softness in professional team sports clubs. Whereas the first question questions the usefulness of the approach, the second question is about further development of the SBC framework.

The first question is considered in Chapter 7 (**'Is there evidence of softness in the budget constraint in football? Some evidence from English clubs'**). In this chapter the author argues that there is not enough evidence to show the relevance of the theory. In other words, even though it is recognized that the SBC theory offers interesting insights into the mechanisms and problems of socialist and post-socialist economies, it is argued that it has not much to offer sports economics and management research.

It follows from the SBC theory that even if the club fails, the employees of the clubs will retain their jobs. If this is not the case, club failure does not have the behavioral consequences assumed in the SBC theory. It is argued that an empirical test is needed to test whether evidence of SBCs in European football can be found. Using data from English football on membership of the board of directors and the club manager (head coach), he shows that there is in fact a high probability of dismissal (higher for directors than for managers), which seems to undermine the theory. Instead, he suggests another approach not based on a failure of governance but on the riskiness inherent in the system of promotion and relegation. In the chapter, this theory is tested against the data and shown to fit. Based on this, the challenge to advocates of the soft budget constraint theory is to develop convincing empirical tests to confirm the SBC hypothesis. It is argued that, for the moment, the soft budget constraint theory is seen as no more than an untested assertion.

Regarding the second question it can - from a theoretical point of view - be hypothesized that there is a potential limit to how much environmental supporter organizations can assist a given organization. In case of repeated financial problems faced by – say – a football club the question is for how long supporter-organizations will be willing to – or is capable of – pouring money in or softening other dimensions of the budget constraint. Kornai argues that because of sunk costs associated with the dynamic commitment problem, it is likely that new rescue operations can be repeated for a long time. Especially in a command economy, the state is a powerful supporter with significant resources at hand and with the power to exercise control over many of the H-conditions of hardness. For example, by softening taxation rules and practices and provision of soft loans and subsidies, state authorities can support troubled organizations for a very long time. However, in capitalist economies supporter-organizations include private creditors, and, in the case of professional football, sponsors or fan trusts with limited resources and with limited or no control over conditions such as taxation or pricing.

The final Chapter 8 (**‘Limits of Softness in Professional Team Sports Clubs’**) aims to understand these limits. Following an overview of bailouts in European professional football, the authors investigate the limits to the ‘too big to fail’ phenomenon that characterizes many of the rescue mechanism present among the big European team sports clubs by means of two case studies: the financial collapse of Glasgow Rangers (no further presentation needed) and Gudme Oure Gudbjerg (GOG) - a very successful Danish team handball club - respectively.

The authors show how clubs may experience the boundaries of environmental softness – even though the same clubs have experienced significant environmental softness prior to the collapse. The chapter examines whether there are potential institutional settings where the probability of rescue is significantly lower than what would usually be expected considering the importance and significance of the clubs to the local community and larger fan base. The case studies show how structural external shocks but also accumulated debt combined with soft accounting and other forms of prior softness in the end hardened the environmental conditions for the clubs examined. It is concluded that it is often tax liabilities that trigger insolvency proceedings, and the tax authorities often decline an agreement to write off debt in the seldom

cases where clubs are liquidated. Pressure from fans/supporters/local communities often contribute to pushing a club into bankruptcy. New owners may come to the rescue. However, overspending - sometimes fuelled by fraudulent behaviour - and collapse of the owners' other businesses may push the clubs over the edge.

The chapter addresses the issues raised in the preceding chapter by outlining how softness influences decision making even against the self-interests of managers. It also qualifies the situations in which the theory applies by specifying the limits to SBC in capitalist economies.

By ending the volume with significant criticism about the relevance of the SBC framework when applied to sport management and economics followed by an attempt to further develop the theory by addressing an issue which has not previously been much analysed, we have outlined some of the future research pathways in the soft budget constraint approach. It is the editors' hope that in the future more researchers will aim to apply the approach to new contexts as well as further deepening the theoretical strengths of the approach in a dialogue with the critics of the approach. Continuous discussion about relevance, correctness and validity is essential to push the research frontier ahead. We hereby invite interested scholars to take part in this endeavour.

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ⁱ In this book, which mainly deals with European professional football, we use ‘soccer’ and ‘football’ as similar terms.