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Long Range Goals: Lessons From the Premier League

BY BARRY GILLMAN, CFA

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Investment managers seem to relish the parallels with professional sports. Sports phrases, analogies, and stories pepper investment presentations. And there are definitely elements in common. Both professions are highly competitive. Results are influenced by luck as well as skill, especially in the short term. Management teams focus on figuring out their competitive edge, and how to increase it.

CAN INVESTORS LEARN FROM SPORTS?

But if our goal as investors is to learn some lessons from professional sports, there's one very useful difference, and that's the time span needed to evaluate success. In investing, a typical short-term horizon is just three months. In sports, the equivalent horizon might be a single game. For investment clients, determining success may therefore take up to ten years or more to allow enough time for skill to over-ride luck. In sports, success can typically be assessed in that context over a single season.

Observing the *ingredients* for success over a sports season can thus be an accelerated lesson in how some of those same ingredients might play out in the investment world. As investors, we can look at sports as our "lab" to illustrate much more quickly the importance of process and patience in our pursuit of success.

While passage of time helps us untangle skill and luck, we need to be careful about deciding on the actual definition of success, as this may differ significantly between sports and investing. In pro sports, there's only one champion each season.

THERE'S ONLY ONE CHAMPION (IN THE PREMIER LEAGUE)

Not so in the investment world, where many can succeed….if success is defined by performing well enough over the long term that the business prospers and clients are happy. This pragmatic definition of success can effectively translate into "avoid failure".

Some of the best work on the lessons for investors from pro sports has been written by Michael Mauboussin, especially his most recent article "Turn and Face the Strange, Overcoming Barriers to Change in Sports and Investing." We can use analogies to bring the excitement and thrill of sports to our investment conversations, but the parallels only go so far, especially for the US-based pro sports Mauboussin commonly cites: football, baseball and basketball.

American pro sports lack two important aspects if we're developing an analogy to investment management.

- First, if assembling a team is to be compared to building a portfolio, we need a good proxy for securities markets to establish a consensus market price for player values.
- Second, and more importantly, the consequences of failure in American sports does not match up with those of failure for investment managers. Failure in the investment business can be punished severely with loss of client business over the long term. But unlike investing (or many other businesses), once you're competing in the sports league, there's actually a reward for failure. For example, the closed shops of American pro sports leagues aim for "parity," with draft picks rewarding the worst teams—and penalizing the best.

FOCUS ON THE PREMIER LEAGUE

But we can resolve both of those issues by switching the focus of our analogy to the English Premier League, the pre-eminent professional soccer league worldwide. The parallels used in American sports are still valid, but with the Premier League, we can access a marketplace to price players (and hence teams), as well as find a closer correspondence in the definition of failure.

Investors may have their view on a security's intrinsic value, but in practice, they need a price representing market consensus views enabling them to trade and take advantage of any discrepancies between that value and the actual price. That's the function of a securities market. There's now an equivalent in professional soccer. The website Transfermarkt[1] provides data on professional soccer worldwide, including consensus market values on every player (and hence every team, by aggregating the values of each player). Unlike a securities market, Transfermarkt doesn't act as an exchange where trades take place, but it is a source of reasonable and realistic pricing.

Now, let's turn back to that more relevant definition of failure. In the Premier League, it's called relegation, and outside US sports leagues, it's the norm. If a team finishes at or sufficiently near the bottom of the standings at the end of the season, it is relegated, dropping down to a lower tier league for the subsequent season, to be replaced by the "promoted" top team(s) from that lower tier.

RELEGATION = FAILURE?

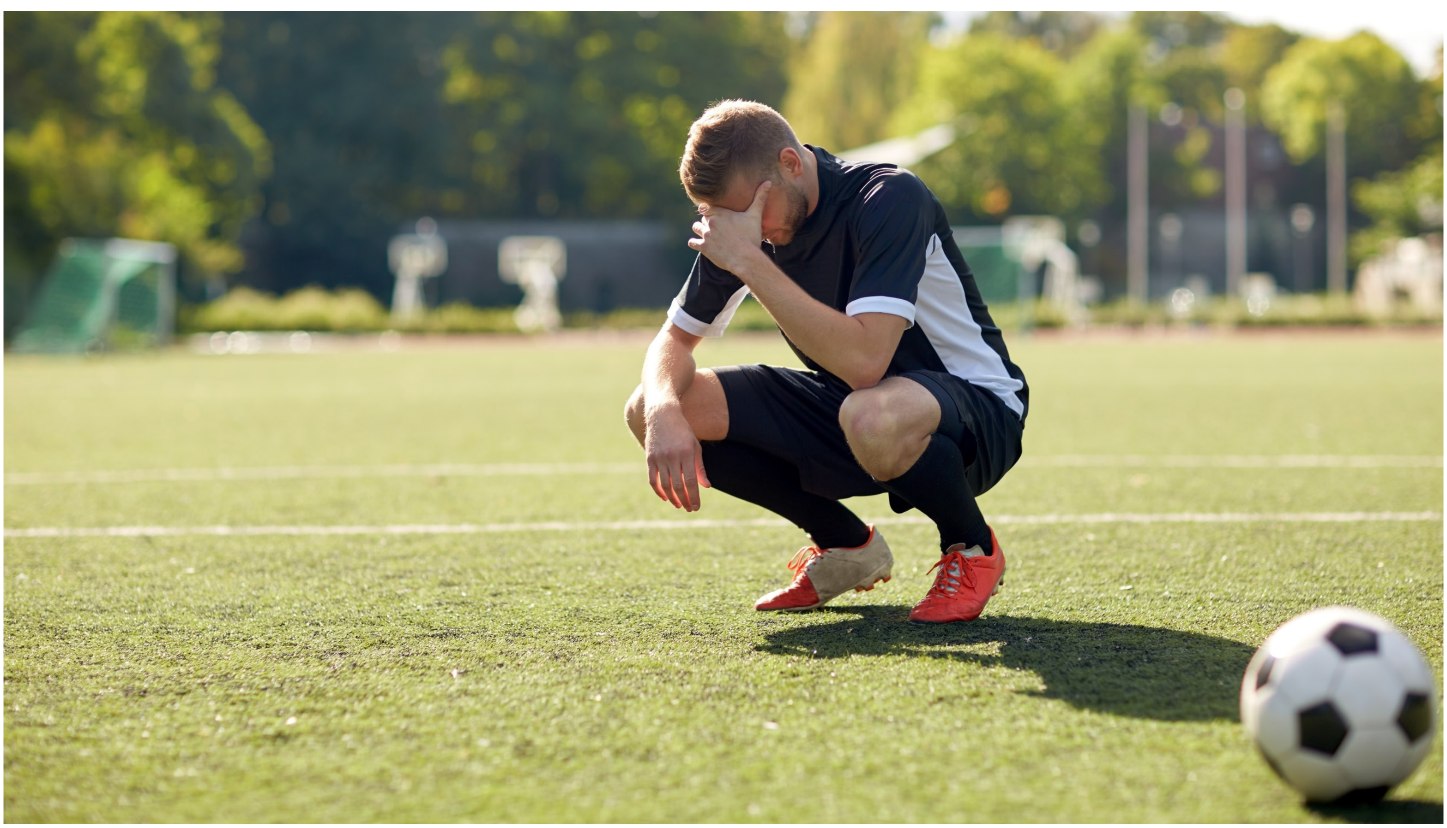
This relegation/promotion system is a core difference between American pro sports and their international counterparts. It allows us to use a definition of success that applies in the real world to investment managers and to most Premier League teams: keep the customers happy and avoid failure.

The reason we say *most* Premier League teams aim to "avoid failure" is due to the income inequality between the Premier League's so-called "big-six"[2] glamour teams and the other 14 teams in the 20-team League. The big six each have resources and budgets unmatchable by the other teams, and essentially constitute an oligopoly competing for the Championship, with miniscule chance of relegation/failure. Realistically, the champions will almost always come from that group of "glamour" teams with mega-budgets.

We'd suggest that there are two lessons that investors can learn from the Premier League: the importance of process, and the need for patience to allow the process to succeed over time. Even more than for investment management, media coverage focuses on the short term: the latest results; the "in-form" player or "hot stock" and, occasionally, the latest scandal. So it needs a deliberate effort to focus on less obvious and immediate topics, such as process and patience.

BUILDING THE PORTFOLIO (TEAM SQUAD)

The data from Transfermarkt allows us to look at a team squad as analogous to a portfolio of securities (with players as the securities). Managers aim to build their best portfolio (or squad) at prices (or transfer fees) that they think are below true value.



They then aim to succeed over time through good portfolio construction (or team strategy/tactics).

Value managers are used to the idea of buying undervalued securities; in the same way, teams may aim to acquire (or develop) undervalued players, and at a later date, "sell" or trade them at higher prices, especially to the top glamour teams when their value is more evident. A successful strategy in professional sports requires the sales process to be just as disciplined and analytical as in investment management.

Some of the big-six glamour teams in the League don't seem to have the patience or discipline for a value approach. They aim to acquire what they see as the "best" player regardless of price, so it's not surprising when valuations are stretched at the top of the rankings.

Is it worth paying up for apparently excessively high valuations? Those with a value-mindset (in either field) may say no. But even with a "glamour" mindset, having a process for evaluating and making decisions may help avoid major errors.

SUCCEEDING LONG TERM

But in my view, lessons for the investment community may be even more relevant when based on the teams *outside* that glamour elite. As I noted, their definitions of success are well-aligned with most investment managers. They are focused on keeping their customers happy, setting expectations realistically, and performing well enough to avoid failure (loss of clients/relegation).

In my opinion, the chance of failure (relegation) is higher in the Premier League than in the investment world. Three of twenty teams are relegated each season, and given the resources of the big six, it's highly likely that all three will come from the "other 14". That's over a 20% chance of relegation each season, leading to an intense focus by all 14 on avoiding this fate.

As an observer of professional soccer for many decades, and of the Premier League since its inception in its current format 30 years ago, I'm surprised that the importance of a disciplined process for organizational management does not seem to be universally accepted. But this does provide a learning opportunity regarding long-term success by contrasting teams that appear to have a disciplined approach with those that don't.

We have long believed that a disciplined and patient process is key for long-term success in the investment business. Conceptually this should hold for organizations in any competitive environment, and the Premier League may prove to be an interesting and entertaining real-time "lab experiment" to test the hypothesis.

APPENDIX: FOR INVESTMENT PROFESSIONALS WHO ARE ALSO SOCCER FANS

WHY THE PREMIER LEAGUE?

I use the Premier League as our example, given its position as the most valuable and most global of the soccer leagues in Transfermarkt's coverage.[3] Of the five teams worldwide with highest squad value, four play in the Premier League (see Exhibit 1).

Exhibit 1: Top Five Teams Worldwide by Valuation of Squad (December 2021)

1	Manchester City	Premier League	$1.19 billion ▲
2	Paris Saint-Germain	Ligue 1	$1.02 billion ▼
3	Manchester United	Premier League	$1.01 billion ▲
4	Chelsea FC	Premier League	$980.65 million ▲
5	Liverpool FC	Premier League	$953.15 million ▼

Source: Transfermarkt, Dec. 16, 2021

Testing the importance of process and patience

Because the resources and goals of the Premier League's big six are so different from the other 14, I'll provide separate examples for each. That allows us to contrast teams with similar resources, but seemingly different attitudes to maintaining a disciplined process.

Big Six Glamour Teams

We'd suggest comparing the two Manchester teams. Manchester United has been the ultimate glamour team of English soccer, winning more Championships than any other team over the years. Manchester City was formerly an "also-ran" until infused with massive new capital in the past decade; they are currently Champions of the Premier League. Our observation is that City has used its new-found wealth effectively, developing a clear philosophy and process to drive term success. In recent years, United has seemed to lack a clear and disciplined process.

The "Other 14"

Examples that may sound familiar to investment professionals include:

- over-reliance on a single star, who then leaves for greener pastures, and the organization struggles to adjust (lack of process)
- managers are fired in rapid succession, and results are inconsistent as team members struggle to adapt to these changes (lack of patience)

The first example is Aston Villa and the second is Watford (with an astonishing six managers within the past two years). We'd contrast these with a team that has consistently (on and off the field) seemed to adhere to disciplined processes focused on longer-term success: Brighton and Hove Albion (see disclosure at the end of the Appendix).

Aside from just following the news and results (fun though that may be), a more analytical approach may be to assess each team's progress relative to its resources.

Soccernomics[4] authors Simon Kuper and Stephan Szymanski claim that league standings are strongly correlated with teams' spending on player wages. While not an exact equivalence, the Transfermarkt valuation rankings may be a good proxy; the correlation between the rankings of teams' wages and transfer value rankings was 88% at the beginning of this season.

This suggests that we can assess the impact of a team's process by the degree their long-term result (final League standing for the season), is better or worse than that predicted by their squad Transfermarkt ranking at the start of that season.

Here in ( ) are our five example teams' Transfermarkt beginning season's rankings, out of 20 teams. We will assess our experiment at season end!

Manchester City (1)	Manchester United (2)
Aston Villa (9)	Watford (19)
Brighton and Hove Albion (13)	

The "Big Seven"?

In October 2021, Newcastle United, a Premier League team that last won the English Championship in 1927, was acquired by the Saudi Public Investment Fund. In terms of available resources, this suggests that eventually the "big six" may become the "big seven". However, at time of writing, Newcastle United sits near the bottom of the standings and in danger of relegation at the end of the current season. This will be an interesting test of the importance of process and patience, with the "lab test" focusing on an organization that now has the resources to apply both, but a history of using neither!

[1] For background on Transfermarkt, including advantages and limitations, we recommend this article by Rory Smith in the 8/12/2021 New York Times, https://www.nytimes.com/2021/08/12/sports/soccer/soccer-football-transfermarkt.html. Or go directly to www.transfermarkt.us

[2] The "big six", with number of Premier League championships in ( ), include: Arsenal (3), Chelsea (5), Liverpool (1), Manchester City (5), Manchester United (13), Tottenham Hotspur (0). Since inception in 1992, the championship has only been won twice by teams outside this group. The last time was in 2016 when Leicester City (pronounced "Lester") improbably won with a squad of (then) unknowns, a new coach, a disciplined system, and a top-scorer who had spent most of his career in the lower tiers of English soccer. Blackburn was the other non "big six" team to win the championship, edging Manchester United in 1995.

[3] Based on data at transfermarkt.com on Dec. 16, 2021, the aggregate roster market value of the 20 Premier League teams was $10.0bn as of December 16, 2021, approximately double that of each of the top tier divisions in the other four major European leagues (Spain and Italy, each $5.4bn, Germany $4.6bn, France $4.0bn). For contrast, the US MLS (Major League Soccer) has aggregate roster value of $1.1bn.

[4] Soccernomics, Kuper and Szymanski, Nations Books, 2018

Disclosures

The author of this article has supported Brighton and Hove Albion for over 60 years. Along with every other long-time supporter of the team, he has learned the importance of patience and the value of a disciplined approach. Having co-authored previous Brandes Institute articles on the connections between sports and investing, he also takes to heart former soccer star Paul Gascoigne's memorable quote when asked for a forecast, "I never make predictions and I never will". If any reader wishes to dispute or debate the opinions contained in this article, please email barry.gillman@brandes.com.

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