THE LONG VIEW

Avoiding own goals

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Skerryvore

What does Europe's recent football controversy teach us about investing? This article looks at how we apply those lessons in our investing strategy, including highlighting examples of how some companies consider their stakeholders.

On Sunday 18 April 2021 some of Europe's richest football clubs stunned tens of millions of fans by announcing that they were quitting the UEFA Champions League to launch a new European Super League (ESL) after months or possibly even years of backroom conversations. More surprising, perhaps, was that within 48 hours the new league had been abandoned in the face of a barrage of opposition from fans, politicians and rival teams. If a week is a long time in politics, it proved to be even longer for a nascent football league.

Football is the world's most popular sport, played by approximately 250 million people across 200 countries[1]. Over 3.6 billion people watched the 2018 FIFA World Cup held in Russia[2]. More than a game, however, it has become a huge global business – a business that this season provided a powerful reminder of the importance of considering all stakeholders when in pursuit of profit, something we consider in this letter.

At stake was potential control over $4 billion in broadcasting revenues[3]. Over the past 30 years, sport has been the fastest-growing segment of the entertainment business, and football has been the fastest-growing sport[4]. In 2010 the Champions League Final overtook the Super Bowl as the world's most-watched sporting event4. The clubs that make up these competitions are strong franchises, demonstrated by growing ticket prices, estimated to have gone up by 3.5 times inflation between 1981 and 2016 without any perceptible impact on attendances[6].

Through the ESL, in which the founding teams were to be guaranteed their places, the clubs intended to create a thoroughly unequal playing field. Under the Super League proposal a large part of the reward for achievement and consequences of failure would have become rather meaningless. Europe's premier competition would have been contested by mostly the same clubs, safely kept there because they are rich, rather than because they are successful. At the top of these clubs were a small number of controlling shareholders who, blinded by strong franchises and extreme privilege, forgot that they, like all businesses, exist at the pleasure of their stakeholders.

What followed was an outpouring of complaints from fans who took to social media, a flood of threats from the establishment the new league was upsetting and, never one to miss an opportunity, pulpit-thumping from politicians. When the owners realised their stakeholders were against them they began to climb down, issuing a number of open letters of apology. Dismissing the apologies, a Liverpool supporters' group wrote that 'the only reason they are sorry is because they have been caught out yet again'[7], highlighting the reputational damage done.

What's this got to do with investing?

We see parallels across emerging markets, where business elites often believe that strong franchises somehow protect them from the wrath of their stakeholders. Jack Ma, the founder of China's Alibaba, appeared blind to this reality when he openly criticised the state banking system in a public talk[8]. The government's response was both swift and severe and led to the cancellation of Alipay's IPO and probably permanent impairment to the investment that sits on Alibaba's balance sheet.

The shift towards populist politicians around the world heightens the risk to business owners as they seek to pillory those perceived to be responsible for inequity. In London, a Downing Street official told a senior football executive that the ESL was '"manna from heaven" as there appeared to be no political downside from opposing it'[9]. Threats of regulation, restrictions and taxes no doubt contributed to its collapse.

On that point, Peruvian voters appear to have elected a populist socialist as their new president. Pedro Castillo's campaign slogan, 'No more poor in a rich country', highlights the growing dissatisfaction with elites that is being used to garner power across the world. Chile, long a bastion of conservative capitalism, is going through a slightly less radical but nonetheless significant rewriting of its constitution by elected left-wing representatives. We have long believed that excessive private profits from public goods such as water, oil, copper and perhaps even football are not sustainable and for that reason prefer to invest away from the spotlight in staples such as **Compañía Cervecerías Unidas (CCU)**, Heineken's partner in Chile, which although linked to a wealthy family is very aware of this and behaves accordingly.

Setting an example

The sense of privilege felt by many elites can blind business owners to the people on whom they depend. In India we prefer the humility of **Tata Sons**' leadership to the showy wealth of the Ambani family, who control the Reliance Group. We like the fact that Tata is controlled by charitable trusts and run by the former CEO of one of the portfolio companies. The family scion, Ratan Tata is known for his low-key presence and is associated with the family's philanthropy. This contrasts with Mukesh Ambani, one of whose homes is a 27-story skyscraper in Mumbai that cost nearly $1 billion[10]. His family was recently called out on social media for flouting pandemic restrictions, underlining that the same forces that led to the collapse of the ESL can turn against out-of-touch elites anywhere in the world.

In contrast to the hubris of the ESL is the example and success of **Leicester City Football Club**. Before being acquired by new owners in 2010, this venerable club had been drifting around the lower levels of English professional football, even falling into administration in 2002. In 2015,however, Leicester defied odds of 5,000–1 against to win the first Premier League title in its 132-year history. To put this into perspective, the odds at the time of Elvis coming back to life were only 2,000–1[11].

This was not a statistical accident – the club went on to win the FA Cup in May this year, again for the first time. It is not just the victories on the pitch that have set Leicester apart; it is the way its owners have managed to demonstrate their interest and care beyond simple financial returns. There are examples of large donations to Leicester Children's Hospital and putting up 75 fans after they were stranded during a storm in France[12]. Last year the club was the only one to vote against controversial pay-per-view proposals that might have brought in more revenue but would have alienated fans.

Reputation and opportunity

Awareness of all stakeholders is something we actively look for in companies because not only does it protect against reputational risk but the good reputation it fosters creates opportunities. **Cipla**, a leading Indian pharmaceutical manufacturer, and currently one of the strategy's largest holdings, is built on this approach. The company was founded in 1935 by Dr K.A. Hamied with a mission to increase the self-sufficiency of the country and provide healthcare that was accessible to all.

This purpose continues to drive the company almost nine decades later. Cipla featured in the 2013 documentary Fire in the Blood, which highlighted its fight against Big Pharma, who were at the time blocking access to low-cost drugs for treating HIV/AIDS in Africa. Cipla's efforts played a significant part in breaking the multinationals' patent stranglehold and helped deliver lifesaving drugs to millions of people.

Unlike many large Indian pharmaceutical companies, Cipla's focus has been on delivering drugs to the domestic market, rather than treating the country as a low-cost manufacturing site for medicines sold in developed markets such as the US. The aggressive focus on cost at many of its peers continues to have a high environmental cost for communities living around production sites. Our research has satisfied us that Cipla's environmental performance is very different from and significantly better than its peers' – a function, we believe, of the Hamied family's care for its reputation with all stakeholders.

How this affects your portfolio

Football clubs – like companies – have many stakeholders, often with competing priorities, but it is these stakeholders that allow the club or the company to exist. If fans stop turning up or customers stop buying it is obvious that the organisation is not sustainable. We might not all be fans of Leicester City at Skerryvore but we can observe the care they appear to have shown beyond ticket sales and broadcasting royalties as well as the results they have achieved. Similarly, the kind of companies we favour recognise that their existence relies on others and taking their needs into consideration creates more durable and successful businesses over the long term.

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For more information visit skerryvoream.com

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