

Transfer Fees in Theory and Practice: An Examination of the Factors Determining Player Transfer Fees in Professional Soccer

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(including questions)
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In the world of professional soccer, players can move from one club to another via a transfer. In the event the player still has a contract with his current club, the new club will have to negotiate a compensation with the current club. This compensation – the transfer fee – can range from nothing to tens of millions of Euros for elite players.

FIFA, the international governing body of the sport of soccer, has calculated the total value of international transfers (not including transfers within countries) in 2011 as three billion Euros (FIFA, 2012). Transfers are not only important in terms of clubs' success on the field, by attracting new talent, but also in terms of their financial health. To estimate what a reasonable transfer fee is to buy or sell a player, the club has to know the factors by which the player can add value and enable the club to recoup its investment. Only this knowledge allows the club to make decisions that are financially sound and support its long term financial health. The need for this knowledge is strengthened by the fact that many professional clubs in European soccer currently face financial difficulties. Despite these facts, academic research on the factors determining transfer fees is somewhat limited.

The goal of this study was to build a framework to determine the factors behind a transfer fee. To do so the transfer fee is treated as a derivative of a soccer player's value. The framework comprises of two steps. First, a standard discount model was combined with past theoretical findings to determine the elements used to value a soccer player. In the second step, the relationship between the value and the transfer fee was defined, thus ascertaining the factors driving the transfer fee. In the last part of the study, interviews were conducted with soccer club representatives and players' managers to determine how the elements of the theoretical framework actually compare to real-world practices.

Past studies have attempted to explain the transfer fee directly using the Ordinary Least Squares (OLS) method, with the transfer fee being the dependent variable. Independent variables included a large number of explanatory factors generally under the categories of player characteristics and factors related to both the selling and buying clubs. Research into transfer fees in the highest English league using this method resulted in the conclusion that Nash's bargaining theory captured, "...the salient features of the bargaining process in the footballers' transfer market" (Carmichael & Thomas, 1993). Other research introduced a two-step approach on the assumption that certain players have a greater likelihood of being transferred. The first step involved determining the possibility of a transfer, and the second step explained the amount of the transfer fee. The conclusion was that players' participation in the transfer market was indeed not random (Carmichael, Forrest & Simmons, 1999). To take inflation into account, time was also added as an explanatory variable (Dobson & Gerrard, 1999). This study also focused on the segmentation of transfers in the highest English divisions and lower professional divisions, and concluded that the results were different for the selected segments. Research involving semi-professional soccer competitions in England gave broadly similar results to those for English professional soccer (Dobson, Gerrard & Howe, 2000).

A player's value in a team sport has received considerable attention in academic literature. Scully introduced a valuation model for baseball players using Marginal Revenue Product (MRP) (Scully, 1974). Further research (Zimbalist, 1992; Fort, 1992; Krautmann, 1999; Fields, 2001; Scully, 2004; Rockerbie, 2011) built on this model, sometimes in a modified format and yielding different results. However the basis of MRP theory definitely proved useful.

Calculating the MRP of a player in a fluid team sport such as soccer has proven more difficult. Soccer has also been described as the least statistical of the professional team sports (Carmichael, Forrest & Simmons, 1999). Using Opta statistics as a performance measure for a player and his team, valuations of an individual player were linked to team income (Tunaru & Viney, 2010). They also concluded that a player's valuation is dependent on the club for which he plays.

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The aforementioned research does normally not take into account the risk related to investment in a soccer player. Applying a model normally used for option valuation allowed risk to be considered a factor (Tunaru, Clark & Viney, 2005). In other research, the Capital Asset Pricing Model (CAPM) is employed to analyze player risk (defined as the variance of the expected return) and cooperation between team players (defined as covariance). The results indicate that a player's MRP is lowered by his variance and increased (in the form of a negative covariance) if he delivers a positive contribution to his team's overall performance (Kedar-Levy & Bar-Eli, 2008).

In this study the use of the discount model resulted in three factors that determine the value of a soccer player: the player's expected yearly MRP, the expected number of years remaining in his career and a discount factor that takes into account the risk related to the transfer. These factors were then further broken down. After establishing the relationship between the value of the player and the transfer fee two factors were added to the equation: the years remaining in his current contract and the length of the new contract. The negotiations between the clubs were also key in the final determination of the transfer fee. The interviews in the third step demonstrated that, although several factors from the framework were used, clubs' decisions pertaining to transfers were generally made based on less tangible factors, namely feelings, experience and human emotion.

In this context, today's soccer world bears something of a resemblance to that of major league baseball as described in Michael Lewis' Moneyball. Future research has yet to confirm whether soccer is simply years behind baseball, or whether the fluid nature of the game makes it difficult to determine the value of a player and thus the transfer fee with the same precision.