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Strategic Change

Strategy and financial management in the football industry

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- *The literatures on strategy and finance have developed very separately, notwithstanding the fact that they have a common economic underpinning. Whilst a number of strategic theorists have looked at how strategic management facilitates the most effective leverage of economic resource, studies of the linkages between strategy and finance literatures are relatively few.*
- *This appears odd because finance is pivotal in making the resource allocation decision in management, especially in major business investment and divestment decisions and in the financing strategies needed to accomplish this. Both financial management as a discipline and financing strategies also play a role in influencing stakeholder behaviour, which is critical in strategy.*
- *Rarer still are studies of how strategy, financial management, financial strategies and stakeholders interact. With continuing examples of devastating corporates such as Enron and more recently Parmalat, it would seem surprising that theorists have been relatively disinterested in this important border between these disciplines.*
- *This paper seeks to make a contribution to our understanding of the topic by focusing on the interesting case of the football industry. Whilst an earlier paper in this journal (Grundy, 2004) dealt with techniques for appraising strategic options to exploit product/market opportunities, financing strategy options warrant separate exploration.*

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Overview: structure and context

The football industry has been chosen as a particularly interesting, empirical case study to focus on as it highlights the various links between strategy, finance and financial strategies (see **Figure 1**). It also builds from work in previous papers published in *Strategic Change* (Grundy, 1998, 1999; Cross and Henderson, 2003), and elsewhere (Grundy, 1992, 1997; Grundy and Johnson, 1993; Ward, 1993).

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Figure 1 highlights that:

- competitive strategy influences financial results and generates funding needs;
- financial management helps identify new value-creating options and projects future financing requirements;
- financing strategy can proactively facilitate new competitive strategies.

The research process is based on a comparative study drawn from data from the annual reports and accounts of four prominent football clubs, together with other commentators (Bose, 1999; Fynn and Whitcher, 2003).

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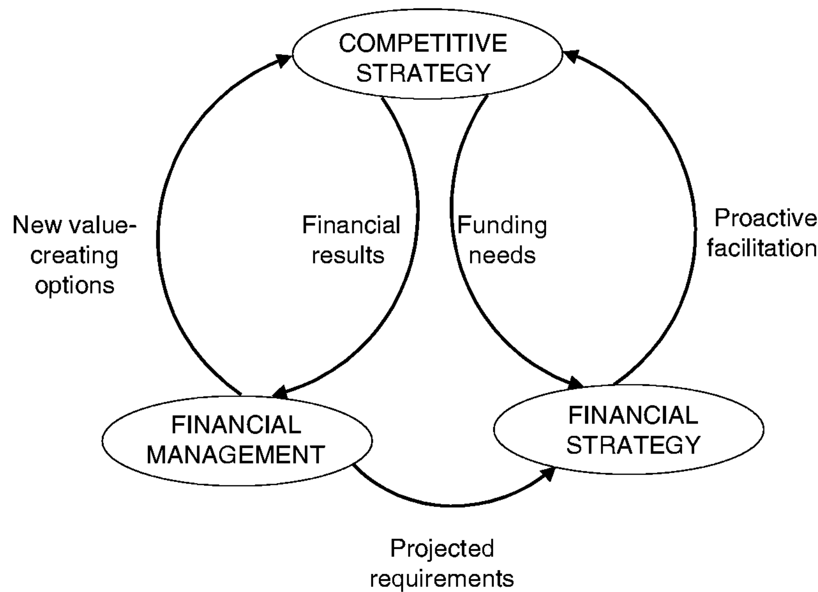

Figure 1. Links between competitive strategy, financial strategy and financial management.

Over the past 15 years the football industry has gone through a phenomenal period of change. This has been achieved in part because of the innovative financing strategies adopted by the leading clubs, which has facilitated expansion — not merely in terms of physical growth (bigger grounds, etc.), but also in terms of development into media, merchandising, sponsorship and other activities. As will be examined below (and echoing Cross and Henderson, 2003), with the exception of Manchester United, major league clubs such as Arsenal, Chelsea and Leeds struggle to cover their cost of capital principally because of competitive market structures, and because of their owners being emotionally over-committed to funding the game. These football clubs have adopted very different approaches to financing strategy, with varying results and consequences.

The football industry has gone through a phenomenal period of change

This paper seeks to explore the following.

- How financial management and financing strategies are linked to the business strategy and the diverse interests of different stakeholders.
- How there are invariably a range of options facing organizations in the financing strategies they might adopt.
- That financing strategies need to reflect the interests of key stakeholders.
- That certain kinds of financing strategies, although appearing to be innovative and exciting and enabling adventurous business strategy to be pursued, may turn out to have some unpleasant downsides that are potentially predicable.
- How these themes are manifest within the football industry and with what implications.

For the purposes of this paper *financial management* is defined as:

> *The process of planning, monitoring and controlling profitability, cash flow and investment within an organization in both the short and long-term.*

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Equally, *financing strategy* is defined as:

> *The sources, structure and mix of capital matched against a company's competitive strategy and financing needs.*

The choice of the four particular clubs examined here, Manchester United, Arsenal, Chelsea and Leeds United, is quite a careful one. Not only are the first three of these clubs (as of late 2003/early 2004) close rivals for the Premiership, outdistancing their rivals significantly, but each has set about its financing strategy very differently. Leeds United, until some three years ago, was a contender for the very top of the UK Premiership and playing in the semi-final of the European Champions League. In early 2004 the club faced potential administration.

Accordingly, the first part of this paper examines alternative financing structures and the business context. This is then followed by a fairly comprehensive review of the football industry, the key changes in competitive markets over 1990–2003, financial results, changing financing strategies and also a comparative overview of each of the four clubs. The analysis then turns to examine how value is added within the industry and how it is being financed. The individual clubs are then presented as four case studies, focusing on their business model and returns, financing strategies and the evaluation of their future financing options. Throughout the paper frameworks are developed for understanding the interplay of the ingredients for effective strategy drawing from systems theory (Senge, 1990). Please refer to Figures 1, 3 and 5. The paper then presents conclusions linking strategy, financial management and financing approaches.

Changing competitive markets, financial results and approaches to financing, 1990–2003

In the late 1980s a number of major structural changes occurred within the British Football Association industry (see also Bolchover and Brady, 2002). These took the form of:

- safety at grounds and all-seater stadiums primarily aimed at reducing hooliganism and making it a family sport;
- creation and capture of media income;
- launch of the Premiership in conjunction with SKY television, estimated to be worth some £250 million a year;
- commercialization of the game;
- escalating player costs;
- innovative financing strategies.

Focusing on some of the changes above, the launch of the Premiership, the collaboration with SKY and the construction of all-seater stadiums, together helped to improve the image of the game and to mass-market it. Previously it had a down-market reputation, with its association with English football thugs and crowd violence. Football was not perceived as being a family game. Now and all at once, it had become a much more effective and sanitized vehicle for family entertainment and one to be commercially exploited. The relationship of the football industry and SKY is worthy of an additional note here. Both were strategically interdependent. Almost certainly SKY would have been far less successful had it not been for its screening of major Premiership games on a regular basis. Merchandising revenue also grew rapidly, but with some clubs more successful in exploiting their brands than others. For instance, Manchester United grew its merchandising revenue from around £1 million in 1990 to over £15 million in 1995, a truly staggering rate of growth.

The arrival of vast new wealth and from a diversity of sources had not escaped the players' attention and that of their agents. In the late 1990s players' wages continued to escalate at a compound growth rate of 30% per annum. The scale of financial results and also of asset values within this industry can be represented in **Figure 2**, which shows revenue growth, cost growth and a scenario where revenue growth overshoots and then consolidates. This is precisely what happened, catching all but the richest clubs totally unaware. Figure 2 also shows 'asset prices',

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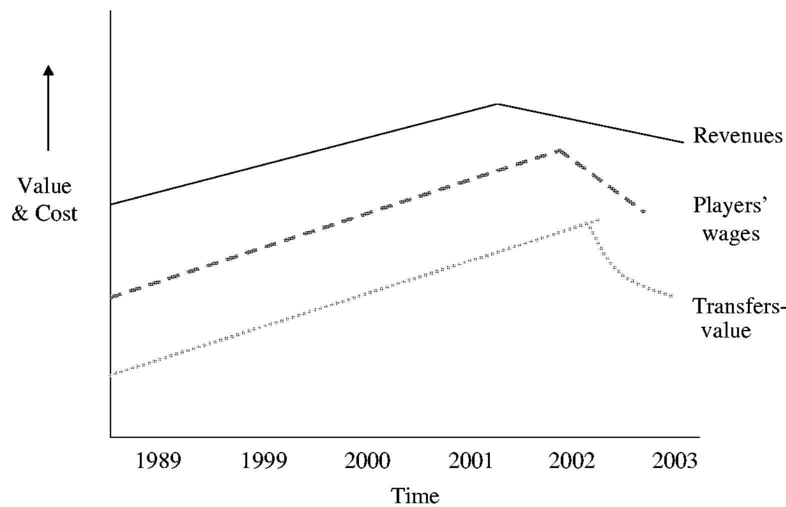

Figure 2. Revenue and cost growth in the football industry.

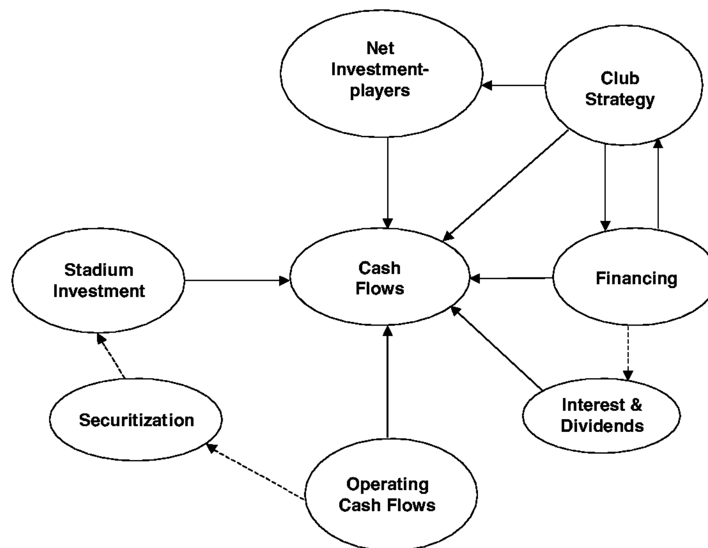

Figure 3. Financing systems: football clubs.

particularly player transfers and their reaction to this dynamic.

The final piece of the jigsaw puzzle is that of the innovative financing strategies themselves. Most obvious as a financing strategy is that of raising finance through share issue, particularly through public flotation. Tottenham Hotspur was the first club to float itself on the stock market in the 1980s. This led to a series of public flotations, the most conspicuous one being that of Manchester United in the early 1990s. Innovative financing strategies have not ended here however. In fact, some of the more imaginative strategies have taken the form of borrowing ahead against future income, especially gate receipts. The paper later examines how Leeds United borrowed against its future incoming revenue in order to purchase new players (known as 'securitization'), in the belief that such purchases would lead to the kind of virtuous financial cycle already enjoyed by Manchester United.

The financing system of the clubs is depicted in **Figure 3**. This figure shows key investment decisions in new players and stadium expansion driving future operating

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revenues. Cash outflows would then be mitigated by securitization (or borrowing against future income) and other ways of capturing future income from seat capacity. Also, cash inflows could be enhanced by share flotation, loans, player divestment and by sponsorship deals. Cash outflows would result from interest payments and from repayment of debt. Possible other ways of financing clubs might come in the future from leasing arrangements, the logic being that if clubs already take on players by way of short-term loans, then why not via a two- or three-year lease. Indeed it would not be impossible to imagine a company formed especially to lease players. This model thus highlights how strategy, finance and financing operate in a highly interdependent manner, with financing strategies often helping to stimulate and shape competitive strategy, rather than being just responsible to it. Whilst many innovative financing strategies have been tried out in the industry, it is highly possible to imagine a whole array of further possible ones.

Value creation and financing strategies are highly interdependent and also fluid, making it possible to be innovative on both fronts. To varying extents, Manchester United, Arsenal, Chelsea and Leeds United have exploited these options, sometimes well and sometimes not as well, as the paper examines next.

> *Value creation and financing strategies are highly interdependent*

Manchester United, Arsenal, Chelsea and Leeds United: an overview

Manchester United

Manchester United is one of the most famous football clubs in the world, ranking it alongside Real Madrid and Barcelona. In the 1960s the club was very successful under the management of Sir Matt Busby. Despite losing many of its best players in the Munich air crash disaster, the club fought back with its young players and went on to win the European Cup. Famous for the 1960s stars George Best, Bobbie Charlton and Dennis Law, United gained a brand heritage which is the envy of many other leading clubs.

In the 1970s, United drifted and was for a period relegated into the second division. During the 1970s Liverpool dominated the English first division and it was only in the early 1990s that United once again dominated the league, now called the *Premiership*. In 1999 United won the *treble*, this being the Premiership, the FA Cup and the European Champions League, under its manager Sir Alex Ferguson. Manchester United is still a very profitable club — it is a public limited company and has zero borrowings. It has also led the commercialization of football in the 1990s (Bose, 1999).

Arsenal

Arsenal Football Club has an illustrious past, having been frequent winners of the league championship and of the Premiership. Whilst its success in England has, over the decades, mirrored that of Manchester United, it has not been as successful on the European stage. Also, whilst Manchester United pursued an aggressive commercial strategy during the 1990s, coupled with its stock market flotation, Arsenal has been much more cautious. Arsenal's exploitation of its commercial activities had only just begun in earnest over the past few years. Also, it has not opted for a major public flotation of shares, resulting in its capital base being quite narrow. The club thus found it extremely difficult to raise finance for a new stadium. Arsenal has lost money in recent times.

In the late 1990s Arsenal experienced a resurgence on the pitch under its manager Arsene Wenger, who achieved the *double* (the Championship and the FA Cup) in two separate seasons, depriving Manchester United of a more or less unbroken run since the early 1990s. Until 2003 when Chelsea was acquired by Roman Abramovich, Manchester United

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and Arsenal had effectively maintained a duopoly of the English league since around 1996, but it has been far less successful in European football than Manchester United.

Arsenal also carries the considerable disadvantage of currently having a very small stadium — 38000 as against over 60000 at Manchester United (as of 2003), putting it at a revenue disadvantage. It intends to develop a very expensive stadium option at Ashburton Grove, with the result that it has strained its finances, prohibiting investment in new players during the 2002/2003 season and resulting in the loss of an opportunity to compete for the *double* in the UK (Fynn and Whitcher, 2003).

Chelsea

Chelsea is one of the major London clubs and has had a lean time in terms of its successes. It has not challenged hard for the Premiership and has only had sporadic successes in the FA and league cups and the second-tier EUFA cups. Its lack of success is in sharp contrast to its more aggressive commercial strategy. More ambitious than Arsenal, Chelsea expanded its ground into a very substantial leisure and hotel centre, called 'Chelsea Village', under the chairmanship of Ken Bates. This expansion has not been notable as a commercial success, due in part to the club's inconsistent record on the pitch.

Over the past five years the club had seen a succession of managers similar to Leeds United, another contrast compared with the stability enjoyed by both Manchester United and Arsenal. Until the arrival of its (now former) manager Ranieri, its managers and style of play were flamboyant and frustratingly inconsistent. Whilst it has bought some reasonably expensive European players it has not over-extended itself financially in the same way as Leeds United has done, nor has it turned such purchases to great effect. Bathed in debt during 2003, Chelsea was rescued by its new owner Roman Abramovich, who at a stroke transformed the potential commercial and financial fortunes of the club. For the foreseeable future Chelsea has no further need of debt and appears to have a virtually unlimited budget to spend on new players.

Leeds United

Leeds United was a major force in the English Football League during the 1960s and 1970s but during the late 1990s, the club appeared to fade into the second tier. After Manchester United, Liverpool, Arsenal and Newcastle, however, Leeds still had a strong brand image and sought to capitalize on it during the 1990s boom in merchandising.

Three years ago (in 2001) Leeds had assembled an impressive number of expensive signings aimed at securing a regular place as part of the top four English clubs with a European Championship place. The Leeds approach was that by investing, as an example £50 million, this could be justified because it could be expected to generate £10 million of extra annual revenue. Indeed, at its peak the Leeds team actually got as far as the semi-final of that lucrative competition. Since then Leeds have gone downhill, compounded by the firing of several of its managers. Weakening performance on the pitch has dampened revenues further and the club is now struggling under the weight of over £70 million of debt. This huge debt remains even after the sale of many of its key players, such as Rio Ferdinand who was sold to Manchester United for £29 million. Leeds managed to lose £49 million in the year to 30 June 2003 and on a turnover of £64 million that is quite an achievement! In early 2004 the club has a deficit of shareholders funds of £44 million and creditors of £121 million (June 30 Balance Sheet). Leeds requires an injection of new capital together with a capital reconstruction, or faces the prospect of administration.

Having reviewed the industry and provided overviews of the four clubs, the paper now proceeds to construct four detailed case studies. These draw heavily for empirical support from the four clubs' annual reports and accounts, which in themselves are strategically, financially and organizationally highly informative.

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Case study: Manchester United

Business model and returns

Manchester United is a very successful commercial organization. Whilst in 1990 its turnover was under £15 million, by 2002 this had grown to an astonishing £146 million, with group operating profits of £33.9 million, based on an extensive *business value system* — a network of interdependent, value-creating activities (Grundy, 1998).

Manchester United is a very successful commercial organization

Manchester United's turnover in 2002 comprised:

- 39% = match takings
- 36% = media
- 18% = commercial (sponsorship and other)
- 7% = merchandising

Interestingly, whilst merchandising had fuelled the club's growth in the early 1990s this has plateaued in the late 1990s and by 2003 had become much less important strategically.

Its objectives in 2002 were neatly summarized in its Annual Report and Accounts as follows.

- 'Maintaining the playing success by ensuring an evolutionary development of the first team squad by acquiring and selling experienced players and developing the younger players through our Academy and overseas alliances.'
- 'Leveraging the awareness of the Group's global brand through developing new products and services with first class partners that will appeal to our worldwide fan base.'
- 'Seeking to control and develop our own routes to market for media rights which can more effectively deliver value by exploiting the Club's own performance and reputation rather than relying on the collective appeal of the competition.'
- 'Converting more fans to customers of the business and enhancing the value of customers through the implementation of customer relationship management (CRM).'

Manchester United has also entered into a number of partnerships, including:

- Vodaphone;
- Nike;
- the New York Yankees, a prominent US basket ball team.

By developing longer-term partnerships such as these, Manchester United could then ensure a regular and steady income which would be, in effect, even more reliable and resilient than the sale of its seat capacity. If there were possible needs for securitization of income then it is perhaps to this source, rather than gate takings, that United's strategic thinking might well be drawn. The club's annual report also draws attention to the upside potential for its media rights. Although two out of the three years of the Premiership's television deal had now run (by 2003), the possibility of the EU intervening to liberalize the current arrangement with SKY provides some potential upside to the major clubs. Perhaps these sources of income would be potentially more volatile than with sponsorship revenues or gate sales, so are less likely candidates for securitization. Whilst the club is still cash rich and the need for securitization may not seem to be a likely possibility, it is still an option.

A further possibility for commercial exploitation for United is its website, relaunched in 2002. Whilst the possibilities to date of realizing economic value through the Internet may have proved elusive, the club are well placed to capture value from emerging activities in this area.

Interestingly, the club decided relatively recently to outsource its overseas merchandising activities. This move was accompanied by the loss of a significant number of jobs at Old Trafford, the home ground. This move reflects the club's clarity of commercial ambition, which is to invest in and to finance those activities where it has distinctive abilities and

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which offers it a superior return over its cost of capital.

In terms of financial performance, Manchester United's recent results are shown below.

	2002	2001	2000	1999	1998
Turnover (millions £)	146.1	129.6	116.0	110.7	87.9
Group operating profits (millions £)	33.9	31.7	30.1	32.3	27.0
Operating profits (as a percentage of turnover)	23.2%	24.4%	25.9%	29.2%	30.7%

These show acceptable, if declining, returns. Manchester United appears alone in being able to beat its cost of capital but returns are still in decline, due to the same forces such as player bargaining power, discussed by Cross and Henderson (2003).

Its summary of the balance sheet as at 2002 is:

	£000
Fixed/long-term assets	212 327
Current assets	33 408
Current liabilities	(53 459)
Other liabilities	(54 833)
Net assets	137 443
Shareholders' funds	137 443

As of 2002, the club's balance sheet being debt-free was highly conservative. Cash flow was approximately neutral (£2 million positive) after spending a net £12 million on players and £15 million on fixed assets. Operating cash inflow was a massive £42.8 million, although this was down from £50.8 million in 2001. Whilst the club's results appear to have continued to improve in terms of size of business and size of profit, in terms of its rate of return compared with turnover, the figures suggest a weakening of performance. This appears to be due in part to the amortization of the acquisition of a small number of very expensive players.

Financing strategies

In 2002 Manchester United had a zero bank overdraft and no complex share structures, the shares being 'ordinary' only, representing the most simple capital structure that can be imagined for an operating context like this. With share capital of £30 million, retained earnings of £110 million and no loans, the club had a gearing percentage of zero.

Future financing options

One way of evaluating financing options is to use the financing options grid (see **Figure 4**),

	Loans	Securitization sponsorship income	Corporate box sale
Sufficiency	2	2	2
Flexibility	3	2	1
Cost	2	1½	2
Risk	3	2	2½
Acceptability	2½	2	1½
	12½	9½	9

Figure 4. Manchester United's financing options.

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which prioritizes using the criteria of sufficiency, flexibility, cost, risk and acceptability (to stakeholders). Here, the grid is used by scoring it as:

3 very attractive
2 medium attractive
1 low attractive

Whilst Manchester United does not appear to be in imminent need of exploring new financing strategies as such, there may well be a need in the scenario of the club having to try to catch up with Chelsea. For if, as was then rumoured (late 2003), Roman Abramovich was proposing to spend another £100 million on a number of additional world class players, it was not inconceivable that at the end of 2003/2004 the season United would come third in the Premiership (which actually happened) after Chelsea! Manchester United might now wish to spend £50–80 million, in which case they would look to do this at the lowest risk, lowest cost and greatest flexibility.

Various financing options in the above scenario could include:

- loans (see grid);
- further shares — either to existing or new shareholders;
- the sale of the club;
- securitization of future sponsorship income (see grid);
- securitization of future gate takings;
- selling off of corporate boxes such as the ones Chelsea has earmarked as costing (en block) £1 million a season (see grid);
- leasing players rather than buying them outright.

Each of these options could then be put through the financing options grid.

Whether Manchester United actively makes systematic use of criteria for evaluating financing options is an interesting question. Certainly the literature on corporate finance gives little guidance on systematic processes for evaluating alternatives *vis à vis* appropriate financing options, so the financing options grid is a useful contribution to its techniques. Interestingly, this discussion reveals that financing strategies can be examined not only in relation to current competitive strategy, but also to the competitive and financing strategies of rivals, in this case Chelsea.

This can be illustrated in **Figure 5**, which suggests that financing strategies need to be benchmarked and also the importance of stakeholder influences on both competitive and financing strategy. It also shows the

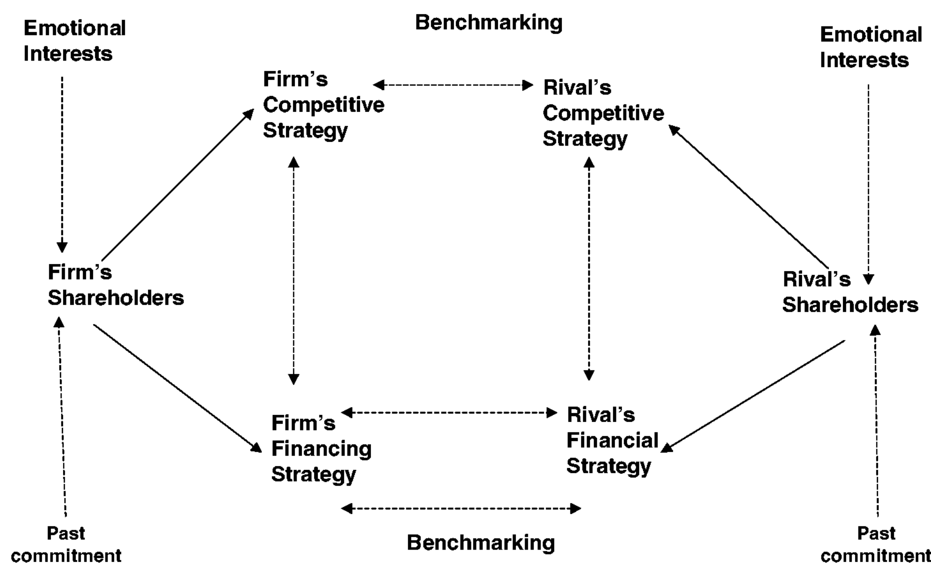

Figure 5. Linking competitive and financing strategy.

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different emotional interests of the shareholders and their past commitment. These play a role in other industries too, and a particularly marked one in football.

Based on this line of argument it would appear that traditional loans might be the most attractive option of the three. A possibility facing the club is takeover by a buyer. This might well not take the form of a billionaire prepared to spend a fortune irrespective of financial returns, but one who is eager to secure it for astute, commercial gain. These thoughts illustrate the dialectical relationship between competitive and financing strategy.

Indeed, as of late 2003 Manchester United's future as a plc did seem to be somewhat uncertain. In the early 2000s two Irish investors began to build significant stakes in the club. Whilst they were at one point thought likely bidders for the club, by 2003, a wealthy Texan began to buy significant amounts of shares in United. This pushed up the market capitalization significantly, discounting the value of a potential bid, which seemed imminent in mid-February 2004.

In sum, whilst the club's combined strategic and financial situation is a little less secure than it has been for some time, its fundamental strengths give it considerable financial flexibility. It also has no need to invest heavily in either a new ground or a whole new team (like Arsenal and Chelsea, respectively). It also has a variety of incremental financing strategies from which it might select. It could usefully appraise these options systematically using the financing options grid and the strategic options grid (Grundy, 2004). The club's financial results reflect a sound past competitive strategy, solid financial management and generally good management of players' salaries, offset by a tendency to overpay the players, reflecting competitive forces and perhaps stakeholder-led biases.

Case study: Arsenal

Business model and returns

Whilst Manchester United's Annual Report and Accounts for 2002 were full of details on brand, media and sponsorship exploitation, Arsenal's were more concerned about its proposed new stadium, Arsenal in the community, Junior Gunners and its travel club. This exemplified a rather different business model to that of Manchester United, who seemed to focus very much on the commercialization of its activities as much as its success on the pitch.

The club's turnover was broken down as follows:

	2002 £000	Arsenal percentages (%)	United comparatives (%)
Gate & other takings	24 553	27.0	39.0
Media	31 921	35.1	36.0
Retail (merchandising)	4 940	5.4	7.0
Commercial (sponsorship & other)	29 553	32.5	18.0
	90 967	100.0	100.0

These comparatives highlight:

- Arsenal's much smaller ground;
- the weakness in retail.

As Arsenal's turnover was 55% of Manchester United's, the gap in both of these areas is greater. Also, one would expect media income to be similar in absolute terms, but Arsenal's is considerably smaller. This reflects its less effective performance in Europe and generally in exploiting its media potential. Whilst Arsenal's turnover is 40% up on the previous year, this has not been translated into profitability, with losses running at a staggering £20 million, including a loss of £15 million in player trading and £15 million exceptional costs relating to its new stadium. Arsenal's accounts are complex and need some unravelling in order to come to a base picture for evaluating its future financing options, as seen below.

Arsenal's turnover is 40% up on the previous year

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Its consolidated profit and loss account (see below) highlights the following.

- Over £20 million of costs written off relating to its new stadium over 2001 and 2002 (£5 million and £15 million, respectively).
- A huge increase in 'operating costs — other' due to increases in players' salary costs, suggesting perhaps that Arsenal's wage bill has begun to get out of control.

Indeed, Fynn and Whitcher (2003) describe an interesting scenario of Arsenal imploding due to unsatisfactory results on the pitch, reduced cash flow and players and/or the manager departing. This scenario was not unlike the melt-down experienced by Leeds United. They also highlight the emotional attachment to a very expensive stadium option driven by key board shareholders, whose emotional commitment was increased by sunk investment costs, a vision to have a European class stadium and a refusal to consider other options such as sharing Wembley stadium.

The deterioration in Arsenal's position is reflected in its cash flow statement, with an increase in cash of £40.2 million (£26.4 million from new financing) in 2001 contrasting with a £32 million cash flow in 2002 with £8.1 million due to capital expenditure. Arsenal's cash flow was clearly in a position which, if temporary, was not exactly precarious but had the potential to become so.

Standing back from this recent downturn in Arsenal's results and looking at the last five years, we have the following:

	2002 £000	2001 £000	2000 £000	1999 £000	1998 £000
Turnover	96 967	64 689	661 260	48 623	40 391
Profit/(loss) before tax	(22 343)	31 367	21 215	2 068	7 086

Whilst Arsenal's profitability has not been stable, in 2000 it began to benefit from significantly increased media income, but this cash inflow has now been absorbed in the extra costs of players' salaries and in its plans to develop its new stadium. Profits in 2001 were buoyed up by very profitable and larger disposals.

Within six months from its 2002 balance sheet date the situation had deteriorated further. There had been a further outflow in cash of £22 million and Arsenal had used up an additional £21 million of financing. By this stage the club had £30 million of bank debt falling due within one year, plus £19 million of longer-term debt. Its cash at the bank and in hand was now a mere £1.8 million (as at 30 November 2003). Its shareholder funds were down to £64.7 million from their peak of £92.7 million at the year end of 2001. This represented a drop in net worth of one-third in only 18 months, primarily due to its new stadium project.

Delays in the Ashburton Ground project have not only resulted in damaging balance sheet decline but also in escalation of project costs, now estimated to be £400 million. Arsenal was caught in a Catch 22 position: it could not easily abandon the project on the one hand, but it would find it very difficult to finance the project from such a poor capital base too. Further, due to difficult financial conditions and constraints, Arsenal could not easily find the funds to replace ageing players. In January 2004, only when funding for the new stadium was secured, were the club able to purchase a Spanish forward, for a record £17 million (for Arsenal). Ironically, it was Chelsea that put them out of the lucrative European championship due to having a bigger squad which overcame Arsenal's tired players.

Future financing options

Arsenal found it very difficult to raise the £260 million in loans for the new stadium, but why did this not generate a sufficient return? The reasons why the net present value (NPV) of the project might have been inadequate or even negative could be as follows:

- the price of the seats being too low;
- the numbers of times (per season) it is occupied being too low;

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- the fact that it does not generate additional revenue streams;
- the seats cost too much in the first place;
- Arsenal was targeting inappropriate market segments.

This analysis shows the very close interdependencies between corporate finance, competitive strategy, financing strategies and financial management of operations. For instance, if we consider the first variable — the price of a seat. A typical seat at Arsenal costs between £25 and £30 per game. This may seem expensive, but many fans are willing to pay £90 on the black market due to pent up demand. Surely the Arsenal Board are aware of this fact, but presumably felt it unethical to charge their loyal fans 50% to 100% per game more for the Arsenal experience? Yet many frustrated fans would be delighted at a premium price strategy. Perhaps traditional fans could buy their tickets at the old price with 'new' fans paying a 100% premium in the bigger stadium? This may be difficult to implement, but it should at least be an option worthy of consideration.

How then could revenues be increased from the project? One option is to opt for different configurations of packaging of the seats. Perhaps attendance of just six times per season, say one in three games, could justify a 60% price premium? Another possibility would be to establish 'satellite' grounds with cube television displays, or maybe along the lines of a Manchester United pub. The holder of a 1/3 season ticket to the ground would also get the right to see the game at his local satellite ground, thus gaining the advantage of ground atmosphere.

Already, drawing from some of the above ideas, the acute limitations of the low NPV per seat seemed to result in Arsenal's financing problems appearing less constraining. The seeds of new competitive strategic options thus sprung originally from examination of *financing strategy*. Potentially, it might even have been possible to consider the mini season ticket and satellite grounds options as alternatives to developing any new site at all.

Of interest too is the option to choose a different site. New football grounds do not come cheap, but they do not need to cost £400 million. A major cost driver of this in Arsenal's case was clearly the site cost and its location. Ashburton Grove was no doubt chosen because it was not too far from Arsenal's home. But were this restriction to be lifted it is quite possible that a major reduction in ground costs would be possible. Provided that the new ground was to be north of London and within the perimeter of the M25, why was it not possible to choose another and cheaper location?

Whilst information about different site costs is not available publicly, this option appears to be worthwhile pursuing, unless of course the difference in costs was comparable to the sunk costs which Arsenal had already expended. Nevertheless, by examining the problem of financing from a variety of perspectives and not as being one of 'How do we obtain funding of £400 million?', this other perspective might at least yield some useful insights and options.

In conclusion, perhaps if Arsenal had grasped the wider context of their corporate financing strategy and looked more broadly at different options for mixing competitive and financing strategies, these difficult constraints might have been at least partly avoided. Also the new ground and associated financing decisions only seem to reflect in part the framework of Figure 5, in terms of did the Arsenal Board really consider these issues?

Case study: Chelsea

Business model and returns

Chelsea is a famous London club with a sizeable ground that has a significant set of commercial activities and a team which has been in the top six Premiership clubs for many seasons. In many ways its business model is a hybrid between that of Arsenal and Manchester United. Whilst it does have extensive merchandising, hotel and related activities and pursues media income aggressively, it has

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not managed to create the same kind of financial success as United and it has not had the success on the pitch that Arsenal has had over the last six years.

Chelsea's financial results over the two years to 2000 are as follows (no five-year analysis is available in the 2002 accounts):

	Operations excluding player trading 2002 £000	Player trading 2002 £000	2002 £000	2001 £000
Turnover	115 319	—	115 319	93 627
Direct operating costs	(86 249)		(86 249)	(81 992)
Gross profit	29 070	—	29 070	11 635
Administrative expenses	(20 680)		(20 680)	(17 226)
	8 390	—	8 390	(5 591)
Loss on player trading	—	(16 155)	(16 155)	(1 235)
Operating profit (loss)	8 390	(16 155)	(7 765)	(6 826)
Net interest costs	(8 686)	—	(8 686)	(4 264)
Loss before tax	(296)	(16 155)	(16 451)	(11 090)

Income had increased substantially, particularly in 'Football Activities', but this did include player trading which may have distorted the figure significantly. Much of the turnover is only marginally profitable with, for example, the Travel Agency making only £243 000 on a turnover of £22.2 million.

Segmental information	Turnover 2002 £000	Turnover 2001 £000
Football activities including player trading	73 663	50 224
Travel agency	22 230	26 224
Property sales/leasing	207	145
Hotel/catering/night club	11 981	11 912
Merchandising	5 214	4 705
Digital media	1 150	—
Car parking/events/other	305	417
Leisure services	569	—
	115 319	93 627

The shareholders' funds for 2002 on Chelsea's balance sheet show a deficit on revenue reserves of £27.8 million. Total bank loans are £82.7 million, with £73.0 million due for repayment in 2007 and longer-term loans standing at £74 million. Chelsea's 2002 cash flow was unsurprisingly strongly negative, with a £13.5 million outflow. In summary then, the club's financial position in 2002 was weak, with its capacity to acquire leading players from other clubs rather limited, its balance sheet strained and its operations hovering around break-even. Whilst its debt approached levels attained only by Leeds United, at least it had avoided calamitous overspending.

But having tangible assets of £179 million and 'intangible' assets (players) capitalized at £60.7 million, this does seem to be a major underperformance by any normal business standards, taking a financial management perspective. By 2003, Chelsea was struggling under the weight of debt which was incurred in building up its hotel and leisure facilities and in improving its ground. Unlike Arsenal, which has therefore been able to generate considerable economic value through buying players cheaply, developing them into world class stars and selling them at a premium, Chelsea has not made 'super' profits from its bought-in or home-grown talent. Whilst Manchester United has tended to retain its home-grown players, it too has benefited from super profits from its players, for example the £25 million on the sale of David Beckham to Real Madrid in 2003.

Whilst not in the same kind of financial trouble as Leeds United (see next case study), nor facing the massive financial challenge of building a highly expensive new series stadium like Arsenal, Chelsea was nevertheless 'stuck in the middle'. Neither being a truly leading club nor a middle-ranking one and not being particularly profitable either, Chelsea could be regarded as an underperformer on many fronts. But little did Chelsea fans know that in 2003 the world was about to change for them, and that Santa Claus would visit them early not from Lapland but from Russia. In spring 2003 a Russian billionaire, Roman Abramovich, decided to diversify into British football. This new stakeholder was to

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transform Chelsea from a Premiership struggle to a leadership contender (Bolchover and Brady, 2002).

It appears that his first thoughts were to buy Manchester United according to a recent 2003 television documentary but finding its market capitalization over £500 million, this was just too expensive. Abramovich was able to negotiate a purchase price for Chelsea Football Club of around £130 million. Chelsea shareholders were exceedingly pleased to receive their value and more in cash. Moreover, the fans were absolutely delighted when Abramovich went on an amazing shopping spree, buying up a number of proven and high potential players. Within three months he had spent £106 million, or nearly £1.2 million per day. As the vice-chairman of Arsenal then put it:

> *The Chelsea tanks are on our lawn and they are firing £50 notes at us.*

Adding to his player acquisitions, Abramovich head-hunted Manchester United's chief executive, Peter Kenyon, who was the brains behind the success of much of the club's successful commercialization strategy. Despite the success of the existing Chelsea manager, Abramovich was widely rumoured to be stalking Sven Erikson, the England coach. For Chelsea's new strategy (rebranded as Chelski) was not completely unlike that of Leeds United in the very early 2000s, to buy a set of players which would dominate the game and which would then pay for itself. However, the key differences between Chelsea and Leeds here are as follows.

- Chelsea would not need to securitize its future team to achieve this.
- Chelsea's cost of capital to do this would be much lower and effectively free, as Abramovich seemed to have made it his life goal to achieve this.
- The quality of the players being bought and their number was of an entirely higher order.
- Chelsea had better quality management resources both on and off the pitch.

Clearly, Chelsea have now upset the longer-term equilibrium of the industry financing structure (see Figure 5) by becoming what appears to be a '*not for profit*' player with comparatively unlimited funding and an owner with unparalleled emotional and financial commitment to succeed.

Chelsea have upset the longer-term equilibrium of the industry financing structure

Future financing options

Chelsea's future financing options are much simpler then those facing the other clubs. Chelsea does not have any foreseeable need for debt. Indeed, Abramovich has apparently made available another £100 million in the January transfer window from his own resources. Even if he spent this amount, his investment in the club would still be less than £400 million and he had already put in place players to develop a commercialization strategy to rival that of Manchester United.

In sum, Chelsea's new competitive and financial strategy appears quite astute, particularly as it potentially knocked both Manchester United and Arsenal off-balance, provided that the new Chelsea team ultimately dominated the UK Premiership. Chelsea's strategy may well not reap true commercial returns because of stakeholder emotional commitment, player bargaining power and the slow speed of the strategy, which might not provide either team alignment or well-targeted player acquisition decisions.

Case study: Leeds United

Business model and returns

In the mid/late 1990s Leeds United were managed by George Graham, the Arsenal ex-boss. Although a shrewd manager, Graham

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was renowned for his conservatism. In the period 1997–1999 Leeds was a solid performer but not a club strongly challenging for the leadership. George Graham left for Tottenham and was replaced by the ex-Arsenal player David O'Leary. O'Leary was encouraged by his chairman, Peter Ridsdale, to challenge aggressively for 'silverware' or trophies, and Ridsdale bank-rolled a huge spending programme on new players. Net of disposals Leeds spent almost £60 million in a very short period of time. To finance this expansion Leeds relied heavily on securitization. In effect this mortgaged future gate receipts and cashed these in to give it the investment resource to buy these players. The idea was that with a superior team in place, not only could it assure a place higher than mid-table in the Premiership but also be able to virtually guarantee a regular place in the lucrative European Champions League. Unfortunately, financial performance is highly dependent on other aligned value-creating activities, especially on match results and the weakness of other teams. A number of events conspired to unsettle what was in 2000 a successfully performing new Leeds team:

- two of its football players were accused of grievous bodily harm;
- some of its new star players performed inconsistently;
- David O'Leary began to lose favour with other key stakeholders within the club;
- when debts had grown to an unsustainable level, Leeds sold Rio Ferdinand, its star defender, for £29 million and in the process alienated the manager, the fans and destabilized the team.

The sale of Ferdinand only helped Leeds to temporarily halt its downward financial spiral. After a succession of managers over 2002 and 2003, Leeds at one time was at the very foot of the Premiership. With the prospects of relegation a very real threat and with debt climbing monthly to fund players' wages, Leeds faced in December 2003 potential administration, which was staved off until January 19, 2004.

Leeds United's recent financial results are as follows:

Five-year summary

	2003 £000	2002 £000	2001 £000	2000 £000	1999 £000
Turnover	64 005	81 503	86 252	57 064	36 971
Cost of sales	(13 051)	(17 689)	(18 680)	(10 434)	(5 764)
Gross profit	59 954	63 814	67 572	46 630	31 207
Administrative expenses	(92 781)	(92 320)	(73 257)	(49 511)	(31 562)
Operating loss	(41 827)	(28 506)	(5 685)	(2 881)	(355)
(Loss)/profit on disposal of player registrations	(614)	296	1 657	5 891	2 518
(Loss)/profit on ordinary activities before interest	(42 441)	(28 210)	(4 028)	3 010	2 163

Its balance sheet as of June 2003 shows the dire positioning deficit of £44 million and total short and long-term loans of around £90 million:

	2003 £000	2002 £000
Long-term assets	60 840	109 006
Current assets	26 141	31 775
Creditors: amounts falling due within one year	(55 200)	(57 042)
Net current (liabilities)/assets	(29 059)	(25 267)
Total assets less current liabilities	31 781	83 739
Creditors: amounts falling due after more than one year	(76 049)	(82 345)
Equity shareholders' (deficit)/funds	(44 268)	1 394

Financing options and evaluation

As of early 2004, what then were the options facing Leeds United? First, the club could ask to be placed into voluntary administration. Clearly this would be disadvantageous to shareholders, lenders and creditors, but it might offer the possibility of someone acquiring the club from the administrator at a more realistic price.

Second, it could seek to bring in new finance from outside — a move which appears

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to be currently in progress as of December 2003/January 2004. Whilst it is hard to see this as being a particularly attractive scenario to an investor given the plight of the club, it might be possible to do this in parallel with a financial reconstruction of the business. Perhaps an arrangement might be made with existing shareholders to accept a £1 for £2 share in a new legal entity. Also, existing lenders might be happy to write off their debts by 25%–50%. Each one of these options would need to be examined from the different perspectives of the various stakeholders.

Separate from, or in parallel with, these options, Leeds could attempt to sell off a number of its existing players. However, because of the more or less forced sale for these players, Leeds could hardly expect to raise very large sums without undermining the team entirely. A further option was to impose a unilateral reduction in players' wages, which was indeed adopted in early 2004, causing significant resistance in the team.

Having explored the options available to Leeds, these do seem to be quite narrow. Were it not for the damage which actual administration might do to the club's chances of remaining in the Premiership, this would probably be the best all-round option. Almost inevitably, capital reconstruction coupled with substantial financial investment from outside is needed, combined with a players' wages cut and more player disposals to stabilize finances.

The options available to Leeds do seem quite narrow

According to the *Daily Mail* (Wednesday December 10, 2003), four groups were then putting together bids for Leeds. Apparently, Leeds asked Deloitte and Touche to find them a Roman Abramovich style benefactor but following its relegation in May 2004, such a rescue appeared unlikely.

Future financing

Had Leeds stayed in the Premiership by the end of the 2003/2004 season, then it would be in a better position to seek extra finance to rebuild its team, or for the new investors to sell out to someone with bigger financial resources. Options such as floating its shares on the stock market would not seem to be plausible at this early stage, with memories of Leeds' close encounter with administration still very fresh in the minds of investors.

With limited financial resources, Leeds might seek to acquire players on loan, at least as part of its rebuilding strategy. Were a 'leased-player' market to establish itself, this might also represent an interesting financing model. Securitization of future income, given the club's bad experience of this financing technique, would probably not be an acceptable option.

Lessons from the four case studies

Not only do competitive and financing strategies need to be matched with each other within an organization, but the financing strategy needs to be matched against the competition as well (as was shown with Chelsea and Manchester United, see Figure 5). There is a complex interplay between rivals competing both in markets and for finance and other stakeholder interests which shape football. It is also affected by shifts in the emotional interests and commitment of different shareholders.

The main lessons from the four case studies are as follows.

- Within the same industry, organizations can have a variety of business models and the choice of business model has a major impact on the corporate financing strategies which might be considered.
- Each football club has a different historical context, legacy and competitive style and this will have a role in determining the optimal financing strategy for that club.
- The various football clubs exhibit a huge diversity in their financial performance,

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both between themselves and over time. This appears to be due in part to the ability to withstand the competitive and financial pressures from players and the quality of management and financial skills as exemplified by Manchester United. This means that financing strategy needs to be carefully tailored to cater for the particular situation.

- The case studies highlighted the dialectical interaction between competitive and financing strategies and that both need to be considered with imagination.
- Financing strategy can in some industries, as in the case of football, play a major role in determining competitive advantage, especially where financial markets are less than perfect.
- Football clubs and indeed other, non-football, organizations might have to steer between extremes of financial strategy such as that of Manchester United with its very conservative zero gearing, pushing up its cost of capital and that of Leeds United, with their aggressive expansion funded by securitization, to a more measured and targeted approach that could be attained by testing a particular financing strategy against a number of scenarios.
- In all cases clubs had perhaps a wider diversity of potential investment and financing options than might have been apparent at first sight. Only Chelsea's case appears to be a simple situation, and then only because equity finance seems unlimited.
- A club's particular situation can change very quickly and therefore their financing strategies need to be relatively flexible and reviewed frequently.
- New and innovative financing techniques might well be possible for this industry, such as player leasing. With the exception of the ill-fated Leeds United, clubs seem to default to a narrow range of financing strategies, just as many organizations seem to do when exploring competitive strategic options.
- Financing strategies might fruitfully be benchmarked within the industry. It may be of little use, for instance, for Arsenal to invest all of its resources in a new stadium whilst Chelsea is investing potentially up to £200 million in new players.
- The choice of financing may usefully be made against some relatively objective criteria, such as the financing option grid. Within these criteria, stakeholder acceptability is likely to play a very significant role in the final decision. Indeed, this appears to have been the clue to the specific financing strategies chosen by clubs, as opposed to any apparently more objective, rational criteria.
- The financing option issue is one to examine and fashion in a proactive manner.
- A highly successful financing strategy may no longer be sustainable and may now need to change, as perhaps in the case of Manchester United, whose success relied in part on having only one main contender for dominance of the UK league, that of Arsenal. It now has two, one of which is Chelsea, which has apparently unlimited capital and lacks the requirement to beat its cost of capital from public shareholders. Manchester United might not be able to compete with Chelsea as a plc and may need to go private again.

The football industry has thus proved once again to be an interesting and illuminating topic for management study. Whilst perhaps exaggerating some of the business phenomena seen in the industries, this serves to highlight some very key interdependencies.

Conclusion

Strategy, financial management and financing strategy are very much the focus of separate literatures with relatively few exceptions. The comparative analysis of four major clubs in the British Premier League has proved highly informative in terms of the number and importance of interdependencies between these disciplines. Not merely can financial management proactivity suggest new or changed competitive strategies but on occasion, so can financing strategy. Managers in

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other industries might also profit from exploring similar sets of interdependencies, especially against the dynamics of a changing environment, through systems models such as those presented here.

Biographical notes

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