The Triumph of Vanity over Sanity?
A Case Study of Strategic Failure in Professional Team Sports

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Research in strategic management often tends to focus on competitive success - how organisations utilise their resources and/or market position to achieve sustainable competitive advantage. However cases in which organisations suffer strategic failures can be equally illuminating. This case study focuses on a leading English professional football club, Leeds United, and investigates how sporting success was transformed into sporting and financial crisis within a 21-month period as a consequence of a series of strategic financial decisions by the senior executive management. It is argued that Leeds United represents a classic example of the Icarus phenomenon of flying too high and getting burnt - an organisation that over-extended itself in pursuit of its overly-ambitious growth objectives and suffered a financial meltdown when it failed to maintain a high level of performance.

The research objectives of the study are: (i) to explain the proximate financial causes of the sporting and financial crisis; (ii) to investigate the governance structure of the organisation to locate the fundamental causes of the current crisis; and (iii) to use the research findings to actively influence the organisational changes required to resolve the crisis. The study draws on three principal theoretical frameworks: the resource-based view (RBV) of the firm, stakeholder theory and corporate finance. The RBV (e.g. Barney and Arikan, 2002) explains sustainable competitive advantage as the consequence of the firm's deployment of its strategic endowment of rare and valuable resources that imperfectly imitable or substitutable. The strategic resources of a professional sports team are its allegiance resources (i.e. fan base), athletic resources, coaching resources and management resources. Stakeholder theory (Freeman, 1984) provides a more general perspective on the organisation that identifies and analyses the roles of the various constituencies both internally and externally impacting on the organisation's decision-making process. Within a professional sports team, the key stakeholders are the corporate owners, the board of directors, the senior management team, the playing and coaching staff, and the fans. Corporate finance (e.g. Brealey and Myers, 2003) provides a framework for understanding the management of operating, investment and financing cash flows in the pursuit of corporate value objectives (usually under the assumption that firms seek to maximize shareholder value). Corporate finance underpins the use of financial diagnostic analysis. In addition, the study is informed by action research (e.g. Frisby et al., 1997) in which the aim is not only to understand the world but also to change it. The research is self-reflexive with the researcher aware of, and transparent about, his position as an active participant engaging in the promotion of change in the behaviour of the organisation under investigation and, as a consequence, often viewed as a hostile party by the organisation's senior management.

The Recent Strategic History of Leeds United

Leeds United was formed in 1919 following the expulsion of Leeds City from the Football League. Leeds United came to prominence in the 1960s/70s when, under the team manager, Don Revie, the club won six major trophies. Leeds United was relegated into Division 2 of the Football League in 1982 but returned to the top division as champions in 1990. Leeds United won the League Championship and 1992. The club was a founding member of the FA Premier League.

The club remained in private hands until 1996 when it was acquired by Caspian, a small media company, which subsequently floated on the London Stock Exchange. The period 1996 – 2004 can be broken down into three sub-periods: (i) Managed growth, 1996 – 1999; (ii) Dash for glory, 1999 – 2002; and (iii) Belated retrenchment, 2002 – 2004. The key change in direction occurred in June 1999 when a new executive management team took control with Peter Ridsdale as chairman and CEO. The company changed strategic direction from developing a diversified sport-leisure business with an indoor arena and involvement in multiple professional team sports (e.g. basketball and ice hockey) to a focus on the core football business. Under Ridsdale the club invested heavily in player acquisitions financed largely by innovative debt instruments such as player sale-and-leaseback and securitization. Initially the strategy was successful in sporting terms with Leeds United reaching the semi-finals of European tournaments in both season 1999-2000 and season 2000-2001. Failure to qualify for the Champions League in May 2001 led to further player expenditure in a gamble to qualify the following season. When this gamble failed, the club was forced into a fire-sale of its best players to avoid bankruptcy but inevitably this led to a slump in its sporting performance. Leeds United plc went into liquidation in March 2004 and the football club was acquired by a new private company, Adulant Force. On the 2nd May 2004, exactly three years to the day that it drew 0-0 with Valencia in the semi-finals of the UEFA Champions League, Leeds United lost 4-1 against Bolton Wanderers and was relegated to the Football League. The club continues to struggle to avoid insolvency.

Method of Analysis

The study employs financial diagnostic analysis to determine the proximate financial causes of the current financial crisis at Leeds United. There are three components of the financial diagnostic analysis: (i) cash flow analysis of Leeds United plc since its flotation on the London Stock Exchange in 1996 with specific emphasis on the impact of the senior management changes in 1999; (ii) financial ratio analysis of the performance of Leeds United plc over the period 1997 - 2003; and (iii) a benchmark analysis of Leeds United's performance relative to other leading English professional football clubs. The financial analysis is supplemented by ongoing conversations with key stakeholders and an analysis of primary and secondary documents. In addition, in order to chart the participatory action consequent on the financial diagnostic analysis, a participant diary of events is maintained.

Results

The cash flow analysis (Table 1) shows that after 1999, Leeds United undertook massive investment in playing resources financed primarily by debt (principally a £60 million 25-year corporate bond securitized against future gate revenues). In contrast, Leeds United undertook virtually no net borrowing from 1996 to 1999. The financial ratio analysis (Table 2) shows an organisation that performed very well as a revenue generator but allowed player wage costs to nearly quadruple after 1999 leading to substantial trading losses. The gearing ratios reflect the massive increase in debt to finance trading losses and net player acquisitions. Leeds United's relative performance (Table 3) is weak compared to other leading English Premiership football clubs particularly in terms of wage costs, profitability and indebtedness.

Discussion

The strategic failure at Leeds United was the reckless debt-financed gamble to achieve sporting success (i.e. “chasing the dream”). There appears to have been inadequate risk management procedures with no viable Plan B if the gamble failed to payoff.

The fundamental reasons for the current organisational crisis at Leeds United are four corporate governance failures: (i) the concentration of executive power in a single individual appointed as chairman and CEO of the holding company as well as chairman of the soccer team; (ii) the promotion of ineffectual loyalists to key senior executive positions; (iii) experienced but disengaged non-executive directors who failed to recognise the early warning signs of an emerging crisis; and (iv) non-activist institutional shareholders

Table 1: Cash flows, Leeds United plc, 1997 - 2003

Cash Flows	1997-1999 £000s	2000-2002 £000s	2003 £000s
Operating activities	7,360	13,397	-12,136
Non-operating returns and debt servicing	-2,995	-8,356	-6,563
Taxation	-510	-76	0
Player trading	-22,415	-69,815	20,473
Other investing activities	-16,091	-13,229	-1,709
Net borrowing	230	79,144	-2,073
Other financing activities	40,409	10,222	-466

Table 2: Financial ratios, Leeds United plc, 1997 - 2002

	1997	**1998**	**1999**	**2000**	**2001**	**2002**	**2003**
Wage-turnover ratio	56.47%	55.62%	50.18%	48.71%	50.24%	65.78%	88.42%
Turnover-gate ratio	£679.00	£813.97	£1,033.49	£1,457.39	£2,210.68	£2,048.38	£1,608.61
Wage efficiency	£267,652	£268,780	£276,881	£402,812	£637,191	£812,303	£857,500
Operating margin	3.64%	15.47%	17.41%	9.78%	10.03%	-9.73%	-39.76%
ROCE	-20.07%	3.25%	5.20%	4.83%	-5.14%	-33.69%	-133.54%

Table 3: Sporting and Financial Performance, Selected FA Premier League Clubs, 2002

	Arsenal	**Chelsea**	**Leeds United**	**Liverpool**	**Manchester United**	**Newcastle United**
Wage-turnover ratio	67.56%	49.65%	65.78%	56.79%	47.92%	45.24%
Turnover-gate ratio	£2,391.04	£2,954.40	£2,048.38	£2,274.03	£2,161.13	£1,379.28
Wage efficiency	£706,356	£894,547	£812,303	£700,388	£909,078	£451,479
Operating margin	-8.70%	7.28%	-9.73%	14.03%	22.64%	20.82%
ROCE	-24.41%	-4.00%	-33.69%	14.21%	16.81%	1.39%
Net profit margin	-25.54%	-6.73%	-34.61%	10.60%	22.13%	2.67%
Asset turnover	0.956	0.594	0.973	1.340	0.760	0.522
Capital gearing	19.79%	55.12%	98.34%	25.52%	0.50%	64.68%

References

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