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**1.0 Executive summary**

The financial performance of any organization is dependent on financial decision-making. Successful decision-making requires effective financial management strategies, including; budgeting, conducting periodical analysis of financial statements, estimating the financial impact of investments, and consistently scrutinizing financial performance. This paper aims to evaluate the financial decision-making styles of Arsenal Holdings Ltd and ascertain their success and role in the company's financial performance. Section one of the body of the paper examines the company's long-term sources of finance by discussing its risk/return characteristics of equity and debt and evaluating the gearing ratio. The section also examines long-term funding through the lenses of the Pecking Order and the Static Trade-off theories. Section two of the paper is concerned with evaluating working capital management through aggressive and conservative working capital management theories. The section also evaluates current and liquidity ratios, day ratios, and cash conversion cycle. Section three of the paper evaluates Arsenal Holding's dividend policy through dividend irrelevance, Clientele, Bird in the Hand, and Signaling theories. Meanwhile, section four of the paper evaluates the company's profitability and risk through profitability ratios, the Capital Asset Pricing Model, PEST analysis, and Minsky Analysis.

# 2.0 Introduction

Arsenal Holdings Ltd is the parent company of Arsenal Football Club and Arsenal Women Football Club. The company was incorporated in 2001 as a private limited company, and its headquarters is in London, United Kingdom. At the same time, the bulk of its customers originates from the UK. Arsenal Holdings' primary sources of revenue include gate receipts, merchandise, and broadcasting rights (Bloomberg, nd). The other sources of revenue for the company include hospitality operations and retail activities at its football clubs' stadium, the Emirates. In 2021, the company reported a group turnover of £328,222 million, compared to £344,527 in 2020 (Arsenal Holdings Plc., 2021). The drop in revenues is primarily attributed to the COVID-19 pandemic, which significantly disrupted sporting activities in the UK. The pandemic saw physical stadium attendance being banned, effectively cutting off revenues from ticket sales. At the same time, minimal football activities disrupted the sale of merchandise and reduced revenues from commercials and broadcasting rights.

# 3.0 Section One: Long-term Sources of Finance

## 3.11 Risk and returns

Firms are formed with the objectives to conduct business stated in their article and memorandum of association. However, management is guided by the shareholders' needs to manage business to increase shareholder value. This relationship is widely known in the business world as the principal-agent relationship in the agency theory of the firm (Ardalan, 2017). For these and many more reasons, firms face myriad risks due to the environment in which they operate. The mode of investment capital will determine the risks of the project. Generally, projects are financed by a combination of debt and equity. Each has its risks complexion.

Firms that finance projects through equity do so because it is acquired at no cost. In most cases, the management defers the dividend payment to set aside retained earnings for investment (Jabbouri & Attar, 2018). Other forms of equity financing include the sale of shares in the IPO. However, besides retained earnings, IPO has an initial cost, including the cost of underwriting the issuance of shares. Retained earnings are still desirable for managers because they do not require considerable acquisition costs (Matsa, 2018). However, once invested, the equity funds have an opportunity cost.

In most cases, the opportunity cost drives the managers to look for alternative funding sources, which is debt financing. Also, the retained earnings are based on the previous earnings after tax and dividend payout ratio (Murtaza et al., 2015) . Equity financing is limited because most companies use retained earnings to sort out liquidity or working capital management.

Debt financing involves securities such as bonds, bank loans, overdrafts, and market debts. These instruments have considerable cost to the firm because the lender must pay periodic payments based on the compounded interest rates. Additionally, debts are issued based on collateral and guarantee. Here, an asset of the firm is used to provide security to the lender. The security acts as a buffer stock for the lender, which can be foreclosed to recover the full amount of the debt upon bankruptcy or the inability of the borrower to pay the loan. Essentially, debt capital limits the ability of the firm to uninterrupted use its assets.

The outstanding features of both debt and equity capital drive most firms to use a combination of equity and debt to finance projects. The desirability of both is determined based on the ability of the management and shareholders to take risks. This is called gearing and is based on the optimum capital structure of the firm. Matsa (2018) define ptimum capital structure is determined by the combination of debt and equity capital, beyond which any additional capital will lead to zero additional marginal benefits to the firm. The gearing ratio determines the capital structure, which can be elucidated based on the pecking order theory and static trade-off theory.

## 3.12 Pecking Order Theory

According to the Pecking Order Model, financial managers follow a particular pecking order when seeking funds for a project. The order of the hierarchy involves retained earnings as the first choice, followed by debt and equity financing as the last option. The key driver of the model is asymmetric information, a situation where the business manager possesses more information about the company's performance than external stakeholders (Asai, 2020). Due to this imbalance, creditors, being external stakeholders, usually demand higher returns on their investments to compensate for the perceived risk arising from information failure. As a result, companies find it cheaper to fund investments using retained earnings due to its minimal information asymmetry and ultimately less risk. On the other hand, the risks attributed to information failure make the cost of funding through debt or equity pretty high. However, where the only option available is external financing, a business manager would mostly opt for debt because it's cheaper than equity.

## 3.13 Static Trade-off Theory

The Static Trade-off theory is concerned with the capital structure of corporations (Ardalan, 2017). The model stipulates that firms realize an optimal capital structure at some point in the combination of debt and equity. The model stems from the capital structure irrelevance theory but branches off where it eliminates one of the assumptions of the original theory. The Static Trade-off theory eliminates the assumption that there's no cost attached to the financial distress caused by acquiring debt (Asai, 2020). If the assumption is eliminated, increasing debt does not necessarily lower the Weighted Average Cost of Capital (WACC). Consequently, the phenomenon will lead to a point where the extra value received from acquiring more debt becomes less than the cost of financial distress caused by borrowing. In this case, debt creates a degree of shield from tax. If the above happens, the company is said to have an optimal capital structure, accompanied by value maximization.

## 3.14 Sources of Finance used by Arsenal Holdings Plc

Arsenal Holdings Plc uses a combination of equity and debt capital. Currently, it operates as a single-family business with two divisions; Arsenal FC and Arsenal Investment. It has outstanding shares capital of £62 million and debt amounting to £199,097 million. A look at the gearing ratio indicates that Arsenal is highly geared. The Club has a debt-to-equity ratio of 63.15% in 2020, which increased to 69.82% in 2021. Therefore, the optimum capital structure of Arsenal stands at 63.15% debt and equity of 36.85%. The firm's working capital requirement stands at -£132,512, a majorly acquired bank overdraft.

# 4.0 Section two: Working Capital Management

## 4.10 Aggressive and conservative theories

Aggressive and conservative working capital management theories play an essential part in analyzing an entity's performance. An aggressive theory maximizes expenditure in delivering services, product manufacturing, and spending as much inventory supply. Conversely, the conservative theory deals with minimizing expenses to save money against the potential risk. Therefore, an organization's optimal working capital ranges between aggressive and conservative approaches. In most cases, an organization's working capital is calculated by subtracting current liabilities from current assets.

## 4.11 Aggressive Working Capital theory

An aggressive working capital theory focuses on maximizing expenses to enhance production efficiency. Organizations utilize their short-term credit to maximize production, sales and marketing, and inventory turnover within the shortest time possible. For example, arsenal football club contracts some players for a short period while paying them a lot of money. Since the contract is short, they try to utilize the footballer's skills to attain their objectives.

## 4.12 Conservative Working Capital theory

The theory focuses on reducing expenses to manage risk. The policy allows an organization to have much capital for its business operations. For example, the arsenal club can only replace a player's shoes upon ascertaining that the latter needs new shoes. They will take the old one, store it for future use, and then give the player a new soccer shoe. Though an organization m benefit but the policy might not motivate employees.

**4.13** Evaluation of Liquidity Ratios

The current ratio and liquid ratio are liquidity ratios that measure the firm's liquidity or working capital requirement. Low current and liquidity ratios indicate poor working capital management. A high liquidity ratio is good for the firm because it shows that it has enough working capital to fund operations. The current ratio for Arsenal Holding Plc reduced from 0.89 in 2020 to 0.40 in 2021, indicating that the firm is struggling to manage working capital. Likewise, the liquid ratio reduced from 0.73 in 2020 to 0.30 in 2021. Low revenues necessitated reduced working capital due to lack of champion league football, loss of revenues due to low match day ticket sales, low shirt sales, and high players and staff salaries. Most football clubs apply aggressive working capital theory for working capital management because much is expected in returns by incurring high costs.

# 5.0 Section Three: Dividend policy

## 5.10 Dividend Irrelevance Theory

Dividend irrelevance policy highlight that dividend doesn't affect a company's stock price. The theory views dividends can only affect an entity in the long term rather than the short term. Therefore, its competitive ability can be felt from a long-term perspective. The organizations tend to reinvest the money to boost their earnings. Jabbouri & Attar (2018) believe when an organization declares its dividend payments and issues them to the shareholders, it should not affect the stock price. The theory postulate that an organization's ability to grow and earn a profit depends on its market value which determines the stock price. Therefore, individuals who believe in the theory argue that dividends do not benefit investors but the company.

## 5.11 Dividend Clientele Theory

Dividend clientele deals with a company's stockholders' view on determining the dividend policy. Therefore, the stakeholders propose a dividend payout ratio based on their age, income level, and personal income tax. In this case, dividend clientele's shareholders can decide the amount a company will issue as dividends. These individuals invest in companies that reputation on dividend-distribution policies that push for their interest.

## 4.12 Bird in Hand Theory

The bird in hand theory highlights that investors tend to work with stock investing dividends than potential capital gains (Husain & Sunardi, 2020). They view that capital gain is associated with unpredictably inherent since it deals with the future. Investors use the theory to seek high dividend payouts, and such dividends have higher market prices. The stock performance predicts the amount an investor can gain from the invested capital.

**5.13 Dividend Signalling Theory**

The dividend signaling theory is concerned with announcements of dividend payout. Most economic experts agree that it's still relevant in some scenarios despite the theory's weakness. According to the theory, investors or investment analysts will perceive a company with a brighter financial prospect if it announces an increase in dividend payout (Asai, 2020). Under normal circumstances, an increased dividend payout portrays a company's financial performance positively and signals a better performance of stock prices in the future. On the other hand, a decrease or lack of dividend payout may signal to investors that a firm is struggling financially. The dividend signaling theory assumes that the higher the dividends, the more profitable the company. However, the assumption is only relevant to specific situations since there are situations where higher dividends do not necessarily result from increased profitability.

## 5.14 Application of the chosen company to the theories

The company applies dividend irrelevance theory because at the moment Arsenal it stsill a private company with shares tightly controlled by the owner. The group consist of 62,217 million of £1 each. The shares are wholy owned by Arsenal Holdings Plc Group. As of June 2021 the company had not declared any dividends.

# 6.0 Section Four: Profitability and Risk of the Company

## 6.10 Calculation and evaluation of suitable profitability ratios

Profitability ratios are used to measure the firm's performance based on the generation of revenues (Husain& Sunardi, 2020). Arsenal Holdings Plc has consistently made losses owing to many factors. While revenues have been improving year after year, 2021 shows a slump in revenue generation fuelled by the adverse effects of the Covid-19 pandemic. Covid-19 led to funs being barred from attending matches which contributed to the loss of revenues from ticket sales. The rumored broadcasting fees expected to grow pre-pandemic reduced significantly as the FA could not collect enough broadcasting revenues due to Covid-19 restrictions. Revenues from shirt sales also reduced because the biggest sales come from fans attending matches in the stadia. Revenues have reduced in tandem with the profitability ratios. The profit margin was -13.87% in 2020 and -32.69% in 2021. Similarly, returns on total assets reduced from -5.1% in 2020 to -13.62% in 2021. This should be a course of concern for the Club because future reductions in revenues can put the Club in precarious situations with players demanding high salaries to cover the lack of champion league football.

## 6.11 Evaluation of return concerning risk Capital Asset Pricing Model

The capital Asset Pricing Model (CAPM) is used to value a firm or securities based on the market risks, risk-free rate, and market returns (Andrei, Cujean, Wilson, 2020). CAPM assumes that securities risks can be measured based on a risk factor called beta. Beta measures the volatility of an asset which is the movement of the returns of an asset based on the movement of the market benchmark, proxy, or index. The market index is assumed to have a beta of one because it is composed of stable firms weighted based on the risk-adjusted returns and market capitalization. Also, CAPM assumes that there are two kinds of risks. Unsystematic risks can be eliminated by selling the asset, and diversification can reduce systematic risks (Andrei, Cujean, Wilson, 2020). Essentially, the expected return of an asset is determined by adding the market premium to the risk-free rate. Market premium is the return an investor is willing to take to invest in an asset. Risk-averse investors require a low-risk premium, while risk-tolerant investors require a higher premium.

## 6.12 Pest Analysis

The Pestle analysis is a financial tool that aids the evaluation of crucial factors that influence business success. According to Nikolaidi (2017), it helps analyze the technological, social, economic, and political business environments. Technologically, the Arsenal football club has greatly benefited from the e-commerce strategies in the football industry. It facilitates online ticketing, whereby the fans can purchase tickets via online outlets making it convenient. The Club has also adopted data protection strategies to secure the clubs' confidential information. Socially, social media is also a crucial part that helps the Club connect with its worldwide fans through fan pages whereby they can share the club experiences and performances. Economically, Arsenal has partnered with various sponsors who improve the Club's financial abilities. Some of the Arsenal partners and sponsors are Adidas, Emirates, Acronis, Ball corporation, and Konami. The sponsorships and partnerships are monetary avenues through the countries and companies that gain pride by associating with the Club as football is a universal activity that attracts fans from all parts of the world. According to this year's wealthiest clubs, Arsenal ranks 11th, which is among the most financially stable clubs (Macdonald, 2022). Politically, Arsenal enjoys a favorable operation climate in London, UK. The region supports football and allows teams to realize their potential.

## 6.13 Evaluation and application of Minsky analysis

Thus, Arsenal's operation environments are stable. However, the economic aspect, which is more crucial, can further be analyzed through the Minsky model. Nikolaidi (2017) argues that it is a model that explores the dynamics of financial instability. Most of the sponsors and partners are currently recurring from the Covid-19 crisis, creating financial hardships for the Club. This implies that the Club is currently financially unstable as the financiers cannot meet their economic obligations due to the economic challenges. Despite many governments easing the pandemics regulations, the prospects indicate that most will recover in a few years. Thus, Arsenal should also develop other money-making strategies to avoid such scenarios of partnerships and sponsors financially induced crisis.

# 7.0 Conclusion

The paper discussed the capital structure of Arsenal Holdings PLc with a focus on therories, ratios and financial statements to elucidate the reason firsm would have a capital structure. AN onservation of the firms financial reports and and calculation of key metrics realized a gearing ratio of 63.15% in 2020 and increased to 69.82% in 2021. The increase in gearing ratio was necessiatated by the need to manage working capital which required additional overdraft to bridge the gap for illiquidity. 69.82% is a high gearing ratio meaning that the financing of Arsenal football club is primarily debt based. Equity capital consist only of 30.18% equity accounting for £237,255. Additionally, the company continued to make losses year-after-year occasioned by large payment of interest to repay the amount borrowed to build the new stadium. Revenues have also been reducing due to lack of champions league football and reduction of tucket sales amid the covid-19 pandemic. For these reasons and Arsenal being private company the directors saw no relevance in declaring dividends.

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# 9.0 Appendices

**Income Statement**

|  |  |  |
| --- | --- | --- |
|  | Y2021 | Y2020 |
| Turnover of the Group including its shares of joint venture | 328,769 | 344,916 |
| Share of turnover of joint venture | - 547 | - 389 |
| **Group turnover** | **328,222** | **344,527** |
| Operating expenses | - 426,096 | -443,486 |
| **Operating profit/(loss)** | **- 97,874** | **- 98,959** |
| Share of joint venture operating loss | - 1,313 | - 1,492 |
| Profit on disposal of player registration | 11,770 | 60,050 |
| **Profit/(loss) before finance cost** | **- 87,417** | **- 40,401** |
| Net finance cherges | - 39,787 | - 13,621 |
| **Loss before tax** | **- 127,204** | **- 54,022** |
| Tax credit on loss | 19,913 | 6,244 |
| **Loss for the financial year** | **- 107,291** | **- 47,778** |

**Balance sheet**

|  |  |  |
| --- | --- | --- |
| **Fixed Assets** | **Y2021** | **Y2020** |
| Tangible assets | 401,477 | 416,852 |
| Intangible assets | 294,241 | 303,547 |
| Investment | 3,664 | 4,880 |
| **Total Fixed Assets** | **699,382** | **725,279** |
| **Current Assets** |  |  |
| Stock-development properties | 8,294 | 8,116 |
| Stock-retail merchandise | 3,898 | 3,294 |
| Debtors-due within one year | 48,712 | 62,609 |
| Debtors- due after one year | 8,815 | 27,151 |
| Cash at bank and in hand | 18,777 | 109,974 |
| **Total current assets** | **88,496** | **211,144** |
| Creditors: amounts falling due within one year | - 221,008 | - 235,792 |
| **Net current(liabilities)/assets** | **- 132,512** | **- 24,648** |
| **Total assets less current liabilities** | **566,870** | **700,631** |
| Creditors: amounts falling due after one year | - 290,023 | - 302,954 |
| Provision for liabilities | - 39,092 | - 52,599 |
| **Net assets** | **237,755** | **345,078** |
| **Capital reserve** |  |  |
| Called up share capital | 62 | 62 |
| Share premium account | 29,997 | 29,997 |
| Merger reserve | 26,699 | 26,699 |
| Profit & Loss Ac | 180,997 | 288,320 |
| **Shareholder's funds** | **237,755** | **345,078** |

**Cash Flow**

|  |  |  |
| --- | --- | --- |
|  | Y2021 | Y2020 |
| Net cash inflow from operating activities | 50,045 | 22,502 |
| Taxation received/(paid) | 2,950 | - 3,900 |
| **Net cash from operating activities** | **52,995** | **18,602** |
| **Cash flow from investing activities** |  |  |
| Interest received | 129 | 667 |
| Proceed from sale of fixed assets | - | - |
| Purchase of fixed assets | - 1,962 | - 13,108 |
| Player registrations | - 101,042 | - 57,959 |
| **Net cash flow from investing activities** | **- 102,875** | **- 70,400** |
| **Cash from financing activities** |  |  |
| Finance charges paid (including exceptional break costs) | - 33,823 | - 10,714 |
| New debt issued | 196,394 | 15,000 |
| Payment of debt | - 203,888 | - 9,471 |
| **Net cash flow from financing activities** | **- 41,317** | **- 5,185** |
| **(Decrease) in cash and cash equivalents** | **- 91,197** | **- 56,983** |
| Cash and cah equivalents at start of year | 109,974 | 166,957 |
| **Cash and cash equivalent at end of year** | **18,777** | **109,974** |

**Key Ratios**

|  |  |  |  |
| --- | --- | --- | --- |
| **Ratio** | **Formula** |  |  |
|  |  | **2021** | **2020** |
|  |  |  |  |
| **Profitability** |  |  |  |
| Profit Margin | Profit / Total Revenue | -32.69% | -13.87% |
| Return on Assets | Profit / Average Total Assets | -13.62% | -5.10% |
|  |  |  |  |
| **Efficiency** |  |  |  |
| Receivable days | (Trade debtors/revenues)\*365 | 63.97 | 95.09 |
| Payable days | (Average a/c payable/COGS)\*365 |  |  |
| **Liquidity** |  |  |  |
| Current Ratio | Current Assets / Current Liabilities | -0.40 | -0.90 |
| Quick Ratio | (Cash Assets + Receivables) / Current Liabilities | -0.31 | -0.73 |
|  |  |  |  |
| **Solvency** |  |  |  |
| Debt Ratio | Total Liabilities / Total Assets | -69.82% | -63.15% |
| Debt to Equity | Total Liabilities / Total Equity | -231.38% | -171.37% |
| Interest Coverage | EBIT / Finance Costs | 319.71% | 396.61% |