PREPARE FOR DESCENT? A COMPARISON OF THE EFFECT OF U.S. AND EUROPEAN LEASING STANDARDS ON MAJOR U.S. AND EUROPEAN AIRLINE LIQUIDITY

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ABSTRACT

The airline industries in the United States and Europe represent fruitful research fields due to their risk of extrinsic demand upsets, namely worldwide contagions and rapid fuel cost surges, reliance on leased assets, and need for robust liquidity and solvency positions to fund an array of short and long-term needs for cash. Key liquidity metrics pre and post passage of the leasing standards were examined and compared to confirm any associations. The results supported a decrease in liquidity for the U.S. but not Europe, found statistically significant differences between the two regions, and is appended by a discussion offering various postulates for such differences as suggestions for future research. The study affirms material connotations for costs of capital and loan covenants, and sanctions additional study to determine the applicability of these findings to other industries reliant on leasing.

Keywords: Airlines, Leasing, Liquidity, Loan Covenants

1.   INTRODUCTION

The U.S. and European airline industries have experienced much change over the years. These industries provide unparalleled safety in terms of transportation modality (Stoop & Kahn, 2005), providing extensive passenger and cargo delivery services. Over the past few decades, both industries have also experienced similar deregulation (Martín & Román, 2008). The U.S. and European airline industries also share a wide range of similar issues pertaining to leverage (Nicolau & Santa-María, 2012; Kiraci & Aydin, 2018), dependence on asset leasing (Gritta & Lippman, 2003; Bourjade et al., 2017), and risks related to extrinsic demand upsets including pandemics (Dube et al., 2021; Sun et al., 2021), terrorist attacks (Corbet et al., 2019), fuel price hikes (Barr, 2022), and liquidity risk (Armen, 2013).

With regard to asset leasing, the Financial Accounting Standards Board in the U.S. and the International Accounting Standards Board overseas recently introduced the passage of new leasing standards which became effective January 1st, 2019 for publicly-traded firms. The almost identical standards mandated that firms list the majority of previously classified operating leases and the present value of the corresponding liabilities on their balance sheets, representing a significant financial reporting change for firms in a wide range of industries (Freeman, 2018). Indeed, the financial implications and gravitas of these standards was noted and quantifiably estimated by both Harris and Sunna (2013) and Bryant and Felsted (2017) who forecasted around $1.3 and $3 trillion respectively of leases could be capitalized onto firms' balance sheets. The spirit and rationale underlying passage of the respective standards highlights a demand for increased clarity among creditors, analysts and investors related to curtailing the loophole that for many years permitted firms in an array of markets to keep significant, material amounts of leased assets and liabilities off their balance sheets.

Even before inception of the respective standards, it was noted in the literature that such increased comparability and transparency would enhance the ability of investors, creditors etc. to effectively and more robustly scrutinize firms' financial statements, especially between firms that owned versus leased assets (DiSalvio & Dorata, 2014). Prior to passage of the standards, details of the leased assets and liabilities were concealed in financial statement disclosures and necessitated, at minimum, complex and elaborate manipulation and evaluation methods in an attempt to reconcile firms' true financial positions, at a cost of true comparability (DiSalvio & Dorata, 2014). For many years prior to passage of these standards, firms in various industries had exploited this leasing loophole to avoid having to capitalize leases in the financial