

CRUISING OR GROUNDED? THE EFFECT OF ASC 842 LEASES ON THE STOCK PRICE AND SIZE OF PUBLICLY-TRADED U.S. AIRLINES

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ABSTRACT

The U.S. airline industry could possibly be labeled as both exciting and glamorous. Even in modern times, the airline industry retains its charm and excitement, and there still exists an aura related to air travel. Yet, despite this, the veneer is permeated by operational and financial uncertainties related to the ever-present shadow of terrorist incidents, worldwide pandemics, unpredictable oil prices, and rising interest rates among others. Such risks are juxtaposed against the unique model by which airlines operate: namely complex capital structures and a strong need for robust liquidity and solvency positions to fund an array of short-term and long-term costs; for example, cabin crew and pilot wages, airport landing fees, fleet maintenance, debt service, and leasing costs.

Leasing costs represent a noteworthy facet as the majority of airlines in the U.S. lease significant portions of their fleets. Such strategies provide increased strategic flexibility and help preserve cash in an already capital intensive industry. In this context, airlines are exposed to passage of new acts that may require significant changes to financial statement reporting. An exemplar of such, ASC 842 Leases, came into force January 1st, 2019 for public firms, requiring balance sheet capitalization of leased assets and corresponding liabilities. Prior to enactment of ASC 842, the majority of leases had been successfully kept off-balance sheet allowing airlines to simply not disclose large amounts of assets and liabilities that they effectively owned.

This research utilized a longitudinal dataset of U.S. airline firm year-level data covering 2017-2019 to investigate the effect of ASC 842 Leases on the size and stock price of publicly-traded U.S. airlines. Several proxies were employed to measure size and firm valuation including total assets, market capitalization and load factor. Other metrics examined included operating income, operating cash flows, airline revenues, and debt-to-equity ratio. The sample was purposefully selected in order to circumvent any potentially confounding issues related to the Covid global contagion. We show that implementation of ASC 842 Leases was not correlated with any statistically significant change in the variables operationalizing the latent constructs set forth in the study. This study offers a viable and noteworthy extension to both the academic and practitioner literature in this area by providing evidence that individual and institutional investors understand that the financial reporting changes and implications of the new leasing act are more of a financial reporting issue than a substantive change to the airlines' financial positions. Such research findings offer implications for financial reporting, debt service and covenants, potential costs of capital, and legislative transparency among others.

Keywords: ASC 842, Airlines, Leasing, Stock Price, Airline Size

1. INTRODUCTION

The airline industry in the United States remains an individualized and indeed unique industry. U.S. airlines are characteristically exposed to a litany of expeditious and extraneous demand shocks including terrorist acts (Albert, 2017; Ritchie & Roser, 2023) global pandemics and contagions (Maneenop & Kotcharin, 2020; Amankwah-Amoah, 2021), continuously mutable oil prices affecting jet fuel costs (Turner & Lim, 2015; Kristjanpoller & Concha, 2016), and recessions (Lee et al., 2018; Sobieralksi, 2020); all of which can wreak devastating effects on passenger demand for airline services. All of the aforementioned operational and