

TURBULENCE AHEAD? A STUDY OF THE IMPACT OF IFRS 16 LEASES ON THE REPORTED LIQUIDITY OF PUBLICLY-TRADED EUROPEAN AIRLINES

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ABSTRACT

Since its inception, the airline industry has been and remains susceptible to exogenous and endogenous shocks, the most recent being the Covid-19 global pandemic which largely grounded the industry. Over the past twenty-five years, rising oil prices, labor strife, the terrorist attacks of September 11, SARS, the 2008-2009 recession, and constantly changing disposable consumer income have had an indelible effect on the industry. Another latent characteristic for this industry is the promulgation of new accounting standards. In 2016, the IASB, in conjunction with the FASB, issued IFRS 16 Leases effective for reporting periods beginning on or after January 1, 2019, with early adoption permitted. The standard required capitalization of most leased assets not previously reported on the balance sheet. Prior to enactment of the standard, forecasts of diminished liquidity pervaded both the academic and practitioner literature.

In this study, we analyze whether passage of IFRS 16 had the predicted impact on the reported liquidity of the major European airlines. To encompass both an accrual and cash-based perspective, liquidity is operationalized using the quick ratio, net current assets as a percentage of total assets ratio, and cash ratio covering the period 2017 to 2019. This period was chosen to avoid the distorting effects of the Covid-19 pandemic. We show that enactment of IFRS 16 did not have a statistically significant effect on the reported liquidity metrics of major European airlines, despite forecasts to the contrary. Given the airline industry's need for strong liquidity and threat of exposure to extraneous supply and demand shocks, these findings provide a valuable contribution to the empirical literature in this field and have implications for debt covenants and costs of capital in this industry and beyond.

Keywords: IFRS 16, Leases, Airlines, Liquidity

1. INTRODUCTION

Notwithstanding the metamorphosis that the airline industry has gone through over the years, it remains one of the most vibrant and exciting global industries. Eliciting nostalgic visions of the glamor of air travel, excitement and even awe, the industry not only contributes to world GDP (IATA) but also provides one of the safest modes of transportation (Stoop & Kahan, 2005), connecting people and delivering cargo in all four corners of the globe. The industry has also seen much deregulation (Martín & Román, 2008).

The increase in demand for, as well as the widespread affordability of air travel has changed that nostalgic vision. Issues such as rising jet fuel prices (Koopmans & Lieshout, 2016), congestion (Roosens, 2008), high leverage (Kiraci & Aydin, 2018; Nicolau & Santa Maria, 2012, and Capobianco & Fernandes, 2004), epidemics (Dube et al., 2021; Sun et al., 2021), economic slowdowns (Chen et al., 2017; Sadi & Henderson, 2000) and the reliance on leased assets (Bourjade et. al., 2017; Gritta & Lippman, 2003), have contributed to the distortion of that image. Unexpected shocks over the past twenty-five years such as terrorist attacks (Corbet et al., 2019), SARS, labor strikes, the 2008-2009 recession, and the Covid-19 pandemic have left an indelible mark on the airline industry. Yet this industry continues to play a crucial and indispensable role in everyday life.