

# Capital Structure of Selected Airlines in India

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## ABSTRACT

The basic aim of firms is to maximize profits though minimizing costs. This goal appreciably affects their decisions in regards to investment financing. When enterprises seek funding for new investments, they consider both cost efficiency and profitability. Financing sources are generally classified into internal and external options. Internal financing usually includes equity, though external financing mainly consists of debt. Many of the aviation companies adopt a blend of these sources, making what is known as a capital structure. Capital structure is a basic concept in corporate finance that reflect the proportion of different funding sources utilized to assist an organization's operations and growth. The composition of capital structure of a firm plays an important part in determining its financial stability, risk exposure, and overall value.

This research paper aimed to examine how the capital structure affects the performance of airlines across different market capitalizations in India. The research will explore current trends and practices in the aviation sector's financing patterns to underline the importance of capital structure decisions.

To attain these objectives, the research will include a trend analysis of the debt to -equity mix and debt-to-equity ratios of selected airlines in India. The study will also appraise different leverage ratios to assess financial reliability and derive insights into the implications of different financing strategies. These analyses are expected to offer a deeper perceptive of the strategic financial decisions within aviation industry in India.

Keywords: Capital Structure, Airline Industry, Financial Performance

## INTRODUCTION

Capital structure refers to the composition of financial resources that support a business, enabling it to acquire assets and fund its day-to-day operations. It also reflects financial decisions related to acquisitions and long-term investments, all of which can extensively effect the company's profitability. The role of capital structure is significant in maintaining an organization's financial stability, and its importance is highlighted by some key aspects.

IndiGo, SpiceJet, Air India, and Vistara are key players in India's aviation industry, each with distinct business models and financial strategies that affect their capital structure. The capital structure of these airlines -

comprising the mix of debt and equity utilized to finance their operations - plays crucial role in making their financial constancy, investment decision, and long term sustainability. IndiGo, with its strong equity base and comparatively low debt levels, emphasizes operational effectiveness and cost control. On the contrary, SpiceJet has relied more heavily on debt financing, which has posed problems during periods of financial distress. Air India, following its acquisition by the Tata Group, is undergoing a major restructuring of its capital and operational system to improve efficiency and profitability. Analyzing the capital structure of these airlines provides valuable insights into how financial strategies impact performance in the highly competitive and capital-intensive aviation sector.

An effective capital structure can enhance an enterprise's market valuation, which in turn may drive up the value of its shares and financial instruments. This elevated market standing offers strategic advantages. Additionally, having an optimized mix of financial resources helps in the efficient allocation and utilization of funds, reducing the risks associated with either excessive borrowing or insufficient capital - commonly known as overcapitalization and undercapitalization.

Also, a balanced and well planned capital structure often leads to improved profitability, as it enables the company to deliver better returns to its investors. This efficiency benefits not only the organization but also its shareholders. Through careful management of the proportion between debt and equity, firms can aim to reduce their cost of capital though maximizing shareholder wealth – an important aspect in attaining long term financial resilience. A well structured capital system offers Airline companies the flexibility to respond to changing financial conditions. The capability to adjust leverage based on the company's requirements boosts strategic decision making and assists sustainable development.

## **STATEMENT OF THE PROBLEM**

The capital structure of major airlines in India presents an important challenge because of the very much capital intensive nature of the aviation industry, fluctuating market conditions, and rising operational costs. Indian airlines companies adopt varied financing strategies, with differing reliance on debt and equity to sustain operations and fund expansion. Though, imbalances in capital structure – like excessive debts or underutilized equity - can cause financial instability, reduced investor confidence, and limited flexibility in crisis management. The major issue lies in identifying an optimal capital structure that make sure long term financial health, competitive performance, and resilience against economic shocks. The research work seeks to examine how the capital structure decision of these major Indian airlines affect their financial performance and sustainability in an unstable and highly regulated industry.

## RESEARCH OBJECTIVES

- To analyze the debt-to-equity ratio of selected airlines in India to assess their financial leverage
- To examine the effect of capital structure on the profitability and growth of Indigo and Spicejet
- To analyze the major sources of financing utilized by selected airlines in India

## LITERATURE REVIEW

Gharge, Vivek (2014) in his research paper offers an inclusive analysis and comparison of the capital structure within the UK's budget airlines. The analysis evaluate the assumption that maintaining a balanced level of financial leverage can contribute to strong financial performance in the airline sector. It also aims to identify an optimal capital structure by targeting a WACC in the range of 9-10%, as referenced from Bloomberg data. The research highlights leading airline companies that manage capital effectively, generating returns on investment that surpass their cost of capital, thereby ensuring profitability. Among these companies, capital structures typically consist of approximately 75% equity, around 20% long-term debt, and less than 5% short-term debt. Although, it is important to recognize that simply replicating a specific capital structure or achieving a targeted WACC does not automatically lead to profitability. To illustrate this point, the report includes a case study on Southwest Airlines, demonstrating how a strategic balance of debt and equity can support the maintenance of a stable WACC and sustainable financial performance. Finally, the report offers recommendations for Monarch Airlines regarding alternative financing options. These suggestions are aimed at helping the company reduce its reliance on short-term debt and regain operational stability.

Umesh Mahtani and Chandra Prakash (2020) points out that Indian airline companies are confronted with numerous challenges stemming from the constantly evolving passenger market and fluctuating input costs. These volatile conditions have pushed several carriers into financial distress, with some even declaring bankruptcy. In such a scenario, it becomes critical for management to pinpoint the key elements that significantly influence their financial performance. This study aims to identify the most impactful factors—spanning financial metrics, operational characteristics, and external conditions—that shape the financial health of Indian airlines. To assess the relevance of incorporating these broader factors, the study compares the predictive accuracy of a comprehensive model that includes all identified variables against a model that relies solely on financial ratios.

Roop Raj (2017) states: Capital structure decisions play a crucial role in a firm's overall financial performance, as they have a direct impact on profitability. Making the right choices regarding the composition and utilization of capital is a fundamental aspect of a company's financial strategy. Therefore, these decisions require careful evaluation and strategic planning. This study aims to explore how a firm's capital structure influences its profitability, with a particular focus on its effect on EVA. To establish a foundation for the analysis, several well-known capital structure theories are examined, including the trade-off theory, pecking

order theory, agency theory, and the free cash flow theory. These theoretical frameworks are used to develop hypotheses regarding the factors that influence capital structure decisions among selected Indian aviation companies. The research relies on secondary data sourced from a reputable financial database to support the analysis and derive meaningful insights. Findings indicate that variables such as profitability, liquidity, earnings volatility, and asset tangibility are inversely associated with the firm's debt ratio. In contrast, company size demonstrates a positive relationship with the debt ratio. Meanwhile, factors like non-debt tax shields and growth potential show no significant correlation with leverage.

### **Factors Affecting Capital Structure Decisions**

**Business Risk:** The extent of operational risk a company faces significantly influences its capital structure decisions. Firms exposed to higher levels of business risk often adopt a more cautious approach by maintaining lower levels of debt, thereby reducing the added burden of financial risk.

**Industry features:** Capital structure trends differ across different sectors based on their inherent financial demands and risk exposure. For instance, sectors that require substantial capital investment, such as manufacturing or infrastructure, typically exhibit higher reliance on debt financing compared to less capital intensive, service oriented sector.

**Profitability:** A company's ability to generate consistent profits is a key determinant of its approach to capital gearing. Firms with strong profitability are better equipped to meet debt servicing obligations, which often enables them to sustain a higher ratio of debt to equity.

**Growth Opportunity:** Companies with promising prospects for expansion may strategically increase their leverage to support investment in growth initiatives. Utilizing debt in such cases can amplify returns for shareholders by facilitating timely and efficient capital deployment.

**Tax Consideration:** The regulatory tax system within which a company operates can significantly shape its capital structure choices. When tax laws permit the deduction of interest payments, companies are often encouraged to increase their debt levels, as this can lead to reduced taxable income and enhanced financial efficiency.

**Operating Structure:** A firm's operational configuration is a key element in capital structure planning. Companies with lower levels of operating leverage—meaning their fixed operating costs are relatively low—are generally better positioned to incorporate financial leverage. This is because the reduced exposure to business risk allows for greater capacity to manage financial obligations.

**Asset Structure:** The nature and type of assets a company holds influence its financing strategies. Assets are generally categorized into general-purpose and special-purpose types. For instance, real estate firms typically own general-purpose assets, which are easier to use as collateral for loans due to their broad applicability. In contrast, firms engaged in high-tech research and development often rely on special purpose assets, which are less suitable for collateralization and therefore limit the firm's capacity to secure debt financing.

**Firm's Internal Condition:** Internal circumstances within a company also play a critical role in determining capital structure. For example, if a firm successfully completes a project, it may expect increased returns in the near future. In such cases, the company might avoid issuing new equity, as the forthcoming gains are not yet visible in the current stock valuation, and issuing shares prematurely could dilute ownership without capturing the full value of future earnings.

## DATA ANALYSIS AND FINDINGS

The capital structure of an airline refers to the mix of debt and equity used to finance its operations. In India's aviation industry - a sector characterized by high operating costs, capital intensity, and sensitivity to external shocks - understanding capital structure is critical to assessing financial health and sustainability. This study compares the capital structures of IndiGo and SpiceJet. The objective is to understand how each airline finances its operations and manages financial risk.

### Debt-Equity Ratios

	SpiceJet	IndiGo
2018	2.2	8.1
2019	2.1	2.3
2020	1.9	1.8
2021	0.6	1.1
2022	0.9	1.4

The debt-to-equity ratio of two airline companies, SpiceJet and IndiGo, was analyzed. It was found that SpiceJet has the lowest average debt-to-equity ratio, indicating that the company is in a stronger position to meet its financial obligations to creditors. Additionally, SpiceJet's standard deviation of the debt-to-equity ratio is also the lowest, signifying that the company's capital structure is more stable and consistent. On the other hand, IndiGo exhibits the highest standard deviation, reflecting greater volatility in its capital structure. Therefore, the standard deviation suggests that IndiGo experiences more fluctuation in its financial leverage, though SpiceJet's capital structure demonstrates greater stability and predictability.

### Total Asset to Debt-Ratio

	Spice Jet	IndiGo
2018	2.1	1.6
2019	2.3	2.0
2020	2.6	2.3
2021	4.1	2.7
2022	3.2	2.5

An analysis of the total assets to debt ratio for SpiceJet and IndiGo revealed that SpiceJet has the highest average ratio, indicating that the company has a stronger ability to cover its external debts with its assets. In contrast, IndiGo has the lowest ratio, suggesting weaker coverage of its debt by its total assets. Furthermore, the standard deviation for SpiceJet's total assets to debt ratio is the lowest, highlighting greater stability and consistency in its financial structure compared to IndiGo, which exhibits more variability.

### Capital Employed to Total Assets Ratios

	Spice Jet	IndiGo
2018	0.2	0.1
2019	0.2	0.2
2020	0.2	0.3
2021	0.4	0.3
2022	0.3	0.3

An analysis of the capital employed to total assets ratio for SpiceJet and IndiGo shows that SpiceJet has the highest average ratio, though IndiGo has the lowest. This suggests that SpiceJet offers better security to its creditors compared to IndiGo. Additionally, the standard deviation results indicate that both airlines maintain a similar proportion between capital employed and total assets, reflecting consistent financial structures for both companies in this regard.

### Current Ratios

	Spice Jet	IndiGo
2018	0.2	1.0
2019	0.3	1.5
2020	0.3	2.0
2021	0.3	2.4
2022	0.4	2.2

An analysis of the current ratio for SpiceJet and IndiGo reveals that IndiGo has the highest average current ratio, indicating a stronger liquidity position compared to SpiceJet, which has the lowest average. This suggests that IndiGo is better positioned to meet its short-term financial obligations. Additionally, the standard deviation is lowest for SpiceJet and highest for IndiGo. This indicates that the current ratio of IndiGo is more volatile, though SpiceJet's current ratio remains more stable and consistent.

### Acid Test Ratios

	Spice Jet	IndiGo
2018	0.2	0.9
2019	0.2	1.5
2020	0.2	1.9
2021	0.3	2.4
2022	0.3	2.2

An analysis of the acid test ratio for SpiceJet and IndiGo shows that IndiGo has the highest average ratio, indicating that its absolute liquidity position is stronger than that of SpiceJet. On the other hand, the standard deviation is highest for IndiGo and lowest for SpiceJet. This suggests that SpiceJet's liquidity position is more consistent, though IndiGo's liquidity position shows greater variability.

### Trend of Spice Jet Airlines (In %)

	2020	2021	2022
Inventories	130.73	186.89	206.36
Total Assets	105.07	141.62	168.44
Total Liabilities	92.65	104.86	132.43
Borrowings	84.26	70.68	60.44

Total Revenue	120.16	150.13	175.73
Total Expenses	124.12	153.79	200.48

Both inventories and total assets have shown a consistent upward trend, suggesting that the company is actively pursuing expansion. Additionally, the company is moving in a positive direction, as evidenced by a steady increase in total revenue, though total liabilities have been on the decline. The company's borrowings have also decreased, indicating a stronger financial position and a greater ability to cover its liabilities and expenses independently. However, total expenses have shown a steady rise, increasing from 124.12% to 200.48%.

### Trend of Indigo (In %)

	2020	2021	2022
Inventories	213.88	240.20	277.18
Total Assets	120.53	167.44	198.21
Total Liabilities	120.53	167.44	198.21
Borrowings	79.67	74.54	72.95
Total Revenue	116.30	143.91	179.06
Total Expenses	124.54	150.68	216.68

The table above presents the trend analysis for IndiGo airline company for the years 2020, 2021, and 2022. These financial ratios play a crucial role in shaping the optimal capital structure for Indian airline companies. They influence the decision-making process regarding whether to finance operations through debt or equity, offering insights into the most suitable funding strategy. Beyond providing a snapshot of the firm's present financial condition, these ratios also serve as key indicators for market participants to assess the airline's performance and future prospects, especially in scenarios involving business valuation. Striking a well-calibrated balance among these ratios enhances an airline's financial resilience and agility—attributes that are essential for surviving and thriving in India's highly competitive and unpredictable aviation sector.

### CONCLUSION

The capital structure analysis of major airlines in India reveals a varied approach to financing operations, with differences in debt levels and equity financing strategies. Companies like IndiGo tend to have a higher reliance on debt, reflecting a more leveraged structure, which may contribute to higher risks but also offers the potential for greater returns. On the other hand, airlines like SpiceJet have a more conservative approach with a lower debt-to-equity ratio, which indicates a more stable capital structure with reduced financial risk. This

conservative strategy may provide better security for creditors and result in lower volatility in terms of debt obligations and interest payments.

Additionally, though some airlines maintain a higher proportion of equity in their capital structure, ensuring financial flexibility and resilience, others lean more heavily on external financing through loans and borrowings. This variation in capital structure strategies is influenced by each airline's growth plans, market conditions, and operational needs. Ultimately, the different strategies adopted by these airlines reflect their unique risk appetites and financial management philosophies, balancing growth ambitions with the need for financial stability.

## SUGGESTIONS

- **Improve Debt Management:** Airlines should focus on optimizing their debt-to-equity ratio by reducing high levels of debt to enhance financial stability and lower interest costs. This approach will make companies more resilient to economic downturns and improve their ability to meet obligations.
- **Strengthen Equity Financing:** To reduce dependency on debt, airlines should consider raising additional equity capital, which will provide a stronger financial foundation and greater flexibility in funding operations and expansion. A balanced approach to equity and debt will help mitigate risks associated with interest rate fluctuations.
- **Focus on Cost Control:** Airlines should implement effective cost control measures to reduce total expenses, especially in areas like fuel, maintenance, and staffing. This will improve profitability and ensure better liquidity, even during periods of lower revenue generation.
- **Enhance Liquidity Management:** Airlines should prioritize maintaining healthy liquidity ratios, such as the current and acid-test ratios, to ensure they can meet short-term obligations without compromising operations. Strong liquidity management will provide a buffer during financial challenges and support operational efficiency.

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