

BOOK REVIEW

Foundations of Airline Finance: Methodology and Practice

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Foundations of Airline Finance: Methodology and Practice

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438 pp.

\$49.95

With deregulation of aviation industry movement and separating regulator from operator, a need has risen to treat airlines, airports, and air traffic controls as none-governmental entities that must operate in new standards and according to new measures. Governments as well as private sector had to learn new language. The new language is the market language using numbers, facts, financial indicators that are foreign to the aviation industry. Indicators like NPV, VC, MC, and FC are unknown to aviation industry. On the other hand, long gone is the day when airlines can write off their debt as governmental loss. With open market and new competitors airline must learn how to count before spend. The lessons first were learned in USA since it was the first to privatize, then

Europe, now the rest of the world. Alas, no one was prepared for the new language: finance, accounting, etc. Although, finance and accounting did exist long before airlines, still, airlines have so many special properties that make applying the same methods of accounting and finance very difficult. From the womb of aviation industry came three authors, and wrote a textbook that will elevate the pains of airlines & regulators, so they can both speak the language of finance and accounting. The textbook is “*Foundations of Airline Finance: Methodology and Practice*”.

The authors of the book come from the womb of the aviation industry Dr. Bijan Vasigh is Professor of Economics and Finance in the College of Business at Embry-Riddle Aeronautical University and Managing Director of the Aviation Consulting Group, LLC. He worked on a NASA Research Grant for “Determination of Statewide Economic Benefits of the Small Aircraft Transportation System (SATS).” He is also a member of the Air Transport Research Society (ATRS) Global Airport Benchmarking Task Force. Dr. Ken Fleming has extensive experience in aviation economics and operations research. He is a published and recognized expert in Aviation Economics

DOI: 10.4018/ijatem.2011010106

as well as a multitude of other areas involving air traffic control and air traffic management. Liam Mackay received his first degree from the University of Western Ontario and his MBA from Embry-Riddle Aeronautical University, both specializing in aviation management. He currently works for Continental Airlines on financial planning and analysis.

The Book *“Foundations of Airline Finance: Methodology and Practice”* is composed of four parts: The first part titled “Theoretical Aspects of Airline Finance” discusses the theoretical issues: Role of finance in the airline industry, Airline cost classifications, Time value of money, Risk and return. In part two “Airline Accounting and Finance” the book discusses more accounting topics: Role of accounting in airlines, Airline financial statements, financial statement analysis. Furthermore part three covers Capital Budgeting in airlines which include: Airline capital budgeting, Airline capital structure and cost of capital, Working capital and current asset management. The fourth part “Practical Applications of Airline Finance” comprised of three chapters: Managing risks: airline fuel and currency hedging, Buy versus lease decision-making, Aviation industry valuation.

The First chapter “The Role of Finance in the Airline Industry” paves the road by discussing the essentials in airline industry: The International Nature of the Aviation Industry, Objectives of Airlines, Accounting Profit, Economic Profit, Business Organizational Structures, and Comparison between Business Structures, Agency Issues, and Financial Markets.

The Second chapter “Airline Cost Classifications” covers the following topics: Startup Costs, Production Costs, Fixed Costs (FC), Variable Costs (VC), Marginal Costs (MC), Using Cost Functions for Managerial Decisions, Structure of Airline Costs, Airline Cost Rebalancing/Restructuring. The third chapter “Time Value of Money” discusses: Future Value, Present Value, Compounding Interest, Annuities, Perpetuities, Amortization Schedule. Furthermore the fourth chapter “Risk and Return” discusses: Expected Rate of Return, Risk Analysis, Financial Risk

Preferences, Risk Diversification, Beta, Capital Asset Pricing Model (CAPM), and Risk in the Aviation Industry.

The fifth chapter digs deeper into “The Role of Accounting in Airlines” by explaining: Financial Accounting, Managerial Accounting, Differences in Airline Accounting, International Trade and IATA Clearing House, Issues Pertaining to the Airline Industry, Revenue Recognition, U.S. Airlines vs. European Airlines, International Operations, Airline Consolidation, and Consolidation in the U.S. Airline Industry.

The sixth chapter “Airline Financial Statements” explains some enigma to aviation industry yet basics in the business world. The chapter explains: Balance Sheet, Depreciation, Common-Size Income Statement, The Statement of Retained Earnings, and Cash Flow Statement.

The seventh chapter “Financial Statement Analysis” explains: Financial Ratio Analysis, Financial Ratios: Airline-Specific Ratios, Predicting Insolvency. The chapter comes with two appendices: Financial Ratios & DuPont Model.

Chapter eight starts part three “Airline Capital Budgeting”. The chapter covers: Airline Capital Budgeting and Cash Flows, Project Classifications, Payback Period, Discounted Payback Period, Net Present Value (NPV), Internal Rate of Return (IRR), Modified Internal Rate of Return (MIRR), Profitability Index (PI), Break-Even Analysis. Such topics were never heard of in government controlled market.

Chapter nine “Airline Capital Structure and Cost of Capital” moves forward to discuss: Equity Financing, Cost of Equity, Bonds, Airline Debt, Cost of Debt, Weighted Average Cost of Capital (WACC), Airline Debt and Equity, CAPM to Estimate k_E , Business Risk vs. Financial Risk, Cost of Capital and Capital Budgeting.

Chapter ten “Working Capital and Current Asset Management” discusses: Working Capital Policy, Cash Management, Accounts Receivable, Current Liabilities Management, and Inventory Control Models. Chapter 10 concludes part three of the book.

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