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THE CHOICE OF LONG-TERM DEBT IN THE HOTEL INDUSTRY

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ABSTRACT

A variety of theories have been used to explain the capital structure decision of firms. Although the empirical work has progressed to include examining the capital structure of specific firms or conducting comparative analysis across firms, only limited work has been done regarding the capital structure of the hospitality industry. The purpose of this paper is to provide an empirical test of established capital structure theory regarding those factors relevant to the long-term debt choice made by hotel firms.

We will use regression models to identify the factors determining the amount of long-term debt being used by hotel firms. The model used in this paper is based largely on research by Barclay and Smith (1995) and Wald (1999) and selects variables based upon the three major theories of capital structure: moral hazard, signaling to capital markets, and tax effects. The moral hazard variables include growth opportunities, firm size, and physical plant assets (PP&E). The signaling variable is measured by the probability of future bankruptcy. Finally, the non-debt tax shield, as represented by depreciation, measures the tax effect.

Therefore, the full regression model is as follows:

- $$\text{LTDR} = \alpha_0 + \alpha_1 \text{MVA} + \alpha_2 \text{MVFL} + \alpha_3 \text{PPE} + \alpha_4 \text{OOR} + \alpha_5 \text{DEP} + \varepsilon_i$$
- LTDR = Debt maturing in more than three years / total assets.
- MVA = A growth opportunity variable measured by the ratio of the market value of the firm's assets to the book value of assets. The market value of the firm's assets is equal to the market value of assets minus the book value of assets plus the market value of equity.
- MVFL = The natural log of the market value of stockholder equity, adjusted for inflation.
- PPE = The ratio of net property, plant, and equipment to total assets.
- OOR = A firm quality variable as measured by the firm's revised O-Score. (The calculation of this variable is explained in the article's Appendix.)
- DEP = A non-debt tax shield variable measured by the ratio of depreciation to total assets.
- ε_i = The error term of the regression.

We did not find a statistically significant relationship between the growth opportunity variable and long-term debt. However, we document a significantly positive relationship between long-term debt and firm risk, and between long-term debt and fixed assets. There is also a significantly negative relationship between long-term debt and depreciation tax shields.