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ABSTRACT

Even though a general capital structure literature suggests an existence of an optimal leverage point, it is extremely difficult to know the exact optimal leverage point for an entire economy, an industry, or a firm if possible at all. Several studies in general finance and accounting literature have examined this particular issue and found some consensus that there are differences in optimal leverage ratio among different industries. However, the focus of those studies was not on the lodging industry and most studies did not include the lodging data for their analysis. Further, no exclusive comparison between the mean and median leverage ratio and between the expansion and recession period have been made. The purpose of this study is, therefore, to investigate the optimal leverage point in the lodging industry setting. In detail, this study examines validity of using industry mean and median leverage ratios as the optimal leverage point for lodging firms and also compares the validity of the two industry ratios between the expansion and recession period. For the entire sample period, 1980 to 2005, the results of this study suggest that the median lodging debt-to-equity ratio works better than the mean value as an optimal leverage point for lodging firms. However, when the ratios were compared under the two different economic conditions, the both worked poorly under the expansion period, but worked well under the recession period. One possible explanation of this phenomenon is that during expansion periods, the economy grows and the market has an expectation that the economy will keep growing for a while. Therefore, the market may become less sensitive to a

certain facts such as a capital structure issue meaning that even though a firm moves away from the optimal leverage point, the market may expect that the firm will still perform well because of the overall economic condition. On the other hand, during recession periods, the market may become more sensitive and tend to punish the firms more that do not perform well.