Modern Ways to Achieve Sustainable Company Growth

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Abstract. In the conditions of sufficient openness of the Russian market, factors such as a decrease in demand and in investment activity, exchange rate fluctuations, economic sanctions against companies and other unstable conditions lead to a slowdown (sometimes to a decrease) in the growth rate of the turnover of Russian companies, and a deterioration in their financial situation and decrease in the degree of financial stability. Therefore, it seems necessary to study the conditions and opportunities for achieving sustainable growth carried out on the example of Russian airlines using econometric modeling methods. Solving this problem requires studying the system of financial and non-financial factors for achieving sustainable growth and also identifying key financial indicators of growth based on an analysis of industry-specific features of the airline passenger transportation market.

Keywords: Airlines growth · Risk factors · Revenue growth · Sustainable growth

1 Introduction

Unstable business conditions significantly reduce the economic potential of Russian companies, which in the long run may deprive them of the opportunity to achieve sustainable growth regardless of the field of economic activity. Airlines are no exception. Despite the annual increase in passenger traffic in recent years, in the current economic situation this growth cannot be described as sustainable, and the airlines themselves are experiencing financial difficulties. Over the past five years such major Russian airlines as “Transaero” Aviation Company JSC and “VIM-Avia” Airlines LLC have gone bankrupt. A difficult situation in the Russian aviation industry has developed since 2014, when Russian carriers began to suffer losses due to a decrease in passenger traffic and a general recession in the Russian economy, which had a negative impact on stability and prospects for their further development.
2 Methodology

The research is aimed at quantifying the opportunities for achieving sustainable growth by Russian airlines. Descriptive and comparative methods of general scientific knowledge, methods of financial analysis and econometric modeling, in particular, regression analysis using the R statistical package, were used as research methods. The regression analysis method allows to determine the significance of selected factors included into the model, as well as the degree of influence of each factor on the resulting feature. A dependent variable that characterizes the quarterly revenue of Aeroflot Group is modeled. Based on the data of operational statistics and artificially simulated dummy variables, a multiple linear regression model of the revenue dependence on financial and non-financial factors of sustainable growth is constructed. The main non-financial factors are the volume of passenger traffic, aircraft load level, seasonality. The model considers sales profitability, current liquidity ratio, asset turnover ratio, financial dependence ratio and the volume of non-current assets as financial factors. The information base is presented by the financial statements of Russian airlines for the period 2014–2019. The research methods and results can be used to develop a mechanism for airlines to achieve sustainable growth.

3 Results

For many companies, regardless of the field of activity, achieving sustainable growth is an important factor for existence and development in the face of falling demand, decrease in the investment activity, currency fluctuations, etc. The lack of sustainable growth in the face of a general economic slowdown has a negative impact on the development of companies and leads to a decrease in shareholder income, which can lead to bankruptcy in case of a combination of adverse factors.

The long-term strategy of many companies involves the development of the company, which is aimed at shareholder value growth by increasing economic efficiency, staff development, which affects labor productivity as well as the growth and increase in business activity. However, not every type of growth leads to the creation of additional value for the company and increase in the welfare of owners. As practice shows not every corporate growth contributes to the prosperity of the company in the medium and long-term time horizons. Thus, unbalanced growth contributes to the accumulation of risks [5]. High growth rates with insufficient level of resources can lead to depletion of company resources, loss of financial stability as a result of debt increase and reduced liquidity. On the contrary, a slowdown in the presence of great potential can make a company a takeover target. Therefore, the actual growth of the company should match its financial capabilities.

To solve this problem, the concept of sustainable growth developed by Higgins can be applied. If a three-factor model of Thompson, Higgins and Howell [11] is used for a comparative analysis of the potential of the regions, which includes GDP per capita, disposable income per capita, unemployment rate, then at the level of corporate structures the model correlates the growth rate of company sales with return on equity and retention ratio [3]. The essence of the concept is to calculate a company’s sales
growth rate that is achievable, on the one hand, with an unchanged operating policy, and, on the other hand, with a stable financial structure of the company.

Thus, «sustainable growth is the ability to generate a constant revenue growth rate with the same operational strategies and financing sources over a long period of time for all interested groups of people» [9, p. 106]. In other words, it characterizes the maximum speed with which a company can increase sales without depleting financial resources [7]. Sustainable growth rate is a possible estimated growth rate of revenue or profit, which is provided with resources, provided that the key indicators of the operating, financial (including dividend) policy of the company are constant [14].

Sustainability of companies can be assessed using models of sustainable growth by Higgins [4], Zakon [15], van Horn and James [13], Ulrich and Arlow [12] and others. Analysis of sustainable growth factors using various models allows to identify the relationships between key indicators, make forecasts and choose the best scenario activities in the forecast period. However, these models take into account only the financial factors of the company. Sustainable growth is influenced by both financial and non-financial factors. Financial indicators of sustainable growth are:

– profitability and cost-intensity indicators, which characterize the financial performance of the company,
– indicators of business activity, evaluating the intensity of growth,
– the higher the turnover rate of assets, the higher the efficiency, solvency and financial stability of the company,
– by analyzing the efficiency of the use of assets it is possible to evaluate the relationship of the company’s commercial revenue with various operating assets [6],
– indicators of liquidity and financial stability of the company, reflecting its financial independence,
– the level of interest rates of commercial banks that affect the value and capital structure of companies,
– inflation and economic growth as exogenous growth factors. Inflation affects corporate financial decisions regarding debt policy. Therefore, during a period of high inflation, companies will have a lower debt ratio, which may lead to underfinancing of operating activities [8].

In our opinion the main non-financial factors for studying endogenous growth are:

– the results of company’s operations depend on the industrial specifics (for airlines it is the level of aircraft loading, the volume of passenger traffic, the composition of the fleet, the number of flight directions etc.),
– the structure of a board of directors and the number of independent directors,
– seasonal dependence of flight direction, which has an impact on company’s results.

Regression analysis is used to assess the impact of both financial and non-financial factors on sustainable growth achievement. It implies development of an econometric model, which describes the relations between company’s sales and different sustainable growth factors. This method makes it possible to assess the influence of different factors on the company’s sustainable growth and find the most important growth factors which will be used in further rational company’s strategy development.
Activities of airlines are related to the passenger transfer, aircraft fleet management, etc. It has a lot of technical and economic features and carries a large number of different types of risks. Socio-economic situation in the country, interest rate and law risks could be defined as non-specific risks for airlines, while seasonal dependence of demand, sensitivity to jet fuel price volatility, which takes a significant part in operating costs of airlines, high operational and foreign exchange risks are specific types of risk for airlines. Moreover, the constant need for renewal of formed assets and technological progress have a significant impact on changing of economic structure, strengthening of potential and accelerating of company’s economic growth [10]. All these risks should be taken into account when assessing the sustainability of economic growth.

The air transportation market is quite concentrated: as of the end of 2019, only 15 out of 107 registered airlines carried 92.6% of passengers and made 93.9% of the passenger turnover. At the same time, the four largest players (8 airlines) of the 15 airlines are Aeroflot Group (Aeroflot, Rossiya, Pobeda, Aurora), S7 (Siberia, Globus), Ural Airlines and UTair occupy 75% of the air transportation market share. Moreover, Aeroflot Group has almost half of the market - 41.2% [2].

Financial and economic analysis of the annual reports of the leading Russian airlines (Aeroflot Group, S7 Airlines, Ural Airlines) for the period 2017–2019 showed that the expansion of their activities was achieved mainly due to the growth of liabilities (the share of borrowed capital in the aggregate capital on average is 63%), which indicates instability of growth. Debt is mainly represented by accounts payable, which forms the main part of the company’s liabilities. As a result, the balance sheets of the company, as shown by current liquidity ratios, during the analyzed period are mostly illiquid while increasing the risk of default on current liabilities.

According to the financial statements, revenues of companies are constantly growing in recent years. However, operating expenses have a higher growth rate, which have a significant impact on profit margins. As a result, lower profits and higher costs leads to decrease in company’s free cash. Based on the estimation of key financial performance indicators, the steady growth rates of Aeroflot Group and S7 Airlines for 2017-2019 were calculated (Table 1).

| Sustainable growth models       | Aeroflot Group | S7 Airlines |
|---------------------------------|----------------|-------------|
|                                 | 2017 | 2018 | 2019 | 2017 | 2018 | 2019 |
| **Revenue growth**              | 4,4  | 13,0 | 9,3  | 31,5 | 8,9  | 23,3 |
| BCG model                       | 18,6 | 4,5  | 8,1  | 26,4 | 54,9 | 31,6 |
| Higgins model                   | 18,2 | 4,6  | 7,6  | 26,1 | 42,5 | 29,8 |
| Van Horne’s model               | 22,3 | 4,9  | 8,2  | 35,3 | 73,8 | 42,5 |
| Ulrich-Arlow’s model            | 34,4 | 6,7  | 10,8 | 30,7 | 44,2 | 22,0 |

Source: authors.

A financial analysis of the activities of Russian airlines showed that a feature of the airline industry is a consistently significant share of debt in total capital (from 2014 to 2019, from 65 to 85%). Therefore, the criteria for sustainable growth for airlines is the
ability to generate a stable revenue growth rate with the same operating strategy. The results of calculating the rates of sustainable growth using the main models show that airline revenue growth is not sustainable in the analyzed period. The growth is not provided by company’s own sources of financing, and in the last two years the activities of airlines are characterized by extremely low profitability. Moreover, the constant growth of short-term accounts payable and a slowdown in its turnover negatively affect liquidity and the possibility of achieving sustainable growth. Airlines need higher revenue growth, which will allow them to become profitable in the case of constantly growing operating expenses and debt.

Regression analysis methods were applied to measure the impact of non-financial factors of sustainable growth, along with financial methods. The determinants of sustainable growth were identified using the regression analysis and their significance for company’s revenue growth was proved. The results showed that the main non-financial factors for the steady growth of airline revenue are the growth in passenger traffic and the seasonal factor characterizing the systematically increased demand for airline services in July-September. The management of these factors can positively affect the growth rate of airline revenues. The research on the possibilities of achieving sustainable growth on the example of Russian airlines showed that the main financial factor for growth is the profitability of sales, as one of the parameters of the effectiveness of the pricing policy of companies. The stable positive financial result indicates that the company is conducting efficient activities, generating profits for distribution and reinvestment. Retained earnings can also help companies mitigate the negative effects of critical situations or loss-making activities.

4 Discussion

The extrapolation of the results obtained to the activities of airlines in 2020 seems to be incorrect. With the development of the COVID-19 pandemic, the cessation of international flights and a significant reduction in the number of domestic flights in 2020, airline operations may be unprofitable. For example, Aeroflot Group revenue for the first three months of 2020 was 11.5% lower than the same period in 2019. The cumulative decrease in passenger turnover in the first quarter was 17.9%. At the same time, cost of sales decreased by 7.4% in comparison with the first quarter of 2019, mainly due to lower variable costs. The fixed costs of the airline almost did not change [1]. Despite the fact that at a complete cancellation of flights to other countries, airlines will not face the same variable costs as before (kerosene, airport taxes, passenger services, air navigation services), international air transportation is still the main source of airlines profit and allows them to cover losses that arise on domestic lines. Also, the termination of international air traffic leads to a decrease in transfer passenger traffic within the country. In order to increase airline sales, possible measures were proposed to influence the factors of sustainable revenue growth; the possibilities of changing the pricing policy of airlines (financial factor) and ways to increase the volume of passenger traffic (non-financial factor) were evaluated. Under the current conditions, a decrease in ticket prices is not possible, because in terms of falling sales, operating expenses reduce slightly and have only a little dependence on company’s operational
and financial policies. Consequently, the volume of activity becomes the main instrument for achieving sustainable growth in 2020. The ways to increase the passenger flow of companies can be the increase of the number of destinations, expand of the air fleet and increase the load of airplanes, and change the baggage tariff policy as a sales incentive.

5 Conclusion

To effectively manage the growth of the company and increase its value, it is necessary to match key indicators of its operating, investment and financial activities, as well as to ensure the required level of profitability and financial stability. The study of key financial and non-financial factors for the sustainable growth of companies involved in air transportation of passengers shows their practical significance, both for individual companies and the entire air transportation sector. The research confirms that, despite the positive dynamics, the growth of Russian airlines in recent years is not sustainable and will not become such in prospect, which is due to the peculiarities of companies operating in the field of air transportation, as well as to the impact of the pandemic. In 2020, the situation in the aviation industry is characterized by an extremely difficult state in which airlines cannot function without financial support from the government as well as new measures to increase revenue by making impact on sustainable growth factors by all possible means in the face of a significant decrease in demand. This requires an increase in airline operating income by influencing the volume of passenger traffic as a key factor in sustainable growth. Implementing the proposed ways to attract new customers can help the airline increase sales.

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