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THE IMPACTS OF GROWTH ON COMMERCIAL INNOVATION IN THE AIRLINE INDUSTRY

Doctoral student ***Michael Trestl***
Faculty of Economics and Management
University of Latvia
University of Applied Sciences Kufstein
Edelweiss Air AG, Operations Center, P.O. Box
CH-8058 Zurich-Airport, Switzerland
Phone: +41-79-729 54 47
E-mail: michael.trestl@edelweissair.ch

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Abstract

In the last forty-five years, the airline industry has undergone an expansion unrivalled by no other form of public transportation; however, these high growth rates have produced only marginal profitability. External factors such as high prices for jet fuel, intense competition and elevated costs for security, given the threat of terrorist attacks, have caused airlines to restructure their organisations, use synergies within alliances and cut costs. Trends in customer needs and behaviours, demographic developments and the general competitive market environment force airlines to constantly revise their strategic directions and critically review their existing business setup. This is not only a challenge for (long) established carriers with organizational capabilities to navigate change and innovation, moreover, it is a key success factor for the future profitability of small- and medium sized market players. Airlines, possessing a relatively high growth rate will therefore have to especially reflect on their key competencies, strategic aims and will have to critically answer the question of how they want to differentiate themselves from competing market players. For those growing businesses, it is therefore essential to navigate growth in order to overcome pitfalls when innovating and preparing for their successful future. Corporate Entrepreneurship (CE) promotes innovation performance in small- and medium sized companies and therefor seems to be a viable tool for airlines to navigate novelty and innovation. This paper aims at investigating the concept of CE, initiated by economic growth for navigating commercial innovation in the small- and medium sized airline industry.

1. Introduction

Twenty years after the pioneering flight of the Wright Brothers at Kitty Hawk in the middle of the 1920s, commercial aviation began and carried some 6,000 passengers a year, before the industry took-off after the invention of jet airplanes. The era of large-scale commercial air transportation however began, when peace was restored after World War II.

Today, the airline industry constitutes the backbone of the world's largest industry, which is travel and tourism: approximately 11% of global consumer expenses are spent in this industry, employing one in nine people of the global workforce. Although the airline industry is highly fragile and heavily influenced by external factors, such as environmental disasters (e.g. tsunamis, volcanic eruptions, earthquakes etc.), terrorism or global pandemics such as SARS, the industry is expected to grow by an average rate of approximately 5% until 2020 (Hanlon 2007, p. 1).

The environment within and around companies, especially around airlines, is constantly changing. Many businesses define growth as their core objective in today's dynamic market environment in order to stay competitive. Facing intense competition, companies must be active in finding new and innovative ways to develop their business further, increase their capabilities for innovation and to grow (Aloulou and Fayolle 2005, p. 21). All of the above is especially applicable for the airline industry, which can be seen as one of the most competitive industries in the world. Growth, however, has many facets, which need to be critically reviewed in order to make the right and most beneficial decisions to the business. Successful growth, therefore is not only heavily dependent on skilful leadership and management, but also on organizational capabilities involving a multitude of dimensions, influencing its success (Merson 2011, pp. 31). These dimensions include employees as well as the organizational capability to innovate, speed, knowledge, financial aspects and various external factors – to mention just a few. Small- and medium sized enterprises are very often lacking the underlying capabilities to strategically innovate and to manage novelty. Many businesses grow too fast or go into wrong directions without strategic intents. This is when growth creates a certain crisis situation within the organisation and thus requires change and innovation for improvement. Corporate entrepreneurship (CE) is as an instrument of strategic management for steering innovation and change within existing organisations (Schendel 1990; Guth and Ginsberg, 1990; Frank 2009). Moreover, CE can be defined as an approach for promoting and sustaining competitiveness and transforming organisations into opportunity-recognizing entities for value-creating innovation (Guth and Ginsberg 1990, Miller 1983, Lumpkin and Dess 1996). The causes for CE very often are associated with a variety of pressing problems within companies, such as economic decline, weaknesses of managerial competencies, decreasing profits, stagnation, extensive bureaucracy, or – growth (Kuratko et. al. 1990, Stopford and Baden-Fuller 1994, Frank 2009).

As small- and medium sized enterprises are very often lacking organisational capabilities to innovate, CE can be seen as a viable tool to introduce novelty within existing organisations.

High growth rates in the airline industry have, paradoxically, not always resulted in elevated profitability. Especially small- and medium sized carriers are once again facing the big challenge of developing their business models further in order to successfully navigate through the quickly changing market environment. Differentiation seems to be at the core of a future-oriented and sustainable commercial strategy for many airlines. Small- and medium-sized carriers have to especially address this issue, as the power of their distribution and marketing systems are endangered to perish beside those of competing large, mega and meta-carriers, referring to global alliances. As growth, however is a strategic goal for many commercial – even small- and medium-sized airlines, it is of vital importance for them to know the influence of growth on distribution and innovation for creating sustainable competitive advantages and to navigate in the right strategic directions. Moreover, small- and medium sized airlines must first carefully define and review their strategic growth objectives and then reflect those with their organizational capabilities to grow and innovate in order to be successful. These capabilities include the organizational structure, competencies of management and further resources (Aloulou and Fayolle 2005, p. 30). Strategic innovation, therefore plays an integral role in the growth of small- and medium sized airline businesses. Sometimes, technology is perceived as the only way of innovation as a source for economic growth. In fact, however, innovation can have an influence on various aspects beside technology, such as the company itself, its organizational dimensions, its customers and its value chain (Moingeon 2006, pp. 50). Without doubt, innovation can contribute to economic growth and sustainable business development. But how does innovation become reality, and what actually is innovation? Johannessen, Olsen and Lumpkin (2001, pp. 20) explain innovation as newness around the questions of what is new, how new and new to whom. Among the numerous attempts in the literature trying to explain the term, these three questions seem to be simple and understandable means of explaining the construct. This implies that it might always heavily depend on the point of view whether something can be characterized as innovative, or not. When American Airlines introduced the world's first frequent flyer program in 1981, it was a breakthrough innovation, causing many other airlines around the world to also introduce their loyalty schemes. Although these were innovative for the individual carrier, the nature of the innovation itself has lost its innovative character with every frequent flyer program launched. Innovation can be triggered by a wide variety of different factors. One of the most interesting theory, trying to explain why innovation occurs states that it needs a certain situation of crisis, which requires new and alternative approaches in order to overcome the underlying challenges (Müller 2006, pp. 61). This 'corporate hopelessness', in turn promotes the creation of new ideas and thus fosters innovation. Obviously, American Airlines was facing the challenge that many customers bought their air tickets with competing carriers, which caused them to create something new in order to retain their clients. This simple example illustrates how innovation can work in practice. Moreover, big organizations, such as American Airlines, are more likely to innovate faster and more powerful as compared to small and medium sized airlines, given their organisational capabilities. The challenge for small- and medium sized businesses is to allocate their resources in a way, which allows them to stay and even enhance their competitive strength through entrepreneurial thinking, organisational learning, innovation and change (Frank 2009)

This paper aims at investigating the framework of innovation and CE in the small- and medium sized airline industry.

2. Problem Statement

In order to understand the framework between CE and innovation better, it is important to gain a better understanding about the terminology. Firstly, Schumpeter (1961) viewed entrepreneurship as the primary catalyst for innovation, which has been supported by a number of different authors in the past (e.g. Drucker 1985; McGrath 1996). Moreover, entrepreneurship deals with why and how economic opportunities arise, and how organizations and individuals make use of them (Shane and Venkataraman 2000). The major necessary distinction between entrepreneurship and CE, which is also referred to as intrapreneurship, however, is that CE promotes entrepreneurial behaviours within already existing organisations (Echols and Neck

1998). In contrast to entrepreneurs, corporate entrepreneurs, or intrapreneus are most likely not engaged with any direct capital in the organisation. The second term, innovation, has been defined in a multitude of different ways and has therefore gained greater ambiguity in the literature (Garcia and Calantone 2002), which will not be covered in great detail within this paper. Innovation, however consists of two main components: products and processes. It involves a variety of different phases, such as research design and development, idea generation, prototype production, marketing and sales (Knox 2002, Rothwell 1994). Moreover, it describes new ideas and the potential for improvement through change, and can be defined as (Covin and Slevin 1991; Knox 2002; Lumpkin and Dess 1996):

> *"a process that provides added value and a degree of novelty to the organisation and its suppliers and customers through the development of new procedures, solutions, products and services as well as new methods of commercialisation".*

As the airline industry is traditionally known for high growth rates and rapid expansions, growth is a critical issue on the strategic agenda of many commercial airlines. Starting with the advent of commercial jet airplanes in the late 1950s, the business model of future (i.e. growth) oriented airlines has completely changed (Golightly 1967, p. 67). This was when – all of a sudden – competition became increasingly intense and technological innovation led to modern marketing and distribution. Still today, technological innovation plays a critical role in commercial aviation. Innovations like the introduction of the first supersonic passenger aircraft Concorde, high-capacity airplanes like the Airbus A380 or even the internet have changed the whole industry – on a more or less sustainable basis. Despite technological innovation, marketing and distribution has fundamentally changed as well. As a consequence of the development of US mega-carriers, many small-, medium- and even large-sized airlines all around the world have had to revise their strategic directions and consider alliance strategies for their profitable future. In fact, small- and medium-sized airlines will have to organize their business model in a way to cope with globally operating mega-brands (Chan 2000, pp. 506). The capabilities to adapt to changing market developments and to innovate, therefore, seem to be central to any small- and medium sized airline business in the future. Moreover, airlines need to find innovative ways to stay competitive and enhance their business models (Shaw 2007, p. 228). Given its adventurous character and its public dimension, the airline industry has constantly found itself in the social and economic limelight. Thus, it has always been a major innovator of marketing and distribution strategies (Rapp 2000, p. 317).

3. Relevance of Corporate Entrepreneurship

Small- and medium sized airlines are currently heavily confronted with intense market dynamics. External factors, such as activities by competing carriers, new products and services, new technologies and distribution solutions require the capability to quickly react to changes in the competitive environment. Businesses are therefore forced to adapt their internal organizational development dynamics to the external dynamics of the market, thus, to create a co-evolutionary linkage between the organisation and the market (Eisenhardt and Galunic 2000, Lewin et al. 1999). This, in turn requires an organizational design and culture suitable for the market environment, which enables the business to cope with market developments and to sometimes influence and break rules within the industry, following the concept of "creative destruction" (Schumpeter 1934, 1993).

In order to grow, companies need to understand the competitive entrepreneurial spirit similar to what they had in the very early phases of their economic history. It has proven successful for growing businesses to stimulate entrepreneurial behaviours and mind-sets within their organisations and to allow groups of individuals to operate independent and self-dynamic (Shulman et al. 2011, p. 40). This is where the concept of CE comes in place to stimulate and navigate growth. CE shall promote the organisation's attitude towards innovation and development at least to such an extent that the business can cope with the surrounding market dynamics, as described above. Thus, a practical goal of CE is it, to promote and support entrepreneurial behaviour within existing organisation. The relevance of CE results from increased competitive intensity, growing environmental- and market dynamics as well as from growing complexity in economic systems (Miller 1983). Environmental factors include uncertainty, risk and change (Amit et al. 1993, Braganza and Ward, 2001). Furthermore, the industry life cycle (Porter 1980) plays an integral role in the strategic behaviour of companies and thus has an important effect on the relevance of CE (Covin and Slevin 1991). A large number of companies react to growing competition with non-entrepreneurial answers and strategies, such as restructuring and reorganisation. The really valuable answers to those challenges would however be strategies around opportunity recognition and sustainable innovation. Businesses, which are following the CE approach will increase their innovation activities through strategic re-orientation and corporate venturing, which bundles key competencies and knowledge (Füglistaller, Müller and Volery 2008). It is evident that innovation plays a key role within the concept of CE. Linking innovation with CE, the following definition helps to understand their framework (Shaw et al. 2005):

> *"CE can be defined as the effort of promoting innovation in an uncertain environment. Innovation is the process that provides added value and novelty to the organization and its suppliers and customers through the development of new procedures, solutions, products and services as well as new methods of commercialization. Within this process the principal roles of the corporate entrepreneur are to challenge bureaucracy, to assess new opportunities, to align and exploit resources and to move the innovation process forward. The corporate entrepreneur's management of the innovation process will lead to greater benefits for the organization."*

Morris and Sexton (1996) claim that innovation is at the core of the CE concept as it combines entrepreneurship and management. While the initial opportunity is recognized through the implementation of innovation and change, a certain phase of exploitation follows. This leads to the aspect that CE and management are two complementing perspectives within an organisation. While management is concerned with the optimal allocation of resources and with the coordination of activities, CE focuses on the generation of innovation, resulting in the recognition of new business opportunities. This requires organisational resources and the development of organisational competencies to implement strategic options. Moreover, CE follows the logic of maximization of opportunities and chances, while management focuses on the creation of competitive advantages and on minimizing losses (Michael, Storey and Thomas 2002, p. 45).

4. Innovation through Corporate Entrepreneurship

In order to explain the concept of CE, various approaches can be followed. Steinle and Draeger (2002) distinguish between a number of different approaches: the person-oriented approach, the organisation-oriented approach, the strategy-oriented approach and the culture-oriented approach. The person-oriented approach focuses on the personalities of the intrapreneurs and attests them very specific characteristics and traits such as high motivation, creativity and the aspiration for autonomy. The challenge for the management is to identify and to promote those intrapreneurs, who are generally able to combine two major tasks: the development of a vision and its realisation. The organisation-oriented approach distinguishes between structure and process. While the structural focus emphasizes the creation of organisational units, which can act autonomous, the process focus targets the innovation process, ranging from idea generation, choice and implementation). The strategy-oriented approach targets the organisational power to innovate and entrepreneurial thinking. Morris, Kuratko and Covin (2008, cited in: Kuratko and Audretsch 2009) describe an entrepreneurial strategy as:

> *"a vision-directed, organization-wide reliance on entrepreneurial behaviour that purposefully and continuously rejuvenates the organization and shapes the scope of its operations through the recognition and exploitation of entrepreneurial opportunities."*

This leads to the culture-oriented approach, which attempts to create an entrepreneurial culture, involving characteristics such as emotional commitment, a sense of responsibility and caring, striving for high performance standards, tolerance for defects and errors and the support of the management for the allocation of resources in order to generate ideas and for opportunity recognition (Ireland, Covin and Kuratko 2009). In this context, it is fundamental to have the appropriate resources available within the organisation. Kirton (2003) argues that people solve problems and develop solutions in different ways. One the one hand, there can be real innovators, who tend to reject the commonly accepted perception of problems and attempt to redefine them. On the other hand, there are adaptors, who tend to accept problems and their constraints. This group of individuals is creating very few novel and creative solutions but is confident in implementing solutions effectively, not questioning their weaknesses. As described by the various models of CE below, human factors play a vital role in the entire framework between CE and innovation for growth.

There are numerous models trying to conceptionalize CE. Kuratko and Welsch (1994) attempt to reflect the various models and come to the conclusion that many of them involve external factors as well as strategy, structure and person-related variables, which are reflected in the various CE approaches, as discussed above. A commonly accepted model is the one by Guth and Ginsberg (1990), which states that CE is expressed by extensive innovation performance and strategic renewal. These consequences are explained by variables around environmental issues, leadership, strategy and structure. This model, however can be criticised because it is lacking a holistic and a process view of CE, which is integrated by the conceptualisation by Aloulou and Fayolle (2005). Their model is also based on an environmental view of CE-driven businesses, however it differentiates between an internal and an external environment. The external environment focuses on macroeconomic aspects as well as legal-, socio-cultural, technological and natural aspects. The competitive environment emphasizes the competitive situation within an industry and is oriented towards suppliers, customers, substitution products, new market players and rivalry among existing firms. The internal environment deals with culture, structure and strategy as well as with resources, competencies and routines. The entrepreneurial orientation within the model of Aloulou and Fayolle results from the external and internal environments acting as suppliers for chances and resources. According to their argumentation, companies following the concept of CE will have aspects of chances and resources as key elements integrated in their corporate (entrepreneurial) strategy. Very few models explicitly focus on the processing of information within CE, which is referred to as “environmental scanning”. The micro model of entrepreneurship and innovation (Shaw, O’Loughlin and McFadzean 2005), however refers to those environmental factors in more detail, as described below.

Shaw, O’Loughlin and McFadzean (2005) have developed models of CE, which integrate the element of innovation and conceptualize the frameworks from a macro- and micro standpoint. The macro-model concentrates on the environmental drivers of innovation, the need of society and advances in technology as well as on the frequency and rate of innovation development, as depicted in the illustration below.

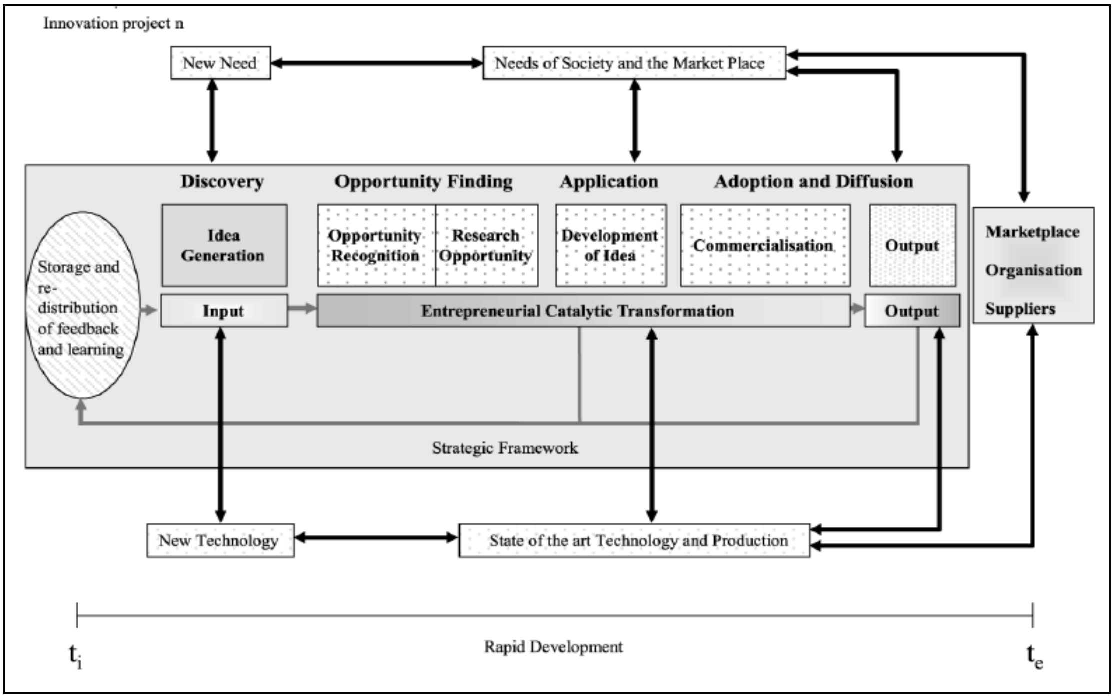

Figure 1. The macro model of entrepreneurship and innovation (Shaw, O’Loughlin and McFadzean 2005, p. 395)

According to the model, companies can respond to environmental challenges or future opportunities by innovation. Thus, new needs of society and the market place act as initiating factors for the innovation process, which is very often linked to uncertainty, risk, and change (Amit et al. 1993; Braganza and Ward 2001). Koontz and Weihrich (1990) extent the initiating factors for innovation by unexpected events, alterations in demographics, changes in industry structure and customer need recognition. Technology also plays an integral role in the innovation process as new technology is an important push-factor impacting innovation (Roberts 1988). Initiated by external factors, the innovation process gets started, which involves the stages of idea generation, opportunity recognition, research opportunity and finally the further development of the idea. This is followed by the commercialisation step, which includes the adoption and diffusion of new products and services and leads to following output stages of innovation. The micro model will further elaborate on the innovation process.

Complementing the macro model of entrepreneurship and innovation, the micro model focuses on the underpinnings of the CE and innovation process, which can be categorized by five elements:

- Inputs
- Entrepreneurial catalytic transformation
- Outputs
- Contextual factors
- Relationships between the various elements.

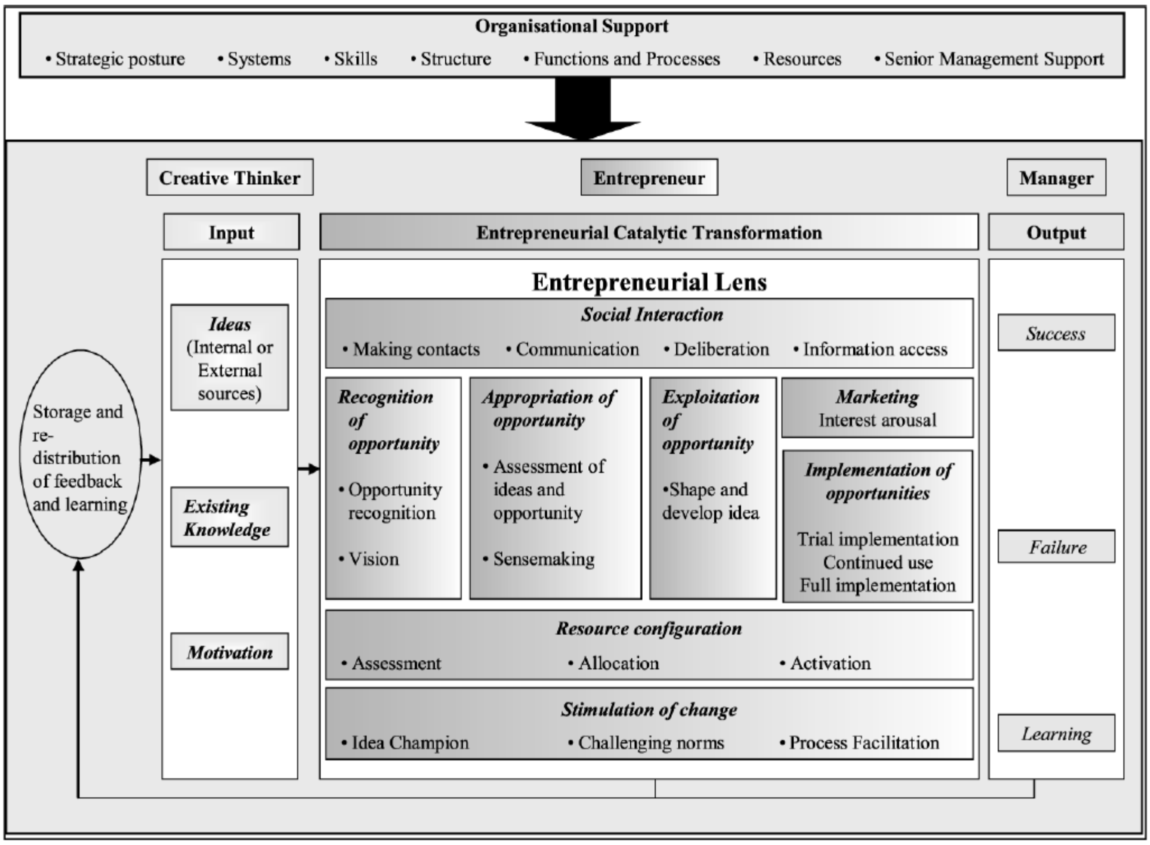

Figure 2. The micro model of entrepreneurship and innovation (Shaw, O'Loughlin and McFadzean 2005, p. 397)

Inputs are generated through internal or external ideas, existing knowledge and motivation. As Amabile (1996) and Couger (1995) state, creativity is at the core at the configuration of the innovation process and thus assists in the development of new ideas. Through the entrepreneurial catalytic transformation, creative inputs are being transformed into measurable outputs, which can be success, failure or lessons learned. In this stage, intrapreneurs, or corporate entrepreneurs, will manage and steer the innovation process in a proactive manner in order to generate success. They will recognize opportunities, assess and evaluate them, shape ideas, and will finally promote them for being implemented.

Generally, one of the underlying aims of CE is to create value for the organisation and to promote wealth creation through innovation (Drucker 1985; Ireland et al. 2001). In order to evaluate whether success or failure can be attested at the end of the CE funnel, Aldred and Unsworth (1991) as well as Zahra (1991) suggest that successful CE manifests itself through the development of new markets, improved products, services and applications as well as through value creation, organizational renewal and growth. Critically reflecting the innovation process, as depicted in Figure 2 and described above, capturing knowledge and learning from experience are the final – and integral – steps. These are independent from success or failure, but most likely the success or failure of future innovations will be dependent on them (McGrath 1999; Schaffer and Paul-Chowdhury 2002). Creative thinking and entrepreneurial behaviour alone, however, will not be sufficient ingredients for successful innovation performance in small- and medium sized companies and airlines. Moreover, there are positive and negative characteristics as requirements for innovation performance (Dömötor and Franke 2009). Factors promoting innovation performance are high flexibility referring to organisational design and structure, linked to low bureaucracy, relatively low complexity and innovation-promoting entrepreneurs and intrapreneurs. Harming factors include a lack of financial resources to fund innovation, limited personnel resources, lack of strategic and tactical thinking, low methodological expertise or innovation-harming entrepreneurs.

5. Conclusions

This paper has elaborated the framework of innovation and CE in the small- and medium sized airline industry. CE deals with the ability of companies to cope with new market opportunities and to recognize them for their business. On a functional basis, CE creates a number of management challenges, which include the identification of strategic opportunities, the development of corresponding business plans, the allocation of resources and involves key elements such as structure, strategy and culture. The relevance of CE results from growing environmental dynamics and competitive intensity and should promote organisation’s abilities to cope with these challenges on a pro-active basis to elevate the probability of success for the business. Thus, CE is inextricably linked with innovation performance and change. As the macro and micro model of entrepreneurship and innovation illustrate, creativity stands at the very beginning of every innovation process. Although creativity, entrepreneurial thinking and behaviour will promote innovation, there are certain external factors, which are not within the scope of organisations to influence, but relevant for the success of the innovation processes. CE can be defined as a strategic attitude, which focuses on the recognition, appropriation, exploitation and implementation of opportunities. The task of CE, therefore is it to explore why and how these opportunities for innovation are discovered, created and implemented. Given all these facts, it is legitimate to conclude that CE is a viable philosophy for small- and medium-sized airline business to orient their internal capabilities towards the external market and competitive environment in order to sustain.

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