Flying high or low: Capabilities for business model innovation in the highly competitive airline industry

The rise of low-cost carriers, consolidation waves and the fact that various prestigious airlines have faced bankruptcy during the past years, have led to the questioning of current business models of established airlines. The industry has become more competitive and profit margins are amongst the lowest compared to other industries. Airlines have to rethink their strategy and moreover rebuild their business model to ensure survival in the near future. In this regard, business model innovation and especially dynamic capabilities are essential for the future success of an airline.

Facing a competitive environment

The airline industry has changed enormously over the past years: Customer expectations vary more than ever and the supply side of air transportation has become more dynamic as traditional network carriers have to face new, cost-efficient airlines. Both rising costs as well as declining revenues have forced legacy carriers to reconsider their business models. The research paper ‘Dynamic Capabilities and their Relevance for Business Model Innovation in the Airline Industry’ analyses the airline industry and especially the ability of different airlines to cope with the exogenous changes the airline industry currently faces. Accordingly, the research paper examines different airlines and studies their ability to innovate their business models. The paper draws on the theories of business model innovation (Chesbrough, 2007, 2010) and dynamic capabilities (Teece et al., 1997; Teece, 2007, 2010) as its driving force. Six airlines are selected, which represent various business models with different degrees of maturity. The sample consists of legacy carriers, which prior were state-owned and provide full network carrier services. Also, so called niche carriers are selected, which specialize in a certain niche of the airlines industry, like low-cost segment or regional carrier services. In-depth interviews with strategy departments or CEOs reveal insights about the business models in place and especially activities of sensing change and seizing opportunities to re-new the existing business models. A cross-case analysis helps to reveal similarities and point out crucial differences.

Sensing the change, not seizing the opportunities

Although almost all airlines understand the importance of business model innovation, the capabilities of perceiving change and transforming these insights into new features or renewed business models is less developed especially amongst legacy carriers. Carriers understand changing customer behavior and recognize trends as well as regulatory changes. However, as the seizing of upcoming opportunities is not well developed, airlines lack to factor in those economic, social or ecological upheavals. The results of the study indicate that the industry’s changes and the renewal of business models are mainly driven by changing customer expectations. Technological evolutions and regulatory interventions are mentioned as well. Accordingly, business models have to be adoptable to new customer expectations and should be responsive enough to react as fast as possible. As many legacy carriers were state-owned in the past, organizational and systemic structures as well as mature labor agreements hinder the renewal of business models. Especially airlines that did not innovate their business model over the past years and tend to follow the same principles and strategies and thus rely on an existing system, have difficulties in realizing dynamic capabilities for seizing opportunities. In comparison, airlines with flexible and decentralized structures as well as a high degree of customer orientation, more easily
adapt their way of doing business to changing customer expectations or changing environmental conditions. Furthermore, organizational learning capabilities as well as constant measurement of key performance indicators like customer satisfaction or quality perception are named as indispensable factors of business model innovation capabilities by airline executives. Apparently, less mature airlines tend to be more flexible and thus have developed dynamic capabilities to a greater extent compared to their legacy competitors.

Implications and recommendations for airlines

The presumption of Teece and his colleagues that dynamic capabilities enable and support business model innovation was worked out and confirmed in this study. But, as pointed out, the research paper revealed differences amongst the airlines and showed that more specialized airlines like the sample of niche carriers have developed dynamic capabilities to a greater extend. Accordingly, path dependency is assumed to influence the development and existence of dynamic capabilities to a great extent. Inertia, which is caused by inflexible structures and size or legal burdens and obligations, is revealed as a main reason for the inability to react to the fast changing environment and erratic customers.

This finding indicates that especially legacy carriers have less dynamic capabilities and thus have more difficulties to further develop and innovate their business models. As this result is in line with the current economic situation of many legacy carriers, those airlines are recommended to overcome their inertia find its ideal relative size, leave well-trodden paths and invest in the development of dynamic capabilities, innovate their business models, establish a competitive advantage and operate both profitable and sustainable in future.

Extract from master thesis of Michael Mandery (Spring 2012)