

Transformational Leadership's Risks and Shortages When a Company Faces the External Crisis: Case Study Based on the Product Line Stretching of Virgin Australia

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ABSTRACT

With the development of uncertainty and connection of the world, companies increasingly face challenge and crisis from the external environment, which possibly becomes the catalyzer of the failure. Given that the crisis and challenges are difficult to identify and solve timely, there is one kind of leadership style to help companies effectively react to the external uncertainty and challenges, which is called transformational leadership. However, the implement of transformational leadership failed to help Virgin Australia out but leads to the file of bankruptcy with a mixture of factors. Noticing that the transformational leadership in Virgin Australia promotes the company's reform in product line stretching but increases the financial burden of the company, we focus on the risks and shortages of transformational leadership like neglect of improvement of risk management and organizational resilience to contribute to making up for gap in research. Finally, we propose some solutions to reduce the risks of transformational leadership and supplement the risk management of the enterprise.

Keywords: *Transformational leadership, Virgin Australia, Product line stretching*

1. INTRODUCTION

Virgin Australia was formerly known as Virgin Blue, whose main business is budget airline. In 2011, Virgin Blue integrated Pacific Blue and V Australia and was renamed as Virgin Australia. On August 4, 2020, Virgin Airlines applied for bankruptcy protection, resulting from COVID-19's influence on the aviation industry and its high debt. Actually, it is unreasonable to blame the failure of Virgin Australia on lack of innovation because the truth is that Virgin Australia is committed to innovation and creating value for customers such as introducing special economy class which provides the service equivalent to business class does and providing beauty and health care services on board. The reason for the failure of Virgin Australia can be divided into two dimensions, the external factors and internal ones. When considering the reasons that Virgin Australia applied for bankruptcy, the most outstanding external factor is the outbreak of COVID-19, which did impact the aviation industry, but it is a general reason for the whole industry. Compared with other airlines that survive through layoffs and flight cuts, what makes Virgin Australia unable to adapt to the dramatic changes in severe business context

still needs to explore. The internal factor of the financial burden should take the responsibility that worsened the business difficulties and finally become one of the essential factors forcing Virgin Australia to file for bankruptcy. The heavy financial burden was caused by plenty of factors, among which the strategy of product line stretching deserves to be rethought. The product line stretching transformed Virgin Australia from a budget airline to a full-service airline to compete with its new main competitors, Qantas.

Transformational leadership is one key for Virgin group to survive and develop. The company provides employees with unlimited vacation time and highlights the motivation to employees. Virgin Australia has a high performance in the aspect of innovation, and it benefits from its innovation ability like implemented the differentiation strategy and seized budget airline market at first. The strategy of product line stretching had already achieved the goal of coping with the market competition before the outbreak of COVID-19, but the fact showed that Virgin Australia suffered a lot from the pandemic and its reform even if it seemed reasonable and remarkable before the dramatic changes of the external environment. Therefore, the effects of leadership style of Virgin

Australia should be rethought and comprehensively analyzed based on the case of the failure of Virgin Airline.

Leadership is considered as the central part of entrepreneurial and innovation processes. [1,2] and the leadership style plays an important role in the job performance and job satisfaction of group members. Due to the deep uncertainty in the external environment, it seems that taking transformations constantly and actively is a suitable method for companies to enhance organizational capacities[9]. Moreover, in a dynamic business context, companies should not only increase the efficiency of their strategy execution but continuously explore the development of new strategies[6]. Transformational leadership, defined as one style of leadership and distinguished from transaction leadership, has the function to transform followers to rise above their self-interest and needs to be perceived by employees[3], which is concentrated more on in-role performance. There are four dimensions of transformational leadership, including idealized influence, inspirational motivation, intellectual stimulation and individualized consideration. [8] Recent theories of transformational leadership have emphasized positive effects of transformational leadership like stimulating innovative behaviors[4] and promoting employees' performance and treat the function of stimulation as the core leadership function. Previous studies have explored this topic in the aspect of relationships on different levels (i.e. individual-level and team-level), different effects, different intermediate mechanisms[7] and the role of transformational leadership in certain situations. Although some research declared some negative effects of transformational leadership in a certain situation, it still lacks sufficient research on the risks and shortages of transformational leadership.

2. REASONS FOR THE FAILURE

2.1 Strategy Mistakes Caused by Transformational Leadership

Considerable factors lead to the failure of Virgin Australia. Two evident intrinsic reasons are the strategy mistake made by the management team, product line stretching (stretching upward) and lack of risk management, in which transformational leadership played a role.

The transformational leadership of Virgin Australia accelerated the rhythm of the company's development and improved the ability to react and adapt to the changes from the external environment by self innovation. However, the transformational leadership may still fail to avoid the operation model that overvalues the business efficiency and short-term benefits, while the top management team neglects the complement of risk

management system and improvement of organizational resilience. As a result, Virgin Airline failed to afford the high debt caused by the reform (i.e., the upward stretching) and lack sufficient measures of risk management to solve the problems.

Product line stretching is the action that a company totally or partially changes its original market position and extends the existing product categories. Specifically, the reform of Virgin Australia belongs to upward stretching, which can effectively enhance the value of brand equity, make use of consumers' awareness and recognition of the company's existing products, and occupy the market in a short time. Virgin Australia has changed its operation policy and integrated Pacific Blue of international short-range routes and V Australia of international long-range routes since May 2011. Instead of operating in a low-cost mode, it has replaced Qantas as its main competitor and replaced the former domestic high-class economy class with a new domestic business class. The strategy of stretching upward helped Virgin Australia become one of the most competitive airlines in the Australia airline market. But stretching upward resulted in a high debt which increased the operating pressure of Virgin Airline.

Another fact is the lack of effective enterprise risk management in Virgin Australia. Theoretically, the company should prepare the emerging strategies to prevent the crisis[5]. The high debt caused by the stretching upward invisibly reduces the ability of Virgin Australia to deal with the crisis. The organizational resilience is impacted by the strategy. The resilience, when facing a crisis, refers to a kind of ability that a company can bounce back from the crisis[5], and in the macro-economy, resilient economies are the ones that can emerge best from the crisis, or that resilience is the necessary condition to get restarted[10]. When a slump in demand occurred during the epidemic period, Virgin Australia is more vulnerable than its competitors and the company had insufficient methods to solve the problems, which made them failed to stop loss effectively. Transformational leadership of Virgin Australia helps itself to integrate the resources and funds, reform to a company providing full-service smoothly and rapidly occupy the market of Australia which makes a great threat to its competitors. But the result of rapid expansion resulted from transformational leadership ignoring the establishment of the system of risk management, which is a necessary supporting system for operating especially in the airline industry characterized by high fixed and current cost along with high vulnerability when faced with dramatic changes of the external environment. After the outbreak of COVID-19 in Australia, Virgin Australia has already cut 8000 of its 10000 employees and grounded all international routes. The dilemma is that the domestic route in Australia still cannot afford the recent operating expenses and the competitors also focus on the domestic market, making the situation even worse.

Compared with Virgin Australia's competitors of the same level, the higher debt makes it undoubted that Virgin Australia has more financial pressure.

2.2 Risk Assessment of Upward Stretching

We use Michael Potter's five forces model to illustrate the effects of the implementation of stretching upward and focus on the change of its organizational resilience to explain the internal reason of the bankruptcy in the perspective of strategy and further illustrate the specific problems led by transformational leadership. We focus on Virgin Australia as the research target.

2.2.1 Bargaining Power of Suppliers

The suppliers of Virgin Australia include aircraft manufacturers, oil suppliers and airports. Due to the limited number of suppliers (for example, the aircraft manufacturers are only Boeing and Airbus) and substitutes, in general, the bargaining power of suppliers is strong. The suppliers usually own stable positions in the market and it is difficult for the airlines to achieve backward integration. However, the reform of Virgin Australia can weaken the power of suppliers to a certain extent because the company will purchase more aircrafts to stretch its product line, which means that Virgin Australia can get the price reduction through a relatively large quantity of orders.

Although the reform of Virgin Australia increases company's bargaining power, it also brings some hidden troubles to operation management. The increase in the number of aircraft will increase the fixed cost of the company. Moreover, with the purpose of providing full-service to suit its strategic goals, the staff training cost and other labor cost will also increase. The integration of three airlines is beneficial to expand the market, but it also increases the difficulty of business division and staff placement. Therefore, the upward stretch can weaken the bargaining power of suppliers but increase the operation cost and make the company more vulnerable in the face of crisis.

2.2.2 Bargaining Power of Buyers

The bargaining power of buyers is strong if we treat all the customers as a whole. As plenty of airlines that customers can choose from, the switching cost is relatively low. What's more, with available tools for customers to search for information of airlines so that customers can make a comparison shopping. Before the reform of Virgin Australia, its market position is a budget airline and its target customers are much sensitive to the price, which makes the bargaining power of the buyers even stronger. With the reform of the airline, the scope of target customers is expanded and those middle-end and high-end customers who are attracted by high-quality service become airline's new target customers. By

enhancing the quality of service, Virgin Australia can increase the switching cost of middle-end and high-end market customers, which will decrease the bargaining power of buyers.

However, the expansion of service will bring a heavy financial burden to the company because the airline has to hire extra employees to serve customers in the new routes and train the employees so that the trained employees can meet the demand of middle-end and high-end customers. The implement of upward stretching successfully expands the scale of Virgin Australia, but it also reduces the external organizational resilience of the airline, that is, the external crisis will cause more damage and loss to the airline and the airline is more difficult to recover from the crisis.

2.2.3 Substitutes

The airline market of Virgin Australia can be divided into two segmented markets, the international aviation market and the domestic aviation market. As for the international aviation market, the threat of substitutes is relatively limited because flight owns the obvious advantages of swift and convenience compared with other manners of transportations. However, in the domestic market, the substitutes of flight include train, coach and ship. The threat of substitutions is larger in the domestic market than it is in the international market.

Virgin Australia focuses on the international market so that it can avoid too much threat of substitutions. However, as the Virgin Airline issues the declaration of closing the international routes, the threat of substitutions in the domestic market soon becomes a problem.

2.2.4 Rivalry

At first, the main business of Virgin Australia is a budget airline. After the reform and integration, Virgin Australia no longer operates under the low-cost airline model, but instead treats Qantas as its main competitor, and replaces the premium economy class on domestic lines with the new business class on domestic lines. The threat of rivalry turns to be stronger because of the change of Virgin Australia's market position and its main competitor. Qantas has abundant capital and a large market share, especially in the domestic airline market. Compared with Virgin Australia which owns a market share of about 28%, Qantas owns about 60% market share in 2018. In addition, the budget airline business of Virgin Australia is also challenged by Qantas's subsidiary company, Jetstar Airways. The competition between Virgin Australia and Qantas lead to an all-round competition, ranging from the ticket price, service quality and the number of routes. Severe competition between two airlines limits the profit margin and increases the expense resulted from the policies of improving the competitiveness of each airline.

With the outbreak of COVID-19, as we mentioned above, the airlines close their international routes and they are forced to compete with each other in the domestic market. It is inevitable that Virgin Australia finds it hard to compete with Qantas in the domestic market. The general airlines and budget airlines of Virgin Australia are at a disadvantage in the competition compared with Qantas or fail to seize the market share from Qantas, which increases the financial burden of Virgin Australia.

2.2.5 Threat of New Entrants

As the aviation industry needs a large number of funds to afford the cost of aircraft material inventory, fuel and labor, the threat of new entrants is limited. The reform of Virgin Australia which increases its competitiveness, together with the severe competition between several large enterprises makes the barrier of entry even higher. The outbreak of COVID-19 cannot show significant changes in the threat of new entrants too.

3. CONCLUSION

Transformational leadership can stimulate the job motivation of employees and promote the innovative performance of the company. But such a leadership style may lead employees to neglect the possible risks and value the performance related to the increase of company scale, market share and efficiency too much. Company should pay attention to enhancing organizational resilience and completing the risk management of the company in order to control the damage, recover swiftly or even experience a positive transformation from a crisis. Strategic risk management is a useful skill for the company to develop to increase resilience in response to uncertainty and crisis.

Company should perform regular risk assessments and evaluate the threats from the environment. Pre-damage targets and damaged targets are required to set. The targets should contain several dimensions like economic, robust, and corporate social responsibility. Transformational leadership needs the supervise of the board and employees. The reform should not only emphasize efficiency but keep a moderate pace to solve the conflicts and enhance the ability of crisis management.

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