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Can Small Banks Lead the Way out of the Crisis in the OECD Area?

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Abstract: The economic shock of 2008, and the Great Recession that followed, created uncertainty of the direction of the global economy. With slow economic growth in the OECD area, political unrest and lack of a clear direction from academics there is a need for new organizational models helping executives out of the financial crisis. The article illustrates how small banks can achieve a competitive advantage by focusing on economic growth through radical innovations by using tacit knowledge in a marketing context. Such an entrepreneurial orientation will, in turn, lead to tailoring of services which will, we argue, lead to growth in the banking industry in the OECD area. We claim that small banks are leading the way in the race for innovation and an entrepreneurial orientation.

Keywords: Banking, Small-scale, OECD area, Entrepreneurship, Schumpeter, Marketing theory, Knowledge management.

1. How Innovation can Create Value in the Banking Sector in Times of Crisis

1.1 Innovation and the Economic Recession

The 2008 financial crisis has severely reduced the short-term willingness of companies to invest in innovation (Paunov, 2012; Archibugi and Filippetti, 2011). There are a number of empirical studies that explore firms' innovative behavior before and during economic recessions. Kanerva and Hollanders (2009) find no association between firm size and a decline in investment during 2008. Their results suggest that highly innovative firms continued to invest in innovation also during downturns. Alvarez et al. (2010), in their analysis of Chilean manufacturing firms, explore the firms' responses to the financial crisis of 1998. They find a positive association between firm size and organizational innovations.

In contrast, Antonioli et al. (2010) find that small and medium-sized firms located in Italy's Emilia-Romagna region were more innovative compared with large firms during the recent crisis. Paunov (2012) show that the current crisis led many firms to stop ongoing innovation projects using firms in eight Latin American countries as the empirical setting. The rising financial constraint and the negative demand shock affected the decisions of firms to abandon innovation projects. Filippetti and Archibugi (2011) explore firms' innovation in Europe and find that (a) the crisis brings about a reduction in the willingness of firms to increase innovation investment, and (b) strong national systems of innovation help firms to retain their investment in innovation.

1.2 Innovation in Small and Medium-Sized Firms

Economic turbulence makes it possible for new and small firms to emerge in a competitive market through innovation (Tushman and Anderson, 1986; Henderson and Clark, 1990; Simonetti, 1996; Freeman and Lauca, 2001; Perez, 2002, 2009). Schumpeter (1942) and his followers (Freeman et al., 1982) suggested that economic cycles are the consequences of innovation, but also that innovative activities are re-shaped by the economic crisis. Firms carry out innovation along established technological trajectories and develop innovation almost as a routine (Schumpeter, 1942). An economic turmoil generates a shakeout in established industries and technological fields; new firms in new sectors play a relatively bigger role than incumbent firms in generating innovations.

New firms are eager to exploit new technological opportunities also as a way to challenge incumbent corporations, as Schumpeter suggested: "it is no the owner of the stage-coaches who builds railways" (Schumpeter, 1911 (1934), p. 66). Competition among companies is fierce and the role played by entrepreneurial spirits is crucial (Nelson and Winter, 1982; Patel and Pavitt, 1994; Bresschi et al., 2000).

1.3 Technological and Market-Based Innovations

The types of innovations we are interested in studying more closely are technological innovations and market-based innovations. Technological innovations can be regarded as links between components, methods, and processes leading to new products and services (Afuah, 1998). Market-based innovations refer to how new knowledge can be embodied in distribution channels, products, applications, and in customer needs (Afuah, 1998).

Authors have combined and technological innovations and market-based innovations (Abernathy and Clark, 1985; Henderson and Clark, 1990; Tushman et al., 1997). By focusing on technological and market-based innovations, it may be possible for banks to tailor-make services to well-defined market segments. By combing technological innovations with market-based innovations, it may be possible to analyze what makes banks move from a situation with unclear priorities to a situation with unclear priorities to a situation with a more clean-cut strategic orientation. Even if we can explain, ex-post, how and why a bank moved from archetype X to archetype Y, or from position A to position B, it would not be fine-tuned enough to show how, de facto, change takes place (James, 1996). By emphasizing radical change as a result of technology-based and market-based innovation, we believe that it might be possible to illustrate how small and medium-sized banks in the OECD area can achieve a competitive advantage.

Over the last decades, the debate has been enriched by new theoretical developments and empirical research. The interest has shifted from a technology regime/industry-level to a micro-level analysis focusing on marketing. Firstly, there is increasing awareness that firm-level characteristics play a greater role in shaping innovation activity within industries. Secondly, greater availability of micro-data, such as the CIS, has made it possible to investigate empirically firms' heterogeneity in innovation-related behavior (Srholec and Verspagan, 2008; Evangelista and Vezzani, 2010; Frenz and Lambert, 2010).

2. Entrepreneurship in the Banking Industry

We live in a time characterized by change, a time where the only constants are confusion and uncertainty. The Newer theory maintains that uncertainty is a driver of change, enhancing the possibilities for achieving competitive advantage (Eignatten and Galen, 2002; Eignatten and Simonse, 1999; Fitzgerald and Eijnatten, 1998; Meyer et al., 2002).

In times of change, we have an opportunity to move into new levels of value creation by identifying and exploring business opportunities by taking an entrepreneurial posture, building on strong performance incentives. Banks can benefit from using new knowledge, as existing knowledge has a tendency to become outdated, particularly in complex business environments (Kuhn, 1970; Lloyd, 1970; Boorstin, 1998; Gottlieb, 2000).

The concept of technological accumulation and creative destruction are the core of Schumpeterian economics. Schumpeter looked at innovation as an event that could revolutionalize economic life by focusing on new entrepreneurs, new companies, and new industries. Schumpeter (1947) introduced the notion of "creative destruction" noting that following technological change certain rents become available to entrepreneurs, which later diminish as innovations become established practices in a given industry. These rents are called Schumpeterian rents and are defined as rents stemming from the risky initiative. Creative destruction is a regime of low cumulative and high technological opportunities, where entry and exit in technological areas are low.

A strong entrepreneurial orientation captures organizational processes and methods that are important for technological and marketing performance (Covin and Slevin, 1991; Lumpkin and Dess, 1996). Entrepreneurial orientation can illustrate how organizational resources can provide a sustainable competitive advantage (Lado and Wilson, 1994; Zahra et al., 1999; Knight, 1997; Lumpkin and Dess, 1996; Lee et al., 2001).
We can add Neo-Schumpeterian stream of research has enriched those insights from Schumpeter, that to a certain extent contradicts the rather clean-cut logic on growth in small- and medium-sized firms in banking found in this article. Antonelli et al., 2010), confirmed that there are several industries where the innovators of today were also the innovators of the past. Following Nelson and Winter (1982) and Dosi (1982), it emerged that there are important differences across

technological regimes and industrial sectors (Malerba and Orsenigo, 1995, 1997). The literature on the persistence of innovation, empirically supported by the analysis of patent data and innovation counts (Geroski et al., 1997; Ceflis and Orsenigo, 2001) and innovation survey data (Peters, 2007; and Roper and Hewitt Dundas, 2008).

2.1 The Resource-Based View and Social Capital Theory

To describe how banks may embrace entrepreneurial processes, we distinguish between the resource-based view (RBV) and social capital theory. While the resource-based view stresses the use of internally accumulated resources, social capital theory underscores its relational characteristics with external entities. RBV is related to the exploitation of knowledge (technological focus), while we are of the opinion that social capital to a greater extent is related to the exploration of knowledge (marketing focus). The two theories may be synthesized since banks can procure firm-specific knowledge, and obtain complementary resources through their external networks.

2.1.1 The Resource-Based View

Exploitation of knowledge can be linked to the resource-based view. This research stream suggests that internal resources may facilitate the definition of durable competitive advantages (Wernerfeldt, 1984; Barney, 1986; Grant, 1996). The RBV of the firm, which builds on Schumpeter's perspective on entrepreneurship, views the firm as a bundle of resources.

The RBV states that marshaling and uniquely combining a set of complementary and specialized resources may lead to entrepreneurial processes (Penrose, 1959; Wernerfeldt, 1984; Barney, 1986; 1991; Amit and Schoemaker, 1993; Peteraf, 1993). The supposition is that, even in equilibrium, firms may differ regarding the resources they control, and that such asymmetric firms may coexist, until some exogenous change or Schumpeterian shock occurs. Examples of such shocks include "radical technological innovation, social and political turmoil" (Haveman et al., 2001, p. 253).

Because they are socially complex and more difficult to understand and imitate, intangible resources are more likely to lead to a competitive advantage than is the case for tangible resources (Barney, 1991; Hitt et al., 2001). One important intangible resource is a firm's reputation (Deephouse, 2000). Reputation can be an important strategic resource since it can give access to resources (e.g., financial capital) and that that it can help firm take advantage of information asymmetries (Hitt et al., 2001).

2.1.2 Social Capital

Exploration of knowledge can be linked to social capital, as this research stream suggests that a firm’s external network is seen as a contributor to firm performance (Leenders and Gabbay, 1999). The ability to mobilize external resources, attract customers, and identify entrepreneurial opportunities can make economic transfers possible, and confer organizational legitimacy (Bunt, 1992; Uzzi, 1996; Pennings and Lee, 1999). The extent to which banks manage to acquire external knowledge from its key customers depends on the ability to recognize and make use of external resources (Cohen and Levinthal, 1990; Dyer and Singh, 1998; Gulati et al., 2000).

2.2 Innovation and knowledge creation

We aim to illustrate how the banking industry can become more competitive by focusing on innovation and knowledge creation. Innovation and knowledge creation result from new combinations of knowledge (Cohen and Levinthal, 1990). The accumulation of knowledge through learning constitutes a driving force for explaining firms’ growth (Penrose, 1959; Spencer and Grant, 1996). Knowledge creation and innovation have a strong and complex relationship, however, seldom examined.

2.2.1 Knowledge creation

Researchers such as Nonaka and Takeuchi (1995) have focused at how tacit knowledge can be transferred into explicit knowledge. We take the opposite approach as we believe that the use of tacit knowledge may be a strategic weapon and that it can be a change agent in the banking industry (Polanyi, 1962, 1967). According to our reasoning, explicit knowledge is related to exploitation of knowledge (technological focus), while tacit knowledge to a greater extent is related to exploration of knowledge (marketing focus).
In order to address the question "where does knowledge come from?", it might be worthwhile to focus on learning, or to be more concrete, how different stimuli can be turned into knowledge (Moreno-Luzon and Lloria, 2007), thus avoiding a possible curtain between explicit and tacit knowledge woven by certain authors, including the contribution of Nonaka and Takeuchi (1995). Explicit and tacit knowledge are not two ends of a continuum but two sides of the same coin.

Learning new capabilities can help firms to compete effectively and efficiently (Autio et al., 2000). Learning new knowledge may be necessary to help a firm to adapt to its environments. Newman (2000) argues that learning can help organizations to change. Learning is a common reason for establishing and participating in strategic alliances (Gulati, 1999; Inkpen, 2000; Steensma and Lyles, 2000).

The trade-off between exploitation and exploration, or long-run and short-run strategies, was put forward by March (1991) who suggests that to survive firms need to maintain an appropriate balance between exploitation associated with cost-cutting and exploration associated with new product or market development. Levinthal and March (1993, p. 105) make the point in the following way: "the basic problem confronting an organization is to engage in sufficient exploitation to ensure its current viability and, at the same time, to devote enough energy to exploration to ensure its future viability."

The balancing between exploitation and exploration is at the core of O'Really and Tushman's (2004) conceptualization of the ambidextrous organization. The importance of a simultaneous exploitation and exploration strategy is also implicit in the concept of dynamic capabilities initially developed by Teece and Pisano (Teece and Pisano, 1994; Teece et al., 1997). By definition, the use of dynamic capabilities involve adaptation and change, building on foundations provided by Schumpeter (1934, 1939, 1942, 1947, 1949), Penrose (1959), Nelson and Winter (1982) and Barney (1986).

We pay attention to the use of heterogeneity of resources when using knowledge in a dynamic manner. There are some conceptual avenues that can be followed when studying knowledge in dynamic settings. We use an approach derived from evolutionary economics (Nelson and Winter, 1982), and describe the evolutionary trajectories of knowledge (Helfat and Peteraf, 2003). Our analysis focuses on the regularities among trajectories and describes both patterns and paths of knowledge evolution. Specifically, we try to illustrate that the use of knowledge is dependent upon routines (Nelson and Winter, 1982). Routines may be given the form as a set of norms, or "theories of action" (Argyris and Schon, 1978).

2.2.2 Exploitation of Knowledge (Technological Focus)

We regard exploitation of knowledge as for how to use technology in efficient ways. The use of technology resembles the concept of arbitration used in the financial sector. The arbitrator's role is buying and selling the same item in different markets in order to profit from price differences. Arbitration as a concept is also applied more broadly to include trading that takes advantage of discrepancies in pricing among groups of assets that are close substitutes. This means that there is a business potential in financial dealing, using technologies as means.

Exploitation of knowledge is illustrated through market imperfections. Solow (1997) claims that steady-state situations are convenient but are less relevant in globalized hypercompetitive business environments. This means that attempts to achieve concentration power may be short-lived because competitors will use innovation and imitation strategies (Grant, 1996, p. 375).

We may add that banks may fail when trying to achieve advantages resulting from technological innovations, as they can find themselves paralyzed by old-fashioned management practices (Leonard-Barton, 1992), and handicapped by a lack of relevant knowledge (Cohen and Levinthal, 1990). Old routines can reinforce status quo (Nelson and Winter, 1982; Gersick and Hackman, 1990). Routines may provide a source of resistance to change, and remain an under-explained factor in the technical literature (Edmondson, 1999).

2.2.3 Exploration of Knowledge (Marketing Focus)

Exploration of knowledge focuses on profits stemming from innovations, and not as a result of concentration tendencies (Jacobsen, 1992). The objective is to innovate through radical steps, and not to influence market factors, per se. By using insights from marketing it is possible for banks to build relation-specific knowledge, and come in closer contact with clients through value-creating processes.

During the 1990s and continuing into the 2000s, the issue of value creation through entrepreneurship has gained interest in the marketing literature. The prevailing view is that the value for customers is embedded in products that are outputs of firms' manufacturing process. The view is called value-in-exchange. This logic is challenged by an alternative viewpoint called value-in-use, where more focus is placed on value-generating processes (Normann, 2001; Vargo and Lusch, 2004; Gronroos, 2006). According to this view, a value is not created by the provider but rather by customers' value-generating processes (Gronroos, 2000). As Vargo and Lush (2004) pointed out, this is not a new approach to value-

creation. In the economics and business economics literature it has long been overshadowed by the value-in-exchange notion. In one of their original propositions of the service-dominant logic, Vargo and Lusch (2004) viewed customers as co-producers but later changed this view into customers as co-creators of value (Vargo and Lusch, 2008). By looking at customers as co-creators will also affect the supplier side as it can make it possible to tailor-make services (Gronroos, 2006).

The classical topic of customer satisfaction/dissatisfaction is still important as it is believed that customer satisfaction has long-term benefits, including customer loyalty, and increased profitability (Anderson et al., 2004; Rust et al., 2000). There is empirical research suggesting that by satisfied customers are more loyal, are involved in cross-selling and positive word-of-mouth advertising (e.g., Fornell, 1992; Fornell et al., 1996).

Such behaviors translate into the superior performance as measured by traditional metrics. For example, customer satisfaction has been found to have and a positive impact on customer loyalty and usage behavior, as well as a reduction in customer complaints (Bolton, 1998; Fornell, 1992). Increased customer loyalty may increase usage levels (Bolton et al., 2000) and secure future revenues (Rust et al., 2000) as well as minimize the likelihood of customer defection (Anderson and Sullivan, 1993; Mithas et al., 2002). Recently, a study by Anderson and Mazvancheryl (2004) found a positive association between a firm's current level of customer satisfaction and contemporaneous financial market measures, such as stock market ratio and market-to-book ratio. Although promising, more research is needed (Gruca and Rego, 2005).

The characteristics of customers' preferences are the antecedents to response to marketers' offers, including individually customized offers. The emerging consensus among researchers of consumer decision making is that buyers often do not have well-defined preferences that can be retrieved. They often construct their preferences when faced with the need to make decisions (for a review, see Fischoff 1991; Slovic, 1995).

3. What is the Relationship between Innovation and Knowledge Creation?

We regard innovation as being dependent on knowledge creation. According to our reasoning resource-based theory is related to knowledge exploitation while there is a closer link between social capital and the exploration of knowledge. While traditional banking is related to the exploitation of knowledge, newer practices in banking are to a larger extent is related to the exploration of knowledge.

The exploitation of knowledge is reflected in organizational outputs. The accumulation of knowledge through learning constitutes a driving force as it enhances the ability to exploit business opportunities. Banks engage in the exploration of knowledge for the purpose of developing combinations of knowledge. Exploration involves discovery and experimentation, which can lead to increased productivity through repeated practices. In this article, we suggest that banks can use tacit knowledge to a greater extent by focusing on radical marketing innovations.

We believe that the exploration of tacit knowledge within new processes is the main driver for the creation of new knowledge within banks. Such a mental framework can be used as a basis for designing new marketing programs in banks, which in turn can lead to path-breaking innovations (Schumpeter, 1947; Nelson and Winter, 1982; Galinic and Rodan, 1998; Fleming, 2001; Nerkar and Roberts, 2004). How explicit knowledge is transferred into tacit knowledge is illustrated in figure two, found at the next page.

Transferring explicit knowledge into tacit knowledge may be difficult. The character of tacit knowledge can prevent other organizations from becoming aware of its existence and can hamper transmissions (Miller et al., 2007). Banks can actively try to keep tacit knowledge secret as such knowledge can be a source of competitive advantage (Lieberskind, 1996). Banks can compensate some of the difficulties connected with the transfer of explicit knowledge into tacit by moving into inter-organizational alliances (Grant, 1996; Liebebeskind, 1996; Rosenkopf and Alemeida, 2003).

More than sixty years since one of Schumpeter's latest contributions ((Schumpeter, 1949), researchers are struggling to come to grips with entrepreneurship within the constraints of the conventional Newtonian paradigm. Researchers have to a certain extent attempted to apply linear approaches are studies of complex business relationships such as the financial crisis within the OECD area. When turbulence and disorder dominate, and there is an accelerating rate of change, traditional management models will have to be used with a greater degree of care. We suggest that rather than looking for causal relationships we can benefit from using more pragmatic concepts such as bottom-up approaches suited for transformation processes found in the OECD area.

Using a bottom-up perspective to tailor-make services, we argue that the days of mass-marketing are numbered. Today, firms are turning back to the competitive value of craftwork as an end in itself. Increasingly, companies succeed by offering tailor-made services to carefully targeted market segments. Whenever and wherever they seek a combination of unique features, customized contents, or creating a variety of products and services, there is an element of craftwork involved.

Bottom-up organizations typically have an incredible appetite for experimentation with new ideas. They allow people to experiment and to test to come up with what might be a pioneer way to conduct business. Business renewal is at the center of the firm's attention, striving to create its internal context for breakthrough performance, and to grow proactively, always searching for new business opportunities.

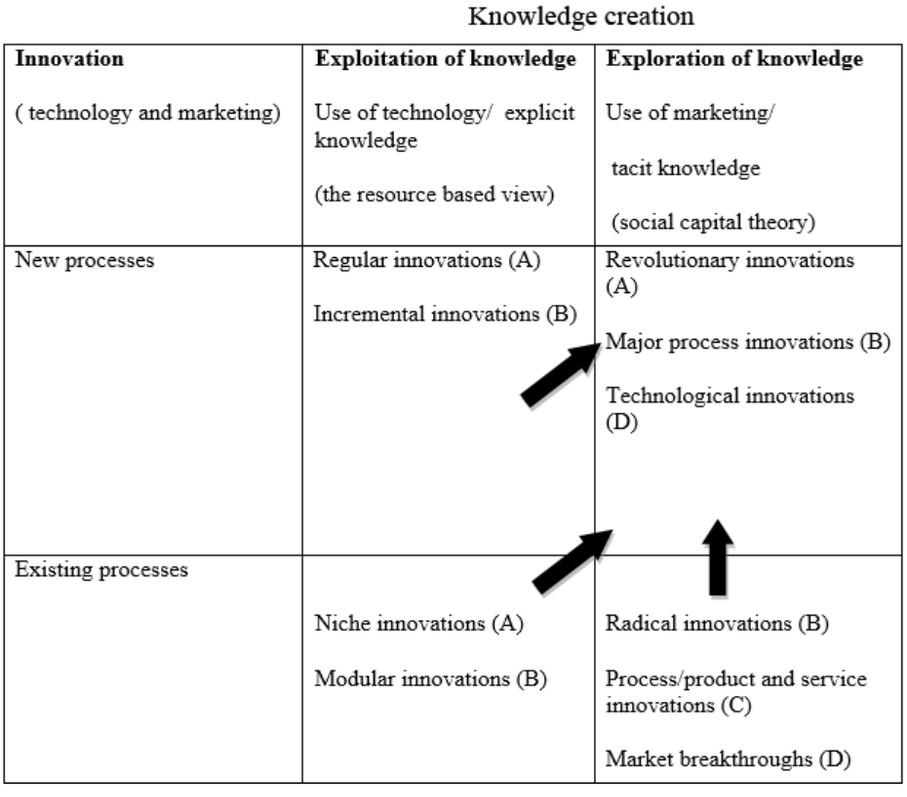

Figure 1: Innovation and knowledge creation in the banking industry

(A) Abernathy and Clark (1985)
(B) Henderson and Clark (1990)
(C) Tushman et al. (1997)
(D) Chandy and Tellis (1998)

4. Conclusion, Implications and Future Research

The economic geography of the post-industrialized world is characterized by fundamental processes of restructuring, an increased mobility of capital and a pursuit of new growth activities, particularly in the service sector (Binns and Nel, 2002). Traditional means of investing and conducting technology work and marketing have undergone dramatic changes. In recent years, the service sector has become more important worldwide, for example when it comes to customer preferences, wealth mobility, and location mobility, for example in the financial community which is the empirical setting for this article.

Given the financial crisis in the OECD area, profitable growth remains top-priority. For this purpose, we focus on radical innovations models with a focus on marketing. These insights are linked to entrepreneurial literature that might give direction as to how small and medium-sized banks can help countries in the OECD area out of the crisis.

A link between innovation and knowledge creation may open new research areas. Such an approach can be suited for studies of complex business practices, leading to more radical ways of organizing than traditionally found in the management literature. By combining technological innovation with market-based innovations, it may be possible to shed light on how banks can create new knowledge.

We suggest that entrepreneurship literature is studied to a larger extent in future writings on the financial sector as such literature often breaks with traditional business practices. We also believe that future research can benefit from using concrete business cases, more so than what has been done in this research. Studies of extreme business cases are welcome as they may give great possibilities for learning about the need for radical innovations. As cases in the OECD area, we suggest that the banks focusing on economic growth within regions are studied more closely.

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