THE NEXT CHALLENGE FOR BOARDS: FOSTER INNOVATION

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No sector, nowhere in the world, can durably shield itself from the disruptions and uncertainties brought about by technology change and the digitalization of activities and business models. Only relentless innovation, combined with an appetite for growth, can have some hope of offsetting these risks. Innovation can be anything from incremental to disruptive. It affects manufacturing, design, products, services, distribution, customer care, back-offices, supply chains, corporate functions and business models. For most companies, it is both the main threat and the main opportunity of the next 10 years.

Every board and every management know that if their company does not innovate, it will disappear. But when was the last time you heard a board of directors say to its management that they needed to be more innovative? That the company should take more "innovation risk", despite uncertain outcomes? That the failure of some of the company's new business initiatives was expected and tolerated?

Boards are about risk oversight, mitigation and control, aren't they? A typical board agenda covers the business update (the last 3 months), the financial review (the last 3 months) and forecasts for the next period (3 months, and perhaps up to the end of the fiscal year). A few times a year, a board will also review controls and risks in the past and current periods (say, over 6 months), bonus criteria and realizations (on a semi-annual or annual basis), and various operational programs. Little time will be spent on strategy, and no time at all on innovation and new business development. In any event, directors will rarely be technology-savvy or informed enough to dare ask far-reaching questions about innovation, let alone encourage a discussion about the threats and opportunities of innovation for the company. Even if they were, the board agenda would already be too busy.

Really good boards will try to overcome these problems. They will hold a serious strategy retreat at least once a year, and will have strategy discussions multiple times during the year. They will think about where the company is going, what its competitors are doing, and what technology and innovation mean for its businesses. They will spend time on new business initiatives. They will try to build longer-term objectives into management's compensation, and will accept to direct investments into R&D, test new business models or acquire innovative and potentially disruptive companies. For all their efforts these boards are likely to be criticized by shareholder, who will complain about wasted financial resources and insufficient board oversight. Shareholders will demand that "financial discipline" and "good corporate governance" be brought back, through appropriate changes to the board and management. Other stakeholders (employees, politicians, the media, etc.) will be equally critical for their own self-centered reasons.

So what is a board to do, if anything, to overcome the lack of "innovation risk" appetite at stakeholder, director and management levels? It might worry about the threats, and see the opportunities, of innovation, but should it bother at all? And if it wants to, how does it go about fostering innovation and taking well thought-out "innovation risk"? There are, unfortunately, no silver bullets. However, a board can at least take action in three areas: on and within the board itself, towards outside stakeholders, and on management and the company culture.

First, the board can act on and within itself. A board can adapt its composition, improve its strategy process, insist on adequate information, and ensure that the board agenda covers strategy and innovation.

A director does not need to be a technology expert to raise questions about innovation, nor be able to “write code” to challenge a presentation on R&D or digital transformation programs. Directors with experience in running technology, telecom or life-sciences entities (companies, divisions, etc.) can get the discussion going, and help colleagues overcome their inhibitions, as discussing innovation in the boardroom is really no different from any other discussion about business. The chairman (or vice-chairman/lead-director/senior independent director) should ensure that the board is composed appropriately to enable these types of discussions.

Product roadmaps, three-year financial projections or short-term crisis action plans are no substitutes for a proper strategy. Relatively few companies have an agreed view of what strategy actually is, conduct a robust strategy process and end up with a fully engaged board. Conversely, good strategy processes consider client, market, technology and competition trends, new business ideas, and necessarily take innovation into account. They have the added advantage of ensuring that the board fully supports and really “co-owns” the strategic outcome.

The information deficit at board level (vs. what management have at their disposal), and the over-reliance on financial information as a proxy for assessing a company, is a major reason for the dearth or mediocrity of discussions about innovation. Financial data is a useful, but highly simplified and biased, view of the current and future health of a company. A board should insist on more holistic information, whether in the form of KPIs or not.

Finally, the board chairman (or vice-chairman/lead-director/senior independent director) should ensure that short-term pressures on the board agenda do not crowd-out presentations and discussions of strategy, technology, new business initiatives and innovation.
Second, the board can act towards outside stakeholders. In particular, an innovative company needs “patient capital”, as the benefits of innovation can take years to materialize.

The board must insist on proper information of all stakeholders regarding the company’s strategy, its risks and opportunities. This is easier said than done, and the education of stakeholders is often frustrating, as shareholders in particular will always complain that the company innovates too much or not enough.

Capital is not naturally patient. It must be educated to become patient through communication, explanation and transparency. To be fair, these do not always work, and the board may have to consider more radical options, for example a “take-private” or dual classes of shares in the case of a listed company. Indeed, many successful innovative companies would rapidly fail if they were publicly listed.
Third, the board can act on management and the company culture. The choice of the

CEO is essential. The board is also justified in challenging the CEO on the members of its executive committee and on the talent management process.

With the right leadership and talent management in place, a key impact of the board is in the tone it sets regarding “innovation risk” appetite and long-term performance. A risk-adverse board will be all too easy to read by the entire company: focus on short-term financial performance, financial KPIs in bonus schemes, “business-as-usual” priorities of the board agenda. Conversely, remuneration plans that incentivize long-term performance, a higher proportion of equity vs. cash pay-outs (including for directors themselves – something that is often, and inexplicably, prohibited in many jurisdictions), long holding period requirements for insiders with “claw-back” provision (the ability for a board to “claw-back” bonuses a certain number of years after they have been paid), all point towards a board that wants to encourage innovation and balance long-term and short-term constraints. Even simple initiatives, like holding board meetings at R&D centers or innovation labs, or ensuring that on-line tools are commonly used for board meetings, will indicate clearly the board’s priorities.

Beyond KPIs and hard incentives, the board also should try to establish a working relationship with management that has as much to do with advising, supporting and encouraging, as it has with controlling, auditing and overseeing.

Finally, setting the “tone-from-the-top” is not only about giving time to management presentations on strategy, technology, new business ideas and innovation, however essential all of these are. It is also about looking out for tangible signs of an open and collaborative culture inside and outside the company. Even if large amounts are channeled toward R&D or digital transformation programs, a company affected with the “NIH syndrome” is unlikely to be sufficiently innovative.

In conclusion, the ability for a board to foster innovation is really only about co-owning the company’s strategy, setting the right risk appetite for growth and innovation, and balancing properly the traditional roles of direction and control. Unfortunately, these are neither easy to achieve nor do they come easily to most boards.