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Jean-Philippe DESCHAMPS

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INNOVATION GOVERNANCE:

How proactive is your board?

Ten good board practices on innovation.

By Jean-Philippe Deschamps

All global business and technology trends point in the same direction: there is a need for more proactive and far-sighted management of innovation. Innovation for business reinforcement and growth, and transformation in particular, are, of course, the prime responsibility of top management. Innovation governance–a holistic approach to steering, promoting and sustaining innovation–is thus becoming a new management imperative.

Boards of directors, too, need to be more than just observers of this renewed management interest in innovation, because so much is at stake. In a growing number of industries and companies, innovation will determine future success or failure. Of course, boards do not need to interfere with company leaders in the day-to-day management of innovation, but they should include a strong innovation element in their traditional corporate governance missions, that is: strategy review, auditing, performance review, risk prevention and, last but not least, CEO nomination.

It is therefore a healthy practice for boards to regularly reflect on the following questions:

- To what extent is innovation, broadly defined, an agenda item in our board meetings?
- What role, if any, should our board play vis-à-vis management regarding innovation?

To facilitate their self-assessment, boards should answer a number of practical questions that represent good practice in the governance of innovation. I have put the following ten questions across to several board members, and surprisingly, only a small minority of directors stated that their board had adopted these practices. A lot therefore remains to be done to ensure that boards embrace their innovation governance role more proactively.

Here are the ten good-practice questions that I would ask:

1. Have we set an innovation agenda in many, if not most, of our meetings?

Board meetings are always crowded with all kinds of statutory corporate governance questions, without talking about the need to handle unexpected events and crises. So, unless innovation issues are inserted into the board agenda, they would not be covered. It is a good practice to include innovation as a regular and open agenda item in at least a couple of board meetings per year. It should also be a key item in the annual strategy retreat that many boards set up with the top management team. Many of the following questions will provide a focus for this open innovation agenda item.

2. Do we regularly review 'make-or-break' innovation projects?

In some industries, like pharmaceuticals, automotive, energy and aerospace, company boards regularly review the big, often risky innovation projects that are expected to provide future growth. They do so because of funding issues, and some of these projects may require extraordinary and long-term investments that need board approval. But in other industries, boards may be only superficially aware of the new products or services under preparation. Yet, I would argue that several projects that may be small in terms of investments could become 'game-changers', and it would be wise for the board to review them regularly in the presence of R&D leaders and innovators.

3. Do we regularly review and discuss the company's innovation strategy?

Boards are generally aware of, and discuss, the company's business strategy, particularly when it involves important investments, mergers and acquisitions, and critical geopolitical moves. But what about the company's innovation strategy (if it exists and is explicit, which is not always the case)? There are indeed important decisions that might concern the board in a company's innovation choices because of their risk level and impact. Think of the adoption of innovative new business models, the creation of totally new product categories, or the conclusion of important strategic alliances and partnerships for the development, introduction and distribution of new products. Management's adoption of a clear typology of innovation thrusts in its board communication would definitely facilitate such reviews and discussions.[1]

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4. Do we regularly review and discuss the company's innovation risk?

Boards usually devote a significant amount of time to risk assessment and reduction. But their focus tends to be on financial, environmental, regulatory and geopolitical risk. Innovation risk may be underestimated, except in the case of large projects involving huge investments and new technologies. But internal innovation risk is not limited to new project and technology uncertainties. It can be linked to the loss of critical staff, for example. Innovation risk can also be purely external. Will competitors introduce a new disruptive technology that will make our products and processes obsolete? Will new entrants invade our market space through different, more effective business models? Will our customers expect new solutions that we have not thought about? Assessing innovation risk is critical to avoid what author Ravi Arora calls "pre-science errors"—underestimating the speed and extent of market or technology changes and, even worse, "obstinacy errors"—sticking to one's solution too long after markets or technologies have changed.[2] It is the duty of the board to prevent such errors.

5. Do we set specific innovation goals for management?

Boards often exert strong pressure on management by setting performance goals. But most of these goals tend to focus on financial performance: top and bottom line growth, earnings per share, capital utilisation ratios, etc. Some companies add other goals to focus management's attention on worthwhile new objectives, such as globalisation or sustainability. But what about innovation if it increasingly becomes a growth driver? A number of highly innovative companies have indeed included innovation goals in the CEO's balanced scorecard. One of the most commonly found is the percentage of sales achieved through new products, typically those introduced in the past few years. But there are many other innovation goals to incite conservative management teams to take more risk, for example, the percentage of R&D spent on high risk/high impact projects. Innovation goals are interesting because they actually determine much of the company's long-term financial performance. It is therefore good practice to discuss these goals with the management team and retain the most meaningful ones.

6. Do we review innovation management issues with the CEO?

Most sustained innovation programmes raise many issues. Some of them are managerial—how to keep innovators motivated and reward them? Others are organisational—how to decentralise our R&D to tap the brains of our international staff? Many deal with intellectual property (IP)—how do we practice open innovation while maintaining our IP position? Others deal with strategic alliances and partnerships—how do we share the efforts and risks of new ventures with our partners? And there are many more issues.

The question boards should ask is: Are we aware of the most acute issues that management faces as it steers the company's innovation programme? The board's mission is of course not to interfere and become too deeply involved in these innovation issues. However, its mission *is* to keep informed and help the CEO and top management team reflect on their options. This is why it is essential to keep a short open agenda item—'innovation issues'—in board meetings with a specific innovation agenda.

7. Do we expect management to conduct innovation audits?

Many companies embarking on a major innovation boosting programme rightfully start with an internal audit and, sometimes, a benchmarking exercise against best-in-class competitors. Where are we deficient in terms of strategy, process, resources and tools? Do we have the right type of people in R&D and marketing, and do we tap their creativity effectively? Do we cover all types of innovation, ie, not just new technologies, products and processes? Are our projects well-resourced and adequately managed? Are they under control? How good is our innovation climate? These audits are extremely effective for highlighting priority improvement areas, and it is therefore good practice for the board to suggest that management undertake such audits and keep them updated. These audits will provide the board with a rich perspective on the company's innovation performance issues.

8. Do we expect management to report on innovation performance?

This question is directly related to the questions on innovation goals (5) and innovation audits (7). Once innovation goals have been set and an audit conducted, it will be natural for the board to follow up and assess innovation performance. To avoid having to delve into too many details, innovation performance reviews should be carried out once or twice a year on the basis of a reasonably limited number of innovation performance indicators.

> CEOs often fall into one of two broad categories: *fixers* and *growers*.

Good practice calls for these indicators to cover several categories. A couple of them should be *lagging indicators*, ie, measuring the current result of past efforts—the percentage of sales achieved through new products being one of them. A couple of others should be *leading indicators*, measuring the level of efforts done today to ensure future innovation performance—for example, the percentage of the R&D budget devoted to high risk/high impact projects mentioned above. One or two others should be in the category of *in-process indicator*—the most usual measure being the percentage of projects managed on schedule and on budget. Finally, it is always interesting to include a *learning indicator* to measure the reactivity of management and its ability to progress on key issues.

9. Do we know and occasionally meet our main corporate innovators?

Nothing conveys a company's strong innovation orientation better than a visit by the entire board to the labs and offices where innovation takes place, both locally and abroad. Such visits, which are often carried out by innovative companies, have a dual advantage. They enable board directors to be aware of the real-world issues that the company's innovators face, and provide them with a good understanding of the risks and rewards of innovation. These visits also motivate the frontline innovators, who often lack exposure to top management.

10. Do we take innovation into account when appointing new leaders?

This last question is probably the most important. The nomination of a new CEO is undoubtedly one of the board's most visible and powerful contributions to the company. It can herald a new and positive era for the company if the capabilities of the CEO match the company's strategic imperatives. But it can sometimes lead to damaging regressive moves if the values of the new CEO are innovation-unfriendly. Management author Robert Tomasko notes that CEOs often fall into one of two broad categories: *fixers* and *growers*.[3] The former are particularly appreciated by boards when the company needs to be restructured and better controlled. But *fixers* often place other values and priorities ahead of innovation. *Growers* are more interested in innovation because of its transformational and growth characteristics.

This does not mean that boards should always prefer *growers* over *fixers*. There are times when companies require drastic performance improvement programmes and an iron-handed CEO is needed. The board should, however, reflect on the impact the new CEO will have on the company's innovation culture and performance. This is why it is so important to look at the composition of the entire management team. How many *growers* does it include and in what position? Will these senior leaders be able to counteract excessive innovation-unfriendly moves by the new *fixer* CEO?

To conclude, let's see what Bill George, the former CEO and board chairman of Medtronic and now a professor at Harvard Business School, wrote in his foreword to my book *Innovation Governance*, "To be successful, companies must be led by leaders—the CEO, top executives and board of directors—who are deeply and irrevocably committed to innovation as their path to success. Just making innovation one of many priorities or passive support for innovation are the best ways to ensure that their company will never become a great innovator."[4] I believe that the ten good practices listed above are undoubtedly a good way for boards to show their real, concrete commitment to innovation and its governance.

Jean-Philippe Deschamps

is Emeritus Professor of Technology and Innovation Management at IMD in Lausanne (Switzerland)

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