

Director tools

This is part of a series of Director Tools prepared by the Australian Institute of Company Directors. The tools have been designed to provide our members with general information and as a starting point for undertaking a board-related activity. These tools are not designed to replace legal advice or a detailed review of the subject matter nor are they intended to cover all circumstances where such a tool might be considered appropriate.

Governing innovation for performance

Background

This article discusses the role of directors and executive managers in governing innovation in mature organisations, with a focus on how improving innovation-related capabilities can lead to improved performance and productivity.

Innovation has been a topic of much discussion in the Australian Institute of Company Directors' Member Group on LinkedIn, with one central theme being the need for greater awareness of what constitutes good practice. In response to member feedback, we have prepared this short article with some suggestions of how directors and boards can assess their current approach and consider opportunities for improvement.

We recognise that the challenge of innovating in established organisations is very different to what start-ups face in establishing their businesses, so we have deliberately excluded discussion of start-ups from this piece.

Executive Summary

We provide a high-level overview on the role of directors and the board in innovation, starting with how the term can be defined. We also address the potential differentiation between the role of the directors and management, as well as how innovation may be considered in the context of an organisation's corporate strategy.

Definition

Innovation is contextual and can be variously interpreted by different organisations and in different markets.

Innovation and Business Skills Australia (IBSA) define innovation as *"the conscious exploitation of ideas leading to a new or modified product, process or service which adds economic and/or social value"*.

While there are many other definitions, the important concepts are breadth and depth – innovation goes beyond new products and ideas. It includes the application or strategic execution of ideas on any aspect of an organisation's activities which represents an investment in the future and/or has the potential to propel organisational performance forward.

Thoughts on the board's role in innovation

It is generally accepted that a primary role of the board is to set and approve the organisation's strategy and oversee its execution.

In most cases, the role of strategy is to guide long-term direction and achievement of short-term outcomes that will result in competitive advantage and profitability while also safeguarding future prospects.

According to the ASX Corporate Governance Council: "Effective corporate governance structures encourage companies to create value, through entrepreneurship, innovation, development and exploration, and provide accountability and control systems commensurate with the risks involved." (ASX Corporate Governance Principles and Recommendations)."

According to Allan Ryan of the Hargraves Institute, innovation is a 'servant' or tool of strategy that drives an organisation to achieve better results.

When an organisation is falling short of achieving its short-term strategic objectives or potential, some form of change in strategy or projects may be required. Options available to the board include improving efficiencies, cutting costs, investing in R&D, undertaking mergers and acquisitions or a combination of these. Innovation can improve the prospect of success of any of these options.

Innovation may be consciously thought of as an initiative, or it may be the result of a new approach to any number of strategic initiatives or a culture transformation.

Questions for directors

As boards or non-executive directors may have a limited opportunity to engage in innovation, they may look to develop governance practices appropriate to their needs and/or to appoint executives and/or consult with advisors to effectively manage both the current and future needs of the organisation.

Within this article, we provide examples of questions that directors can ask to determine their strategic approach to innovation, assess their innovation capabilities and identify potential opportunities for improvement. We consider areas such as frameworks, relationships, practices and decision-making processes.

These questions are framed three ways, reflecting the broad system of governance in mature organisations:

1. Questions individual directors and board members can consider/discuss;
2. Questions directors can discuss with their leadership team; and
3. How directors and organisations engage with their stakeholders.

We have suggested more than 35 questions to encourage a range of different conversations about innovation. Not all questions will be relevant to every organisation – or appropriate for directors to ask – given their organisation's current circumstances and/or level of innovation maturity.

There are many different areas that directors can explore with their leadership teams, organisations and stakeholders to trigger renewed thinking. Ten key questions are offered as a starting point below.

Renewing governance thinking on innovation

Below are some sample questions directors can ask about innovation:

Governance Context	Starting questions
Director / board	<p>What will our customers value most in 3-5 years time?</p> <p>Are we investing today to deliver on our customers' future expectations?</p> <p>What future scenarios has management considered?</p> <p>Does our culture encourage and support innovation, idea generation, sharing of ideas and innovative action?</p> <p>Are we enabling good ideas to thrive?</p>
Board / Executive Leadership	<p>How will we (board and management) govern and manage the risk of innovation failure?</p> <p>Do you (management) have a process for generating, testing, implementing and capturing the value of ideas?</p>
Stakeholder engagement	<p>How do we consider suggestions from our shareholders, customers, suppliers, and partners?</p> <p>Are we actively seeking ideas from our stakeholders?</p> <p>Are stakeholder engagement, collaboration and knowledge-sharing actively encouraged and facilitated?</p>

Continue reading for more ideas on questions that directors can consider asking about innovation.

Individual directors and board members

- What investments are we making today that will safeguard our future? What is our strategy for long-term growth and value creation?
- Do we have visibility of how our management team is considering innovation? Do we need a formal governance framework or set of metrics to provide greater visibility of our innovation-related activities?
- How is innovation being considered by management? Is management sourcing and assessing ideas and suggestions from our employees and customers?
- Does our culture encourage and support idea generation, sharing of ideas, experimentation, controlled failure, innovative action and learning? Are we enabling good ideas to thrive?
- Do we have quality measures in place to provide confidence in the reliability of information that is the basis of our decision-making?
- Does our strategy and decision-making process allow us to test/act on new ideas/make agile decisions?
- How much consideration is given to ideas before they are presented to the board for discussion (are we given the opportunity to hear a range of big ideas before management invest in business cases)?
- What budget will be allocated to strategic or other innovation-related projects?

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- Does management perceive the board as a reporting 'mechanism' only, or a resource to tap into for new ideas?
 - Would a board sub-committee encourage greater innovation or enable us to provide more effective oversight (without additional bureaucracy)?
 - Should we consider innovation as a desired skill set in our board skills matrix/when considering suitable candidates for board vacancies?
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Directors with the organisation's leadership team

Directors may consider or discuss some of these questions with the leadership team:

- Do we have a shared understanding of what the future holds?
 - Are our activities and KPIs appropriately aligned with our strategy? If not, what needs to change?
 - How will innovation be considered in our strategy workshop(s) and board meetings?
 - Is fear of the board's response to an idea (before analysis is done) preventing ideas from being shared?
 - Are we considering new ways of undertaking our business-as-usual activities or strategic initiatives?
 - How will we manage the risk of innovation failure?
 - Are we looking at our investment portfolio from multiple dimensions?
 - Do you have a process for generating, testing, implementing and capturing the value of ideas? What is our process of discovery?
 - What evidence/assumptions are our business cases/decisions based upon? (Considered in relation to a specific project)
 - What prior experience are we basing decisions on? What new insights do we have into current issues?
 - How do we consider/allocate budget to new high-risk/high-impact, projects?
 - Are we taking advantage of potential opportunities to work with government organisations or access government grants?
 - Do our business cases consider at what point we re-scope, stop or inject additional resources into projects (if projects are not meeting outcomes)?
 - What resources are required for innovation process and action? Is there a need for a process of securing budget for ideas outside the normal budget cycle?
 - Are we open to creative or radical ideas, even if they do not at first seem to be aligned with 3-5 year strategy? Do we need a shift in thinking on some of our established operations?
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Engaging with organisational stakeholders

- How do we consider suggestions from our shareholders, customers, suppliers, and partners? Are we maximising stakeholder engagement to identify new opportunities?
- Are stakeholder engagement, collaboration and knowledge-sharing actively encouraged and facilitated?
- Are we leveraging our own networks (as directors) to come up with new ideas? To who can we introduce our board and executive for new inspiration?
- How are partnerships and collaboration used to encourage innovation?
- What initiatives are we undertaking to strengthen our connection to stakeholders?
- Are we bringing together disparate people or creating the opportunity for 'chance encounters' in new networks?
- Can we be more transparent about our experiments that failed and our learnings from them?

Appendix 1

Hargraves

I N S T I T U T E

Hargraves Institute: Principles of Innovation

The Hargraves Institute has developed eight principles of innovation for organisations which align with general good governance principles and can support organisations to assess and enhance their innovation capability.

Leadership and People

Principle 1: Enterprise leadership has a genuine commitment to innovation performance and recognition; and

Principle 2: Empowers all people and teams and provides fast and regular feedback.

Innovation Process

Principle 3: Enterprises execute through a simple, accessible and disciplined innovation process; and

Principle 4: Proactively manage risk and support learning from both failure and success

Innovation Action

Principle 5: Enterprises explicitly link vision and strategy to innovation with ownership and accountability; and

Principle 6: Provide resources when needed for innovation.

Collaboration

Principle 7: Enterprises/teams proactively connect with all stakeholders; and

Principle 8: Encourage cooperation and challenges both internally and externally.

Balanced innovation

The Hargraves Institute also suggests that organisations consider the concept of ‘balanced innovation’. Leaders need to consider whether their strategy is enabling the organisation to both respond to current stakeholder demands, while also securing their ability to serve what stakeholders will demand in the future.

According to the Hargraves Institute, there are two questions to ask which reflect an organisation’s level of ‘innovation maturity’. These are shown in the matrix below.

Are we:

	Reactive	Proactive
... doing the right things?	Resilience	Agility
... doing things right?	Fire-fighting	Competency

Appendix 2

In his Masters dissertation 'Systems of Innovation' (Gould, 2000), Doug Gould MAICD described another framework by which boards may consider innovation. Gould's research identified seven factors that form part of innovation systems, which create the acronym ExPPERTT:

- Experimentation: Structure, culture, reward system, idea generation, feedback mechanisms
 - Priorities: Leadership and strategy
 - Perspective: Stakeholder feedback
 - Empowered people
 - Risk management
 - Teams
 - Tension
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Appendix 3

What are some example innovation measures?

- New product/service sales
 - Number of new products/services introduced
 - Employee engagement in innovation process
 - Where (which department, stakeholders) new ideas (executed) came from
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Further reading and tools

Innovation and Business Skills Australia (IBSA), Innovation Inside

Hargraves Institute for Innovation

The Thinking Corporation, Test your organization's ability to innovate

Cap Gemini, 'The Digital Advantage: How Digital Leaders Outperform their Peers in Every Industry', 2012

IBM and NIEIR, 'Reinventing Australian Enterprises for the Digital Economy', 2013

Kelley, B., Innovation excellence, 'Top 50 Innovation Twitter Sharers of 2013', August 2013

Social media

Search for, or follow #innovation on Twitter

Feedback

We encourage members to provide feedback on this Director Tool by emailing jchandler@companydirectors.com.au.

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