The role of the board in innovation

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Introduction

What is the role of the board in innovation? There are mixed views on this question within the governance literature. Part of the problem relates to the ill-defined nature of innovation itself, how it relates to the strategy of the organisation and the division of responsibilities between the board and the executive.

This paper will draw on research conducted for the AICD during 2014 (Kay and Goldspink 2015), involving interviews with over 100 Chairs of listed, private, public and not for profit boards, as well as two other studies conducted by the authors. These additional studies involved interviews with 25 CEOs drawn from both listed and private organisations, as well as 25 Departmental Secretaries and Directors-General drawn from both the federal and state public sectors. These latter studies canvassed executive views on what innovation means to them and what it takes to innovate effectively within their respective sectors (Kay and Goldspink 2012a, 2012b).

In combination, these three studies show there is a very real role for the board in the stewardship of innovation.

"In combination, these three studies show there is a very real role for the board in the stewardship of innovation."
Innovation and directorship: a role at the core of good governance

Innovation is typically not present in the lists of duties or guidelines for directors. It could be argued that innovation is subsumed into the broad fiduciary nature of directorship. If that is the case, however, it is in considerable contrast to the extensive duties and responsibilities described in relation to risk management and compliance. This imbalance is striking in that, in many ways, risk and innovation present two sides of the same coin. Risk management deals with uncertainty on the downside, innovation deals with uncertainty on the upside.

Only a relatively small number of Chairs (32 out of 100) interviewed for the 2014 AICD study explicitly discussed the role of innovation in organisational performance, for example:

**[Chair 67]** Why is innovation not an agenda item?
Why is it not built into everybody’s strategy?
What’s your team? Who are your innovation staff?
Who’s responsible? And that’s not just R&D… innovation is something that the whole company should be interested in and embracing.

**[Chair 25]** …the board’s role is very clearly to make sure that you’ve got more eyes and ears out there and down there so that you’re picking these things up quickly and accurately.

In the 2014 AICD study, key attributes of good governance identified by the Chairs included:

- Diversity of views and experience;
- Independence of mind (as distinct from structural independence);
- Openness to alternatives; and
- Trust.

These points were argued to be important because they contributed towards a collective capacity to read the changing organisational context (internal and external) and deal with the inherent uncertainty. While this was seen as key to managing the risks associated with that uncertainty, it was equally associated with capturing opportunity.

This is not to suggest that others didn’t think it was important. Indeed it is arguably implicit in the way most thought about the nature of good governance. However, rather than speak explicitly about innovation, the Chairs thought more about the board’s collective capacity to ‘read’ the environment in order to manage downside risk and encourage innovation to capitalise on the upside opportunity.
Reading the context and steering the approach

Clearly it is not the role of the board to innovate for the company, but, like other aspects of the board’s role, to provide effective governance over the innovation activities of the organisation. The problem is that:

- What directors should be looking for may vary at different stages of the organisation’s life cycle;
- The best innovation approach will differ depending on the organisational context; and
- Innovation governance may differ between different types of organisations.

Unfortunately these are all issues on which the governance literature is more or less mute. This is surprising, as poorly conceived, timed and executed examples of innovation have been the undoing of many organisations.

One of the few researchers to explore innovation governance is Jean-Phillipe Deschamps (2013), who proposes the following list of innovation governance responsibilities:

- Defining roles and ways of working around the innovation process;
- Defining decision power lines and commitments on innovation;
- Defining key responsibilities of the main players;
- Establishing the set of values underpinning all innovation efforts;
- Making decisions that define expectations;
- Defining how to measure innovation;
- Making decisions on innovation budgets;
- Orchestrating, balancing and prioritizing innovation activities across divisions; and
- Establishing management routines regarding communications and decisions.

Whilst these points appear logical and sound, we feel compelled to ask if we removed the word “innovation” and replaced it with “efficiency”, “marketing” or “compliance” would the list be significantly different? Arguably it is the unique characteristics of innovation that need to be understood in more detail.

“...innovation is not an end in itself, but is undertaken to achieve a particular outcome or solve a particular organisational problem.”
A starting point to explore this is to acknowledge that innovation is not an end in itself, but is undertaken to achieve a particular outcome or solve a particular organisational problem. If the board is not clear why the organisation is innovating, it is difficult to provide useful governance of the activity.

The nature of the problem that innovation is being used to solve is important, as different problems have different levels of uncertainty associated with them and different models of innovation to deal with them. The table below provides a basic description of how innovation can change by circumstance.

Whilst Table 1 is far from exhaustive, it serves to illustrate that innovation responds to and drives different circumstances for the organisation. As a result, the attention it receives from the CEO and the board should also differ. It also follows that the structures and processes required to deliver innovation will be different.

### Table 1: Innovation by circumstance

<table>
<thead>
<tr>
<th>Circumstance</th>
<th>Uncertainty</th>
<th>Form of innovation</th>
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</table>
| Business model is under disruption, or there is a desire to disrupt competitors | High        | Revolutionary  
High uncertainty in relation to both the internal and external aspects of the organisation. Revolutions represent a significant departure from the previous business model of the organisation and may have a disruptive impact on the industry involved. For the customer, they can represent a fundamentally different opportunity or experience. |
| Organisation needs to adapt to changes in technology; significant restructuring of the cost-base; changes to the product portfolio | Medium      | Evolutionary  
Moderately high levels of uncertainty in either the external or internal environment of the organisation, but usually not both at the same time. |
| Business model is stable, seeking to increase staff engagement; embed continuous improvement | Low         | Incremental  
Characterised by high levels of certainty about both the internal and external business environment of the organisation. Often this involves fixing problems with current operations as opposed to creating new operations. |
CEOs and innovation

Often it is the CEO who sets the tone for the style of innovation the organisation engages in (or not, as the case may be). Numerous Chairs spoke to the importance of selecting the right CEO as a critical role for the board:

[Chair 94]…the biggest failure that a board can make is to have a CEO who is not going to be able to take you forward.

In the context of innovation, however, the general lack of clarity most people have when they talk about the topic can make this task difficult. In 2012, we interviewed 50 CEOs: 25 from the private sector and 25 from the public sector to compare their approaches to and views of innovation. In short, we wanted to understand what the CEOs meant when they said they wanted to innovate. To understand their perspectives, we collected two stories of innovation from each CEO – one of success and one of failure – and compared the patterns of activity and thinking associated with each. The results were interesting and surprising.

The stories were generally rich, involving a mix of factors, constraints and variables that had shaped the CEOs’ approaches. In analysing the stories, we looked to identify different patterns of thought and action that contributed to success or failure.

Did the CEOs focus on idea generation, the need for partners, the role of culture etc, and how did this differ between the success and failure stories? 12 patterns were identified that captured some aspect of how the CEOs thought about innovation and/or what they thought had to be managed in relation to it. These patterns are not mutually exclusive. Different CEOs placed emphasis on different patterns depending on the type of innovation being discussed. Table 2 (page 9), describes the patterns that were identified.

The stories were coded for these patterns, making it possible to analyse the relative frequency with which each was invoked, how this varied by context and whether some combinations were more likely to lead to success or failure. The stories were divided into three broad groupings according to the type of innovation they were describing: Revolutionary, Evolutionary or Incremental in order to see if there were meaningful differences in the way these patterns contributed to the different forms of innovation.

1 The methodology involved scoring each story for the level uncertainty present at the beginning of the project, and the degree of proactivity with which it was initiated (as opposed to a response to outside disturbance). The sample of stories were then plotted and grouped according to this scoring. Each story was then bottom-up coded.
Table 2: Descriptions of the 12 Innovation Patterns identified (Kay and Goldspink 2012b)

<table>
<thead>
<tr>
<th>Patterns</th>
<th>Description</th>
</tr>
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<tbody>
<tr>
<td>Improving Current Practice</td>
<td>This refers to the application of ideas to improving a current or existing practice. The key motivator is increasing efficiency, though in some cases it was simply doing things a bit better than before.</td>
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<tr>
<td>Personality Driven</td>
<td>This pattern is characterised by the force of personality of the leader to drive through the change and keep the innovation going in spite of the various hurdles it may face. It extends to the ability to influence others in the organisation both politically and behaviourally to get behind the change.</td>
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<tr>
<td>Culture Sourced</td>
<td>This pattern is based on the assumption that “innovation is everyone’s responsibility”. The source of innovation is the organisation’s culture, and the extent to which the CEO can nurture it.</td>
</tr>
<tr>
<td>Process Based</td>
<td>This typology refers to the process or method adopted by the organisation for its innovation. This includes stage-gated commercialisation pipelines, ideation methods, due diligence, partnering agreements etc. The engagement with and use of partners to assist in the development, commercialisation and adoption of the new idea as opposed to attempting to do it all within the organisation.</td>
</tr>
<tr>
<td>Partner Based</td>
<td>The engagement with and use of partners to assist in the development, commercialisation and adoption of the new idea as opposed to attempting to do it all within the organisation.</td>
</tr>
<tr>
<td>Probability Based</td>
<td>Innovation is approached as bets within a portfolio. It is expected that few innovations will succeed and most will fail. There is a high acceptance of failure and an associated need to spread risk as well as killing an idea that was not working out as expected.</td>
</tr>
<tr>
<td>Discovery Driven</td>
<td>This pattern is characterised by the application of high domain skills to overcome a current technical barrier. The absence of an expected application for the innovation is often not a concern with the commercialisation process occurring later on after the discovery has been made.</td>
</tr>
<tr>
<td>Use Inspired</td>
<td>Refers to the pursuit of ideas that are inspired through the use of existing products or practices.</td>
</tr>
<tr>
<td>Unseen Need Inspired</td>
<td>Refers to the ideas that were not inspired through use, but through the vision of an inventor or entrepreneur. In most cases the customer had been unable to conceptualise the need until the product was commercialised.</td>
</tr>
<tr>
<td>Capability Based</td>
<td>A belief that through the recruitment of a selection of ‘smart’ people, innovation will occur. Under this approach it is assumed that by putting ‘smart people’ (i.e. highly developed domain skills, intelligent) together and freeing them of day-to-day distraction the organisation will become innovative.</td>
</tr>
<tr>
<td>Ideas Based</td>
<td>Here the innovation is based upon a powerful idea or vision. The power or love of the idea then becomes the driving force behind investment and the political will to push the idea through.</td>
</tr>
<tr>
<td>Structure Based</td>
<td>Here the CEO begins their approach to innovation by attempting to work around the organisational structure, which could involve breaking down silos, or setting up a unique structure to deal with the idea.</td>
</tr>
</tbody>
</table>
Figures 1 – 3 below illustrate the differences in innovation styles that resulted from this analysis for each of the innovation forms. Each style is an emergent combination of the 12 patterns described in Table 2. The percentages described in Figures 1 – 3 are an average of the relative frequency with which each pattern was noted in the stories for the given form of innovation. As such, the percentage score simply reflects how frequently a pattern was referred to in the stories compared with the others. It is important to consider the overall combination of patterns (the shape of the line) in making sense of the diagram rather than focusing on individual scores. It is the interplay between these patterns that CEOs implicitly believed impacted the probability of success or failure in the innovation stories.

The significance of these patterns for directors is that there are certain combinations that are more likely to be associated with success and others that are more likely to be associated with failure for each of these three types of innovation. Directors should be attentive to these patterns when governing innovation in their organisations, as the executive and the rest of the organisation will likely be unconscious of them.

Revolutionary Innovation will be most appropriate where the strategic imperative is to disrupt the current operation of an industry or market, and/or where there is a struggle to establish a fundamentally new business model as the foundation for the development of that industry or market.

For Revolutionary Innovation, the board should be attentive to the effective management of partnerships. Whilst a revolutionary idea may have been internally sourced, the ability to execute it requires the involvement of external parties. Therefore when Revolutionary Innovations occur, they are less likely to occur as the output of a single organisation, but through collaboration between multiple organisations. In this context, the key distinguishing feature between success and failure is the personality of the CEO. CEOs who attempted to be ‘stars’ in the middle of the innovation typically failed to engage other stakeholders over whom they had no positional power and the innovation failed as a result.

Conversely, for Evolutionary Innovations, success often required the direct involvement of the CEO. Evolutionary Innovations described by our sample were typically characterised as large organisational transformation initiatives, e.g. the introduction of a significant technological change, repositioning of the product portfolio or a high-risk new product. Success was often related to the power of the CEO’s personality to protect and support the idea either through funding or the removal of roadblocks. Failure often resulted from an absence of involvement by the CEO, enabling those within the organisation who were opposed to the idea to kill it off.

2 It must be stressed that in the interests of simplicity we have only included the diagrams for private sector CEOs in this paper. There are significant differences between sectors. For this reason discussion of public sector innovation will form the focus of a separate paper.
Perhaps unsurprisingly, most CEOs viewed Incremental Innovation as more of a cultural concern. Successful Incremental Innovation was dependent upon enabling a culture within the organisation that supported continuous, rapid Incremental Innovations. The expertise and knowledge of those at the coalface was crucial, and, as such, the involvement of the CEO in Incremental Innovation was often associated with failure. Two factors influenced this outcome; the first, is that often the CEO lacked the knowledge of the business to innovate on an incremental level, and, secondly, when they did it sent a message to the organisation that innovation is about the CEO’s ideas, rather than those of its people.

It could be misinterpreted that the board has less of a role in relation to Incremental Innovation than the other forms. However, a repeated theme in the interviews with the Chairs, was the critical role the board played in setting the culture of the organisation. For example:

[Chair 02] …the culture of an organisation is strongly influenced by the board. And the culture strongly dictates the behaviour and the way the companies operate, and its very, very important to the achievement of performance.

As such, the board has a clear though changing role in innovation, regardless of the form of innovation that is taking place.

There were two other factors that are important to note from the CEO research. The first, critically from a governance perspective, is that each CEO in our sample exhibited the same basic approach to innovation in both their stories (success and failure), regardless of the broader innovation outcome they were trying to achieve. In other words the CEOs seemed to have one innovation ‘style’ that they applied in all circumstances.

Figure 2: Profiles for Successful and Failed Evolutionary Innovation (Kay and Goldspink 2012b)

Figure 3: Profiles for Successful and Failed Incremental Innovation (Kay and Goldspink, 2012b)
This presented a challenge when the form of innovation the organisation needed was different from their personal style of innovating, potentially increasing the probability of failure. A tangible and critical role for the board in innovation is therefore monitoring the alignment between the style of innovation the organisation engages in and the organisational challenge innovation is being used to address. This extends to the capacity of the current executive to deliver the approach required and the alignment of systems, incentives and rewards.

Secondly, it is important to note that the role of the board in supporting these innovations was not discussed by any of the CEOs in the sample. However, the need for alignment between the views of the board and the CEO were mentioned a number of times by the Chairs.

Further examination of the differences between public and private sector innovation will be discussed in a future paper in this series.
Differences between the public and private sectors

Further complicating innovation governance are a number of largely unquestioned orthodoxies with regard to the similarities and differences between innovation in the public and private sectors. As noted above, for the purposes of simplicity we have only included the profiles for the private sector CEOs in this paper, as the inclusion of the public sector profiles makes the discussion much more complicated. The public sector innovation literature broadly assumes the public sector is less innovative than the private sector (an assumption we don’t share). It is also broadly assumed that the public sector could be more innovative if they had a higher risk appetite and adopted private sector innovation models.

The comparative study made clear that while both public and private sector CEOs saw innovation as a primary means for responding to organisational challenges, each had available to them very different constraints on, and strategies for, managing down uncertainty and turning it into opportunity. Despite what is commonly argued, this did not appear to have its origin in differences in culture but was intrinsic to structural differences in context.
Conclusion

Innovation is perhaps one of the most talked about, yet least understood, organisational activities that come under the purview of the board. 

[Chair 57] If you look at the ravings of the last few years, and you trawled all the newspaper articles, the word innovation would probably turn up thousands and thousands of times. And it’s as if innovation is something you’ve got to tack on to your business.

Yet despite the considerable noise, there is remarkably little available to guide boards in terms of how effectively they are governing this aspect of their operations, and what specifically they should be looking for and asking about. That which is available tends not to be based on systematic research and often makes considerable assumptions about the circumstances of the organisation and its stakeholders. In the same way directors need a basic level of financial literacy, there is an argument here that to provide effective innovation governance, directors require a basic level of innovation literacy as well.

The research presented in this paper provides pointers in terms of the general styles and approaches to innovation that most effectively align with different organisational circumstances. In particular, there are pointers to those styles that tend to increase the probability of success, versus failure, in different situations. But ultimately there are no silver bullets here, as one of the Chairs said:

[Chair 11] Like all of these things, it’s not black and white so there is judgement needed… So what you need with your governance is to have a mixture of skills sitting around a board table who are capable of having independent thought but working collectively as a team to achieve a solution, where you can have debate and people’s egos are left at the door.
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