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Innovation and Corporate Renewal also disrupt boards

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Innovation and corporate renewal also disrupt boards

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Renewal and innovation capabilities are vital in the modern business economy. The combined forces of globalization and technological progress are changing competitive conditions more rapidly than ever. The biggest identified risk that companies are facing now is the risk of being disrupted by competitors with new innovations based on new technologies, new offers and new business models.

The turbulent context has implications for *boards of directors*, who collectively assume the legal responsibility for a company, including its future. The current context thus makes innovation and corporate renewal key priorities for boards.

Our research has focused on how boards deal with the innovation and disruption challenge. This research confirms that boards, if they wish to be effective in their fiduciary obligations for the corporation, and its future, face a disruption on their own, if they are to effectively address their many challenges. This research further strengthens earlier findings by McKinsey, which identified major gaps in boards' understanding: 84% of board directors lack strong understanding of the dynamics of their firms' industries, 78% miss complete awareness of how their firms create value, and 76% do not fully comprehend their strategies.[1] The research does show improvement, with boards indeed spending more time than before on strategy, but many lack an effective framework to guide them in their efforts to integrate strategy with innovation and feel they do not collaborate effectively with management in the task.

Motivated by this diagnosis, we propose a necessary and easy-to-use *framework* for boards consisting of three fun-

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damental competences – *sensing*, *pivoting*, and *aligning* - that effective boards must master to carry out their responsibilities in our turbulent economy. We also present *concrete practices*, identified in our research, that support boards eager to avail themselves of these fundamental board competences.

A shift toward more dynamic and innovation-focused strategies

As a response to our turbulent environment, more dynamic models for strategic management have been developed. However, the combination of strategy and innovation has nevertheless not been treated extensively in existing strategic frameworks.

A few notable exceptions are *Blue Ocean Strategy* by Kim and Mauborgne, and *Fast Strategy* by Doz and Kosonen covering characteristics of strategic innovators that we found as well in our research. These approaches are however formulated primarily for the organization and its management and insufficiently explicit on how to best guide the board in the development of such strategies.

A focus on better frameworks and practices for boards

Our research focus on how boards integrate innovation components in their strategy work, on whether boards provide a satisfactory *frame* when guiding management on strategy and innovation, and what effective boards do to organize this discussion with the management.

During the last two years we have performed two research projects in close collaboration with selected company boards, practicing board members, managers, academia, and business advisors. Our empirical observations have led to the identification of three distinct, yet related competences that boards need to master if they are to create suitable conditions for the corporate renewal and innovation needed for long term value creation. These three competences are:

- Sensing for better and faster insights into the external environments of the corporation – essentially understanding markets, customers and technology;
- Pivoting these insights into an innovation engagement with management leading to a renewed strategy formulation;
- Aligning decision-making and ultimately resource and asset allocations, turn "strategy as intent" into a new reality both inside the corporation and for the customers.

The second capability is specific to the board and might be the key research contribution. Pivoting is identified as the key intervention of boards in this discussion: it consists in the decision by the board to force the management to review the current strategy, as a result of having sensed and developed new fundamental insights in the corporation's environment. The recurrent question of "who develops and decides strategy?" is thus answered collaboratively. Boards needs to sense and prioritise the most material impacts of new insights and ensure that management leverage them when returning with new strategic and innovation proposals. We regard pivoting as the critical value-adding activity by the board, but it can only be truly value adding if preceded by high quality sensing, and followed by effective alignment of the organization and its resources.

For boards eager to apply the proposed framework into their functioning, an overview of the three sequential board competences, with concrete better practices, are presented in Table 1.

Conclusions

Traditional models and practices of corporate governance are an adaptation to a world of hierarchical organizations and rather ill-suited to future organizations and market dynamics. A rethinking of corporate governance practices is needed to support long term value creation in a context of fast changing markets, disrupted value chains and novel ways of working.

We found that boards need to improve their engagement with shareholders and stakeholders in a continuous process of *Sensing*, *Pivoting* and *Aligning*. Pivoting is the key disrupting action for existing operations and strategies, triggering the need for alignment in a changed innovation context for the organization.

There is a need of further research on characterizing board effectiveness in steering corporate renewal, as well as greater experimentation by engaged and future-oriented directors.

THE RESEARCH – A BRIEF DESCRIPTION

The research includes two Vinnova funded projects, OSIRIS and SISU Boards, exploring how boards can strategically address the innovation and renewal challenge in more effective ways. Authors have during the period June 2017 to May 2019 performed extensive literature studies, and interviews with senior executives and board members, and also implemented new ways of working in boards of companies participating in the research. The literature review covered both academic research and a broad range of reports from corporate sources such as advisors and auditors. In-depth interviews were performed with around fifty board members and experts globally, and four board workshops with up to 120 board members, including surveys, were held. Finally, we also drew upon insights gained through running education program for board directors at INSEAD and at the Swedish Academy of Board Directors, and from running webinars at INSEAD Directors Network.

Table 1.

BOARD STRATEGIC INNOVATION COMPETENCE	PROBLEMS IN TODAY'S BOARDS AS OBSERVED BY RESEARCH (INCLUDING OUR OWN)	EXAMPLES OF BETTER PRACTICE OPPORTUNITIES FOR BOARDS EAGER TO STEER THE COMPANY IN INNOVATION AND CORPORATE RENEWAL
SENSING Searching for and developing new insights into the firm's external environment, i.e. fast changing markets, customers and technology Sensing generates insights about: (1) Changes in the firm's external environment (2) Potential implications for the organization, its competitive position, competences and functioning (3) Potential implications for board competence and composition	Directors spend too much time reviewing materials from management and too little time on information from external sources Directors generally perceive that their own board needs changes in composition, in order to increase digitalization, innovation, and customer understanding Directors' lack of digital competence holds back corporate innovation activities Directors and managers are frustrated with the gap between the need for more substantial innovation and the continued focus on incremental changes	– Regular listening to experts presenting new technologies and/or business models (on social media, blogs and podcasts, before board meetings, or even at board meetings and retreats) – Engage young talents on strategic dilemmas or opportunity areas – Be Involved in start-ups – Seek diversity in thought, experience and background – Mandate digital and innovation competence for all board members – Appoint a competent nominations committee – Appropriate remuneration, matching management – Board and management joint education/strategy week – Have a messaging group (such as WhatsApp) exchanging sensing insights – Budget for individual members to educate themselves – Corporate secretary and board share list of online and offline courses for directors – Cooperate with academia

Table 1. forts

PIVOTING Moving insights into an innovation engagement challenging the firm's current formulation of its purpose, mission and vision, its materiality aspects, its value creation, its organizational structure, culture, and strategy (offer, business model, key performance measures). Pivoting results in the board explicitly committing to an approved plan to explore a few questions judged to be critical for the firm going forward: (1) Assessment and prioritisation of long-term material risk factors (2) Identifying clear value creation opportunities and challenges (3) Ensuring exploration of those opportunities and challenges (4) Ensure board guides and judges the quality of the answers (5) Assess the board's performance by verifying timely pivots for the company	A majority of directors' state that they must make an effort to better understand the company's positioning and strategy Communication between board and management is often viewed as insufficient Most boards have no assessment of the performance of individual directors Managers do not feel the board is clear on the guidance regarding how major sustainability challenges will be met or on the sustainable position the company aims for	– Assess board composition, strengthen it's (digital) innovation and renewal competences – Change the board agenda to focus at least 50% on future challenges and opportunities – Require more effective board materials with executive summaries, e.g. two-pagers shared with full write up of issues, and key questions to debate – Usage of permanent and temporary subcommittees, dealing with strategy, innovation, and technology – Clarity and agreement of roles and responsibilities between Chair/CEO and Board/Management – Ensuring strategy addresses threats of innovation by others, innovation strategy and innovative opportunities – Risk analysis includes also risk of missed opportunities – Board members involved in innovation exploration as part of Dragon's Dens – Active involvement in assessment of the long-term material risk factors, including sustainability and technology, for the company and their prioritisation – Ensure sustainability and technology as key drivers for innovation agenda
ALIGNING Ensuring agile decision-making and ultimately resource and asset allocations turning the pivots into a new reality, both inside the corporation and for the customer. **Aligning consists of changes in several distinct areas:** (1) Agreement on modified long-term perspectives and ambitions for the firm and its stakeholders including long-term mission and value creation and people & planet impacts (2) Agile organizational restructuring and resource (re-)allocation, with due consideration of induced risks and how to mitigate them (3) Shared modified strategic and market commitments and targets (4) Renewed owner and stakeholder dialogue regarding financing, performance, incentives, and impact	Most CFOs state that they would sacrifice long-term economic value to meet quarterly expectations, indicating a lack of alignment regarding long term value creation Effective monitoring requires a balanced combination of short, medium and long-term metrics to drive the right opportunity-seeking and risk-taking behavior Negative scoring on the innovation pipe-line indicating the absence of key innovation prospects Excessive importance on buybacks as the way to boost share price when not currently meeting (financial) market expectations	– Active ownership by the board of the innovation agenda and clear commitment to innovation investments, ensuring aligned incentives and tighter governance – Attend investor presentations include capital allocation plan, 3-5 year plans, and ESG impact of business strategy – Board and Management are active on social media and accessible to investors and stakeholders – Regular monitoring of Innovation portfolio and innovation performance: measuring innovation input, throughput, output and outcomes – Fencing of resources for three different time horizons (core, complementary, transformational) – Monitor comments of insiders and outsiders

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