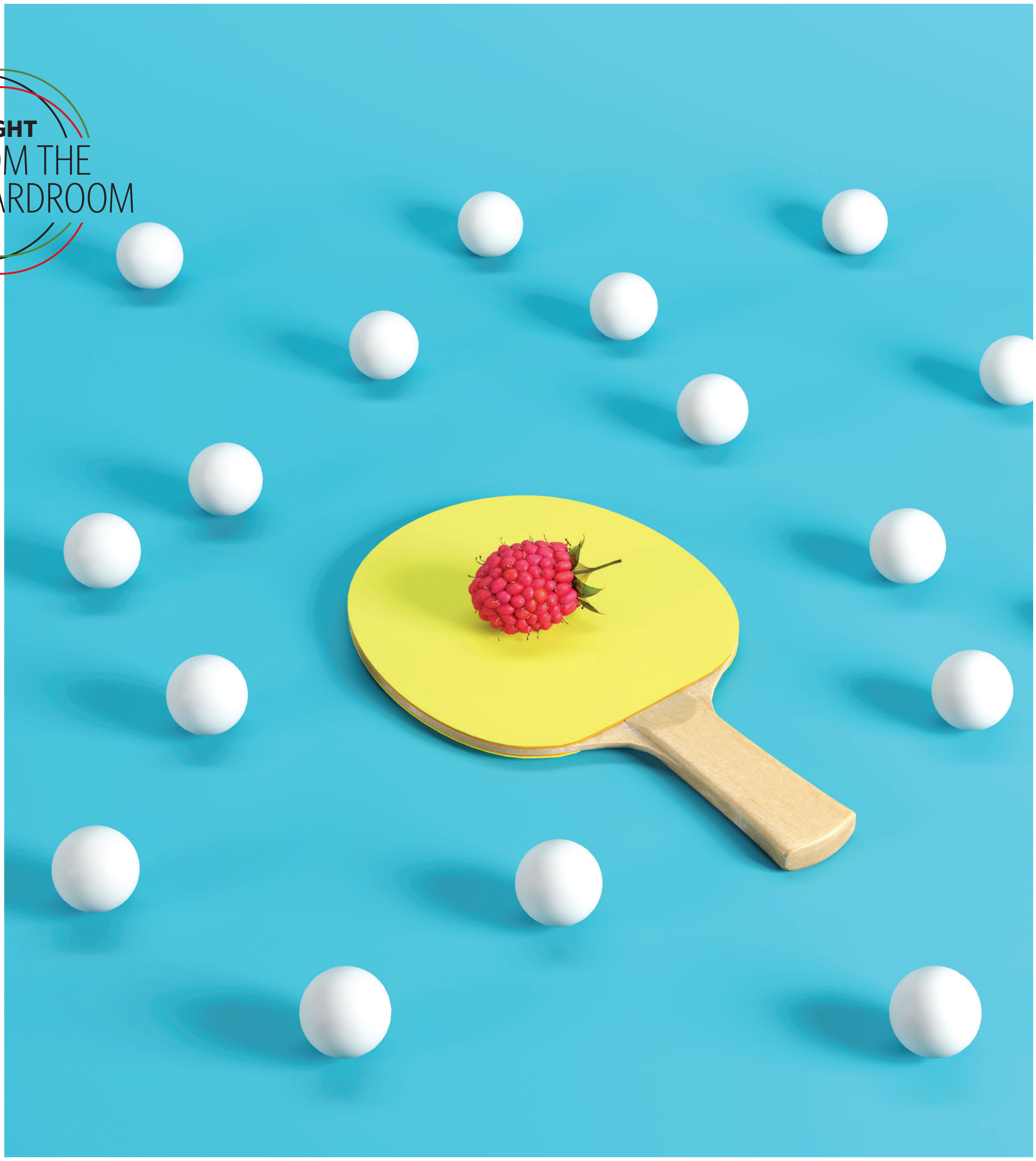

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INSIGHT FROM THE BOARDROOM

SETTING THE TABLE FOR INNOVATION

Boards must work to keep companies ahead of the curve. It starts with prioritizing innovation as a strategic imperative.

By Reva Nelson

It is now commonplace, even cliché, to note that the accelerating pace of innovation is making mincemeat of legacy businesses. Corporations must not only look out for new competition, but for new industries, technologies and consumer expectations too. Put simply, innovation is crucial for the long-term performance of any organization.

Yet innovation is always experimental, frequently expensive and inherently fraught with risk, which boards are tasked with managing. Perhaps this is why so few board members seem to view innovation as a keystone to a successful strategy. A Harvard Business School survey of more than 5,000 board members around the world conducted

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in 2018 found that only 30% of respondents considered innovation one of the top three strategic challenges facing their company. Attracting and retaining top talent, the regulatory environment and threats from global competition were all more likely to be seen as top threats.

But most board members do acknowledge that their efforts to support innovation "fall short when compared with their other activities," Harvard Business School Professor Boris Groysberg and J. Yo-Jud Cheng, who conducted the survey, wrote in the *Harvard Business Review*. For example, 70% of respondents think their boards can effectively keep current with company activities, while just 42% of respondents think the same about how they foster innovation.

So what can boards do to make sure their companies stay ahead of the innovation curve? Here are six tips.

1. Make innovation part of every strategy discussion

Assessing the company's strategy and how it will be achieved is one of the board's basic responsibilities—and innovation must be part of that strategy. Though the executive team may lead the strategy, the board must know where it is going and be able to ask the right questions to properly evaluate its game plan.

"There is no forward-looking strategy without innovation," says Stephanie Woerner, research scientist at the MIT Sloan Center for Information Systems Research, whose research focuses on enterprise digitization and related strategy implications. "It permeates everything. If you're not talking about innovation, that's problematic."

Boards should do an annual deep dive into the company's strategy, assessing the current status of customers, suppliers, competitors and broader market trends. They should also launch an internal assessment, examining how the organization is aligned with those factors. Irene Chang Britt, board member at Dunkin' Brands Group Inc., Tailored Brands Inc., Amica Senior Lifestyles and Brighthouse Financial Inc., and a former board member at Sunoco, says that in addition to asking basic strategy questions like, "Are we prepared, and how are we prepared?" boards should regularly ask themselves about innovation. She offers these examples:

"What is getting in the way of our organization's ability to respond to signals about changes? Are we creating an environment that allows management to pursue innovations—whether in products, services, technologies or go-to-market approaches? And how do we allocate human and capital resources to new innovations when we have a current business that needs those resources?"

2. Commit to board-wide education

Board members need to stay ahead of the game with new technologies and innovations relative to their company and sector—or risk holding the organization back. A 2019 study co-authored by Ms. Woerner in *MIT Sloan Management Review* found that publicly listed U.S. companies that have digitally savvy board directors outperform those that do not.

To deepen their knowledge of these emerging technologies, boards can follow more formal approaches like bringing in experts on specific topics to present to the board, or visiting noncompetitor organizations with innovative methods. And informal education is now easier than ever. "We've also seen self-directed learning that directors pursue to be quite important," says Ms. Woerner. "Directors themselves need to be thinking about how they can increase their digital savviness. Curiosity is really important."

Ms. Britt notes that board members "must

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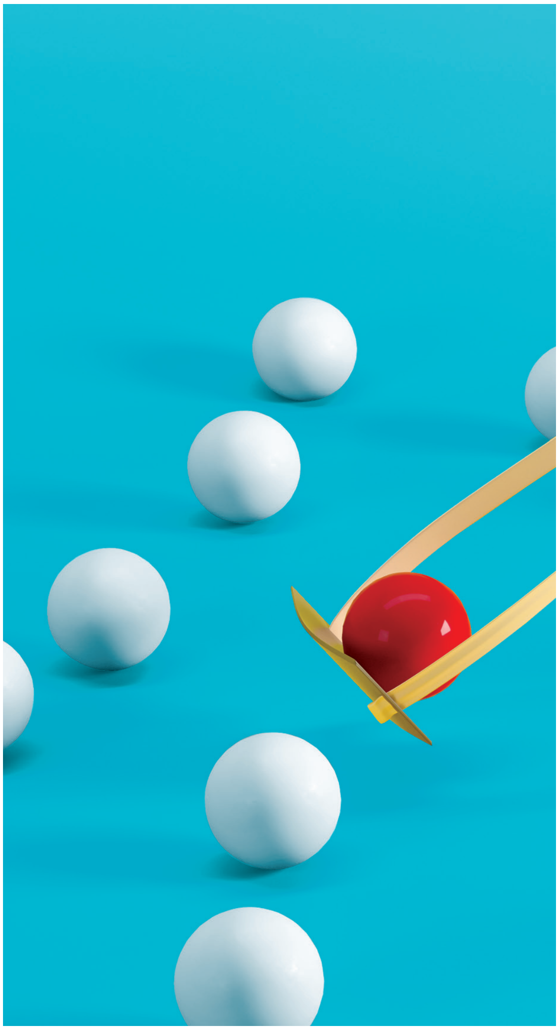

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stay current not only on their industry, but also on the concentric circles around that industry that might affect it." She does this by reading and attending conferences to monitor new ideas and trends. A combination of formal education and 24/7 engagement with what is happening in an industry "is the care and feeding of the board member," Ms. Britt says. "It sets the foundation for how and what we ask management."

3. Embrace robust evaluations

Some form of board evaluation is pro forma for public companies. According to the 2019 Spencer Stuart Board Index, 98% of S&P 500 companies conducted board assessments during the previous year. But the best boards use it as a real opportunity for deeper feedback on how to improve.

Questions to include in a board evaluation, Ms. Woerner says, include: Is our board prepared? Do we have the right skill sets? Do we have people on the board who are curious and genuinely engaged? Are we devoting enough time to thinking about digital disruption?

Individual director evaluations, while still less common than full board assessments, are gaining traction. In 2019, 44% of S&P 500 companies conducted some form of individual director evaluation, up from 38% in 2018.

Individual director evaluations have been a feature of the boards Ms. Britt has served on, including Brighthouse, Dunkin' and Tailored Brands. She says that self-evaluations and peer performance evaluations are especially useful. "Are people contributing at a high level and as well as they should be? Managing performance is a little trickier with peers, but it helps us keep up the level of performance of the board."

4. Strike the right balance

While board members need to always foster a collaborative and trusting relationship with management, they must be more than a rubber stamp. It is a fine line: helping companies manage risks while also supporting innovation.

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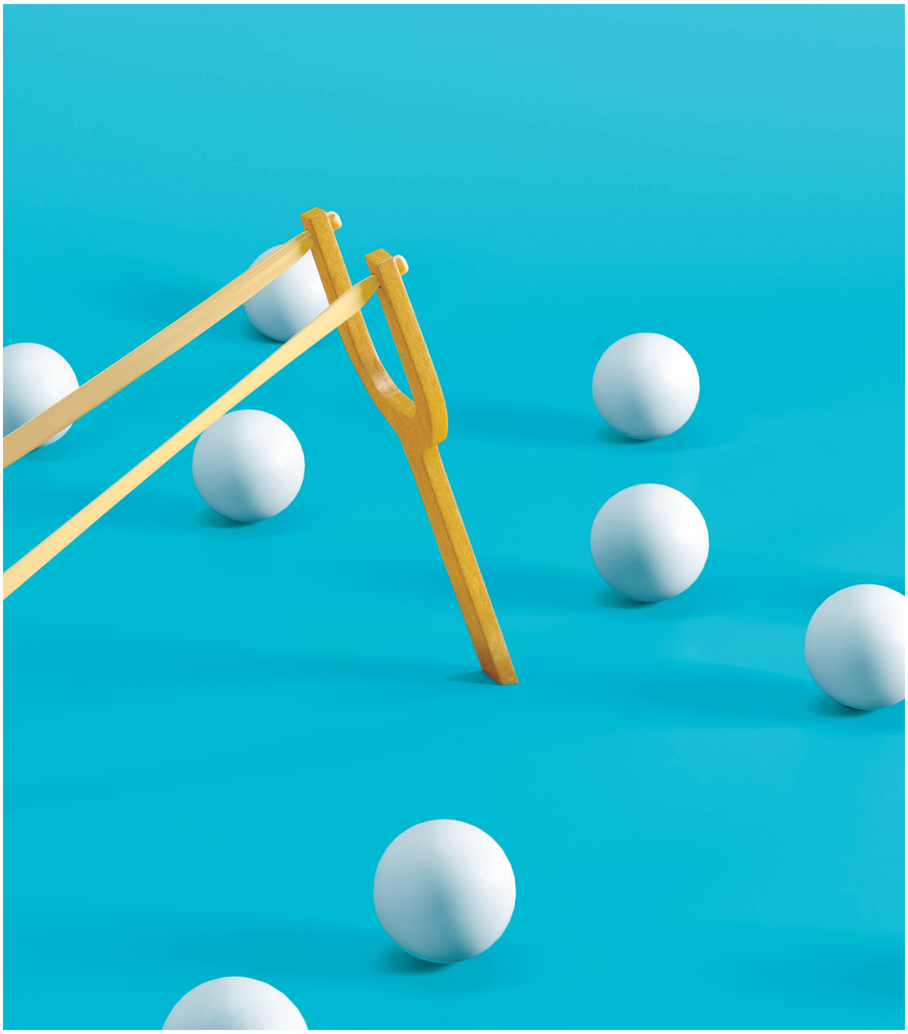

expect. Boards that overmanage risk do not leave room for innovation.

6. Time for a refresh?
Just as technology is rapidly advancing, boards too should ensure they are keeping pace. This means regularly assessing whether a director's mix of knowledge and background aligns with the company's evolving strategy, innovation appetite and risk profile. If it is out of alignment, it may be time to refresh the boardroom with new and more relevant perspectives.

There is no specific set of skills, background or expertise that boards should add to enhance their ability to oversee innovation, Ms. Britt says—it depends on the company and strategy. That agrees with research published last year by Edward J. Zajac, a professor at Northwestern University's Kellogg School of Management, and Razvan Lungeanu, a professor at Northeastern University's D'Amore-McKim School of Business. They analyzed the strategic evolution of companies after the arrival of new board directors and found that the directors who most effectively exerted influence on strategic direction possessed both a depth and breadth of experience—rather than one particular industry background or type of expertise. Remarkably, the study found that boards that added a "deep and broad director" with specific experience fostering innovation saw a 30% difference in their company's R&D activities one year later.

"You want your senior management team members to have both depth and breadth," Mr. Zajac told *Kellogg Insight*. "So why wouldn't you want it from your board members as well?" **IQ**

This requires nuance, Ms. Britt says, "so that you don't just hand management the keys, but you also don't scare them into not wanting to innovate." An effective board helps management gauge which opportunities the company should pursue, how to fund innovation and which trade-offs the organization will make between short-term and long-term ROI. This takes "a fabulous board dynamic that is 100% working together with management but also has enough tension to have good arguments," she says.

5. Expect some failures
Innovation often involves failure, so boards should be ready to both celebrate wins and learn quickly from losses. "If you're not failing, you're not innovating boldly enough," Ms. Britt notes.

To be truly first-to-market with a product, service or approach, a company is often betting on faint signals. And sometimes the bet does not pay off. Boards must recognize that risk and innovation are a balancing act and explicitly outline how much failure they will tolerate and should

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