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Pakistan Institute of Corporate Governance

# Innovation as agenda item on Board meetings

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There is no denying that companies are the most important drivers of economy for any region. The prosperity of a company is often highly linked to the quality of the board and its practices. In this age of technology, it is not hard to conclude that the last three decades of human civilization have seen more changes than any other period in history. A lot of times we have come across stories that entities that were unable to adapt to these changing times disappeared.

The prevalent times have hence forced companies to either innovate or vanish.

With newfound technological advantage companies are innovating newer products and are discovering more efficient methods of production; organizations that were unable to adapt to this change were ruthlessly brushed aside. Add to this a mammoth population of 7 billion and the ability to seamlessly access potential consumers (thanks to extraordinary internet connectivity and e-commerce that has allowed the uninterrupted flowing of capital across regions). While competition may have intensified, creating a market however from such an unprecedented population base has never been easier.

The biggest modern day example in favor of this argument would be Nokia. For almost 2 decades Nokia dominated the market and revolutionized the telecom business – they were one of the first companies that were successfully able to bring the cellular phone technology globally to the masses. The Finnish telecom giant at one point in time was hence the biggest cell phone manufacturing company in the world. But in those changing times, Nokia perhaps failed to catch up with the notion that in this era of 'disruptive innovation' (which is a form of innovation that creates a new market and value network, and eventually disrupts an existing market and value network, displacing established market leading firms, products and alliances)[1] nothing remains

[1] (Harvard Business Review, 2016)

constant – similar to how alternate platforms like Apple and Linux barged in and took over a significant chunk of Microsoft's operating systems' market in the 2000s, Nokia in its three-plus decades of existence since the 80s posted its first loss in the year 2009. It is worth mentioning here that while the first 6-8 years of the last decade were spent by other companies trying to emulate Nokia's success story, everything changed when two new entrants entered the market with new technology – Google's Android platform and Apple's IPhone – these new entrants gave Nokia severe competition. Their groundbreaking touch screen technology rendered almost all of Nokia's cellular phones irrelevant as consumers started switching to the newer technology. Although they strived hard to catch up with the smart phone market, but were unable to catch up; slowly and gradually the company started fading away into oblivion. The company was eventually bought by IT giant Microsoft which plans to phase out the brand. The question that arises is that in today's hostile business atmosphere where newer entities can easily wipe off older, much experienced entities, can a company afford to not think about innovating?

It is evident that most 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 for transformation in particular – are, of course, the prime responsibility of top management.

In the current economic sphere, organizations face a two-fold challenge – the most obvious one is that of fierce competition from competitors who are continuously innovating better products. The second challenge is related to sustainability – it is worth mentioning here that in recent years the definition of the word has expanded colossally from mere survival of the organization itself, and greatly takes into account the social and environmental impact of businesses on all stake holders. The answer to this two-fold challenge lies in innovation.

Since the industrial revolution, the colossal use of natural resources has resulted in an unprecedented waste problem. The industrial revolution and the subsequent reckless consumerism led to unprecedented negative impact on our environment. Hence in this highly connected, tech savvy world, the collective realization that damage control needs to be done on an immediate basis is high and unprecedented. The World Bank's predictions for global waste generation are staggering: on current trends it will double between now and 2025 to 6.5 million tons of solid waste every day.[2] For sure with time recycling rates have improved, and so has the efficient use of resources; however a vast majority of companies' business models are not set up to do much else than earn money from volume. The fact that few businesses are vertically integrated makes it more difficult for businesses to reform the model for "closed" product loops even if their

[2] (Co.Exist, 2016)

CEOs want to. When you add to this the OECD's estimate of an extra two billion middle class consumers before 2030, commodity price volatility and new environmental regulations, we start seeing the magnanimous scale of challenge.[3] The good news, however, is that circular economy thinking— which is building an economy that doesn't create waste— has started to make more and more business-sense.[4] Every day companies are improving their products, trying to minimize their respective carbon footprints, and are seeking more efficient means of production.

In recent years, environmentally and socially reckless corporations have been lambasted in the press, faced vehement protests, warnings, fines, and were even forced to halt operations (in some extreme cases). A prime example in this regard would be oil spills in seas caused by oil companies which caused severe damages to marine life and the ecosystem – thanks to the advent of social media a news – good or bad – spreads like wildfire; it is no longer about an editorial against the company being published in some newspaper temporarily with people forgetting about it a day later. With the advent of social media, every voiceless individual has found a voice – online campaigns against a particular organization's or individual's misdoings can go on for months (case in point: The Occupy Wall Street Movement in New York which demanded remuneration equality and was innovatively built around both online and actual presence, and gained widespread coverage by global media). Considering all these pressure mediums, a hazardous environmental accident can act as a death blow to the company's reputation.

Companies today certainly have to be more cautious about their business practices than they were a few decades ago; they have to start believing that minimizing the company's impact on the environment will enhance their reputation, which may also subsequently result improved monetary worth of the company (likely due to increased shareholders' interest). It is also worth mentioning here that some companies have already taken sustainable practices a notch higher by voluntarily adhering to Integrated Reporting (IR) (a contemporary reporting system that also takes consideration non-financial disclosures). All of these innovative practices were almost unheard of 2 to 3 decades ago. Coupled with the tech-driven desire to make better and better products, innovation certainly should be one of the most important themes, for businesses across the globe to ponder upon, in their respective board meetings.

**Implementation**

While conventional preconceived notions confined Corporate Governance as a means of maximizing and safeguarding shareowners' wealth, the contemporary definition however takes into account the welfare of all stakeholders, and gives due

[3] (Co.Exist, 2016)
[4] (Co.Exist, 2016)

consideration to the environment and society – the belief that infinite advantages can be reaped from a finite planet is fading away fast and stakeholders are willing to devise a system that enables the welfare of all stakeholders. Having established the notion that sustainable practices and keeping up with competitors is greatly linked to innovation, it is important that boards are keen on setting an innovation agenda in almost all of their board meetings. The reason being the verity that the board is primarily responsible for setting the company's strategic direction top to down, and is often the visionary entity that guides the management, albeit simultaneously avoiding micromanaging the company's day to day affairs.

It should be mentioned here that innovation is a fairly new practice even in the more developed parts of the world, and it would be beneficial to assume that it will take some time for companies to fully implement innovation as a cornerstone of their respective companies' strategies, cultures and policies. While considering the scenario of a developing country like Pakistan, it should be kept in mind that the country has a long way to go before it is fully able to achieve the high standards of corporate culture practices in more developed parts of the world, particularly the West. While it is an encouraging sign that Pakistan has fully adopted the Code of Corporate Governance as part of its listing regulations (with some companies also striving to voluntarily adopt the Integrated Reporting Framework without any legal obligations as such), it will take a lot of time for a large number of companies to evolve to an extent where they can understand the importance of innovation as a means of keeping up with competitors locally and globally, and for enhancing their own reputation with respect to the impact of their businesses on the environment and the society.

Barring the technology industry (which is by default forced to continuously try and break new ground with products or be swept away by competition; this also triggers them to strive to achieve higher thresholds of efficiency in production, and are also likely to be more concerned with sustainable practices to avoid activists coming hard on them in case of accidental environmental or socially recklessness), innovation in most cases will however remain a fairly new practice. One of the key reasons for this is the notion that innovation is not directly linked to a company's short term pursuits – such as a company's immediate sales, profits, revenues or day to day affairs. It is rather more aligned with farsightedness and establishing a sustainable vision for the future – the board is often required to carefully study and assess current and newer industry practices, trends, and the impact of their organization on the society and environment; if correctly done this subsequently enables them to chalk out a futuristic strategy for their company to deal with unforeseen competition and circumstances. The management hence will only take it seriously if the board establishes innovation as a cornerstone of their company strategy and culture, and for that to happen innovation will have to become a primary agenda at board meetings, amongst various others.

The board will be required to objectively devise realistic innovation goals for the management and develop key indicators that will enable them to analyze whether those goals are being achieved. There is also an aspect of risk management to this – the board will be required to carefully assess the type of risks that are associated with the innovation goals being pursued by the management, and as to how these risks can be mitigated. Most importantly the board will also be required to carefully analyze whether they are appointing the right managerial leaders for those innovation goals. The company's top management will specifically be required to meet to define the company's innovation policy; subsequently they will have to ensure that the company's precious capital is rightfully invested and that that the innovation investment decisions are diligently executed.[5]

It is worth mentioning here that Corporate Governance and ethics become more difficult with the indirect implications of particular practices, making it important to assess the way in which certain operations may adversely affect the community at large. Hence environmental and societal protection is an important ethical obligation that modern organizations cannot choose to ignore. However, businesses themselves cannot be ethical: managers are the primary decision makers of an organization, and therefore must hold themselves accountable for the way in which a business operates and affects stakeholders, shareholders, employees, and the community at large. Only the managers and corporate strategists can implement ethics within the framework of the business strategy. While corporate ethics and shareholder desires for profitability may not always be aligned, it is however the responsibility of executive management to ensure that ethics supersedes profitability.

It should also be noted here that all of these diverse aspects of innovation can be clubbed together and resolved through adherence to Innovation Governance – which is a holistic approach to steering, promoting and sustaining innovation.[6] Innovation Governance is greatly aligned with this newfound global realization to do more than just mere financial disclosures. Companies are willing to go beyond voluntary non-financial disclosures to address the limitations of prevalent reporting systems. These voluntary adherences are likely to enable organizations to develop long-term business strategies, which take into consideration both the financial and the non-financial aspects such as environment and society. Globally it is becoming a new management imperative, as companies and their boards are striving to endlessly engage in keeping up with their competitors, as well as reducing their impact on the environment (which is likely to enhance their reputation with investors and consumers alike). Subsequently a more important part of Innovation Governance is the 'Innovation Audit' – it is a way to

[5] (Som.cranfield.ac.uk, 2016)

[6] (Deschamps, 2016)

understand how effective an organization is at managing innovation.[7] Individual employees are asked to anonymously give their opinions on different aspects of innovation management, such as the way ideas are generated.[8] Often innovation is classified into outputs (such as products, services, processes, and business models) and five aspects of innovation management: strategy; ideas generation; prioritization; implementation; and people, culture and organization.[9] The careful usage of qualitative and quantitative data

We live in changing times and there is no doubt that organizations that do not innovate are bound to perish. I would like to end this paper with a quote from renowned 19th physicist William Pollard who about innovation said, "Without change there is no innovation, creativity, or incentive for improvement. Those who initiate change will have a better opportunity to manage the change that is inevitable. The arrogance of success is to think that what you did yesterday will be sufficient for tomorrow."[10]

[7] (Som.cranfield.ac.uk, 2016)
[8] (Som.cranfield.ac.uk, 2016)
[9] (Som.cranfield.ac.uk, 2016)
[10] (BrainyQuote, 2016)

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