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Face the Future with Confidence

Board Perspectives:
Risk Oversight

Sustaining an Innovation Culture in the Digital Age

Innovation is the lifeblood of every organization. An innovation culture is what sustains reinvention and breathes life into the organization itself. In the digital age, the board has an important role to play in strengthening and nurturing this culture.

Digital transformation is disrupting entrenched incumbents and even whole industries as the pace of change impacts the performance of traditional business models for creating value. As the combination of high-speed, ever-connected networks and maturing digital technologies enhances ties between organizations and their various stakeholders, opportunities to innovate processes, products and services emerge that were unthinkable a few years ago.

With such unmistakable mega trends in the business environment, the board of directors has a role in ensuring that the organization it serves is not missing out on opportunities to innovate and, as a result, running the risk of getting swept aside by the forces of disruptive change. In this context, the oft-referenced adage of "disrupt or be disrupted" gives way to the harsher specter of "innovate or die."

Not Yesterday's Innovation Process!

For organizations that make innovation a priority, the process has traditionally involved designating responsible individuals, setting performance expectations linked to entity objectives, allowing designated innovators to operate in a risk-free environment, monitoring their progress using appropriate metrics, and then holding them accountable for results. However, for most organizations, innovation has been opportunistic and ad hoc. For innovation to reach its full potential in the digital age, a culture that emphasizes innovation must also encourage diversity, collaboration, empowerment, continuous learning, ingenuity, change enablement and team performance.

Everyone across the organization must recognize that, if the business is to achieve sustained innovation excellence, innovating must be integral to their job. To that end, organizations need to measure and reward

innovation so that it becomes a core competency that drives priority-setting, resource allocation, talent acquisition and the development of influential leaders. Essentially, the entire workforce must share a commitment to innovation.

Creative people tasked with innovating for the business can set reasonable parameters for their work based on the company's strategy, objectives, core capabilities, and commitments to customers and stakeholders. At the same time, the business must be confident that it has the right people focused on the right opportunities, and that everyone understands the primary objective of innovation is to bring to market practical processes, products and services that can enhance the customer experience, critical decision-making processes and operational excellence. Executive management must "get it" — success is not final, fail fast and learn from failure, and quickly engage with customers to test new ideas through trial and error.

Customer engagement is vital to innovation in the digital age. Attempting to perfect a concept before trialing it with customers ignores the reality that customer response to innovation is notoriously difficult to predict. Text messaging is a prime example of something that on paper may have made little sense for mass use commercially, particularly once email became available. But once phones and networks adapted to accommodate the technology better, it transformed the way people communicate through its mobility, immediacy and brevity. The point is that users often do not use products in the way that inventors expect. That is why obtaining input from end users should be an integral part of informing the innovation process. Companies cannot afford to waste time and resources trying to improve things that customers do not want.

Decide on the Desired Digital Maturity Level

In the digital age, leaders are very good at innovation and disruption. Accordingly, it is contextually important to the board's oversight of the innovation culture to understand how the organization should position itself, even if it has little appetite for competing as a front-runner.

Given that every organization is different, the board should consider whether the organization is a digital follower, expert or leader:

- **Digital follower** — The organization has developed a digital strategy and has a proven track record delivering on digital initiatives, which are typically focused on discrete aspects of the customer journey.

- **Digital expert** — The organization has a proven track record of adopting emerging technologies, has achieved high levels of process automation and quantitatively manages digital aspects of its strategy enterprisewide.

- **Digital leader** — The organization has a proven track record of disrupting traditional business models; digital aspects of strategic plans are continually improved based on lessons learned and predictive indicators.

The approach to innovation is very different for these distinct classes of organizations. Leaders disrupt. Experts aspire to be leaders. Many companies are content to be agile followers, meaning that they frequently reassess and adapt their digital strategy as the market changes. Most businesses are not where they want to be. Many that desire to be followers are in fact beginners. They have multiple digital initiatives underway with objectives that are well-understood, but they lack fully developed digital plans. And many companies that want to be leaders are in fact followers.

Even though they may not know it, some entities are actually skeptics (or observers) because they do not fully buy into the digital revolution and its impact on the business. Usually, these organizations lack formalized digital plans, and their management of digital initiatives is ad hoc. Also, their leadership team may view digital business as mere hype and their business as immune to change.

Neither the skeptic nor the beginner is likely to foster the culture necessary for sustained innovation in the digital age because, at best, they are digital on the edges but not at the core. Therefore, moving beyond these two levels of digital maturity — whether a skeptic or beginner — is desirable.

The challenge for management and the board is to decide what level of digital maturity they desire for the organization. In this context, the digital follower can be a relatively high-performing business.

Effective followers play the waiting game, monitor the competitive landscape, and react quickly when necessary to defend market share by enhancing the customer experience. Followers, to succeed, must be agile enough to respond quickly as an early mover, even if they aren't first movers.

Focus on Competencies

Regarding the assessment of digital maturity, Protiviti's original research has identified more than 30 empirically supported competencies arrayed across six core disciplines at which digital leaders excel. These competencies consist of capabilities and structural characteristics that can be used to benchmark the organization to identify its strengths and weaknesses. They can be used to assess an entity's resilience and likely innovation performance in creating new markets and eventually disrupting existing markets and displacing established incumbents, products, services and alliances.

These are the real stakes of the innovation game in the digital world. Everything else is small ball.

Competencies that have a direct impact on stimulating and rewarding innovation performance include those related to vision, leadership and culture. In the digital age, an organization's ability to convert its ideas into practical applications is crucial to sustaining an innovation culture; therefore, competencies related to technology innovation development and big data analytics automation play an important role.

Some competencies indirectly impact innovation performance. For example, the way digital leaders approach financial planning can be very different from that of followers or beginners. Too much of a focus on individual performance, current year results, immediate return on investment (ROI) and other traditional measures can get in the way of unleashing innovative behavior. Innovation does not usually deliver immediate results.

Another indirect impact comes from governance and compliance. When teams responsible for innovation actively seek input from risk and compliance professionals, the input they receive must help them manage risk or overcome regulatory challenges in creative but appropriate ways that advance the entity's digital initiatives.

One of the core disciplines of Protiviti's digital maturity assessment framework is "organization, structure and processes." Within that discipline is the innovation and research competency, which is useful in distinguishing between digital leaders and followers.

Highly innovation-driven digital leaders align all products and services with relevant digital trends and business models. Responsible executives within the company understand the importance of continuous reinvention to long-term success and are fully engaged in nurturing an innovation culture. For example, they think big in reimagining business models, products and processes and break down significant undertakings into manageable, well-defined parts. They organize lean, focused teams and hold them accountable to move fast. Their respective contributions are measured and rewarded in performance appraisals.

Research is conducted to determine the market potential for digital products, services and solutions and to provide a clear focus on customer demand. When integrated throughout the company, innovation applies processes that follow predefined innovation rules (e.g., idea generation, idea screening, experimentation, commercialization, diffusion). Partnerships are established with technical partners, universities and others to foster creativity and gain access to needed capabilities. Leaders and employees are encouraged to attend conferences, seminars and events that focus on ideas relevant to the business.

Digital followers are also innovation-driven. However, they tend to orient digitization to a technical or general innovation path with product and service innovations limited by various internal constraints and a company-centric view. Innovation is often the responsibility of the enterprise's research and development (R&D) and innovation team, which may not be connected to the rest of the organization; therefore, employees across the entity do not necessarily feel responsible for innovation.

This disconnect with the business may lead to failing innovation projects lasting too long before they are stopped. Often, the organizational structure is not suitable for an agile and continuous innovation process.

Context Is Important to Oversight

Understanding whether the company desires to be a leader or a follower or something in-between is important, as management's digital appetite provides directors with the context they need to focus their oversight of the innovation process. If the enterprise is a skeptic or beginner, directors may need to strongly encourage management to assess the organization's digital readiness and review the results of that assessment with the board. When changes to the corporate culture are needed, the required investments should be made to forge an environment that empowers and rewards employees to test new ideas and take the appropriate risks to make those ideas a reality, without the fear of repercussions or reprisals if they don't succeed.

Companies committed to innovation are confident in facing the future because they know they are playing the right game: viewing innovation as a continuous process rather than a dramatic event. Innovation as a strategic imperative is an integral part of the confident organization's DNA and is evidenced by setting accountability for results with innovation-related metrics at the organizational, process and individual levels to encourage and reward creativity.

Questions for Boards

Following are some suggested questions that boards of directors may consider, based on the risks inherent in the entity's operations:

- Does the board understand where the organization stands on the digital maturity continuum? Is it a follower? Or an expert or a leader? If the company is a beginner or skeptic, does the board encourage management to advance its digital maturity?

- Does the board agenda allocate time for discussing the company's innovation strategy and culture, encouraging open discussion on direction and progress? Is this dialogue supported with appropriate innovation-related metrics that tell the full story regarding the results the strategy is delivering, ROI, and the effectiveness of the company's innovation culture and capabilities?

- Is the organization capable of challenging conventional thinking and disrupting recognized ways of working? Is it agile and adaptive enough to recognize market opportunities and emerging risks over time and capitalize on, endure or overcome them with timely adjustments to its strategy and infrastructure?

- Are there barriers to innovation and digital transformation that exist within the organization that require the board's attention? For example:
  - Lack of effective processes for (a) identifying and understanding maturing technologies that are expected to have a disruptive impact on the business and (b) capturing external ideas and best practices that can invigorate innovation;
  - Inability to apply knowledge of maturing technologies to drive relevant digital innovation initiatives;
  - Lack of a strategy or road map outlining steps the company should take to advance its innovation journey;
  - Innovation placed in the hands of only a few (e.g., the R&D department) rather than emphasized across all aspects of the business, including third-party partnerships;
  - Lack of transparency and knowledge-sharing that constrains the organization's ability to learn from its successes and failures;
  - Inadequate staffing and resources assigned to innovation projects leading to insufficient progress; or
  - Preoccupation with budgets and deadlines and other behaviors that starve good ideas before they get a fair trial.

  Are steps being taken to eliminate these and any other barriers?

How Protiviti Can Help

Protiviti is working with 60 percent of the Fortune 1000 and 35 percent of the Fortune Global 500, as well as smaller companies, including fast-growing technology organizations, both pre- and post-IPO. We have a proven track record for bringing innovative solutions to help companies solve some of their most difficult business problems. Our digitalization offerings help enhance the innovation culture of companies by focusing on:

- **Customer engagement** — Exploring new ways to build strong relationships with customers.

- **Digitizing products and services** — Launching new, enhanced products, and exploring new business models.

- **Better-informed decisions** — Enhancing the information available to enable timely and effective data-driven decision-making.

- **Operational performance** — Creatively using technology to improve performance.

Is It Time for Your Board to Evaluate Its Risk Oversight Process?

The TBI Protiviti Board Risk Oversight Meter™ provides boards with an opportunity to refresh their risk oversight process to ensure it's focused sharply on the opportunities and risks that truly matter. Protiviti's commitment to facilitating continuous process improvement to enable companies to confidently face the future is why we collaborated with The Board Institute, Inc. (TBI) to offer the director community a flexible, cost-effective tool that assists boards in their periodic self-evaluation of the board's risk oversight and mirrors the way many directors prefer to conduct self-evaluations. Boards interested in using this evaluation tool should visit the TBI website at http://theboardinstitute.com/board-risk-meter/.

Learn more at
www.protiviti.com/boardriskoversightmeter

Protiviti is a global consulting firm that delivers deep expertise, objective insights, a tailored approach and unparalleled collaboration to help leaders confidently face the future. Protiviti and our independently owned Member Firms provide consulting solutions in finance, technology, operations, data, analytics, governance, risk and internal audit to our clients through our network of more than 70 offices in over 20 countries.

We have served more than 60 percent of *Fortune* 1000® and 35 percent of *Fortune* Global 500® companies. We also work with smaller, growing companies, including those looking to go public, as well as with government agencies. Protiviti is a wholly owned subsidiary of Robert Half (NYSE: RHI). Founded in 1948, Robert Half is a member of the S&P 500 index.

Protiviti partners with the National Association of Corporate Directors (NACD) to publish articles of interest to boardroom executives related to effective or emerging practices on the many aspects of risk oversight. As of January 2013, NACD has been publishing online contributed articles from Protiviti, with the content featured on https://blog.nacdonline.org/author/jdeloach/. Twice per year, the six most recent issues of *Board Perspectives: Risk Oversight* are consolidated into a printed booklet that is co-branded with NACD. Protiviti also posts these articles at protiviti.com.

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