2016
Innovation
Report

View From The Top

A conversation with 20+ Chairs and CEOs from major corporations on the state of innovation in Australia.

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We wanted to accelerate the innovation journey in Australia, so we took a different approach

We spoke to 21 leaders of Australian business, 9 CEOs and 12 Chairs of top ASX-listed companies. We had a semi-structured agenda for the conversations, but we wanted them to flow naturally so that deeper concerns and insights could emerge.*

These conversations are the data for our research - and they offer a unique look into the hearts and minds of leaders in Australia and their experience of innovation in their companies, as well as their observations on the systems and structures supporting innovation.

* THIS REPORT IS BASED ON RESEARCH CONDUCTED IN COLLABORATION WITH DR LINDA LEUNG, DR NATALIA NIKOLOVA, AND DR JOCHEN SCHWEITZER AT THE UNIVERSITY OF TECHNOLOGY BUSINESS SCHOOLWITH APPROVAL FROM THE UTS HUMAN RESEARCH ETHICS COMMITTEE (REFERENCE NUMBER 2015000439).

What is the role of Boards & CEOs in fostering innovation?

What are their current practices & concerns?

Where do we look to map the best way forward?

There have been many quality ‘innovation surveys’ undertaken in Australia recently. Most of these provided a ‘fifty-thousand foot’ macro-economic view of innovation and relied on traditional ‘tick box’ survey techniques to gather data.

We wanted to go deeper. We wanted to look under the hood, get practical, and go beyond descriptive analysis to the heart of innovation.

So we did two things:

1. We chose to focus on the role of Boards and CEOs in driving large-scale innovation. This allowed us to limit our research to the insights and impact of senior leadership on innovation in Australia.
2. We took a ‘design research’ approach rather than a more usual quantitative approach. We interviewed Chairs and CEOs in broad one-on-one conversations that stretched from one to two hours each. This gave us detailed insights into what leaders of large businesses are thinking and doing.

Design research gets closer to the action and is more suitable for the topic of innovation. It relies on qualitative methods – wide ranging conversations, scenarios, examples and stories – to discover the culture and behaviours that are driving results.

It yields rich ideas and solutions in a way that surveys cannot.

Where is Australia placed in the global innovation economy?

/ Our natural resources are a blessing and a curse

We face some deep challenges to innovation due to our history and the present structure of our economy. Our wealth to date has been based on vast mining and agricultural resources. While, on one level, this is fortunate, it has also inhibited our drive to innovate, simply because we can get by being complacent. If 'necessity is the mother of invention', do we currently share a sense of urgency and need sufficient to drive us to invent? This question is put into stark contrast by the recent success of similar size (or smaller) countries that do NOT have natural resources to leverage. Hong Kong and Singapore lack our material wealth and all have achieved greater 'innovation efficiencies' (how much innovation a given country is getting for its inputs) than we have in Australia.*

/ We tend to be nationally introverted

Australia is also hampered by its geographical size and relative isolation. We don't meet face-to-face with markets and customers at an international level and this lack of direct proximity has fostered introversion; if markets and competition drive innovation, our isolation does not serve us well.

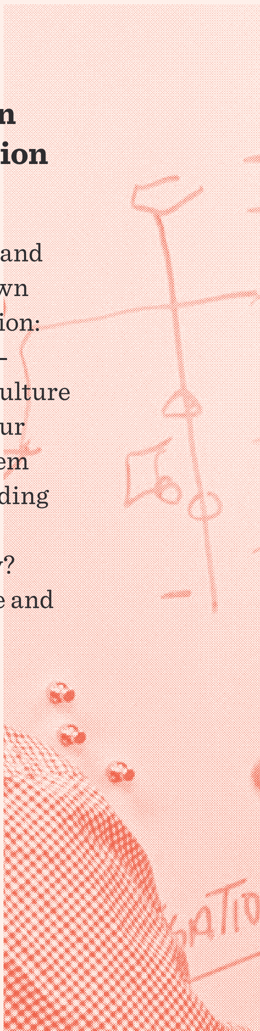
* PALMER, C., SHILTON, D., JEYARATNAM, E., & MOUNTAIN W. "AUSTRALIA'S INNOVATION PROBLEM EXPLAINED IN 10 CHARTS" LAST MODIFIED DECEMBER 7, 2015. HTTP://THECONVERSATION.COM/AUSTRALIAS-INNOVATION-PROBLEM-EXPLAINED-IN-10-CHARTS-51898.

/ Yet we are on the doorstep of the biggest market of all

In Australia we also enjoy huge advantages. We are on the doorstep of Asia, have stable and fair legal and political structures, and possess an increasingly educated populace. We have a long and successful tradition in pure and applied scientific research, examples of world-class technologies being developed here, and a large university sector. We have a diverse multicultural population, and we are an attractive place for people to live and work. By and large, our economy is ethical, so fair play can thrive and markets can be transparent.

/ So the big question is what can big business do to lift innovation nationally?

Acknowledging Australia's challenges and opportunities in this way, we were drawn to a series of questions around innovation: How large a role does business culture - particularly large corporate business culture - play in innovating in Australia? Are our largest businesses creating an ecosystem for innovation to flourish? Are they leading the way? Do they think innovation is important for them and for the country? What blockers and enablers do they see and experience daily?



Can corporate giants learn to dance?

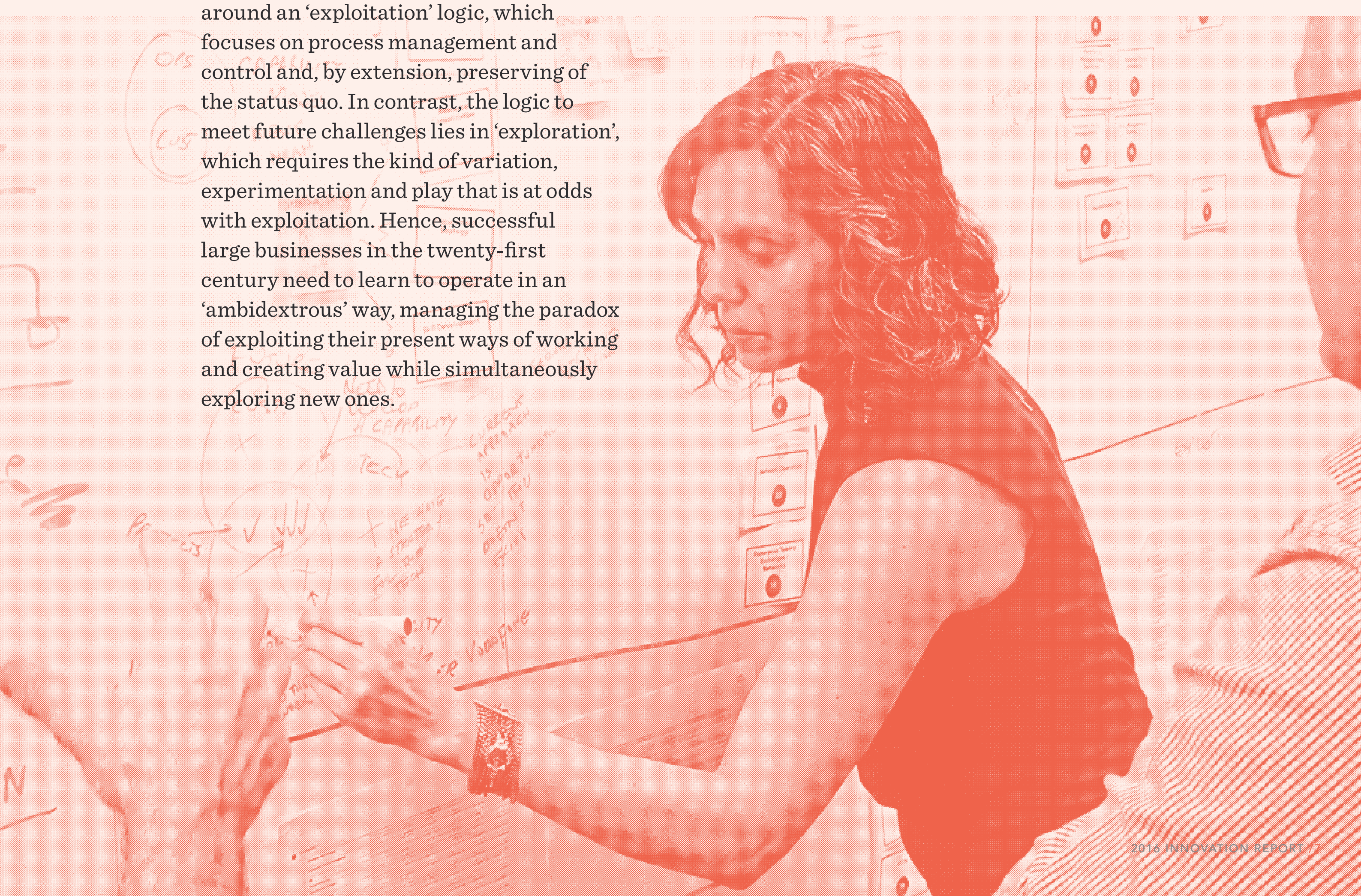
The challenge of the status quo and the 'ambidextrous' organisation

It is not easy for large businesses to innovate. They are not natural hosts for innovation. Almost by definition, they are mature organisations that long ago grew out of their entrepreneurial roots. They have developed systems of control and risk management that can discourage the kind of risk-taking that is so central to innovation. A seminal article in *The Academy of Management Review*[*] explored how many large businesses are built around an 'exploitation' logic, which focuses on process management and control and, by extension, preserving of the status quo. In contrast, the logic to meet future challenges lies in 'exploration', which requires the kind of variation, experimentation and play that is at odds with exploitation. Hence, successful large businesses in the twenty-first century need to learn to operate in an 'ambidextrous' way, managing the paradox of exploiting their present ways of working and creating value while simultaneously exploring new ones.

This paradox provided the background for our inquiry. In particular, we focused our research around the following major questions:

1. What are Boards and CEOs of large Australian businesses doing to drive innovation?
2. How are they doing it?
3. Are their actions enough to shift the dial on innovation - at a national scale?

* BENNER, M. J. & TUSHMAN, M. L. (2003). "EXPLOITATION, EXPLORATION, AND PROCESS MANAGEMENT: THE PRODUCTIVITY DILEMMA REVISITED" *THE ACADEMY OF MANAGEMENT REVIEW*. VOL 28. NO 2. 238-256.



We have begun the journey, but we are not masters of innovation

– yet

Here is what we heard and what we diagnosed

1/ THE AUSTRALIAN CONTEXT

- On the global stage, we are too cosy and comfortable
- Markets encourage a conservative approach
- Capital rules make it easier to buy than to build
- Regulations hamstring innovation

2/ FOCUS OF INNOVATION

- Innovation is important but not always central
- Large businesses want to defend the core, then invent
- Small bets and incrementalism reign
- Short-term thinking drives decision making
- Innovation is stifled by the demand for certainty

3/ METHODS OF INNOVATION

- There are few integrated approaches to innovation
- Culture is seen to trump formal practices
- Everyone is responsible for innovation but the CEO must lead

4/ ROLE OF BOARDS

- Boards want to encourage, rather than initiate, innovation
- Boards want to look outside and bring lessons inside
- Boards can communicate the value of innovation to markets

5/ LEADING THE WAY

- Become an 'ambidextrous' organisation
- Create 'special purpose vehicles'
- Invest in effective innovation methodologies
- Strategy, strategy, strategy

6/ OFF THE RADAR

- What we didn't hear but expected to...

1/

THE AUSTRALIAN CONTEXT

On the global stage, we are too cosy and comfortable

Is the overseas context more exciting for young executives?

Interviewees had different perspectives on the various challenges for innovation in Australia. There was a sense that the more exciting and career-building experiences working for innovative organisations were to be had overseas.

> *They do think longer term overseas.... American companies are much bigger, and the bigger you get, the more you can do smaller time innovation. The smaller you are,...you can do [innovation] because no one is watching, but if people are watching, it's a problem.*
>
> (CHAIR / INTERVIEWEE 9)

Is our economy too oligopolistic and our markets not competitive enough?

When ex-pat chief executives have 'earned their stripes' and come to the end of their 'adventure years' abroad, they return to Australia for an easier and more comfortable life. This translates at an industrial level to the way Australia does big business.

> *Australia is a great country for creating cocktails, which usually then stifles innovation. I don't know whether it's because we are just the right size for two big supermarkets, four big banks and two airlines. It means they tend to end up pretty profitable, with strong positions of incumbency. There is no doubt that that stifles innovation. It's difficult for externals to come and compete there, and it turns out to be quite difficult for us to go and be really good everywhere else. So you look at industry after industry that are characterised by a small number of very profitable incumbents.*
>
> (CEO / INTERVIEWEE 18)

> *It might just be our size and maybe there's a little bit of laziness - and a bit of comfort factor that's come into Australia.*
>
> (CEO / INTERVIEWEE 5)

Markets encourage a conservative approach

Boards and markets reward a conservative approach

There was little reference to being 'best in world at...' or aspiring to be so. Nor was there discussion about companies' positioning in a global marketplace:

> *It seems to me that if you do nothing, from a PR point of view, your reputation is fairly safe. Because doing nothing probably won't wreck the company immediately, it would be done in the next person's lot. But doing something not only can wreck your reputation now, but can wreck your reputation down the line, because they all blame it. The next generation of directors will say, 'It goes back to what you were'. As Boards, it's really not in our interests to be innovative. The market doesn't respond quickly on it, the market likes short term things in general. Finally, there is a fear, be it publicity, be it liability, be it class actions, be it takeovers, etc., the whole structure is against the innovative thinking.*
>
> (CHAIR / INTERVIEWEE 9)

We are missing a large innovation community of practice in Australia

Such a community of practice would enable people running big, established businesses to interact and collaborate with entrepreneurs. To compensate for this lack, most of the respondents interviewed take senior executives and Board members to other countries that do have a flourishing innovative communities. However, this has its limits, as it does not enable the ongoing exchange of ideas, views, and perspectives:

> *We have got a big job in this country to connect properly the innovation centres. We are still too tribal, and certainly the people that run businesses are not properly or sufficiently connected with the leaders of innovation in this country. We have pockets of innovative excellence. There is no doubt of that, in my mind. The problem is they are pockets and we don't have that nationwide culture. That is the bit that's missing.*
>
> (CHAIR / INTERVIEWEE 8)

Capital rules make it easier to buy than to build

"Impact on earnings" is the biggest inhibitor of large investments in innovation

Importing innovation and 'squeezing suppliers' for good ideas was seen as better for the company's bottom line than building or growing a company through innovation.

> *It's a lot easier for a Board to go and buy capability, because there's no immediate earnings impact.... Often what you are better off doing is to build capability. Take $100 million, you split it up, spread it over 10 years and spend $10 million a year. You will end up with a better result at the end. But what happens to earnings? They go down by $10 million a year. But if you write a cheque for $100 million, earnings don't go down.*
>
> (CEO / INTERVIEWEE 5)

Large organisations don't do much R&D today – they outsource it

There was acknowledgement that building capability from within was a better option, yet big corporates are not doing enough of their own R&D and, as a result, disruptive innovation was coming from smaller businesses.

> *Disruption is coming from smaller companies, but the people who know what that means to them are usually big companies.... The problem is, [the big companies] don't know how to make the innovation.*
>
> (CHAIR / INTERVIEWEE 9)

> *The issue about R&D is that larger organisations do not do a lot of it now. So you do it through smaller organisations. Only four percent of all businesses are working with a research institution. Larger organisations are certainly outsourcing their R&D.*
>
> (CHAIR / INTERVIEWEE 3)

Regulations hamstring innovation

Regulatory structures restrict innovation and take up most of your time

From a Board perspective, the time required to address compliance issues at Board meetings restricts the capacity to engage with issues of strategic innovation:

> *There are so many things that actually restrict your ability to be innovative, and a lot of it comes from the regulatory structure that you have then got to deal with, because more often than not, if you want to do something different to the way you have done it before, you've got to go check to make sure that there is no regulatory intervention that might occur down the track, or something that is going to give you some problem.*
>
> (CHAIR / INTERVIEWEE 16)

Our reform agenda has to be globally ambitious yet both sides of politics are weak on it

From a CEO's viewpoint, Australia must compete with other countries for big business and international talent. Regulation and taxes will influence the movement of multinational corporations and the innovation catalysts who work in and with them.

> *We know we have got problems with the tax system.... So the reform agenda has to be huge. At the moment there is a lack of appetite from both sides of politics to address those reforms. I think that is a real problem for the country.*
>
> (CEO / INTERVIEWEE 19)

2 /

FOCUS OF INNOVATION

Innovation is important but not always central

Everybody recognised the need for innovation and there was a thirst for fresh ideas. However, the underlying tone suggested 'it's interesting' rather than 'it's central to our strategy.'

Interviewees were well aware of the need to innovate constantly. However, the comments below convey a sense of polite interest, as opposed to urgency and priority:

> *Innovation is not something you just do at one point in time - it has to be continual. You can't stop still, and particularly in this day and age, with so many changes and the advent of the internet, and the Internet of Things. It really is controlling so much of what is going on in the world today, that you need to be continually upgrading yourself and making sure that you are fit for market in every sense of the word, which means continually changing your procedures, changing your - or upgrading your people, developing your people.*
>
> (CHAIR / INTERVIEWEE 16)

> *There's a very strong recognition from the Board that if we don't innovate we will become irrelevant. There's a real thirst for knowledge on the Board. So, we spend a lot of focus at the Board on outside stimulus and learning and different perspectives.... [Our industry] can be very, very insular and we can talk to ourselves all day long and convince ourselves of this is how the world is.*
>
> (CEO / INTERVIEWEE 1)

The scope of real interest was more 'incremental' than 'game changing'

Because incremental innovations are less risky and generate quicker return on investment, many companies prefer to focus on these:

> *If it's incremental, we would probably go for it. If it's incremental, your investors will follow and we will be able to get the money.*
>
> (CHAIR / INTERVIEWEE 13)

Few of the participants were envisaging the scenarios of the digital world threatening their business model. The following comment was typical of most:

> *We don't see the disruptive threats immediately. We are worried that it could always happen. We see the opportunities. We know the Board is supportive of it. Do we really have a handle on what a true budget is going to be? We don't yet.*
>
> (CHAIR / INTERVIEWEE 11)

Large businesses want to defend the core, then invent

Innovation needs to feel relevant and to defend the current business model, which narrows its scope

Many interviewees framed innovation in terms of what is known and familiar, as it must add value to the existing business and provide a competitive advantage:

> *I don't think innovation requires [betting] the business. Innovation now is much more about improving, constant change, constant improvement.*
>
> (CHAIR / INTERVIEWEE 4)

> *Our transformation program was leveraging a whole series of new ideas and different ways of doing things that really improved our performance. We see innovation covering probably just about everything that you do from the marketing of the company to the transformation of your core business to the new businesses.*
>
> (CEO / INTERVIEWEE 19)

> *Basically [innovation is] doing what you do more efficiently and measuring it and benchmarking...you quite often go through periods of change and you identify better ways of doing things generally in tough environments. The trick is not going back to bad habits when things improve...we are not being disrupted digitally.*
>
> (CHAIR / INTERVIEWEE 6)

Sometimes it's hard enough just managing current complexities

Innovation was regarded as a defensive strategy that kept core business safe from disruption by others:

> *We are quite good at trying to play the game rather than changing it at the moment.... We are not even good at what we currently do, let alone getting into something else and creating a separate set of competencies. Maybe in three years' time when we are crash hot at what we do now then it's a different conversation. But at the moment we are just not there.... If we are going to spend an extra million bucks here, how do we find a million and a half in cost savings elsewhere to fund what we are doing over here?*
>
> (CEO / INTERVIEWEE 12)

Small bets and incrementalism reign

Funding proceeds in small bets rather than deep investments

Firms made small bets rather than deep investments in innovation, which were then deemed 'nice to have' because the companies were not in crisis:

> *I am publicly committed to not raiding the cookie jar of its [separate] budget. But we are not in crisis, so it's all very nice to say…. But you are not going to get $1 million and eight people in six months. You are going to get $200 and go out and try something and come back with learnings and try something else and come back with learnings.*
>
> (CEO / INTERVIEWEE 1)

> *You need to do [innovation] when the business can afford it…if you have so many current fires to fix, then it becomes almost impossible to get people to try. Every organisation has a limited capability. If an organisation has got so many fires…then the Chief Executive and the executive team are focused on fixing fires. Then they don't have the luxury of looking forward too much.*
>
> (CHAIR / INTERVIEWEE 4)

Innovation needs to prove itself and so is usually in a precarious position

Interviewees acknowledged that experimental products or programs are the first to be culled because they do not demonstrate profitability:

> *Innovative ideas are all well and good but when a project gets under pressure or an investment gets under pressure, the manager is going to stop it. They are going to value manage it out.*
>
> (CEO / INTERVIEWEE 1)

Short-term thinking drives decision making

Quarterly reporting drives short-term thinking and endangers innovation

Participants acknowledged a bias towards short-termism as a result of accountability to investors. The obligation of quarterly reporting was seen as a restriction to innovation:

> *Boards are encouraged to be short term. So if you are looking as to what your returns are going to be, sometimes quarterly, that does constrain enormously the innovation I can do. I have to trade-off the short- and long-term, and the short-term is much encouraged by our investors. As such, we respond by being short-term, and that cuts the innovation.*
>
> (CHAIR / INTERVIEWEE 9)

Even where Boards seek to educate their investors about the need for exploration in order to develop a long-term vision and strategy for the company, the personal risk to Board members is another factor in the current model being the default:

> *A director's life is not worth living if you preside over an insolvent company, because the debts of the company become yours.*
>
> (CHAIR / INTERVIEWEE 9)

Others put the short-term thinking down to the self-interest of management

Some interviewees attribute an excessive focus on exploiting immediate opportunities to the self-interest of management. There is no real interest in taking a risk that may pay off in the long-term, as the CEO may not be there to see the project come to fruition:

> *People try and blame shareholders, but it's not. It's management saying, 'Am I really going to be here in 10 years' time when this actually kicks off?'*
>
> (CEO / INTERVIEWEE 5)

Focusing and exploiting what the companies do well was considered mandatory while radical innovation could only be done when the company could afford it:

> *Catch up is 1,000 times harder than actually defending what you have, leading it, and being proactive. Because you start with a customer base and once they have gone, it's really hard to drag them back. Because they have gone to something better.*
>
> (CHAIR / INTERVIEWEE 7)

Innovation is stifled by the demand for certainty

The metaphors people use to describe innovation are revealing

A cautious approach to innovation is well illustrated by the metaphors some of the participants used when reflecting on the nature of innovation. One CEO referred to 'squeezing the lemon of the business', that is, thinking innovatively about how to get more out of the current business model. Likewise, a Chair talked about 'playing the hand that has been dealt, while trying to figure out the next set of cards and assess whether to go to another table'. Yet another Chair described strategic innovation as 'crystal ball gazing':

> *I think it's really important that the CEO [does strategic innovation] and the COO, if you have one, and the CFO, if possible. Beyond that, I think, certainly in the size team we have got, I would be a bit nervous about having too many other people crystal ball gazing and things like that.*
>
> (CHAIR / INTERVIEWEE 13)

Innovation has to satisfy business case criteria and a demand for certainty

Rather than having the space to be exploratory, innovations had to be weighed up according to shareholder return, productivity, or sustainability. In other words, initiatives had to be justifiable in those terms, or, better still, demonstrate likely success, before they were supported.

> *I tend to think if we are making long-term decisions we have to explain why we are doing them and if we are explaining them properly to the market that will satisfy a lot of our shareholders.*
>
> (CHAIR / INTERVIEWEE 15)

> *We look for markets that are large and growing, where the competition is rational, and where we think we can have a significant competitive advantage. If you don't have any competitive advantage, why be there? So that's really our test. What are the markets that fulfil those four characteristics?*
>
> (CEO / INTERVIEWEE 18)

> *So I think there's a core competency question and also a confidence question, that you have almost got to converge and that will hopefully give you an idea of whether something can work or not work for you.*
>
> (CEO / INTERVIEWEE 12)

3 /

METHODS OF INNOVATION

There are few integrated approaches to innovation

Suggestion schemes and incentives not connected to strategy

Some companies had programs that incentivised innovation through awards schemes. However, these were usually small investments relative to the financial health of the company that were not necessarily intrinsic to or integrated with company strategy.

> *We have this internal award system where we nominate, I can nominate, or other people can, an individual for coming up with an idea. We do an award ceremony each year to promote the innovation and the successes of these things. Then it's well known around the company that we celebrate that. Celebrate successes and keep on celebrating, and keep on reinforcing them. Then people will learn that that's the right thing to do in an organisation.*
>
> (CEO / INTERVIEWEE 19)

Investment in innovation is mostly ad hoc

There were no standard protocols for allocating CapEx to innovation projects, with funding seemingly made on a case-by-case basis and in an ad hoc manner. Investment in innovation was not tied to revenue, and instead had to be justified through cost savings:

> *We don't tend to allocate capital that way. It tends to be on returns, more than anything. Defensive capital in a lot of cases has a pretty low return. That's where you need the innovation, to actually make it even.*
>
> (CHAIR / INTERVIEWEE 7)

> *In growth years you are actually expected to spend more. In fact, you fail if you don't spend the right level of investment in research and development, because you are not going to get the three- or four-year payback.*
>
> (CEO / INTERVIEWEE 14)

There was a sense that the more profitable a company was in any given year, the more investment there should be in innovation, but this was not practised consistently.

Culture is seen to trump formal practices

Clear innovation methods are the exception, not the rule

Organisations that identified clear methodologies for innovation practice, such as Lean Startup and Design Thinking, were exceptional:

> *We are wedded to the principals of Lean Startup methodology and so we spent a year thinking about what were the things we wanted to innovate around because to us, it's certainly not sitting on a bean bag dreaming up ideas. It's quite disciplined how you go about innovating. You don't just look out the window and have a light bulb and there's your innovation.*
>
> (CEO / INTERVIEWEE 1)

Most favoured informal 'culture' over formal 'practices'

There was a lack of clearly articulated and formalised practices or processes of innovation. Instead, there was much talk of creating the right 'culture' in which innovation can happen:

> *There wouldn't be a measure that I could actually put my finger on. So it's not something written down and mandated. Not structured. I just think it's the mindset.*
>
> (CHAIR / INTERVIEWEE 7)

> *The culture to encourage and to promote risk taking is really key.... We then take an approach of trying to encourage people and celebrate success when they try new ideas instead of actually penalising it.*
>
> (CEO / INTERVIEWEE 19)

Everyone is responsible for innovation but the CEO must lead

The CEO is the key figure to drive enterprise-wide innovation

There was consensus that the CEO was the person best suited to driving innovation throughout the organisation, although interviewees also maintained that it should not be a specialist role, for example, a Chief Innovation Officer.

> *My instincts say that it should be embedded, innovation, it's not somebody's job, it's everybody's job. We as an organisation need to support innovation in every part of our organisation.*
>
> (CEO / INTERVIEWEE 2)

> *Everyone is expected to think about how we do things differently or better or whatever.... [The CEO] recognises the changing world and is prepared to adapt and sees a necessity to adapt and is encouraged by the Board to do so. There's an alignment there.*
>
> (CHAIR / INTERVIEWEE 4)

It is vital to look beyond today's portfolio

Accountability for innovation remains with the CEO, and the expectation from the Board was that senior management must go beyond managing today's portfolio of businesses:

> *We had a Chief Executive who was a Chief Operating Officer. He wasn't a Chief Executive who looked forward, had a vision, understood what that required. He was a strong Chief Operating Officer.*
>
> (CHAIR / INTERVIEWEE 4)

> *Innovation at that level has to be owned by the most senior people in the organisation.*
>
> (CHAIR / INTERVIEWEE 11)

4 /

ROLE OF BOARDS

Boards want to encourage, rather than initiate, innovation

Management brings ideas forward and the Board is a sounding board

Advocating for innovation was unequivocally seen as part of the role of the CEO, who is tasked with bringing forward proposed new directions for the company and making the case to the Board.

> *I think it is management's role to bring it forward and the Board to be open-minded and stimulated and then to be a sounding board as well as a real Board and to be able to take the discussion and the debate and the review to a much higher level.*
>
> (CHAIR / INTERVIEWEE 11)

> *If you don't have a CEO who pushes innovation, you have a big problem. If a Board doesn't respond then you have a bad Board.*
>
> (CHAIR / INTERVIEWEE 10)

CEOs see Boards as both supportive and cautious

The Board has a 'check and balance' function in ensuring the risk is justifiable. While all CEOs interviewed felt their Board was supportive of their proposals, external pressures also encourage risk aversion:

> *The Board is very supportive and encouraging innovation but also wants to keep control of... innovation [not] becoming a black hole.*
>
> (CHAIR / INTERVIEWEE 4)

> *One step away from our current core competencies - yeah, that's probably fine. If you go two steps, then that is a much bigger hurdle.*
>
> (CHAIR / INTERVIEWEE 7)

Boards help create the right culture by asking the right questions

There was general agreement that the role of the Board extends beyond governance. Rather, the Board must also challenge the CEO to be adapting the business to a changing world:

> *I think all Boards have to own innovation...you have got to be encouraging the business to always challenge what it is doing today and trying to find a better way of doing it tomorrow.*
>
> (CHAIR / INTERVIEWEE 7)

Boards want to look outside and bring lessons inside

Boards want to learn about innovation from diverse sources

In order to do stimulate innovation, the Board requires diversity to generate new perspectives. Boards routinely visit Silicon Valley or other innovation hubs to observe how new businesses scale, operate and govern differently to their own.

> *We take the Board away twice a year and we try and expose the Board to things that are happening, things that are going on. Different things, different people. Either the Board is better able to ask questions, or when management is actually talking about something, then you have better hope of the Board understanding the implications of that in terms of potential business models.... The more sensing you can do the more you can bring in to the conversation different things and the greater the hope that the patterns will emerge and that people will see the patterns. Because it needs more than one person to see a pattern, otherwise the immune response of the organisation is too effective.*
>
> (CHAIR / INTERVIEWEE 3)

Boards can communicate the value of innovation to markets

The ability to communicate a strategy clearly to stakeholders - shareholders, employees, customers, suppliers, government, as appropriate to the business - is an essential component of being able to invest in innovation. Boards can help the executive team communicate to the market that the company is making long-term investments in innovation. They can contribute to persuading the market and shareholders of the value of innovation:

> *I think it's all about ensuring that you don't fall into that trap of short-termism and having the courage to say to a market, 'Look, you're investing in us and some things we don't produce short-term results. If you want to invest in companies that only are motivated by short-term results, it's not us'.*
>
> (CHAIR / INTERVIEWEE 8)

> *You get the investors you deserve. [You need] a coherent and sensible strategy, articulate it well, explain it to the various stakeholders and particularly the shareholders in this case, but also your employees and, if it's relevant, your customers and suppliers, whoever it is. Or it could be very relevant to government, depending where it is, which business you are in, or to the local communities. Articulate the policy, explain it to them, and then start to get some runs on the Board, and then I think you will actually have a runway to implement that strategy and begin it.*
>
> (CHAIR / INTERVIEWEE 11)

5 /

LEADING THE WAY

Become an 'ambidextrous' organisation

You have to actively manage the 'exploit-explore' paradox

Developing and implementing both incremental and radical types of innovation require different skills and capabilities:

> *We are trying to do two things at once: owning the now and owning the future at the same time. They are quite different ways of thinking. As an organisation, we have to be somewhat ambidextrous to be able to [do that].*
>
> (CEO / INTERVIEWEE 1)

Create 'special purpose vehicles'

Sometimes innovation only succeeds outside of existing structures

Interviewees acknowledged that companies often experience 'tissue rejection' of innovation, whereby experimental products or programs are the first to be culled because they do not demonstrate profitability in the short-term. As result, it was necessary to establish separate entities outside of the business in order for innovation to take place:

> *We have deliberately established different governance. [Innovative projects] are run on, if you like, a more agile model so they are very much connected but they are not absorbed. It's pretty clear that if we tried to integrate them we would have killed them. We may yet kill them but we are trying not to.*
>
> (CHAIR / INTERVIEWEE 3)

> *Having [innovative projects] in a separate division with a separate president, with a line of sight to the Board and with a very specific cap allocation [has been very positive for innovation]; there have been a lot of small purchases which have been bolt-ons.*
>
> (CHAIR / INTERVIEWEE 11)

Invest in effective innovation methodologies

Embrace Design Thinking as a formal approach

One or two organisations were investing in a specific methodology – usually 'Design Thinking' - as the 'how to' of innovation:

> *The two components to that are the human-centred design process, which is really about problem definition and building the hypothesis. Then, an agile delivery mechanism, which is about, how do we get to what we call a minimum buyable offer into the marketplace as soon as we possibly can. So that's really changed the way we run programs in the organisation... we run a two or three day HCD (Human Centred Design) program that we've now put 300 or 400 people in the business through to basically say we want new solutions. We call it a solutions-innovation process.*
>
> (CEO / INTERVIEWEE 18)

ON DESIGN & INNOVATION

Innovation is an outcome not a method. Around the world, the most innovative business schools and businesses are turning to 'Design Thinking' as the way to give structure and method to innovation. Design Thinking combines the creative arts of design with the psychology of human experience. It focuses on inventing new products and services that delight customers. Hence it moves well beyond customer service into making the customer experience the new basis for creating value and advantage.

The Design Thinking movement began in the 1990s but it really took over on the back of Apple's unprecedented success – which was built squarely on Design Thinking and a supreme focus on the customer. As a result, many more conservative organisations began to think "If this worked for Apple, perhaps it can work for us...." Proctor & Gamble and Samsung are two major examples of where such musings can lead.

Now the most innovative business schools are combining Business topics with Design skills to produce more creative graduates and post-graduates. Some business schools in Australia are following suit but generally we lag behind the intensity of the overseas programs and initiatives. For instance, the Government's Innovation Agenda made almost no mention of Design Thinking in its ideas and approaches – a sure sign of its naiveté and short sightedness.

Strategy, strategy, strategy

Split the Board agenda to separate strategic issues from operational ones

There was acknowledgement that innovation must be intrinsic to the organisation and happen at a strategic level in order for it to move beyond idea suggestion schemes and good intentions. In response to these needs, one interviewee described how strategy was visibly prioritised over operations and governance at their Board meetings:

> *The first day is all strategy and longer term and the second day is operations, oversight and governance, with compliance happening right at the end of the second day, unless there is an issue, in which case it will come forward to the beginning of the second day. But it does not contaminate the first day.*
>
> (CHAIR / INTERVIEWEE 3)

In another case, a CEO and senior executives claimed to spend 50% of their time on strategy on the proviso that there are no immediate threats to the business:

> *The senior group - myself and the strategy group and these key leaders - spend half of our time on strategy. Now it's a silly thing to say, but it's hard as a CEO to do that if your business is not performing well, because you are actually constantly worried about the burning platform.*
>
> (CEO / INTERVIEWEE 14)

ON BOARDS & STRATEGY

Boards get bogged down in risk management and operations – and being a Board Director is now heavily constrained with liabilities. Most Board meetings that we have seen are overcrowded with operational management information – and Directors are drowning in long-winded Board papers. One Chair commented that it was a crisis – 400-page long Board papers for one meeting. This is not sustainable, as no human can absorb that level of detail regularly and be responsible for decisions based on it.

The majority of this information is not even strategic. It drags the level of discussion down to the wrong level for a Board - to the minutiae of operational details.

Finally, and most alarmingly, Board meetings are not composed and delivered in a way that plays to the strengths of most Board members. These are experienced leaders, often with diverse industrial experience and a somewhat independent perspective. In this sense, Boards become prisoners of the system of Board reporting and governance.

The alternatives to information overload we heard about took a lot of effort, lifting the Board out of the quicksand of information overload and ensuring the agenda left large amounts of time to report on strategic matters, especially innovation.

6 /

OFF THE RADAR

What we didn't hear but expected to...

The following are ideas we know to characterise global best practice around innovation. A few of them were mentioned once or twice, but most interviewees did not have them on their radar. We think they will interest people.

A/ DEVELOP A SHARED LANGUAGE AROUND INNOVATION

Nobody mentioned a shared language around innovation – although one or two interviewees pondered how it should be defined. This leaves the word meaning lots of different things to different people, and innovation suffers as a result. We recommend that 'innovation' be discussed and defined so that it means something specific for the organisation. We think this Chair was thinking in the right direction:

> *Unless you are prepared to take risks, how will you innovate? Because if it's all incremental and predictable - I mean incremental is right and necessary but I am not sure that's innovation. It could be called innovation but incremental improvement really maintains the status quo. So you have got to be prepared to take a risk but it's got to be a calculated risk and thought through.*
>
> (CHAIR / INTERVIEWEE 3)

This model from the Doblin group usefully names and arranges ten possible types of innovation:*

* FOR A FULL DISCUSSION OF THESE TYPES, SEE: KEELEY, L., PIKKEL, R., QUINN, B., & WALTERS, H. (2013). *TEN TYPES OF INNOVATION: THE DISCIPLINE OF BUILDING BREAKTHROUGHS.* HOBOKEN, NJ: JOHN WILEY & SONS.

B/ FOCUS ON THE CUSTOMER

Only one or two interviewees connected innovation to the customer and their unmet needs. Most interviewees were concerned over either internal processes and costs, risk and compliance, or over competition. While innovation can certainly help transform our operating models, that is not where the real value game lies today. Instead it lies in transforming the customer experience – and then letting that customer experience transform our business models.

This is a big theme in international markets and business schools – including Asia and China – but less so in Australia. Focusing on the customer increases empathy and, rather surprisingly, recent research reveals that empathy is one of the key drivers of creativity and Design Thinking.*

C/ DEVELOP AN INNOVATION STRATEGY

Most innovation gets domesticated inside the traditional business planning process. Hence it gets pushed to the edges and becomes an optional extra rather than a serious investment of mind, time and money. Worse still, it gets constrained to the normal disciplines of budgets and goals – and hence it becomes too conservative.

The best of practices separates out the 'planning system' into two halves: a business plan to manage today's business and an innovation strategy to create tomorrow's business.

D/ DEVELOP AN INNOVATION ECOSYSTEM

Organisations have a natural do-it-yourself bias, yet this is likely to channel thinking down familiar boundaries. Some of the smartest thinking around innovation today moves outside the organisation to create an ecosystem of innovation, complete with structured pathways for introducing external perspectives and ideas. This philosophy of innovation stresses open systems. Organisations struggle to stay open because it means (or is perceived to mean) losing control. Nevertheless, no matter how they are organised, such ecosystems seem to be emerging as a vital ingredient for organisations to foster deep and challenging creativity.

* MARTIN, R. (2009). *THE DESIGN OF BUSINESS: WHY DESIGN THINKING IS THE NEXT COMPETITIVE ADVANTAGE*. CAMBRIDGE MA: HARVARD BUSINESS PRESS.

E/ ALLOCATE CAPITAL FOR INNOVATION

No-one mentioned a policy of how much to invest in R&D and/or innovation as a dedicated fund. This means that innovative projects have to be funded out of operating expenses, subject to scrutiny by business case to prove their potential return on investment in order to get funds. This puts corporate innovators in a Catch-22 situation: they have to prove future revenues but future revenues are predicated on as yet un-invented products. So how can they 'prove' the future revenues?

An important study of 30 US entrepreneurial founders, ranging in size from $200 million to $6.5 billion companies, revealed that they generally don't think like this. Rather than applying causal reasoning, focusing on expected return, these expert entrepreneurs applied effectual reasoning, focusing on affordable loss. This means they didn't analyse markets and select customer segments up-front; instead, they found a way to go directly to potential customers to talk to them, even before anything was built. Based on this early feedback, they would then pick markets to enter or new markets to create.* In other words, they selected and funded ideas based on engaging potential customers rather than the creation of elaborate market models and business cases.

F/ SET ACCOUNTABILITIES FOR INNOVATION

If the old adage, 'what gets measured, gets done' applies to innovation, then not much would get done. We heard that Boards expect senior executives to lead innovation, but we did not hear anyone talk about how that turned into accountabilities or KPIs.

G/ EXPLORE HOW TECHNOLOGY CAN NOT ONLY DISRUPT OLD BUSINESS MODELS, BUT ALSO CREATE NEW ONES

Not many interviewees talked about how technology can change their business models radically. Technology did not really come up in the conversations as much as we expected. Technology – digital and big data – has moved from being a servant of the business to being a disruptor of many business models. It can also create very different business models. We think there is huge space to develop scenarios and possibilities around the kinds of futures that technology can open up for a business.

* SARASVATHY, S. D. "WHAT MAKES ENTREPRENEURS ENTREPRENEURIAL?" LAST MODIFIED OCTOBER 21, 2008. HTTP://SSRN.COM/ABSTRACT=909038

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