
# DOES YOUR COMPANY HAVE AN INNOVATION STRATEGY?

## What every Board Member should know

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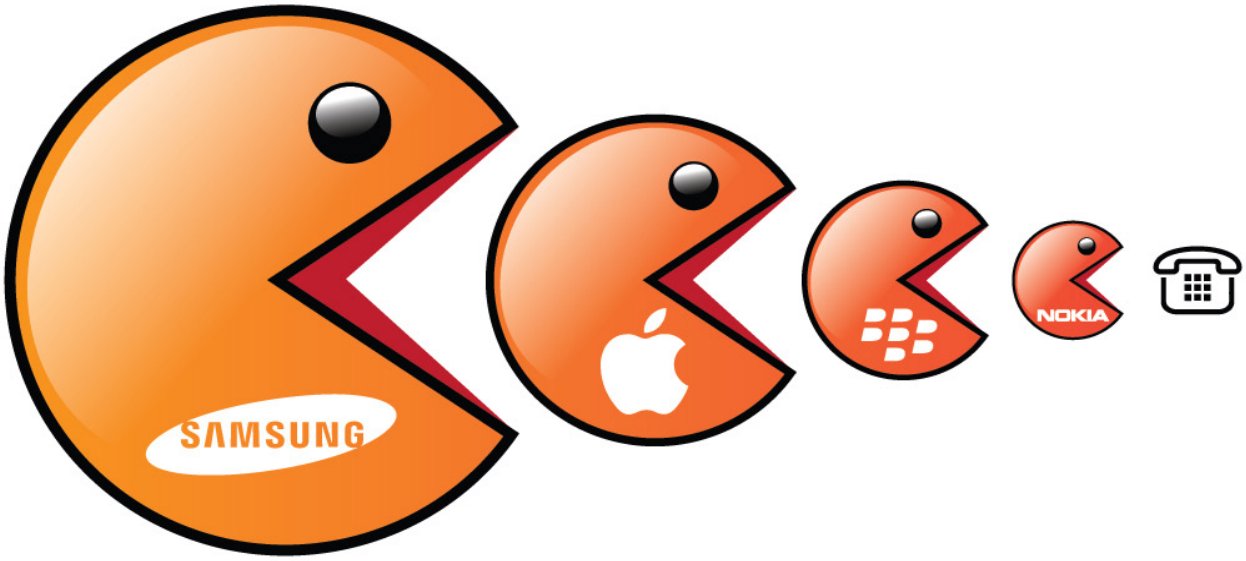
**A new CEO. A new strategy. A new blueprint for moving forward.**

How often have we heard this? With many CEOs just averaging a 2 to 3 year tenure, employees and companies will undeniably feel the burden of change. For the CEO, it's definitely not a crime to be determined to transform the company and leave your mark in the possibly short tenure you may have; however, who is looking out for continuity? Who is looking at the long term growth strategies?

The Boards, who do not undergo as much shuffling, especially as a team, now seemingly quiet stalwarts, are perhaps the real parents or guardians of the company - the one constant that remains through the CEO change. What role therefore should the Board play in light of these common transitions? And more importantly, what role CAN the Board play in driving innovation within the company?




## Changing Competitive Landscapes

In the face of an ever changing environment, sustaining the mere existence of a company is a colossal challenge, on its own.

- How do companies constantly keep abreast of the advancements and innovation around them?
- How do companies keep an ear out for innovations coming from beyond the boundaries of their own industry?
- How many giants have been buried because they failed to see the oncoming onslaught?

**The one constant that remains through the CEO change is the Board**

## Is it complaisance, an oversight, or the unwillingness to take on risk?

The telecommunications industry is a classic spectacle of how unforgiving the fast changing landscape can be - of shifting market winners or losers. Constantly bombarded with disruptive innovation, many telco companies massively lost revenue – first from voicecalls when Skype took the voice market by storm; Then, Whatsapp and Facebook disrupted revenue from SMS, and now, with Apple's iOS7, peer to peer networking is making even the previously enabling wi-fi archaic. It's not only the consumer who is demanding from the industry, regulators are also punishing network providers for poor service standards. MCMC, in March 2013, slapped Malaysia's key players - DiGi, Maxis, and Celcom with a compound totaling RM190,000 for the drop in service levels, in particular for dropped calls. Many in the telecommunications business would also be familiar with common threads or stories of cannibalization; Nokia being made irrelevant by Blackberry, who then got overtaken by the iPhone.

Another landscape disruptor is the rise of social media. In a recent episode, 50 disgruntled Volkswagen owners gathered at the Volkswagen Malaysia headquarters in Bangsar to complain about the poor after sales experience and unreliability of their cars; this was all initiated through Facebook. There are many more examples of movements that one can cite, be it political rallies or uproar from a poorly managed customer interaction, which snowballed from a single post on social media.

What is clear is that companies need to constantly look out for new business models, to consistently find new sources of growth and value creation. Companies who want to continue sustaining in business realize that innovation has to be part and parcel of their agenda. Competition is fierce. Customers are growing increasingly more demanding. Legislation is getting more stringent. The pace at which technology is developing is expediting the emergence of new services and products, faster than ever.

Thus, the role of the Board in directing strategy and ensuring long term value growth and marketplace relevance has never been more important.

## 1. Clarify the purpose of Innovation

Why does your company need to innovate?

Organizations innovate for various reasons. For many, the various types of innovation overlap and culminates in the same thing - an increase in revenue or a reduction in cost. There are, however, many ways to achieve these two priorities; Having the ability to distinguish the exact focus for innovation may help companies narrow down their strategies and concentrate their efforts better. Although not absolute, different strategies sometimes are better enabled by different types of innovation.

For instance, a focus on cost reduction mostly relies on process innovations. Entering new markets may need a focus on new business models or new products and services. An increase in market share could also be achieved solely by marketing innovations or by the introduction of new products and services.

New regulatory requirements may also spur companies to innovate. An example is the European emission standards that define the acceptable limits for exhaust emissions of new vehicles sold in EU member states. This has had a major impact in the design of new vehicle models introduced. Volkswagen for example, uses smaller capacity engines with turbo and dual clutch technology to maintain a similar power delivery compared to cars with bigger engine capacity, while reducing CO emissions.

Regulatory requirements or standards may also spark innovation as organizations attempt to maintain competitive pricing or overheads by increasing output or decreasing cost. An example is the minimum wage policy recently set in Malaysia. For some industries, this may drive technology adoption or automation.

An aspect that Boards and top management of the company should be clear about is the types of innovation that the company will leverage - is it product, service, process, marketing or business model innovation? What processes would need to be put in place to institute these?

## 2. Quantify the impacts from innovation

Although most companies do not yet have the discipline of quantifying returns from innovation, it is important to start setting up the mindset and structure to do so. Companies that allocate funding and are focused on encouraging innovation-driven activities within their firms, can expect to see more ideas and projects stem from their employees. Future investments into innovation will also be easily persuaded for approval if there is a track record of getting good returns from innovation.

Granted, this would not be the easiest of tasks, and some returns would be difficult to quantify. Companies thus need to observe and measure many direct and indirect outcomes that emerge due to the innovations introduced. Boards need to bear in mind that returns on innovation may be tangible and intangible; Therefore, measurements of these parameters may be direct or through surrogate indicators. As a rough indicator of sustainable innovation activity within the company, Boards could monitor the sales revenue from new products, services or business models introduced in the last year or last 3 years.

Some of the returns that may be garnered by the company are:

- ability to enter new markets
- greater brand value
- deeper customer loyalty
- improved efficiency
- stronger employee engagement
- larger market share
- increased revenue
- higher share price
- lower costs or overheads

If a company outlines its innovation journey and plan, and shares compelling and clear 'stories on growth innovation,' it can help players in the equity markets better understand and value innovation within the company. This in turn shall attract investments into the company.

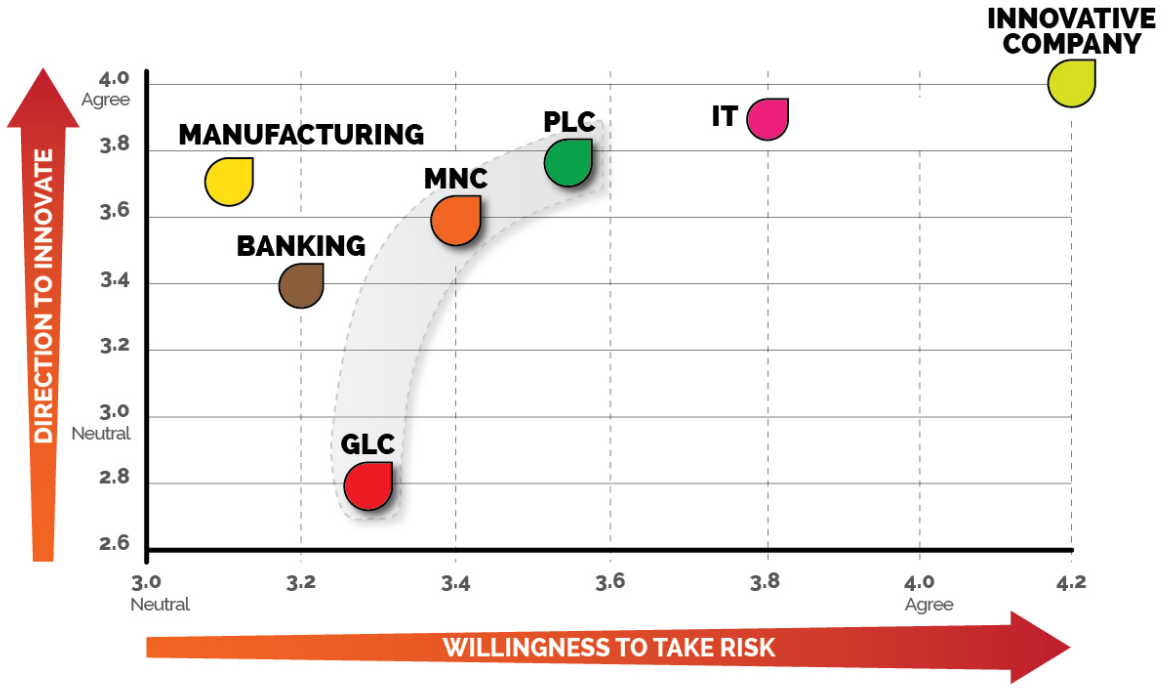
## 3. Define & communicate the direction and scope of innovation

One of the significant challenges faced by companies is in clarifying the definition of innovation itself. In our experience, even with companies where innovation is part of the company mission or values, many employees actually had no clear understanding of their company´s official definition´ of innovation. We have encountered many occasions where 'innovation' is understood as synonymous only with technology change or 'something hi-tech'.

Therefore, those in disciplines not embroiled with R&D or the creation of technology, like HR or finance or marketing, felt they were excluded from the need to innovate. It should be made clear that the role to innovate encompasses everyone. Elucidate the roles each division can play. Each division could also have different focus areas for innovation. Have the expectations and strategies be crystal clear, and have defined innovation KPIs for each division. Thus, all of the company's employees can be fully tapped towards driving innovation.

## 4. Shape the risk appetite

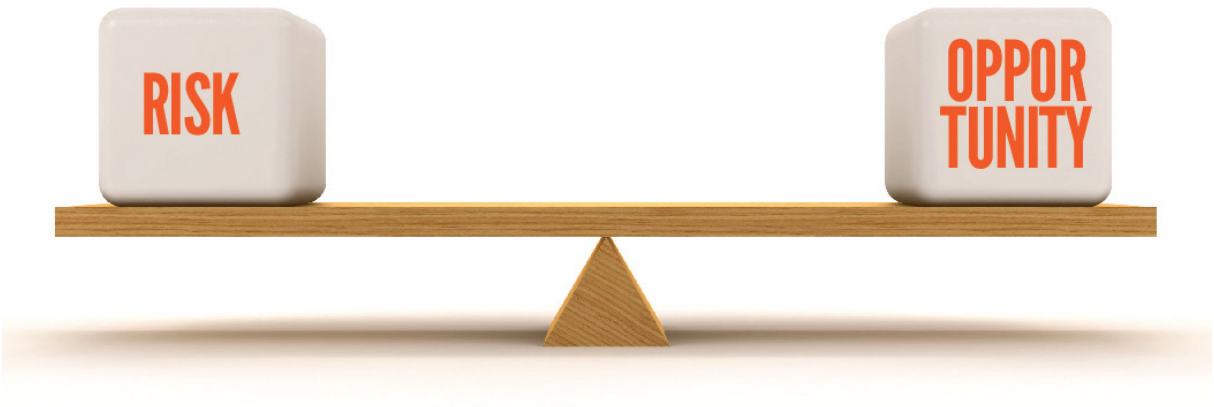
The scale of innovation that the company wants to venture into should also be determined. Would this be more skewed to incremental or radical innovation? What would the portfolio look like?




The Intersection of Clarity and Boldness to Innovate.
The scores for various types of companies (government-linked companies, multinational companies, and public listed companies), as well as datapoints for comparison across several sectors (manufacturing, banking, IT) are shown in the graph above. Also shown on the top right corner is a benchmark from an innovative Malaysian public listed company. The graph shows the clarity employees have in terms of knowing the direction to innovate versus their perception of their leaders' willingness to take on risks.

*Datapoints are extracted from Alpha Catalyst Consulting's report on the National Innovation Strategy Study in 2011, and Alpha Catalyst Consulting's Malaysian Innovation Climate Survey Report (2010).

The two core elements shown in the graph - clarity in direction to innovate and the willingness of leaders to take on risk - are juxtaposed together, as these form the core foundation for the innovation success of the company. As a Board member, what is your honest assessment of where your company resides? Companies should aim to be able to definitively say 'yes', they know which areas they need to innovate in and back this up with a willingness to take on risks. This is exemplified by the actual data from an innovative Malaysian PLC (shown in the upper right quadrant). The industries portrayed here also show a significant contrast between the IT sector and that of the banking and manufacturing sector. Where would your company be – ahead of your industry peers, or lagging behind?




Companies need to have both low and high risk projects, and it is up to the Board to ensure there is that balance – and not be skewed on being too safe or in taking too much of a gamble. Finding that balance is indeed a challenge especially when investment analysts often look at historical information indicators of share price or bottom line alone, which makes companies think twice, long and hard, before investing into innovation – even in opportunity areas that can pass the company's minimum threshold of expected return on investment. Two key guiding questions for the Board to ask, which may be helpful when at this juncture are:

- What is the cost of missed opportunities?
- How much risk capital are we willing to put aside?

## Moving Full Speed Ahead

Pushing the boundaries of norms is common in demanding times of change. Boards should challenge themselves too. 'How can we take on more risk to leapfrog the company?'

Many companies previously engulfed in the flames of the "burning platform," would have quickly realized that those days of just keeping the engine lubricated and running smoothly are gone. Innovation is not a start/stop process, but an evolving one that requires constant attention or long term commitment. It can't happen simply in a reactive mode. Speed is of utmost concern.

The adage 'Failing to plan is Planning to Fail' is most apt here. Board members are entrusted to help ensure the long term relevance and viability of the company, and being the advisors to ensure the companies have plans in place for that. If innovation is to be an important agenda and strategy for the company, it needs to be on the agenda at Board meetings and brought up by Board members.

**About Alpha Catalyst Consulting**

We are a boutique Innovation Consulting company that specializes in helping Asian organizations develop and execute their growth strategy through innovation, without compromising on their unique and ever-evolving Asian culture and values.

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