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EY Center for Board Matters

How boards can sharpen their focus on innovation

As boards seek to increase their effectiveness and impact on long-term value and growth, leading directors are emphasizing oversight of innovation and enhancing the role they play.

The board's role in overseeing and enabling innovation has always been an important part of supporting the organization's long-term growth. Yet the compounding disruptions of the past several years have tested the limits of many boards and created an urgent call to action to improve the board's capability to oversee and enable innovation.

COVID-19, supply shortages, cyber breaches, geopolitical instability, and new technologies have created a sometimes volatile environment in which companies must continually

and quickly adapt and react. Critical opportunities, risks, investment decisions, and ethical concerns that exist today were not on the radar during the last strategic off-site for many boards. Directors recognize this and are concerned. When we asked a group of board members who collectively represent more than 100 companies a simple question – "How effective are most boards today at overseeing innovation?" – the common answer was "Not enough for what is happening today and what is coming."

In brief

- ▶ With full agendas and never-ending crises, directors worry the focus on innovation will be diminished even though it plays a critical role in strategy and growth.
- ▶ Embracing innovation requires board members to rethink why and how they engage with management and with each other.
- ▶ Getting hands-on experience with emerging technologies, embracing new perspectives and inviting healthy debate are key to successful oversight.

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Most boards hardly touch the topic of innovation. It's a miss for sure.

Jeanette Gorgas, public company board member

Winning in these dynamic times will rely not just on managing new and emerging risks, but also prioritizing innovation to stay relevant and drive growth. When we delved deeper in our conversations with seasoned board members during the spring and summer of 2023, it became clear that leading directors are rethinking the rules of engagement and shifting their perspective on how to navigate these challenges and changing board practices as a result. We found that leading boards are redefining how they oversee innovation in four important ways.

1

Embracing a range of perspectives and experiences

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Diversity is key to ensuring the board is overseeing innovation, because adding directors with different backgrounds and experience will bring different relevant perspectives.

Barbara Duganier, public company board member

Leading directors we interviewed started with the importance of who is around the table to discuss innovation. They noted that having a mix of backgrounds, experiences and perspectives on the board has become essential. Several noted their boards are now actively targeting candidates who bring perspectives from different backgrounds (e.g., generation, industry, plus gender and race) and who have the skills for where the company is going rather than where it is today.

Seats at the board do not open frequently, yet the skill set mix may need to change more often given accelerating trends. Perhaps it is not surprising that future-focused boards are now undertaking an annual review of skills and experiences and identifying instances where turnover may be needed. This represents a significant departure from tradition where turnover has been driven more by voluntary attrition or age limits, and boards have been reluctant to make needed changes in a timelier fashion. Simply bringing in people with different expertise is not enough, however. There must also be ways for them to impact the conversation and be included in board decisions.

Giving time and space to the variety of perspectives is achieved by some boards through committee structures and assignments. One of the noteworthy changes in board structures has been to create a standing technology committee. In 2022, 12% of S&P 500 boards had these committees, up from 8% in 2019. In proxy statements, the key responsibilities of these committees include innovation. Another approach is to expand the role of the risk committee by increasing the horizons and definitions of risks to look for potential disruptors, such as “gray rhinos” (highly probable threats) and unintended consequences.

Given the average board size, directors are clear about the implication that there will be trade-offs in terms of skill sets. For example, one director noted their board has considered a chief information officer (CIO) who can speak to emerging technologies while understanding business implications of cyber risk rather than a chief information security officer (CISO) who is specifically versed in cyber risk. Each board is unique because it is made up of a combination of individuals, yet future-focused boards are clear they need to include individuals who are different from past candidates.

2

Gaining visibility into external trends and internal capabilities

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Board oversight of innovation is tied with board education. [We] need to understand what's going on and why it's important in the landscape.

Deb Byers, public company board member

Bringing in new directors with knowledge and experience oriented to the future direction of the company is necessary but not sufficient for a board to effectively oversee and enable innovation. The entire board must be aware of external trends and internal innovation efforts in order to understand what management is doing and where there may be critical gaps. Just as cybersecurity and geopolitical risk issues now permeate discussions across many committees and are part of the broad business conversations of the board, the same must apply to innovation concepts critical to future growth.

With the rapid pace of technological change and innovations, future-focused boards realize they need to come up to speed both collectively and individually in ways that look different from the past. Typically, management covers market trends and innovation as an agenda item with information in the board packet or a longer session during the annual strategy retreat. For areas outside the board members' expertise, working only from information shared by management or selected guest speakers can make it difficult to ask the right questions or ask the second- or third-level questions that can be so important in helping to identify gaps or steps needed.

Nearly all the directors we spoke with emphasized the importance of educating themselves and their board colleagues on emerging trends and technologies and highlighted the need for intellectual curiosity as a critical board characteristic.

In many cases, directors are attending conferences or workshops or conducting online learning. More boards are now also letting management teams know they would like to hear from startups, researchers and other experts to upskill the board as a whole.

In addition, directors noted that they require more access to and understanding of internal innovation investments. This includes briefings from innovation leaders, research and development (R&D) lab programs and joint development partners. The benefit of having an outside-in understanding of trends and comparing that to the inside-out focus of the company allows board members to have a full picture of the focus, risks and need for investment in innovation. As one director noted, "You need trust and transparency to really see what's going on at the company. Board members should touch, feel and experience products and services themselves."

Board education sessions can also ensure that all board members start with the same baseline information and have an opportunity to ask questions or probe deeper. Other practices include director access and experimenting directly with new technologies such as the metaverse, digital twinning, and generative AI. In a few interesting cases, boards are even using generative AI in real time during board meetings as an additional input to brainstorm counterpoints, tweak scenario planning and summarize trends. As one director put it, "We can use AI almost like a copilot."

3

Redefining collegiality to include provocative debate

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Long-standing strategic assumptions are often held so dear, it is career-limiting to question them.

Derek van Bever, public company board member

Having board members who represent the needed mix of skills and experiences and are knowledgeable about changes and disruptions underway will still fall short if they are not able to have robust debate about the opportunities and challenges represented by innovation. Traditionally, collegiality in the boardroom is highly valued by directors who understand that difficult and complex discussions can create tension and make it difficult for the board to present a unanimous front to management. However, directors we spoke with expressed concern that boards can overemphasize getting along at the expense of healthy debate, particularly in terms of innovation, where issues are not always clear-cut and trends are still emerging and open to debate.

The ability to challenge and debate actively can keep boards away from the trap of groupthink in which changes to industries and disruptors are dismissed too easily. Directors we spoke with noted that productive and constructive disagreement among directors can help uncover hidden but strongly held assumptions that may need to be revised to enable innovation and strategic changes. Embedding debate into director education is one way to help foster collaborative criticism. “The board should engage in some exercises around disruption, bring in external speakers, and create an environment that makes it OK to ask contrarian questions,” said a board

member. This may help socialize all board members to become comfortable pushing back and providing productive critique to ideas, wherever they may have come from.

Other practices shared included premortems, appointing a rotating “contrarian” at each meeting or using frameworks such as parallel thinking designed to encourage everyone to voice positive and negative viewpoints and provocative questions. One technique is to leverage future-back thinking, in which the group is encouraged to think through possible future scenarios where the company could be disrupted out of its market position and ask how that could happen, how it could be avoided, and implications from those futures to the current strategy and investments.

Regardless of which tools and tactics are used, directors emphasized the importance of making active, robust debate a deliberate part of the discussions for the board rather than relying on individuals taking an ad hoc approach depending on the issue. “It is hard to talk about difficult things, and questioning management is hard. You need [multiple] directors willing to raise questions,” said a seasoned director. “You can’t afford to have one person – no matter how great they are – be the gateway to all the changes and answers,” another board member said.

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Build agility into board decision processes

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Scrutiny of existing processes is the place to start for boards who are thinking about how to do things better ... especially for those who want to be more supportive of innovation.

Thomas Monahan, public company board member

While the elements covered to this point – diversity of skills and experiences; being knowledgeable about changes and potential disruptions; encouraging healthy, productive debate about trends and innovation – have been identified by directors as changes that are essential for effective board oversight of innovation, the processes for boards must also change to enable the right discussions at the right time. The traditional board calendar was developed to distribute the board's work across the year and align board decision-making with annual corporate budgeting and capital allocation decisions. Five or six full board meetings, with an early fall strategy off-site, is a familiar experience for many directors.

Today, however, many directors we interviewed noted the accelerated speed at which the world is changing. “Generative AI” went from a phrase few had heard of in Q3 2022 to the dominant disruptive technology in Q2 2023. Traditional board decision-making cadences and processes do not move at the pace of today's decision-making needs. Future-focused boards look for ways to embed opportunities for faster recognition of new innovations, disruptions, and relevant decision-making into their processes. Rather than radically altering the cadence of the board, they identify opportunities to streamline work or discuss cutting-edge issues within the context of existing processes.

Directors we spoke with are very clear that an important part of the board's role is to help management not get distracted by headlines and the noise that comes from our world of social media. However, the importance of understanding and addressing a trend line rather than a headline is still core to how future-focused directors approach their role. They understand there may be times when discussions and decisions may need to be accelerated and critical assumptions in the strategy may need to be revisited. One director spoke for many in sharing that finding the right balance is not easy, noting that full strategy sessions three to four times a year can be “overkill” while acknowledging once a year is also insufficient.

One practice is to set up an early warning system for potential disruptions. This can be a set of “triggers” (metrics/indicators) that are tracked and managed and identify when a disruptive pattern may be emerging at a level that can cause significant impact. In examples shared, boards asked management to first identify the most critical assumptions on which current and future strategy depend. Then look for ways to measure when these assumptions are under threat and what level of tension is necessary to revisit the firm's strategic position. This may also work with, rather than against, existing management processes. “Telling management what you want tracked helps to focus their energies,” one board director advised. “Performance – getting aligned goals, metrics, and compensation models helps management drive innovation in a way the board can assess.”

Another set of practices for future-focused boards is to revise the structure of traditional strategy planning to enable agility when needed. Typically, strategy is implemented via a 5/3/1 planning process (five-year vision, three-year strategy, one-year operating plan). Instead, leaders are putting in a more dynamic process that considers the *now*, *next* and *beyond* horizons that are less time-bound and more change-driven. Starting in the future, the “beyond” horizon is where to address futures, scenarios and trend-tracking that informs the vision and strategy for the organization from an outside-in point of view. The “next” horizon ties to the corporate strategy that may be a rolling three-year view but should be called into question if any of the tracked strategic triggers are tripped at any point in the operating year. This enables flexibility and a quick response to impactful changes. Finally, stability of planning and budgeting is needed in the “now” horizon, which includes the annual operating plan and budget but can be paired with crisis management approaches if the current-year plan has to be revised due to a major unexpected disruption.

How boards are shifting their approach for the future

	Standard, historical approach		Future-focused approach
Embracing a range of perspectives and experiences	Favor those with backgrounds similar to current board members, particularly coming from finance backgrounds or same industry.	▶	Seek directors with advanced technology and business innovation experience from other relevant industries rather than replicating existing skills.
Gaining visibility into external trends and internal capabilities	Receive information from guest speakers or management about the company's innovation efforts and participate in select early stage product demonstrations.	▶	Seek immersive experiences and expanded information on innovation externally and internally, including field visits and hands-on experiences with startup products or advanced technology labs.
Redefining collegiality to include provocative debate	Focus on collegiality and getting to consensus to create an environment where challenges, contrarian views, or unintended consequences of decisions are glossed over.	▶	Embrace constructive disagreement to test assumptions that are critical for current and future strategy and to uncover new ideas and novel thinking.
Build agility into board decision processes	Focus on dialogue and decisions, with standard baseline and upside/downside scenarios reviewed annually during the strategy off-site.	▶	Remain agile so that critical issues and opportunities essential to innovation can be discussed and decided in a timely fashion.

How boards can move forward

"Innovation and technology" was identified by board members as a top-three [priority for boards in 2023](#), behind only "economic conditions" and "capital strategy and availability." From our research, it is clear that the strategic environment in which boards and their organizations find themselves is changing rapidly to the point where traditional mental models and systems/processes are proving to be hindrances. The early leaders are already changing to the benefit of their companies.

The good news is that we have identified targeted changes that can be tailored to each board depending on the company lifecycle and where the company is today as it prepares for tomorrow. These will require intentional leadership from boards, who sit at the nexus of strategy, risk and opportunity. Directors who embrace this call to leadership and engagement are finding a new level of energy and impact for themselves and their boards.

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Questions for the board to consider

- ▶ Is the board a help or a hindrance to innovation? How does it know which category it falls into?
- ▶ Are board members aligned with each other and with management on strategy and time horizons for change and disruption?
- ▶ Has the nomination and governance committee reviewed the skill matrix for the full board and considered bringing in those who can address future business drivers and technical enablement?
- ▶ Has the board identified trade-offs in terms of areas that can be covered by outside advisors rather than needing a particular board member?
- ▶ How is the board enabling productive debate so that core assumptions can be questioned, and board members are not singled out as disruptors?
- ▶ With today's pace of change, how often should the board evaluate how technologies and innovations can impact their strategy?
- ▶ How well does the strategy, planning and budgeting cycle work in an environment where more agility and flexibility may be needed? Are there changes to timing that can and should be made?

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