INNOVATION: IS THE EU CORPORATE GOVERNANCE FRAMEWORK FIT FOR PURPOSE?

WHITE PAPER

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The Corporate Governance Dialogue

An initiative of ecoda
About ecoDa

The European Confederation of Directors' Associations (ecoDa) is a non-profit association founded in December 2004 under the laws of Belgium. Through its membership of 20 national institutes of directors (the main national institutes existing in Europe), ecoDa represents around 55,000 board directors from across Europe. ecoDa’s member organisations represent board directors from the largest public companies to the smallest private firms, both listed and unlisted.

The Corporate Governance Dialogue

The Corporate Governance Dialogue is a reflection platform led by ecoDa. Its aim is to reflect on the future evolution of Corporate Governance, the governance trends and challenges business firms and other organisations are confronted with in the European and international context, and potential future amendments to the CG framework and mechanisms. Consequently, the CG Dialogue wants to identify and discuss what the next topical issues in corporate governance will be, what the role of tomorrow’s board members will be, bringing awareness of the participants of new emerging topics that will impact their organisation and their market. The CG Dialogue has been established as an open forum, with input from the business world as well as the academic community, with the input of directors as well as managers or shareholders.

Members of The Corporate Governance Dialogue’s Advisory Committee: Prof. dr. Abigail Levrau (Leader of The CG Dialogue); Prof. David Beatty (Rotman Prof Strategy); Dr. Roger Barker (Head of CG, IoD); Torben Bellagaard Sorensen (Independent board member); Prof. Michael Hilb (Chairman, International Board Foundation); Arne Karlsson (Independent board member); Daniela Matheus (Independent board member); Prof. Paola Schwiizer (Independent board member); Lutgart Vanden Berghe (Independent board member); Dr. Béatrice Richez-Baum (Director General); Manon Roehrig (Policy Adviser).
Societies, companies and boards face unprecedented challenges. Climate change, pandemic, geopolitics and the crises and shortages caused by them leave no company unaffected. The Covid crisis and the race for a vaccine have demonstrated, if necessary, how essential the ability to respond to imminent challenges for society has become.

Innovation is the key to steering a company to a successful future under the current difficult and unpredictable circumstances. However, regulatory pressures within the European Union may lead to a misguided emphasis in board work. Compliance issues should not swallow the bulk of board work time. Private sector innovations are necessary to tackle the challenges societies are facing. For boards to perform their task successfully, they need access to independent and quality information. Furthermore, despite much talk during the recent years, the diversity of board compositions still needs to be strengthened. Culture is a key driver of innovation in any organisation, and should be a major responsibility of the board.

Sustainability issues will create new innovation opportunities for businesses. Innovation for the sake of it no longer makes sense, companies must now commit to innovations that serve the common good and the greatest number. Digitization is certainly a powerful lever to achieving these objectives, but are boards of directors sufficiently aware of these technological advances?

This White Paper, which is not intended to be an exhaustive academic paper (eluding, for example, the issue of ownership structure, extensively covered elsewhere) brings together some interesting perspectives to make this subject a major concern for European companies and regulators if Europe wants to remain in the race for international competitiveness. ecoDa wishes to give food for thought and emphasize the urgency of all boards to concentrate on the future of the company. Without innovations, companies will not survive the challenges they are facing.
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Introduction

Boards are at a critical time. Because of simultaneous crises and unprecedented societal challenges boards are faced with tough decisions. Their scope of action and responsibilities is constantly expanding while, in addition, their strategic compass and priorities must change in line with a rapidly evolving context. Societal considerations that were -until a few years ago- only on the periphery of a company's activities, increasingly deserve a more prominent place in board decision-making. Indeed, sustainable value creation as a guiding principle is gaining momentum. It is no longer about protecting value but creating value for the greatest number without harming the business ecosystem. As expressed in a recent report from the European Commission, “research and innovation (R&I) are an integral part of the response to these challenges.”¹ However, it is not a question of innovating for the sake of it, but a strategic innovation that brings value for society at large. The approach underlying innovation must be part of a more ethical dimension, taking into account changes in terms of consumption, the limits of the planet and the deeper aspirations of society. Innovation must be a source of progress for society.²

Traditional governance recipes are stretched and require a more dynamic and flexible approach. In short, the definition of ‘doing the right things’ and ‘doing things right’ has changed; consequently, governance itself is in transition.

The future of many companies, if not so of all, increasingly depends on their capacity to innovate. It is well documented that innovation is a major driver of economic growth, while being also at the heart of solutions for current challenges (such as pandemic, climate transition etc).

¹ Science, research and innovation performance of the EU, European Commission, 2022.
² L'entreprise interpellée, Rapport de l'Observatoire de l'Innovation, Rémi Maniak, Professeur, École polytechnique, 2022.
In fact, there is no successful sustainability transition without innovative thinking. Innovation enables companies to think about and implement alternative ways of operating, it enables them to become more efficient and to increase profits that must be redirected to the sustainability transition. Still, Europe must remain in the race for innovation to maintain its rank as a market power. Facts do not lie. The competition with other continents such as the US and China is a daily given.

Concerned with European competitiveness, in particular with respect to the corporate governance framework and the need to stimulate board members to transform their businesses towards a more sustainable future, ecoDa’s Corporate Governance Dialogue, dedicated its effort to map the boosters for innovation. Based on the insights from research, complemented with practitioners’ interviews (see list in appendix), ecoDa has identified five major topics. Each of these topics is elaborated by a different author who brings a unique perspective.

This white paper is a warning call and a call for action both for boards of directors and policy makers.

The very structure of the ownership has a certain impact on business innovation, but ecoDa has paid less attention to these aspects, which are covered in other publications.

Authors:

- **Prof. Michael Hilb**, “Digitalisation - The state of digital governance in 2022 - How boards fared, and what should be on the board agenda in the future”;
- **Prof. Abigail Levrau**, “Business ecosystems and platforms as new forms of value creation and innovation”;
- **Dr. Béatrice Richez-Baum**, “Access for board members to independent and quality information”;
- **Manon Roehrig**, “Promoting innovation enhancing regulation: flaws to avoid, features and incentives to pursue”;
- **Prof. Paola Schwizer**, “ESG/Sustainability when truly embedded in the strategy”.

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3 Extract from an interview with Denise Koopmans, Non-Executive Director, Chair of the Remuneration Committee, Royal BAM Group nv
IN SHORT: Recommendations for board members

- Board members should tackle compliance as a strategic exercise to anticipate societal expectations and possible regulation;
- Innovation should be the first item discussed during board meetings;
- For the strategic and innovation reflections to be fruitful and successful, board diversity and cross-fertilization are critical;
- As corporate culture is a key component for innovation, the board (and management) should stimulate/foster a culture of open information exchange and tolerance for ‘out of the box’ thinking or diverging opinions;
- Board members should reflect on how they can expose the management to new thinking. They should try to widen the networks of contacts and opportunities available to the organization (as it is done by some advisory boards to the management);
- Boards must clearly define the type of information they need, and which makes sense in view of the company’s purpose;
- Boards should reflect on which budget they will need for getting access to the right information through the right channels (trainings, experts, etc.);
- A mapping of access to information should be a strategic topic as well as the sources of information (external / internal);
- Access to information and consideration of information in the decision-making system should be systematically integrated into boards evaluation processes;
- Training programs for board members should include the issue of information management, possibly with the support of military schools that have expertise in intelligence matters;
- Board members should be using digital tools more often and be more familiar with them;
Leaders should master a new type of strategic-organizational thinking that is based on a decentered perspective; i.e. an in-depth understanding of their interconnected position within the larger ecosystem that informs their actions;

Incorporate innovation perspectives of various internal and external stakeholders into strategy setting sessions;

Systematically connecting boards with the external ecosystem to assess the current landscape and state of innovation;

Board members should focus on the end, not the means: Digital technologies should not be viewed as the end of a business transformation;

Board members should focus on transformation, and less on digital: Therefore, the board should ensure that the digital initiative focuses on people and not on technology;

Board members need to acknowledge the power of power: Upheavals and transformations always lead to a change in power structures, with some gaining influence and others losing it;

Board members should be humble and learn about the unknowns;

Board members should never stop questioning and challenging the benefits and limitations of digital transformation. What works perfectly for some organization may not produce the same result for others. Finding the optimal solution for each organization is one of the core responsibilities of an effective board member;

The board should be directly involved in a reflection on the company’s purpose and long-term strategic goals, on the basis of a direct dialogue with relevant stakeholders. The “materiality matrix”, on which non-financial reporting is based, should be appropriately defined and discussed in the boardroom, and should inspire strategic thinking and innovation;

Directors should also raise their attention on the quality of financial and non-financial reporting and the use of the EU taxonomy. The board should ensure a more integrated and specific corporate reporting, aimed at showing the links between financial and non-financial profiles;

The board must be involved in the assessment and, if needed, in the transformation of the business model along the entire value chain;
• The board’s role in providing strategic direction and defining long-term strategic guidelines, must be enhanced, trade-offs have to be made on the basis of a thorough analysis of risks and opportunities linked to ESG;

• Short- and Long-term management incentive schemes should include some KPIs linked to ESG goals;

• The board skill mix should be revised, in order to include a higher degree of diversity in terms of background, age, attitudes, etc., which may boost integrated thinking and provide innovative perspectives;

• The diversity policy must be targeted to support an innovation in mindset, culture, decision-making and, ultimately, in the way of conducting the business. Moreover, in assessing the knowledge and skills of new candidates, soft skills should also be taken into account;

• The board should be involved in scenario analysis, based on the interaction with relevant stakeholders.

IN SHORT: Recommendations for managers

• Managers must understand that board members need to look for external inputs. It should not be seen as a sign of distrust, but on the contrary as the sign of commitment and good governance.
IN SHORT: Recommendations for policy makers

- Having a sound regulatory framework is of utmost importance to create a level playing field and a fair business environment. For companies to innovate and thrive, it needs to be underpinned by a flexible and clear legal framework;
- To avoid unintended effects, innovation should be at the heart of the EU impact assessment methodology. Meaning that policy options should be assessed based on their innovation-enhancing or innovation-constraining potential;
- The role of the Regulatory Scrutiny Board should be strengthened in making it as independent as possible to give credibility and reinforce its quality assurance role;
- Three principles policymakers could adopt to promote innovation especially based on new technologies:
  - Data-driven Regulatory Intervention: relying on different sources of data surrounding new technologies can provide some signals or clues about what, when and, to a certain extent, how to regulate;
  - Adhere to a Principle–Based Approach: facilitating more openness and flexibility on the part of regulators;
  - Introduce the Regulatory “Sandbox”: the idea is to provide a safe space for testing innovative products and services without being forced to comply with the applicable set of rules and regulations (lowering regulatory barriers and costs).
- Policy makers should focus on the need for clarity, comparability, audit and assurance of non-financial reporting, its consistency and integration with financial data, while ensuring flexibility and fostering innovation and competitiveness with appropriate incentives.
What are the boosters for innovation?

1. Promoting innovation enhancing regulation: flaws to avoid, features and incentives to pursue

- Manon Roehrig, Policy Adviser, ecoDa

What is the issue about?

Having an appropriate and innovation-enhancing regulatory framework is a prerequisite to boost and support companies’ innovation potential, a necessary condition which is not sufficiently enhanced and present at EU level. Based on corporate governance experts’ and practitioners’ insights, one wonders if the European regulatory framework does not stifle innovation by affecting its three main levers (the opportunity, the willingness, and the capacity/capability of companies to innovate), instead of stimulating it.

While before the Lisbon strategy, innovation was mainly a national prerogative, the evolution in understanding of the innovation process resulted in the launch of several European initiatives to enhance innovation, seen as a competitiveness factor, driver of wealth and employment. If the underlying intentions were to establish a regulatory framework encouraging the creation and growth of innovative enterprises, the European Union has not entirely reached the intended objective and is still lagging behind in terms of innovation. According to the European Innovation Scoreboard 2021, Canada, Australia, the United States, and Japan have indeed a performance lead over the EU (taking into consideration R&D expenditures, venture capital, employment in information and communication technology...).

With the desire for better European Governance, the European Commission has adopted, in 2015, a Better Regulation policy. Composed by a set of tools and guidelines, this Better Regulation agenda aims at guiding the European Institutions to legislate as transparently and efficiently as possible. As a result, public consultations have been simplified to reach a larger audience, the “one in, one out” approach (ensuring that any newly introduced burden is offset by removing equivalent burden in the same policy area) has been introduced to minimise burdens for businesses, incremental legislative reforms have been preferred in certain sectors...

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4 European Parliament, EU Innovation Policy - Part 1: Building the EU innovation policy mix, 2016,

5 «European Innovation Scoreboard 2021», European Commission, 2021
To begin with, one should not forget that actions and policies which do not directly target
innovation may nevertheless have unintended effects on the process. Regulation matters at
all stages of innovation, from research and development (education policy, tax policy,
incentives on R&D...) to the commercialization phase (consumer protection rules,
licenses...). To be successful, regulatory efforts should therefore always consider the
dynamics between constraints and opportunities.

A non-negligible hindrance to innovation is burdensome regulation. By creating red tape
and/or excessive administrative burdens, some regulation may deprive companies from the
resources they would have devoted to strategy and innovative activities. The more stringent
a regulation is, the more a business must adapt to its requirements, the more it will
undermine the company’s innovative capacity. This is all the more true for SMEs, which
simply do not have the required resources to comply with challenging obligations (some
even lack the necessary in-house expertise having therefore to pay for external
consultants). For example, it is essential that the ambitious and laudable project of the
Green Deal goes along with sufficient accompanying measures so as not to lose companies
in the transition path and to install a creative and innovative dynamic, necessary for a real
change of mindset.

The rather negative approach the European regulation conveys regarding the corporate
world is all the more counterproductive as it increases civil society’s and more specifically
young generations' increasing mistrust towards companies. This trend is particularly
worrying insofar as young people are the pipeline of today’s talent but also of future leaders.
The European Commission should change course to incentivize the emergence and
attractiveness of tomorrow’s pool of entrepreneurs. This shift will only happen if the regulator
takes an accompanying role for companies rather than a stigmatizing one.

Innovation also presupposes a favourable regulatory environment that allows for a multitude
of governance regimes. One-size-fits-all requirements not allowing for flexibility cannot be
relevant and suitable for all European companies which have different size, ownership
models, business models, sector of activity, strategy, and goals. They overlook the diversity
of corporate governance models across Europe. In addition, such rigidity does not give
companies the possibility to experiment with alternative and potentially more innovative
solutions.

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6 Jacques Pelkmans, Andrea Renda (European Commission), How can EU legislation enable and/or disable innovation,
2014.

7 Burdensome regulation does not simply equate to monetary costs, it
embraces all possible adverse effects that make it hard to comply with a
regulation (pace of change, complexity of the requirements, litigation risks...).
In addition to its prescriptivism and its rigidity aspect, a regulation can hamper innovation through the uncertainty it might give rise to. Such counterproductive effects occur when the details of the regulation are unclear (creating loopholes) and/or difficult to interpret (resulting in diverging and inconsistent transposition and application). Nowadays, the lack of clarity is exacerbated by increasing regulation and amendments as well as the tendency to develop different layers of legislation (while delegated acts and guidance are rapidly considered as must-have by regulators and proxy advisors). This situation drives companies to excessive prudence, which can slow down strategic decision-making processes.

The European institutions should again take up national corporate governance codes as conveyors of rapid change. Establishing standards for good practices and adapted to national realities, corporate governance codes evolve quickly and anticipate markets’ demand, providing faster adaptation.

Innovation-enhancing culture should permeate all new European legislation. Greater attention should be given to financial capital and risk appetite. Two features still poorly present and developed in the European culture (especially when compared to its global competitors).

The availability of risk capital is crucial to finance companies with a high growth and innovative potential. Despite a non-negligible increase in investment volumes in Europe, the European equity market (including venture capital markets, business angels and private equity) still underperforms its US counterpart (even if some national markets stand out, like the Swedish one). To leapfrog the scattered European landscape, the European Union should foster a more integrated Capital Market Union, evolving towards a European-wide stock market.

Due to the scarcity of risk capital, European companies continue to heavily rely on bank financing, with, according to ESMA, less than one-third of businesses securing finance from the EU’s capital markets (compared to two-thirds in the US). For those receiving funding from venture capital funds, here again the level of amount perceived is less attractive than in the US for example, which limits the possibility for fast growing companies to scale up and compete globally (with an average of 1.3€ million received by European VC backed companies compared to €6.4 million in the US). This lower average fund size is indeed seen as the top three explaining factor for the European scale-up gap with the US according to an EIF Venture Capital Survey realized in 2021.

8 ESMA response to the Commission consultation on the Listings Act, February 2022.
If the European Commission is well aware of its underperforming risk capital market and is trying to strengthen this ecosystem across Europe (through the recent European Investment Bank and European Investment Fund pan-European Scale-up initiative to provide sufficient European capital for growth funding of scale-ups), certain aspects of the EU regulatory framework could also be reviewed to attract private investors and relevant stakeholders.

Without being exhaustive, the European Commission should facilitate investment in risk capital with a more favourable tax regime on capital gains and a better protection scheme in case of bankruptcy. This latter point indeed risks making both companies and investors risk averse, to avoid being penalized because of a liquidation process (in Germany for example, bankrupts can face a lifetime ban on senior executive positions at big companies).\(^{11}\) Efforts should also be made in the direction of individual investors, who are hampered from investing cross-border within the EU. As recently described\(^{12}\) by BETTER FINANCE, the European Federation of Investors and Financial Services Users, the European Single Market presents many barriers, notably when it comes to taxation. In addition to the widespread double taxation of investment income, tax refund procedures are too costly, lengthy, and burdensome for retail investors to obtain refunds. Reforms must target simplification, digitalization, lighter bureaucratic requirements, and cost of procedures, but the regulatory framework should above all put the emphasis on society’s financial education.

**What do board members think about the issue?**

Prescriptive corporate governance regulation is a source of concern for European Board Members. Defining the right balance between compliance and strategy at board level is a tricky exercise. As a result of ever evolving and increasingly complex EU regulation, boards are confronted with important risks of litigation, penalties, potential reputation risks and deterioration of the brand. Consequently, board members are forced to prioritize compliance at the detriment of strategic discussions, obliging them to analyse all (often very operational) details instead of focusing on business development and innovation.

Another counterproductive effect of demanding regulation is to deter experienced people from becoming board member as the liability attached to the position is now easily engaged (both based on what the company did or did not do - see French NGOs’ complaint against water giant Suez for the lack of preventive measures to combat human rights abuses in the company’s supply chain in Chile).\(^ {13}\)

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12 BETTER FINANCE, EU Commission Consultation on the New EU System for the avoidance of double taxation and prevention of tax abuse, 26 June 2022.

13 «NGOs file complaint against Suez for alleged failure to respond French duty of vigilance law following sanitary crisis in Chile», Business & Human Rights Resource Centre, July 2020.
If this can be seen as a way to make room for the young generation, the "judicialization of corporate social responsibility" remains problematic as it creates legal uncertainty and hesitant attitudes. The risk of this increased pace in regulation is to drive a certain culture within companies that might encourage high-level and skilled board members to join less regulated markets and companies. It also risks turning European companies into risk adverse entities whose innovation capabilities will ultimately decline over time.

**Recommendations**

**For board members:**

To bypass the constraints arising from a rigid legislative framework, board members should change their approach towards compliance. Rather than taking it as a mere check-the-box exercise from which no added value can emerge, board members should tackle compliance as a strategic exercise. This means putting an anticipatory approach at the heart of board decisions to anticipate societal expectations and possible regulation. By taking a step back from the day-to-day operation, board members will be able to adopt a forward-looking approach that will naturally lead to innovation discussions and insights.

If board members are under constant pressure to embrace more and more topics, they should not however neglect strategic discussions. Innovation should be the first item discussed during board meetings and should be the company's core principle. It is a survival related question that might even require extra dedicated exchanges.

In addition, for the strategic and innovation reflections to be fruitful and successful, the board composition is critical. Diversity (in terms of gender, age, nationality, educational and professional background...) and cross-fertilization provide the company with a variety of human and social capital resources that can lead to a broader range of ideas, greater creativity and thus a higher level and quality of innovation.

**For policy makers:**

Even though regulation can inhibit innovation by steering board members' commitment and energy towards compliance, having a sound regulatory framework is of utmost importance to create a level playing field and a fair business environment.

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14 Concept developed by two French Lawyers, Sébastien Mabile and François de Cambiaie in the following article Marine Fabre, «Devoir de vigilance: les entreprises sont de plus en plus poursuivies en justice par des ONG», Novethics, June 2021

15 Béatrice Richez-Baum, Why directors should make compliance a strategic exercise, Board Agenda, 2021

For companies to innovate and thrive, it needs to be underpinned by a flexible and clear legal framework, that we would recommend the European Commission to achieve, based on the following recommendations:

- To avoid unintended effects, innovation should be at the heart of the EU impact assessment methodology. Meaning that policy options should be assessed based on their innovation-enhancing or innovation-constraining potential;
- The role of the Regulatory Scrutiny Board should be strengthened in making it as independent as possible to give credibility and reinforce its quality assurance role.
Access for board members to independent and quality information

- Dr. Béatrice Richez-Baum, Director General, ecoDa

What is the issue about?

Access to information has always been a key issue in corporate governance, if only to combat the asymmetry of information between the management and outside directors. Board members can request information on any matter related to the business and corporate affairs. Of particular relevance for board effectiveness and innovation is the access to information for non-executive board members since executive directors (in a 1-tier board) and management have an information advantage. However, the Corporate Governance codes do not devote any real recommendation (except the Belgian Code, which includes a recommendation that the board can call upon external advice on the cost of the company) on the means that can be used by board members to get access to any relevant information.

Effective governance requires well-informed board members to allow them to challenge the management, to exercise proper oversight and to incentivize innovation. In terms of information, most of the time, directors rely on the information given by the management, which makes them vulnerable (e.g., from a controlling perspective) and dependent (e.g., from an entrepreneurial and innovation perspective). Private Equity boards are often considered as the best example for effective strategic reflection at board level with regard to a board’s resources and information. However, access to independent information has accelerated in recent years due to several factors.

First of all, the growing complexity of the business world, but also the impact of geopolitics, the access to (natural) resources and the increasing burden of regulations have led boards of directors to find additional support with more and more specialized committees.

The ‘traditional’ board committees such as Audit, Remuneration and Nomination committees are historically recommended in governance codes and merely installed from the perspective of avoiding ‘conflicts of interest’. Besides these ‘regulatory’ committees, we observe a new set of committees, that do not focus on the strict areas of conflicts of interest but are much more related to the complexity of the business world and societal evolutions, such as sustainability committee, technology committee, strategic committee, etc..

The tendency is even to tackle each new emerging challenge by installing a dedicated committee. Those committees allow board members to collect and select the most relevant information in their fields of attention in order to prepare the board's decision making. But the risk is also to lose the overview with a fragmented thinking. Specialists tend to lose sight of the big picture. Moreover, for the board to get the full picture, much more ‘reporting’ needs to be done to secure that all board members can fulfil their collegial duties.

Furthermore, the tendency to integrate the company’s externalities into decision-making, calculate the impact on its ecosystem and its business, and give sufficient attention to the interests of stakeholders necessitates board members to further expand their access to information (and even more challenging, to allow analysing the impact throughout the supply chain). In this respect, the quantity and quality of information is becoming an essential means for directors to effectively exercise their duty of care and their duty of due diligence. This is a way to guard against any questioning of their decisions.

Finally, digitization (like access to business intelligence data tools) is an accelerator of this trend towards an increasingly broad use by board members of information.

In accessing and managing information, board members can come up against two biases: 1- misinformation (fake news or biased information) and hidden information (fraud), 2- over-information. To overcome the first pitfall, access to various external and internal sources of information is essential. To avoid over-information, board members have first to define what types of information they need. They also must make the effort to find the right balance between:

- Backward-looking information versus forward-looking information;
- Internal versus external sources of information;
- Specialized versus general information.

To strike the right balance, a prior alignment with the raison d’être and the corporate purpose is required, since the information must make sense for this ultimate goal. As a basic principle, the information should be useful to a board’s roles.

In terms of innovation, it should be remembered that strategic thinking and discussions are only taken seriously by the board and CEO when external information is brought into the boardrooms. What matters more and more in today’s boards is the capacity of its members to acquire business intelligence, and to find the right indices (as varied as the index of well-being in the company).
It is about their capacity to look for information and to value it from the perspective of board decision-making. Board members need to be able to identify weak signals and scan blind spots that can be relevant e.g., to identify new customers’ needs.

This board capability can be enhanced through diversity. Approaching decisions through diverse problem-solving frameworks widens the prism of analysis and therefore reduces decision-making bias. Cohesion and status-quo should not be privileged at the expense of productive frictions. Having complementary decision-making styles will create an informed collective intelligence, capable of treating information in a holistic manner. From this constructive perspective, confrontation will arise, bringing new strategic considerations and opportunities.

The Chair has also an important role to play in ensuring the appropriate level of diversity in his/her board composition strategy. If a disequilibrium is witnessed, this can be mitigated through supplementary external expertise and insights. A mapping of board skills is becoming of utmost importance. Some Corporate Governance Codes are already encouraging boards to follow that route.

**What do board members think about the issue?**

To boost innovation in companies, board members generally agree that they should operate as inspiring partners for the management. As a prerequisite, boards should embed a culture that doesn’t kill new ideas. The board should not be there only to provide rubber stamps but to co-develop, while providing sufficient checks and balances.

To remain relevant in such a fast-evolving environment, board members must have the right mindset to question the assumptions, to remain agile and to be curious about what is going on in other companies and outside the business. This touches on the delicate question of the composition of boards of directors.

Getting the right combination of board members, coming from the same sector with relying on cross-fertilization across different sectors, is a difficult exercise.

In terms of innovation, managers are judged on their ability to identify the right questions/challenges, to switch from one model to another, and to run different things in parallel.
Board members are expected to support the innovation journey by anticipating the next steps, connecting the dots and allocating the right resources (responding to the questions: can I make sustainable/ circular products, how will the products be impacted by disruption and deep adaptation?).

To provide concrete input, independent directors should get prepared and bring any relevant external information into the boardrooms. By showing different perspectives, they can avoid turning a topic into a mere compliance exercise. The role of the board secretary is essential but not sufficient. Providing add-on vision or alternative routes is crucial for innovation, as shown e.g., by the example of a meat producer changing its vision to become a protein producer (with plant support). A challenge for board members is to digest and understand the huge amount of information that is nowadays available and the speed of change in business that requires sufficient updates and real-time information.

Board members should not neglect the fact that they can turn to ad hoc experts at any time. In practice, this recourse to external expertise can take different forms:

- Specialised experts, who can increase the collective expertise of the board (example of Belfius which appointed a CEO of a digital tech firm as advisor to the board and the management in order to help them with their digital compliance analysis – It was an intermediate solution before upgrading the board profiles with digital competence);
- Advisors who can help individual board members prepare for board meetings (an increasing trend in Germany);
- Boards trainings on specific topics;
- Experts hired by the board to argue/contradict reports done by consulting firms for the management;
- Advisory committees of the board with stakeholders or representatives of the new generation;
- Technology committees advising board members on IT topics (a growing tendency in the US - 74% S&P companies have institutionalized them);
- Peer group discussions (example of Tapestry Network: Beyond the importance of institutes of directors to generate content and good practices, directors increasingly have an appetite to group together by sector of activity or by function in the board to acquire new sources of information and to exchange experiences).
Moreover, already years ago, academics reflected on the need for « boards to have their own staff and counsel to review and evaluate information coming from the management and to conduct independent investigations ».\footnote{Journal of Comparative Business and Capital Market Law 6 (1984) 243-255 243 North-Holland - Session four: the board of directors' access to and use of information.}

Finally, if independent board members must provide openness and expertise, they must keep ground with what is happening in the company. This can be facilitated by business reviews presented at board meetings. The whole issue is therefore that they keep the capacity for objective critical analysis, while being fully updated of the business and its volatile context.

\textit{Recommendations:}

\textbf{For managers:}

- Managers must understand that board members need to look for external inputs. It should not be seen as a sign of distrust, but on the contrary as the sign of commitment and good governance.

\textbf{For board members:}

Acting as a controller is quite different from discussing together with management about the future of the company. Delineation of the role of management, the board and eventually board committees is completely different in this respect.

- As corporate culture is a key component for innovation, the board (and management) should stimulate/foster a culture of open information exchange and tolerance for ‘out of the box’ thinking or diverging opinions (it also links to diversity in the board – namely tolerance for diversity of thoughts);
- Board members should reflect on how they can expose the management to new thinking, thereby broadening horizons, improving understanding of a company’s markets, risks and future drivers of growth, challenging assumptions and guarding against groupthink. They should try to widen the networks of contacts and opportunities available to the organization (as it is done by some advisory boards to the management);
- Boards must clearly define the type of information they need, and which makes sense in view of the company’s purpose. They must ensure the right balance between backward-looking information versus forward-looking information / internal versus external sources of information / specialized versus general information / sector-centric versus cross fertilization. Information must serve 3 objectives: 1- preventing, 2- anticipating, but also 3- guiding and innovating;
• Boards should reflect on which budget they will need for getting access to the right information through the right channels (trainings, experts, etc.);
• A mapping of access to information should be a strategic topic as well as the sources of information (external / internal);
• Access to information and consideration of information in the decision-making system should be systematically integrated into boards evaluation processes;
• Training programs for board members should include the issue of information management, possibly with the support of military schools that have expertise in intelligence matters;
• Board members should be using digital tools more often and be more familiar with them, such as:
  ○ Board book/portal or extranet to manage the board packages and story information relevant for the board members;
  ○ Business intelligence data tools;
  ○ The use of AI (basic form is NLP) to analyse external data sources.
3. Business ecosystems and platforms as new forms of value creation and innovation

- Prof. dr. Abigail Levrau, Leader of The Corporate Governance Dialogue Advisory Committee

What is the issue about?

Innovation is a major driver of productivity, growth and competitiveness. Rankings, published annually, keep track of the most innovative economies and companies. Although seven European countries are in the top 10 of the Global Innovation Index, the list of innovative companies -on the contrary- is mainly dominated by companies from the US and Asia. European innovative leaders are under-represented, or undoubtedly less admired by innovation executives worldwide.

Let’s zoom in. A company that is able to successfully embrace innovation is well-placed to outperform its competitors and create value for investors, customers and other stakeholders. The leading innovative companies in the BCG rankings demonstrate clear leadership (namely unambiguous C-level ownership and priority-setting fostering greater tolerance for risk) and successfully maintain strong collaboration (teaming) between R&D and facing functions (e.g. marketing & sales) with a focus on customer first.

Nonetheless, companies seek to innovate in different ways. More routine forms of innovation – which incrementally build on existing technologies and business models – are not necessarily any less important for profitability and economic growth than radical or disruptive innovation.

In addition, in the last couple of years, companies are increasingly looking beyond their own walls for new ideas, being focused on external innovation by leveraging incubators, academic relationships and business partnerships.

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19 https://www.wipo.int/global_innovation_index/en/2021/; the Global Innovation Index (GII) presents the annual global innovation ranking of 132 economies, relying on 81 different indicators. The world most innovative European economies are Switzerland, Sweden, UK, the Netherlands, Finland, Denmark and Germany.

20 https://www.bcg.com/publications/most-innovative-companies-historical-rankings. The ranking is based on a survey among 1,500 global innovation executives.


22 Boston Consulting Group (BCG), the most innovative companies 2019, the rise of AI, platforms and ecosystems.
Analysing the top innovative companies it becomes clear that the use of artificial intelligence (AI), platforms\textsuperscript{23} and ecosystems\textsuperscript{24} to support their innovation efforts is on the rise. Their remarkable success can to a large extent be attributed to the emergence of inter-connected digital technologies. The shift cannot be ignored. Whereas twentieth century capitalism was organized around larger industrial companies, the contemporary economy is now steered by software-driven platforms. They are considered both disruptive and controversial.

Besides, growing customer demands for a higher user experience and huge societal challenges (e.g. health, global warming, water shortage, energy concerns, poverty, etc) further amplify the need for partnerships in all kinds of sectors, as one single organisation cannot tackle these alone.\textsuperscript{25} Various “partnering” strategies and collaborative networking formats emerge between stakeholders to come up with innovative offerings. Platform businesses are just one form of ecosystems in this respect.

The integration of the young generation into the business world is also a subject of concern which should invite companies to think about new management methods and a more collaborative approach.

It is clear that these new models are also disrupting the traditional economic theories of the firm and markets as well as mainstream corporate governance frameworks. The latter are indeed developed in pre-platform times in response to the needs of large, industrial (listed) companies. In particular, the classical forms of hierarchical “command and control” or “contracts and pricing mechanisms” are now being challenged.

\textbf{What are the governance challenges?}

Literature on platform, network and ecosystem governance is still in its infancy, primarily trying to understand the organisational distinctive features, benefits and weaknesses as well as identifying the governance challenges. Yet, clear cut solutions and best practices are rarely provided.

\textsuperscript{23} Platforms are technologies that provide a foundation for developing other business offerings. Organisations such as Amazon, Alphabet/Google, Uber use platforms to create value by facilitating connections between two or more groups. Fenwick, M., Vermeulen, Erik, P.M. (2019) “A sustainable platform economy & the future of corporate governance”, in Levrau A, Gobert, S. (Eds) Governance the art of aligning interests. Liber Amicorum Lutgart Van den Berghe.

\textsuperscript{24} A business ecosystem can be defined as an interdependent value-creation network of an organization, that reaches beyond its boundaries. It includes customers, suppliers, distributors, technology partners, Joint Ventures, alliances, government agencies, industry associations and others, who play a role in the overall creation and delivery of a company’s products and services. R. Deiser https://futureorg.org/wp-content/themes/futureorg/assets/Ecosystem-Leadership-Part.pdf

\textsuperscript{25} De Stobbeleir, K.; Peeters, C.; Pfisterer, M. Business ecosystems. What do they mean for your company? And how do they impact your role as a leader? Vlerick White Paper
Literature on platform, network and ecosystem governance is still in its infancy, primarily trying to understand the organisational distinctive features, benefits and weaknesses as well as identifying the governance challenges. Yet, clear cut solutions and best practices are rarely provided.

In essence, mainstream corporate governance intertwines with a vertical structure of authority, delegation of power, control of management by a board of directors, and clear lines of accountability. It is obvious that the characteristics of network settings and platform-based ecosystems (e.g. interdependence, horizontal structures etc.), require a different governance approach rather than a hardcore ‘cut and paste’ application of traditional corporate governance principles.

Business practice shows that the failure of ecosystems is often attributed to a lack of effective governance. Ecosystem governance appears to be a success factor but at the same time it is challenging as the network and platform based ecosystems’ landscape is very diverse. Examples of companies operating in centralized, decentralized and even distributed ecosystems reveal different governance implications. Moreover, the governance of the ecosystem itself, may strongly depend on the relative power of each player, its negotiation skills and contractual infrastructure due to the absence of formal legal structures which provides a constitutional framework. The power play is particularly tangible when partners are quite diverse in size.

Nevertheless, common key questions need to be addressed: How are interests aligned in the first place? How are these interests orchestrated effectively and fairly? In fact safeguarding goal consensus (common purpose) and managing conflicting interests remains the main governance challenge.

Additional governance challenges are identified and may evolve according to the stage of the ecosystem’s development path. They can be summarized as follows:

- Coordinating work and dividing responsibility;
- Management of commitment and trust;
- Building internal and external legitimacy;
- The need for skilled people and specialized competencies/capabilities;
- Lack of accountability.


**Recommendations:**

**For managers and board members:**

It is argued that to thrive in the complex world of networked value creation, organizations and their leaders need new capabilities and a new mindset. “*One needs to move from an “ego-system” to an “ecosystem” state of mind*.\(^\text{29}\)

Leaders face two concurrent and interdependent governance tasks: the governance of their own organization, and the governance of the ecosystem.\(^\text{30}\) In particular, leaders should master a new type of strategic-organizational thinking that is based on a decentered perspective; i.e. an in-depth understanding of their interconnected position within the larger ecosystem that informs their actions. The typical central and vertical control must give way to an empowered periphery of micro-organisations, tied together by a strong framework of values, strategic orientation and purpose.

“The challenge is to find our right spot in these ecosystems – a spot where nobody is going to be better than you, and you can’t be made redundant” – Sylvie Ouziel, former CEO, Allianz Assistance (Allianz Group).

In addition, there is an undisputable role for the board of directors to play in guiding each company along its innovation journey. Key recommendations\(^\text{31}\) in this respect relates to:

- Incorporate innovation perspectives of various internal and external stakeholders into strategy setting sessions;
- Systematically connecting boards with the external ecosystem to assess the current landscape and state of innovation;
- Boards members can best provide oversight when they are becoming more familiar with emerging issues in operations, supply chain, digital and technology enablement, cybersecurity and ESG;
- Keeping track of progress and implementation.

The transition to platforms’ and ecosystems’ strategies also introduce more boundary spanning activities for the board of directors.


\(^{30}\) Deiser, R. (2020) “Organizing for Business Ecosystem Leadership Insights from Expert Conversations and a Global Survey”

Board members may play increasingly active roles throughout these transitions, such as providing introductions and network connections. Boards of directors need to adopt and understand the metric changes that will affect their role in evaluating and compensating executives’ performance. New interaction-metrics such as platform engagement, transactions enabled, or value created for complementors deviate from traditional metrics used in product and service companies.\textsuperscript{32}

\textbf{For policy makers:}

Although experiments with familiar legal forms (such as The Association or The Group) are reported,\textsuperscript{33} it can be argued that traditional governance frameworks and recipes seem to be ill-suited for companies and business needs that are becoming flatter and more open. Companies need to be resilient and continuously adapt to rapidly evolving technologies, markets and consumer demands. The tendency towards compliance-oriented governance, strengthened by a complex and tighter regulatory environment contrasts sharply with the promise of the new business forms, supported by new technologies. Moreover, the latter is subject to uncertainty about risks, benefits, future directions as well as to broader social and ethical concerns. Of particular interest, for example, are the concerns raised with regards to competition and data protection law issues.

Corresponding laws and the understanding of what should be permissible vary a lot from one country to another offering opportunities to find loopholes, benefiting some platform companies. Taken all together, one can question whether the European regulatory framework is a hurdle or a trump.

So what can policymakers do to promote innovation especially based on new technologies? Three principles suggested by Fenwick et.al (2016)\textsuperscript{34} are worthwhile considering:

- Data-driven Regulatory Intervention: relying on different sources of data surrounding new technologies can provide some signals or clues about what, when and, to a certain extent, how to regulate;


• Adhere to a Principle–Based Approach: facilitating more openness and flexibility on the part of regulators;
• Introduce the Regulatory “Sandbox”: the idea is to provide a safe space for testing innovative products and services without being forced to comply with the applicable set of rules and regulations (lowering regulatory barriers and costs).

Some additional remarks:

The impact of the pandemic has clearly accelerated innovation in many sectors. “Creating a new COVID-19 vaccine in less than a year, inventing test kits in weeks to protect public health, and redefining online shopping and safe home delivery reflect the versatility of the world’s most innovative companies in 2021.”

In contrast, research suggests that geopolitical risk has a substantial stifling effect on private sector innovation, in particular for companies with substantial exposure to foreign markets, and that that negative impact can persist for three to five years after the initial conflict.

Finally, a new picture of technology and geopolitics is emerging as well. “There is a new map of power in the modern world that is no longer defined by geography, by control of territory or oceans but rather by control over flows of people, goods, money and data and by exploiting the connections technology creates.”

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35 https://www.linkedin.com/pulse/most-innovative-companies-2021-according-bcg-louis-columbus


37 https://www.weforum.org/agenda/2021/04/seven-business-leaders-on-how-technology-will-shape-geopolitics/
4. Digitalisation: The state of digital governance in 2022 - How boards fared, and what should be on the board agenda in the future

- Prof. Michael Hilb, Chairman, Internation Board Foundation

On the surface, the topic seems to be done. As usual with management fads (Abrahamson 1996) - digital transformation can well be seen as the fashion of the 2010s, currently being superseded by sustainability - it takes some time for the topic to be noticed, until the tipping point is passed and inflationary use of the term can be observed. Since management or, in this case, governance ideas can also be seen as a means for organizations to differentiate themselves and signal their future orientation to their shareholders and stakeholders, such concepts are evolving over time.

The signs of this shift cannot be ignored: While companies have highlighted their digital initiatives or even appointed chief digital officers to underscore their leadership, digital activities have become mainstream and increasingly no longer deserve special designations. Those companies that still emphasize digital leadership tend to be laggards, following pioneering companies in every field. Some companies are even experiencing digital fatigue, as employees are sick of hearing about the inflationary rollout of digital initiatives, some of which have failed to meet their expectations.

Behind the curtain, however, the mission is far from complete. Too many companies are still failing to realize the full potential of digitalization, others are struggling to overcome the obstacles of digital transformation, and still others have abandoned their original aspiration and are settling for less than ambitious targets. What are the reasons for this, what still needs to be done, and how can the board address the challenges so that companies become fit for the future?
Five main reasons why boards have struggled to fully embrace the opportunities of digital transformation can be summarized as following:

1. **Insufficient framework for digitalization**: Too many boards still view digital transformation primarily as a technological challenge. The appointment of people from technology companies as board members is evidence of this assumption. While technology can provide useful means to solve a problem or exploit an opportunity, the problem or opportunity is economic or organizational in nature and should be framed accordingly.

2. **Underestimating the technical complexity of legacy systems**: Because most board members rightly have a user-centric view of digitalization based on their own experience or professional background, they often tend to underestimate the complexity of back-end system integration, especially when new digital solutions depend on full integration with legacy systems and databases.

3. **Underestimating organizational and cultural barriers**: While companies and boards are well aware of the complexity of business transformation and have learned how to deal with it, these insights do not always seem to be at the forefront of boards’ minds when addressing digital transformation. All too often, they focus on digitalization rather than transformation when setting priorities.

4. **Overconfidence of digital skills**: As digitalization has become a pervasive concept that no board member can ignore, board members have read, learned and discussed a lot about it. This has led to a significant level of confidence in understanding and grasping the topic with all its implications. The sometimes costly failures of many companies’ digitalization efforts can be read as overconfidence in the board’s abilities, as surveys also show (Huber and Hilb 2019).

5. **Herd behavior and lack of critical reflection**: As with any topic that is in vogue, decision-makers can easily fall into the herd behavior trap, i.e., try to imitate the behavior of other players without fully reflecting on the appropriateness of the underlying assumptions and implications. Especially in times when companies are expected to be ahead of the curve, to act progressively and to innovate, it is not easy not to fall for the buzz of digital transformation.
The journey ahead

Five key digital opportunities emerge:

1. **Innovate the digital business models:** Digital technologies can enable a variety of new business models, giving business leaders an expanded option space from which to choose. Board members play a central role in helping business leaders identify the option space and make the right decisions.

2. **Datafy the business:** Although everyone talks about data, few companies take a strategic perspective and view and manage it as a strategic asset. It is up to the board to ask management to take this perspective and act accordingly. This requires a sound understanding of the possibilities and limitations of data and algorithms.

3. **Drive digital venturing:** Many incumbents are turning their attention to start-ups and scale-ups, which are often more agile and sometimes outperform incumbents. At the same time, many established companies struggle to operate and grow their own digital ventures. Venturing requires a very different mindset, which must also be represented on the board.

4. **Shape digital ecosystems:** As industry boundaries shift and new ecosystems emerge based on user needs, company boards must not only understand these shifts, but also be able to discuss and decide their company's future positioning in future ecosystems.

5. **Collaborate with others:** Whether in ecosystems or more traditional strategic alliances, partnerships are becoming increasingly important and a key strategic capability. This is often not only a management challenge, but also a corporate governance challenge, as the focus shifts from control to influence.

**Recommendations for board members:**

Digitalization is one of many opportunities and challenges that organizations and their leaders face these days. As with all opportunities and challenges, it usually takes time to fully grasp the relevance, but most importantly, it takes a disciplined approach to setting a strategy and implementing change over time. In this type of business transformation, the board plays a central role, not only in helping to shape the transformation, but also in ensuring proper execution, especially once the caravan has moved on and the next governance fad has taken hold.
What can boards of directors learn from the past as they intend to champion digital value creation in the future?

1. **Focus on the end, not the means**: Digital technologies can be a great enabler, but should not be viewed as the end of a business transformation. This should be a key guiding principle for board members deciding on digital initiatives.

2. **Focus on transformation ... and less on digital**: Digital transformation is mainly about convincing employees, customers or business partners of the benefits of change. Therefore, the board should ensure that the digital initiative focuses on people and not on technology.

3. **Acknowledge the power of power**: Upheavals and transformations always lead to a change in power structures, with some gaining influence and others losing it. Board members are well advised to recognize this and take it into account when creating plans.

4. **Be humble and learn about the unknowns**: No one is perfect. This also applies to board members, who should be honest with themselves and their fellow board members about what they know about digitalization and what they may still need to learn.

5. **Think for yourself and do not just go along**: Finally, board members should never stop questioning and challenging the benefits and limitations of digital transformation. What works perfectly for some organization may not produce the same result for others. Finding the optimal solution for each organization is one of the core responsibilities of an effective board member.
5. ESG/Sustainability when truly embedded in the strategy

- Prof. Paola Schwizer, Professor in Financial Markets and Institutions, University of Parma

Sustainability\(^3^8\) is a key driver of innovation and a new way to gain or maintain competitive advantage. Many companies are changing their business models to incorporate sustainability.

Sustainability-driven innovation can include finding new applications for current services and products, changing existing business processes, developing new products and services, using or creating new technologies, and changing management techniques, all the while ensuring that these result in environmental and social benefits as well as financial ones.\(^3^9\)

Corporate Governance Codes of many countries, as well as upcoming regulations and reporting requirements, societal pressure and different sorts of activisms from institutional investors, are now requesting boards pursue the goal of long-term value creation for the benefit of shareholders, assessing all relevant financial and non-financial risks and ensuring adequate consideration of sustainability issues and stakeholders' interests\(^4^0\) and expectations. The board of directors, and particularly non-executive independent directors, should thus play a key role in leading this sustainable business transformation.\(^4^1\) A new leadership model for boards could significantly contribute to unlocking the change, contaminating the management team and the whole company, and make the board of directors able to master sustainable success.

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\(^3^8\) Sustainable development was defined in the World Commission on Environment and Development's 1987 Brundtland report ‘Our Common Future’ as ‘development that meets the needs of the present without compromising the ability of future generations to meet their own needs’. It seeks to reconcile economic development with the protection of social and environmental balance. The 2030 Agenda has at its core the Sustainable Development Goals (SDGs) and covers the three dimensions of sustainability: economic, social and environmental. Sustainability and the transition to a safe, climate-neutral, climate-resilient, more resource-efficient and circular economy are crucial to ensuring the long-term competitiveness of the Union economy (EU Taxonomy Regulation 2020/852 of 18 June 2020, recitals No 2 and 4).


\(^4^0\) See for instance the UK and the Italian Corporate Governance Codes.

\(^4^1\) Nedcommunity, Board and sustainable success: a new leadership model for the director, 2021.
The board should lead business processes towards long-term sustainable goals, starting from scenario analysis and strategic planning, on the basis of the assumption that taking into account emerging trends and challenges and related stakeholders’ interests could help companies mitigate risks and catch new opportunities to generate long-term value. Both international academic literature and a few international successful experiences are there to confirm it. 42

However, behaviours and mindset practiced in board of directors are still often very formal and do not allow for active, fluid interaction among its members, with the management team, or with other stakeholders. Scenario analysis and forward thinking are rarely exercised and performed by board members, who are overloaded with daily tasks. Especially in highly regulated sectors, such as the financial service industry, boards are struggling to comply with the accumulation of legal requirements and to innovate at the same time.

So, we strongly recommend that individual board members be constantly informed and updated on new sustainability issues, trends and relating public policies and regulation, and that the board be adequately involved in business model analysis and long-term strategic planning, in the purse of an effective governance of sustainable innovation and of the integration of ESG issues in corporate governance and strategy direction and oversight.

What do directors think about the issue?

How to integrate sustainability issues into strategic planning and decision-making? The panel of directors interviewed strongly agree on the urgency of change, and state that:

- The ESG dimension must definitely be integrated into the strategy, in a substantial way: it’s not about just “greening the strategy”;
- Companies have to make strategic trade-offs and find the courage to forgo certain contracts/projects. An appropriate error management can support the learning process of the board and the organization as a whole, encouraging the development of an appropriate culture of innovation. The “sustainability test” is a first step used to make trade-offs: does the solution developed by the company respond to a need without (significantly during the transition period) endangering any future needs?

For example Belfius has developed a digital exchange platform (“Re=Bel : the investment app with a cause”) to buy and sell share while calculating the ecological footprint of the companies they invest in.  


ESG might not be seen as a mere compliance exercise but rather as an opportunity that brings scenario analysis and strategic discussions in boardrooms as well as a key driver to innovate;  

Business models have to be aligned with climate targets and other SGDs. The more ESG will be integrated in a company’s business model and reflected in every policy defined by the company, the more the potential for innovation and value creation will be exploited. However, so far, the E (Environmental Goals) receive far more attention than the others, due also to an enhanced regulatory framework. The board skill-mix shall be revised, in order to move towards more active, diverse, sustainability-driven and committed directors, with expertise in ESG issues, as well as in crises and turnaround management, new and inter-market, digital and media, IT, cyber security;  

Diversity of competences and views in the boardroom remains key, for several reasons: a. it facilitates a good understanding of the business organization and affairs; b. it enables members to constructively challenge the management decisions and to be more open to innovative ideas, avoiding ‘group-think’; c. it contributes to effective oversight of the management and to successful governance of the company towards long-term sustainable goals.

Directors also acknowledge that sustainability matters require tremendous changes for boards themselves: there is a need for platforms (bootcamps/ESG learning programmes from strategy to operations and disclosures) to share experiences, to inspire and help companies deal with the transformation process.

Individual and collective directors’ training shall be increasingly focused on sustainability and to those personal skills which might favour team-think and long-term integrated thinking.

Continuous personal development of board members is often seen as an explanatory factor of the inventiveness of some companies. However, boards have to move to a logic of permanent learning in a collective way.

Directors are aware that some potential obstacles may hinder effective board leadership in this process. They recognize that the sustainability transition cannot happen overnight: it should be done in a phased manner in order to avoid putting business “out of the business”. Timeliness is however highly sector-related.

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43 For example Belfius has developed a digital exchange platform (“Re=Bel : the investment app with a cause”) to buy and sell share while calculating the ecological footprint of the companies they invest in.  

Some industries are more intensively exposed to climate-related risks, and have to carry out the transition as quickly as possible. Other sectors might see the issue as less urgent. Anyway, the question of time should be raised by the board. How should it combine the efforts in dealing with sustainability issues which may have an impact on the business only in the long run, while they are coping with urgent matters, such as the pandemic emergency? An effective management of the board agenda and of strategic board meetings and board activity is thus requested, and in this regard the Chairperson’s strategic acumen and skills are key.

Good governance practices aimed at enhancing integrated thinking in the boardroom could be the following:

- Organizing brainstorming sessions and strategic board meetings with no strict agenda;
- Enforcing open and frequent communication channels between management and board;
- Analyzing internal and external ESG case studies at board level;
- Defining goals and measuring ESG performances;
- Developing effective processes, beyond compliance: board evaluation, training and induction, succession planning can help identify and cultivate critical resources, skills and talents.

Less consensual, although there is a trend in practice, is setting up Sustainability or Scenarios Committee, where directors can meet external experts on selected issues. It can be argued that ESG should be mainstreamed in each (board) committee and board meeting, and not be tackled by a separate group.

Board leadership can also be compromised by a lack of preparation of individual directors. Potentially, when a member’s background does not cover a subject, he/she may tend to behave and reason in a conformist way, that is to say to act in line with the opinion of the majority. Once more, board training can be the appropriate solution in these cases, as well as the ability of the Chair to foster individual contributions to the board discussion. Additionally, directors’ behavior and board dynamics also depend on the individual personality characteristics of being open-minded, courageous etc. These elements should be investigated during the recruitment process, also in order to better quality the skills and expertise assessment, as suggested by the EBA-ESMA Guidelines on suitability of bank board members.44

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Although new competences in digital technology, environmental and social matters may positively add to the board skill-mix and foster innovation, every director can lead the process of transformation towards more sustainable governance and business models by being proactive and raising awareness of the topic in the other board members. More important is that directors develop the ability to look for and detect connections between different resources and different types of capital (economic and financial, manufacturing, social and relationship, natural, intellectual and human). This approach helps achieve more effective risk management, limiting siloed thinking and promoting a broader view of potential future challenges. It also leads to a clearer identification of the organization’s key internal and external stakeholders. As stated by EBA and ESMA in their revised Guidelines on sustainability of board members, ESG risk factors should be included into every company’s risk map, and, when assessing the knowledge, skills and experience of a member of the management body, consideration should be given to theoretical and practical experience relating to, among other things, risk management, i.e. identifying, assessing, monitoring, controlling and mitigating the main types of risk of an institution including environmental, governance and social risks and risk factors (EBA-ESMA, 2021).

Another obstacle to an effective transformation is the insufficient understanding at board level on how ESG impacts businesses. Measurement of SDGs remains a critical issue, also in light of the ESG reporting requirements, as no uniform standard/methodology exists. Many companies, and boards, have started to look at their footprint (e.g. carbon footprint). But what about other social or human-related issues? What kind of value can a company overall, under the leadership of the board, bring to sustainability? How far will an ESG-driven strategy produce a competitive advantage? The benefits of creating a more sustainable business are mostly long-term and they can be both tangible (e.g. increased sales, customer base, profits, etc.) and intangible (e.g. better image, reputation and customer loyalty). Companies have to accept that sustainable strategies and policies may have a longer pay back, and that part of the value created will go to stakeholders other than investors. However, sustainable investments are often fundamental to allow the survival of the company itself and promote its competitive success in the long run.

So, the board should try to find new value and performance indicators, beyond pure financial ones, and help managers understand that there are more measures of success in business than profit.
In doing this, it should understand how to take into account several material ESG factors in computing the cost of capital and which measure to use in the assessment of the value created in a broader sense.

A final concern of board directors relates to the difficulty in considering stakeholders’ interests and expectations in strategic decision-making. As is well known, boards and companies often face decisions involving trade-offs among stakeholders’ interests because given the limited resources satisfying the needs of one stakeholder group is incompatible with meeting another stakeholder group’s needs. Making the right decision about which stakeholder to prioritize case by case is not an easy task for the boards and it usually requires large, diverse sets of information from a variety of sources and a longer decision-making process. The board should be aware of this difficulty and of the fact that the key to good stakeholder governance is not necessarily about meeting all stakeholders’ requests, but about taking their role into account, and engaging them as much as possible into the process, by actively listening to their demands, analysing and predicting their behaviour, and communicating with them effectively and regularly.
Guidelines to enhance board leadership on sustainable strategies

- The board must be involved in the assessment and, if needed, in the transformation of the business model along the entire value chain;
- The board's role in providing strategic direction and defining long-term strategic guidelines, must be enhanced, trade-offs have to be made on the basis of a thorough analysis of risks and opportunities linked to ESG;
- Emerging risks have to be taken into account in asset valuation processes;
- Performance measures have to embed emerging risks;
- Short- and Long-term management incentive schemes should include some KPIs linked to ESG goals;
- The board skill mix should be revised, in order to include a higher degree of diversity in terms of background, age, attitudes, etc., which may boost integrated thinking and provide innovative perspectives;
- The diversity policy approved by the board must not cover only legal obligations or be driven by compliance with corporate governance codes; conversely, it must be targeted to support an innovation in mindset, culture, decision-making and, ultimately, in the way of conducting the business;
- Non-executive independent directors should play an active role in the transformation process and should ensure fair stakeholder-oriented decision-making and reliable non-financial reporting;
- The board should be involved in scenario analysis, based on the interaction with relevant stakeholders;
- The board should ensure a more integrated and specific corporate reporting, aimed at showing the links between financial and non-financial profiles.
In order to enhance the integration of sustainability issues into corporate governance processes and strategic decision-making, the above-mentioned considerations and concerns suggest the following recommendations and policy implications for boards, institute of directors and regulators.

First, board members should be directly involved in a reflection on the company’s purpose and long-term strategic goals, on the basis of a direct dialogue with relevant stakeholders. The “materiality matrix”, on which non-financial reporting is based, should be appropriately defined and discussed in the boardroom, and should inspire strategic thinking and innovation. Directors should also be more involved in scenario and business model analyses. Many companies, and boards, are working to be ready to face the new challenges on the basis of concrete plans and goals. But there are, however, a few cases where boards are still dealing with ESG issues only when they are facing big competitive or reputational problems. This means they are adopting a short-term view, which is typical of crisis management, rather than a strategic, forward-looking risk management approach.

In their assessment of the future desired board composition, with a view to renewing the corporate bodies, directors should also ask themselves whether the same skills and knowledge used in the past are suitable to address the new challenges. Isn’t it time to bring creative thinking, innovative thinking into the board, and to hire some new talent, coming from different pools and thus able to “imagine” a completely different way of doing business? Moreover, in assessing the knowledge and skills of new candidates, soft skills should also be taken into account, as critical abilities aimed at qualifying the potential value that the individual directors can bring to the board dynamics and to the effectiveness of decision-making.

The board agenda should also be revised, to make sure that enough time is devoted to strategic thinking and planning, with a focus and a time horizon beyond those of the business plan.

Ultimately, directors should be aware of the fact that their duties in fact go beyond the interests of the shareholders who appointed them, and that they should be more and more driven towards a stakeholder long-term oriented governance approach. They should also raise their attention on the quality of financial and non-financial reporting and the use of the EU taxonomy, and they should carry out an appropriate due diligence on sustainability-linked strategies and policies.
Second, the institute of directors should provide the necessary resources (information, benchmarking, training programs) to support directors in the development of new skills and a new leadership style in driving the attention of the board on ESG issues and their impact on strategy and business models. Beyond new training opportunities, they should enhance their activity of promoting best practices, advise companies and individuals, and help directors find new opportunities for discussions and comparisons with peers, experts and “outsiders”, such as millennials and specialists in environmental, social and innovation topics.

Third, regulators – and supervisors – should focus on the need for clarity, comparability, audit and assurance of non-financial reporting, its consistency and integration with financial data, while ensuring flexibility and fostering innovation and competitiveness with appropriate incentives.
Conclusion

This white paper is intended to be a warning call. For decades business and academic circles are debating about corporate governance and sustainability matters with varying perspectives on the way forward. Advantages and disadvantages of various ownership structures and the associated topic of short-termism vis-à-vis long-term value creation are well documented. Nonetheless, attention for entrepreneurship and innovation was not as such of great concern. Moreover, compliance driven principles aiming to prevent (mainly shareholder) value of being destroyed have taken the upper hand. Did the pendulum swing too much to one side?

At the same time we face the “inconvenient truth”. Unrestrained economic growth touches upon the boundaries of our planet and is stretching the natural resources too far. It is not about a future of “more” but “better”: namely innovations enhancing health and quality of life. Moreover, business are confronted with an accumulated power of stakeholders: from show me, to prove to me, to involve me…and now…to value me.

This white paper is also intended as a call for action. All contributions in this white paper, although reflecting unique perspectives on boosters for innovation, do convey common messages:

- Doing nothing is not an option, doing business as usual is not an option either. The interdependence of organisations, governments, people and planet requires a collective, collaborative approach and calls for efforts and changes by all individual actors;
- The regulatory framework shapes the actions, but more effort should be invested in better (instead of more) regulation fostering a culture of innovation and entrepreneurship, with a focus on incentivizing (rather than punishing) and flexibility/proportionality;
- Boards of directors need to critically reconsider their strategic priorities, their composition, their modus operandi with management, their information needs and sources etc. to really unlock their potential. Above all, it’s a shift in mindset and ability to challenge the traditional recipes and ‘the way we do things around here’, to move beyond boundaries to open up to new ideas and new generations, to have the courage to find balance in delicate trade-offs and to show leadership;
In addition, corporate culture is key in any organization as either encouraging or discouraging innovation. In this respect, the plea is clear: it should be one of the major responsibilities of the board. Of particular importance is to embrace the capacity to champion digital value enabled by new technologies. In the end it is about stimulating and convincing people;

- Power shift might and will happen.

The call to action is not limited to the large or more regulated companies, who fall within the scope of European regulation. The engines of the European economic landscape are SMEs but they do not operate in isolation. Many SMEs are actors in the supply chain or part of an ecosystem. They cannot be left out but need sufficient support to enable them to transform as well.

For sure the sense of urgency is present in Europe. No more time can be wasted: Boards need to take responsibility for tough choices in order to transform to a more sustainable value driven business model. The board needs to set the purpose and steer the company in the right direction. As we all know “If one does not know to which port one is sailing, no wind is favorable. (Seneca).”
APPENDIX 1:

Board’s and the Digital Tsunami

Professor David R. Beatty - Rotman School of Management, University of Toronto

The transformation occurring today in the world of business is nothing short of a fourth industrial revolution that I term the digital tsunami. It is upon us today and increasing in its intensity every minute and the question is how many of today’s businesses will survive. Google estimates that possibly as many as 75% of the today’s S&P 500 companies will be gone in 5 to 7 years. Gone, not just simply assaulted, but GONE as this digital tsunami sweeps over us.

I have been working with Google’s chief evangelist Nick Darveau-Garneau to figure out what boards are doing to help their companies survive.

1. Firstly, we looked at age. We were inspired by Walmart. Walmart now has three directors in their 40s because the Walmart Board and C-suite deemed their main, long-term competitor to be Amazon not another grocery chain.

In the Toronto Stock Exchange (TSX) Composite 220 from 2016 to 2021 we looked at the percentage who are below 50, not 40 but 50. Only 6% of the directors on the TSX220 were below the age of 50 – unchanged for the last 6 years. There are 18% above 70 - three times as many as below 50.

In the S&P500 the boards are even older: 4% of directors are below 50 and 21% are over 70 and neither of those numbers have changed in the last six years. In the UK it looks like it’s going in reverse: the FTSE100 had 38 companies with a director under 50 in 2017 and now that’s down to 34.

So, more youthful boards are not happening anywhere. However, thinking about your own board it’s certainly something you ought to consider about if you want to be able to discern what’s going to happen to your company in the new digital tsunami age.
2. Secondly, we looked at expertise. We took about 20 words that would indicate there was some skill set relating to digital knowledge, expertise in machine learning or artificial intelligence.

On the TSX the proportion of total directors identified as tech savvy has gone from 13% to 24% and the number of boards with tech savvy directors has almost doubled as well up to 114.

In the US the S&P500 number of tech savvy directors are up to 30% and the total number of boards with tech savvy boards with tech savvy directors are 366 out of 500.

So clearly, there is considerable movement towards tech savvy directors in both Canada and the United States.

In the United Kingdom is difficult to know because 75% of the listed companies don’t provide a skills matrix but of those that do 70% had some skills on the board that would indicate tech savviness.

<table>
<thead>
<tr>
<th>Year</th>
<th>% of Total Directors</th>
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<tbody>
<tr>
<td>2016</td>
<td>20%</td>
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<td>2017</td>
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<td>2021</td>
<td>21%</td>
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Source: David & Sharon Johnston Centre for Corporate Governance Innovation
It’s interesting that Berkshire Hathaway, the publicly traded company of Warren Buffett, the sage of Omaha, has always had a tech savvy board that includes both Bill Gates and Susan Decker!

3. Thirdly, we looked at specialised board committees. Walmart has one they call the “Technology and e-Commerce Committee”. This allows the board to dive more deeply into the potential impact of the digital tsunami upon their businesses.

The S&P500 now have 74 “technology” committees up from 52 in 2016. This is a dramatic development.

In Canada we now have four where we had zero in 2016 but hardly a sweeping change by comparison.
4. Fourth, consider creating an Advisory Board, a less formal way of trying to bring a little bit more expertise into the boardroom. We don't have any data on how many advisory boards there are in any of the three markets we examined but it is certainly something for boards to think about.

5. Fifth, the creation of innovation labs. Remember the phrase: “Routine drives out creativity.” So any large organization that wants to do innovative things must create a “Lab” separated from the on-going operations of the company. In the US S&P500 some 90 companies had set up an innovation lab. That's a dramatic number! We have no composite numbers for Canada, but we do know that three of our large banks have created innovation labs or their equivalent to keep track of what's happening in the FinTech space.

6. Sixth, CVC or corporate venture capital – direct investments to acquire and bring in-house innovative new ideas. In the first half of 2021 there was something in the order of 2,500 different deals representing almost $80 billion. So corporate venture capital is huge, growing and effective in trying to keep companies alive in the age of digital disruption.

7. Seventh, consider tasking the CEO. This is the board saying to the CEO: “We want you to invest X percent of your time in understanding the future.” A.G. Lafley, when he was the CEO of Procter and Gamble he said “To me CEO stands for Chief External Officer. I've got 16 executives who run multibillion dollar global businesses, sure they could use my help, but that's not my job. My job is to find out what's happening out there on the horizon and decide what to do about what I find.”

Every board should be able to ask every CEO to invest X% of her/his time in figuring out what's going to hit us in the back of the head. A good example is Craig Smith, now Marriott’s International COO but previously head of the Asia Pacific division, the fastest growing part of Marriott set in the middle of the Chinese digital revolution. So, Arne Sorenson, then the CEO of Marriott, said to Craig: “I want you to invest 50% of your time in understanding what's happening in the hospitality industry in China. This is the most important thing you could do for our company.” Craig went and did a joint venture deal with Alibaba, the largest single New York Stock exchange listing in history at $25 billion, and that joint venture is now transforming Marriott’s view of it’s core operations.

8. Eight, task the CEO to copy the fast movers. The directors should ask: “Who are the fastest moving people in the technology arenas that we should be looking at? Find out what's happening.” For example, there's been over 7,000 new start-ups in the marketing space alone in the last three years - which of those should we worry about and learn more about? Then copy the fast movers or use your venture capital fund or start an innovation lab. Something, anything to get yourself on the trail. Get going and get going NOW!

9. Nine, ask the right questions. Nick Darveau-Garneau, the chief evangelist at Google says:
“Don't ask when it will happen.”
BUT
“When it does happen how much of a difference will it make?”
CONCLUSION

Something, anything to get yourself on the trail. Get going and get going NOW!

Nick spoke to Elon Musk and asked him: “In 10 years what will be Tesla’s competitive advantage?” - Nick was thinking to himself possibly batteries, self-driving capabilities, or the charging network.

The answer he got: “No one else will be as fast we are.”

Nick’s boss, Sundar Pichai, the CEO of Google, says that the only sustainable competitive advantages is speed. So, if you want the company you serve to survive this Digital Tsunami get them moving today – delay might well mean death!
APPENDIX 2:

Questions for the board to consider

- How does the board bring in external parties to provide a “future-back” and “outside-in” perspective?
- How is your board thinking about and redefining competitors or industry boundaries? Who might now be a competitor that wasn't previously?
- How are responses to COVID-19, supply chain and ESG challenges leading management teams to innovate?
- How are major investments reviewed by the board? What are the triggers?
- How are investments in innovation tracked and reported to the board?
- How does the board ensure management’s processes are flexible and adaptable to be able to incorporate lessons learned along the way?
- How is the board engaged in innovation discussions as part of the strategy setting process?
- If money were not a constraint, which game-changing innovation would management pursue?
- What do our employees and management team people think is our distinct capability? Where should we innovate more aggressively?
- What innovation is happening out there that we’re not paying enough attention to? What do we do if a major online-only provider comes into our space?

(Source: EY study 2022)
Appendix 3:

List of interviews

The Corporate Governance Dialogue has conducted nine interviews with business angels, venture capital, consultants and experienced board members to exchange on innovation and competitiveness within the European Corporate Governance framework.

The list of interviewees:

- Evan Epstein, Founder and Managing Partner, Pacifica Global;
- Emma Fau, Founder, EUcapital SRL;
- Johan Rippe, Partner and member of the board, PwC Sweden;
- Bruno Kaufmann, Founder and CEO, WeBoard;
- Julien Krantz, Research Director, Invest Europe;
- Ehud Menipaz, Chairman of the International and Advisory Boards of the Israel Directors’ Union; Chairman, Board of Governors, National Association of Engineers & Architects of Israel;
- Mr. Alessandro Merli, Ms. Livia Aliberti Amidani, Ms. Paola Bonomo, Independent Board Members;
- Dr. Johannes Schneider, Dr. Andreas Enders, Andrew Hobbs, EY;
- Viktorija Trimbel, Head of the Policy Group (Lithuania) at BICG (Baltic Institute of Corporate Governance), Managing Partner, Quantum Capital;
- Dr Marianna Zangrillo and Dr Thomas Keil authors of the Book, «The Next CEO: Board and CEO Perspectives for Successful CEO Succession». 
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