# EXPLORING THE LINK BETWEEN CORPORATE GOVERNANCE AND INNOVATIVE CAPACITY IN THE AUSTRALIAN SUPERANNUATION INDUSTRY

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## Abstract

In a large-scale single industry case study, insights are provided into corporate governance factors affecting innovative capacity in the superannuation industry in Australia. Analysis of the data indicated that the major corporate governance factors driving innovation in the industry included: 'possessing a progressive organisational culture', 'emphasis on marketing-orientation', and 'engaging in co-opetition'. Similarly, the data indicated that the major corporate governance factors inhibiting innovation included: 'possessing a conservative/risk-averse organisational culture', 'unwillingness to deviate from a strict interpretation of regulation', 'emphasis on a profit-orientation', and 'the absence of any formalised innovation processes within the firm'. These findings are used to develop a 'theory of innovation' link between corporate governance approaches and innovative capacity in the Australian superannuation industry. Although this study is limited in its scope, it does represent an initial exploration of the critical relationship that exists between Board-level functions and the ability of a superannuation firm to innovate in the Australian context.

**Keywords:** Innovative Capacity, Corporate Governance, Pensions, Superannuation

## 1. INTRODUCTION

Whilst the importance of 'effective governance' and 'innovative capacity' in the superannuation[1] (i.e. 'pension scheme') industries in Western economies is well established in the literature (King Committee on Corporate Governance, 2002; Clark, 2003, 2004, 2006; Urwin & Clarke, 2009), the link between corporate governance and innovative capacity in that industry has not been investigated to any significant degree (Ambachsheer, 2007). O'Sullivan (2000) and Lazonick (1998) were arguably the first researchers to attempt to establish a theoretical link between governance and innovative capacity; they found that without a 'theory of innovation' to draw upon, the link between corporate governance, innovative capacity and economic performance could not be made. In order to address this issue, this research examines the link between corporate governance and innovative capacity in the fourth largest superannuation industry in the world (i.e. the Australian superannuation industry). As at 2012, the Australian superannuation industry accounted for twenty-one per cent of total Australian financial sector assets, approximately 120 per cent of the Australian share market capitalisation, and 90 percent of Australia's annual gross domestic product (KPMG, 2012).

The superannuation industry is highly competitive in Australia; clients have many investment and administration options (e.g. balanced portfolio of industry funds, choice of managers in master trusts, individual shares holdings, bonds in small self-managed funds etc.). The main competitive measure in the Australian market is return on investment; however, competition has also been based on more innovative measures (i.e. new or significantly adapted products and services) that seek a point of positive differentiation in a crowded marketplace (e.g. investment philosophy, specialised expertise and the type of service offered (Rice & McEwin, 2002)). Given the demonstrable importance of the superannuation industry to the Australian economy, and the need for Australian superannuation firms to innovate effectively in order to remain competitive in a strictly regulated environment, this research seeks to investigate the following broad research opportunity: *What corporate governance factors impact innovative capacity in the Australian superannuation industry?*

[1] As a matter of terminology, the Australian usage of the term superannuation is unique compared to other countries, where the corresponding term used for the provision of benefits upon retirement is pensions. For the purposes of this paper, the term superannuation is used throughout.

## 2. LITERATURE REVIEW

In order to address this important research opportunity, it was necessary to examine the manner in which the three dominant theories of corporate governance (i.e. 'Agency', 'Stakeholder', and 'Stewardship' theories) conceptualised the link between effective governance and innovative capacity. After reviewing the three theories, however, it became apparent that each remained silent about how the requirements of developmental, organisational and strategic resource allocation impacted on a corporation's innovative capacity. From an Agency Theory perspective, for example, adequate monitoring or control mechanisms need to be established to protect the principals' (i.e. the members of any superannuation fund) from managerial conflicts of interest – the so-called 'agency costs' of modern capitalism (Fama & Jensen, 1985). O'Sullivan (2000) points out that the empirical problems of Agency Theory are rooted in its tenets; far from providing an analysis of the relationship between corporate resources and innovation, it makes no attempt to deal with innovation and its implications for resource allocation. She further contends that "…financial economists make no attempt to deal with innovation and its implications for resource allocation" (2000, p. 89).

Similarly, the Stakeholder Theory of corporate governance is based on the notion that there are many groups in society besides owners and employees to whom the corporation is responsible (Blair, 2004). Blair (2004) contends that the corporate governance should recognise the central importance of investment in human assets to the success of the organisation and the prosperity of the economy. Wang, Dewhirst and Dudley (1992) considered that this theory can best explain how members of the governing board think about the interests of corporate constituencies and therefore how organisations are actually managed. Stakeholder Theory has been used to describe the nature of the firm and the way managers think about managing (Brenner & Molander, 1977), how board members think about the interests of corporate constituencies (Wang, Dewhirst & Dudley, 1992) and how corporations are actually managed. In summary, this theory offers a different perspective of corporate governance that provides useful insights for theoretical development for the platform of corporate governance, yet it is silent on the issue of resource allocation and any possible link with innovation within the organisation.

Stewardship Theory of corporate governance is underpinned by the assumption that managers are inherently trustworthy individuals who will, by default, be 'good stewards' of corporate resources under their control (Donaldson & Davis, 1994; Donaldson, 1990). The theory contends that superior corporate performance will be most strongly linked to the action of a majority of directors as they work to maximise profit for their shareholders. The reasoning behind this is that directors understand the business they govern better than independent directors and so can make better decisions (Donaldson & Davis, 1994; Donaldson, 1990). Stewardship Theory requires formal board structures that empower managers through structures that integrate decision management with decision control (Davis, Schoorman & Donaldson, 1997). The theory posits that non-executive directors do not always have the expertise and inside knowledge of executive directors to effectively contribute to strategic decision-making. Whereas, executive directors offer direct working knowledge and experience (Kesner & Johnson, 1990). Arguably, boards are likely to be better informed about the sources of uncertainty and the potential returns stemming from innovative projects. According to Donaldson (1990), there is no motivational problem or non-alignment of interest between management and ownership, and the governing board will be responsible mainly for the setting of strategies for the organisation. This theory is not without criticism; for example, Tricker (1994, p. 56) notes that the Stewardship Theory "…ignores the dynamics of boards, interpersonal perceptions of roles and the effect of board leadership". Donaldson's (1990) view is important with respect to contemporary leadership practices for the requirement of the CEO and the board of directors or trustees in an overall corporate governance framework. In relation to the relationship between corporate governance and innovation, Stewardship Theory remains similarly silent and presents no implications for resource allocation within a corporate governance framework in this regard.

Given the silence that each of the three dominant theories on the relationship between corporate governance and innovation, there is a need to locate a more appropriate theoretical framework for the purposes of addressing the broad research opportunity. The Managerial-Control perspective of strategic management advanced by Porter (1996) was deemed appropriate for this purpose, as it recognises the integral role that managers play in corporate resource allocation. Akin with Agency Theory, the Managerial-Control perspective views managers as agents of shareholders; however, it recognises the need for managers to make innovative investments if their enterprise is to achieve sustained competitive advantages. The Managerial-Control perspective argues for managerial autonomy in setting and implementing investment strategy and looks to wealthy shareholders (i.e. superannuation funds) to become "patient capitalists" - that is, to provide their managers with the control over the financial resources needed for innovative investment strategies. Unlike the dominant theories described above, therefore, this perspective includes the concept of 'innovation' as a central issue to its concept of resource allocation within the corporate governance framework. The advocates of the Managerial-Control perspective recognise that the competitive success of the organisation depends on economic and cultural investment in innovation, which among other things, involves specialised in-house knowledge, time and financial commitment. The difficulty with this perspective, as O'Sullivan (2000) points out, is that there is no systematic explanation of the conditions under which managers will make investments that promote innovation and those under which such investments will not be made. In order to address the broad research opportunity, whilst simultaneously addressing the shortcoming of Porter's (1996) Managerial-Control perspective in the superannuation industry context, this study poses the following specific research questions:

*RQ1:* What corporate governance mechanisms positively impacted the innovative capacity of firms in the Australian superannuation industry?

*RQ2:* What corporate governance mechanisms negatively impacted the innovative capacity of firms in the Australian superannuation industry?

The research questions were formulated to achieve two specific and concurrent outcomes. Firstly, their answers will provide a basis for understanding the corporate governance factors that impact (both positively and negatively) on firms' innovation capacity in the Australian superannuation industry. Secondly, their ancestors will provide the basis for developing a model of salient corporate governance issues and their impact on the innovative capacity of firms in the Australian superannuation industry.

## 3. METHODOLOGY

In order to address these research questions, this study comprised a series of semi-structured interviews with senior executives (i.e. CEOs, trustees, Chairmen, Board members) from 20 (out of a population of 45) Australian superannuation firms in 2008 - all of which were registered as members of the Australian Institute of Superannuation Trustees in 2015. Of the 20 CEOs interviewed in this study: 20 were in charge of 'industry-based' funds; and 2 were in charge of the 'government-based', 'corporate-based' and 'public offer-based' funds respectively (see Table 1 for a summary of the respondents and their superannuation funds).

**Table 1.** Summary of the superannuation funds represented in the study

| *Superannuation Fund Type* | *Characteristics* | *n =* | *Number of Clients (approx.)* | *Funds Under Management (approx.)* |
|---|---|---|---|---|
| Industry-based | Usually open for anyone to join. Some are restricted to employees in a particular industry. | 14 | 5,000,000 | AUD$140b |
| Government-based | Created for employees of Federal and State government departments. | 2 | 300,000 | AUD$15b |
| Corporate-based | Managed by an employer, for their employees. Some larger funds are 'employer-sponsored' - i.e. the employer also operates the fund under a board of trustees. | 2 | 200,000 | AUD$15b |
| Public Offer-based | Includes commercial funds and trusts, although a standard employer-sponsored fund (such as an industry fund) may opt to be treated as a public offer fund | 2 | 1,000,000 | AUD$30b |
| *Total* | | *20* | *6,500,000* | *AUD$200 billion* |

Given the exploratory nature of the research questions, we provided the semi-structured interview questions in advance to the respondents so that the senior executives could prepare their responses in advance (i.e. it allowed time for the respondents to gather their own internal information and reflect on how their firm's corporate governance measures and/or approaches). In addition to this, it allowed the researchers to focus the interviews on the specific elements of the research questions (i.e. what corporate governance measures they believed increased their firm's innovative capacity, as well as those they believed inhibited or constrained it). The semi-structured interview questions (see Table 2) were designed to cover the necessary issues but were framed in an open-ended manner, to allow the respondents sufficient latitude for introspection and open reporting of their own perspectives. As a result, the respondents were free to pursue those matters that they considered important.

**Table 2.** The semi-structured interview questions

| *№* | *Question* |
|---|---|
| 1 | Describe the nature and extent of innovation in the superannuation industry. |
| 2 | To what extent does your firm gather intelligence about competitor innovations? |
| 3 | What do you believe are the drivers of innovation in your firm? |
| 4 | What do you believe are the inhibitors of innovation in your firm? |
| 5 | To what extent does the Board of Directors in your firm play a role in the innovation process? |
| 6 | To what extent do trustees play a role in the innovation process? |
| 7 | To what extent does your firm measure the impacts of its innovation processes? |
| 8 | To what extent does government regulation of the superannuation industry impact the innovation process in your firm? |
| 9 | What other external factors that impact on innovation in your firm? |

In total, twenty semi-structured interviews were conducted, each of which lasted between 60 and 120 minutes. The semi-structured interview questions were formulated to facilitate the aggregation, analysis, and validation of information, and the approach enabled the researchers to interrogate evidence gathered from secondary sources. For these purposes, secondary data were collected from the representative firms' Annual Report documentation (for the years 2003/4 – 2008/9) as they related to 'Board of Directors membership', 'corporate governance', 'compliance with industry regulations', 'financial performance' and 'innovation' (e.g. new product developments, changes in marketing strategy, new corporate processes etc.). In order to triangulate the data collected from the respondent firms, secondary data concerning the same issues were collected from independent external financial sources (i.e. *The Australian Financial Review* and the national Australian Broadcasting Corporation's *Kohler Report*) over the same time period.

Each of the primary interview transcripts and secondary data sources was subject to a rigorous content analysis process that followed the protocol proposed by Finn, White and Walton (2000). The content analysis and the verification of the conclusions drawn were facilitated by the use of the NVIVO (version 10) software package. Computer software programs such as NVIVO are of significant value in qualitative analysis and any subsequent theory building (Richards & Richards, 1995; Wickham & Woods, 2005). During the first stage of the content analysis, the aims and objectives of the research were identified, and the first-round coding rules were developed. Coding refers to the process of converting information into contextual values for the purposes of data storage, management and analysis allowing theme identification (Ticehurst & Veal, 2000). This research used the literature review as a guide to initially organise the data by the variables listed in Table 3.

**Table 3.** First-round coding variables and definitions

| *Node* | *Coding Rules* |
|---|---|
| Aspects of corporate governance linked positively to innovative capacity | This node captures any data that links corporate governance factors/policies/procedures positively with innovative capacity within the firm. |
| Aspects of corporate governance linked negatively to innovative capacity | This node captures any data that links corporate governance factors/policies/procedures negatively with innovative capacity within the firm. |

In the second stage of the content analysis, all of the interview transcripts and secondary data were converted into MS Word™ format and entered into a codified NVIVO database. In the final stage of the content analysis, the coded data were further interrogated to detect any significant themes that emerged in terms of the drivers and inhibitors of innovative capacity as they related to corporate governance measures (see Table 4).

**Table 4.** Second-round coding variables and definitions

| *Node* | *Second-round coding (Emergent Themes)* |
|---|---|
| Aspects of corporate governance linked positively to innovative capacity | A progressive organisational Culture<br>Top-management-led innovation agenda<br>An emphasis on marketing-oriented decisions at the Board of Directors level<br>Engaging in Co-opetition |
| Aspects of corporate governance linked negatively to innovative capacity | A conservative/risk-averse organisational culture<br>Unwillingness to deviate from a strict interpretation of regulation<br>An emphasis on profit-oriented decisions at the Board of Directors level<br>The absence of any formalised innovation processes within the firm |

At regular intervals throughout the analysis, inter-coder reliability checks were taken to ensure that the data were coded consistently with the coding rules set in the first stage of the content analysis. The inter-coder reliability checking process for this research was based on the three-stage process recommended by Compton, Love and Sell (2012): firstly, the researchers developed and pre-tested the coding rules against all of the primary data gathered from the interviews (and as per the coding rules in Table 3). Secondly, the researchers developed an agreement as to how ambiguous data were to be handled (i.e. instances where data could either be coded into more than one code or where the data did not readily fit into an existing code). Thirdly, the researchers determined the level of inter-coder reliability achieved in the coding process by calculating its Krippendorff's Alpha. The researchers selected Krippendorff's Alpha as the measure as it is flexible enough to be used for any number of coders, and it can be used for determining the coding reliability of a wide range of (nominal, ordinal, interval and ratio) data. Typically, the Krippendorff's Alpha score needs to exceed 0.800 in order for the coding results to be considered reliable and replicable; the Krippendorff's Alpha score for this research was calculated as $\alpha = 0.940$.

In order to generate the necessary empirical knowledge, memos were maintained about the data, the first and second-round coding categories, and the relationships between them as they emerged (Wilson, 1985). Appendix 1 provides a summary of how the data were interrogated and how the validity of the relationships between the categories was verified through the memo analysis process. NVIVO has a facility for the creation and retention of such memos for later consideration and analysis. Utilising the memo capability within the NVIVO package, memo reports were generated by the software after second-round coding. From these reports, the trends and emerging themes became clearer. The themes emanating from the second-round of coding form the basis of the results section that follows.

## 4. RESULTS

The broad research opportunity in this study was to develop a theoretical model that describes the impact of corporate governance mechanisms on the innovative capacity of firms in the superannuation sector. After reviewing the literature, the broad research opportunity was expressed as two specific research questions; the answers to these two specific research questions are presented below and form the basis of the theoretical model presented in this paper.

*RQ1:* What corporate governance mechanisms positively impacted the innovative capacity of firms in the Australian superannuation industry?

The second-round coding of the interviews and secondary data sources revealed three corporate governance mechanisms that positively impacted the innovative capacity of firms in the Australian superannuation industry: a progressive organisational culture (i.e. a CEO/Board of Directors-led innovation agenda), the emphasis of the marketing orientation at the Board of Directors level, and a willingness to engage in co-opetition.

### 4.1. A progressive organisational culture – CEO/Board of Directors-led innovation agenda

The first corporate governance mechanism that positively impacted the innovative capacity of the superannuation firms sampled in this study related to the progressive organisational culture generated and perpetuated by a CEO/Board of Directors-led innovation agenda. This CEO/Board Directors-led innovation agenda had a two-fold effect: firstly, it set the tone for the role of industry regulation in the strategic decision-making process at the Board of Directors-level:

«We [the senior executives of the fund] are not fussed by regulation… We just get the approval of the Board and the Australian Prudential Regulation Authority, if necessary. We are not stifled by corporate governance in any way.

…it the right environment to spawn innovation; otherwise you may be stifled by the regulatory environment.

Culture comes down to whether they see it as business or service. Where you stand on that spectrum determines level of innovation… innovation in this industry is about member services and using your abilities to deliver better service to members».

Respondent data indicated that industry regulation need not be viewed as a constraint on innovative capacity, but rather a framework that enabled the superannuation firms to engage proactively and positively with the relevant regulatory bodies. Thematic analysis indicated that respondents believed that a functional and proactive working relationship with the regulatory bodies created a relationship of trust and information flow that allowed the superannuation firm to test the boundaries of what regulatory bodies would be willing to accept in terms of innovation and new-product development. Secondly, the progressive organisational culture positively reinforces the idea that innovative activity (most notably in the form of new-product development, and new-process development) was a desired and generously rewarded work product throughout the firm:

«Innovation is valued … and encouraged during the induction process for all staff members of this fund.

…innovation is driven by the CEO and the Executive team when they develop their business plan».

The progressive organisational culture underpinned by a CEO/Board of Directors-led innovation agenda had a flow-on effect to the HRM functions of the superannuation firm (i.e. the recruitment and selection, training and development, and compensation and benefits) that attracted and retained employees with a greater propensity for innovation in the industry. Similarly, the progressive organisational culture had an impact on the marketing strategies of the superannuation firms, which is discussed in the next section.

### 4.2. An emphasis on marketing-oriented decision-making at the Board of Directors level

The second corporate governance mechanism that positively impacted the innovative capacity of the superannuation firms sampled in this study related to the marketing orientation that underpinned Board of Directors-level decision processes. Respondent data indicated that the greater the focus on determining and acting of customer/client needs the greater the level of innovative services and new products that were developed by the firms:

«…understanding the role of new technology is an exciting development – it gives our members the opportunity to 'carry' their super around with them. No longer will funds have to rely on its members reading the information in their statements, visiting their website or ringing their call centre.

Insights into the market led us to develop the first interactive online calculator of its kind in Australia.

When the Storm [Australian national Rugby League team] they are playing, their games are beamed into pubs and clubs where our members are actually working. Given the youth demographics of our members, the average age is 29, our members are probably out enjoying themselves …and watching the teams …we're sponsoring. Sponsoring sporting teams makes perfect sense and gives us greater bang for our dollars».

Similarly, the recognition that the superannuation firms needed to positively differentiate themselves in an increasingly crowded marketplace raised the level of competitive rivalry within the superannuation industry; this, in turn, led to the recognition that 'innovative activity' was actually a strategic necessity:

«… a number of the industry funds they are starting to develop complex products as they are looking at competing with retail funds… and industry funds have the belief that more complex products will help them compete.

This makes a huge difference…now we target different messages and allocate resources more efficiently to align with members' needs. This fund is innovative in the segmentation of work and development of portfolio analysis.

Large public offer funds have to be innovative otherwise members will simply join other funds».

In addition to this, the establishment of defined market positions encouraged international financial institutions to approach them with strategic investment opportunities, further freeing up the corporate resources and capabilities needed to offer even greater levels of innovation:

«…Our sheer size had attracted a large Investment bank, Goldman Sachs [located in the United States] which had gained market knowledge of the fact that this particular fund had an appetite for infrastructure assets, and directly approached the fund… this had dramatically cut costs as exorbitant fees had been paid to third parties who traditionally manage or brokerage deals within the industry».

The increased level of competitive rivalry in the Australian superannuation industry (which included a greater emphasis on marketing research, market positioning, and competitor intelligence gathering) had a subsequent effect on firm interrelationships, which is discussed in the next section.

### 4.3. Willingness to engage in co-opetition

The third corporate governance mechanism that positively impacted the innovative capacity of the superannuation firms sampled in this study related to the willingness of the Board of Directors to engage in co-operative marketing strategies (i.e. "co-opetition"). Respondent data indicated that the innovative capacity of individual firms was significantly augmented by the pooling of resources and experience between firms:

«A good example of innovation was created where resources had been pulled together to establish an asset consultancy business for industry funds.

Innovation has been created where resources have been pulled together and established.

Innovation is created within industry funds by pooling resources and creating collective vehicles [like the Frontier joint-venture».

Respondents noted that co-opetition was most effective in increasing a firm's innovative capacity in two specific circumstances: firstly, where it allowed an individual firm to develop new products and services for their existing clientele (and with no cannibalisation of the cooperating firm's clientele); and secondly, where it enabled all of the cooperating firms to attract new clientele simultaneously.

*RQ2:* What corporate governance mechanisms negatively impacted the innovative capacity of firms in the Australian superannuation industry?

The second-round coding of the interviews and secondary data sources revealed four corporate governance mechanisms that negatively impacted the innovative capacity of firms in the Australian superannuation industry: a conservative/risk-averse organisational culture, an unwillingness to deviate from a strict interpretation of industry regulation, the emphasis on profit-oriented decisions at the Board of Directors level, and the absence of any formalised innovation processes in the firm.

## 4.4. A conservative/risk-averse CEO/Board of Directors

The first corporate governance mechanism that negatively impacted innovative capacity related to the conservative nature of the firm's CEO/Board of Directors. Respondent data indicated that the composition of the Board of Directors (and perhaps more accurately, their attitude towards risk) had the most significant impact on superannuation firms' innovative capacity. The data suggested that the main issue was the role that 'risk-averse group-think' played at the Board level – respondents noted that whilst only a percentage of Board members were likely to be significantly risk-averse in any given firm, their conservatism had a greater ability to influence decisions than those Board members that were more progressive in this particular industry:

«Essentially, the industry is expected to be risk averse and there is an expectation that our Board on behalf of the fund membership should make conservative decisions.

If one board member was uncomfortable with the motion about to be resolved by the majority of the trustees, then the entire board 'would fold' on that particular decision.

In relation to investment choices, I felt pressured into putting funds under management into the property and not innovation as a reaction to the market.

There is a general lack of desire to innovate due to the current board composition».

Respondents also suggested that when conservatism and risk-aversion was prevalent at the Board level, it negatively diminished the innovative capacity of firm's culture in three main ways: firstly, the signals sent from the firm's senior executives emphasised conservatism as the preferred strategic stance in the firm's decision-making (thereby signalling what types of activities would be rewarded and promoted in the firm); secondly, that any progressive or risk-averse ideas and discussions would be quickly shut down by conservative factions; and lastly, it perpetuated a fear of making mistakes (and lack of clarity about who would be blamed and what the punishment might be) amongst the firm's employees:

«The culture does not support innovation through any strategic leadership, the vision of the Board or from any formal platform at an operational level.

…it is extremely difficult to arrive at any constructive decision for the fund, let alone making any decision in relation to innovation.

I'm not sure where blame would lay with any innovation stuff ups…

We were here to serve the members' best interests and innovation does not centre on that».

## 4.5. Unwillingness to deviate from a strict interpretation of industry regulation

The second corporate governance mechanism that negatively impacted innovative capacity related to the unwillingness of the CEO/Board of Directors to deviate from strict interpretations of industry regulation. Respondent data indicated that the impact that industry regulation has on the innovative capacity of superannuation firms is dependent on the extent to which their Board's perceive it as being a strict set of rules (as opposed to 'rigourous guidelines'), and the extent their Board's perceive it as requiring strict interpretation and adherence:

«Innovation is *difficult* in this sector... the fiduciary duty of a trustee runs *counter* to innovation.

We are *unable* to be innovative due to restrictions placed on us by current industry regulations…this industry is too over-regulated to support innovation.

One of the negative consequences of corporate governance is that it is an *inhibitor* of innovation».

That the greater the level of unwillingness to deviate from a strict interpretation of industry regulation, the less capacity the firm had (1) to work alongside regulatory bodies (if and when the need arose), and (2) to innovate effectively in response to opportunities and threats in the marketplace.

## 4.6. An emphasis on short-term profit-oriented decision-making

The third corporate governance mechanism that negatively impacted innovative capacity related to the decision-making process being underpinned by a profit-oriented perspective at the Board of Directors-level. Respondent data indicated that the more corporate governance decision-making emphasised controls on cash flows and returns-on-investment, the less was emphasised innovation and new product development:

«Our fund used a system for innovation; we focus our efforts in this process on passing through various 'gates'. Stage one involves asking the question 'does it fit with sustainable products?' Stage two involves a risk assessment process, and if there is an unmitigated risk to profit then they will not continue with the process.

The mandate is that industry funds have low costs, which *automatically* mean less innovation as it would cost money to develop innovative solutions and money to service innovative solutions.

…the industry doesn't have an 'innovation focus' or 'new product development focus'…rather just a 'growth focus'».

This finding effectively mirrors that associated with marketing-oriented decision-making discussed earlier; it suggests that achieving an optimal level of innovative capacity in this industry requires a balance be struck between a dependence on profit-oriented decision-making (which emphasises cash flow be generated from a set of extant products/services) and marketing-oriented decision-making (which emphasises new product development and innovations in terms of products/services).

### 4.7. Absence of any formalised innovation processes

The fourth corporate governance mechanism negatively impacted innovative capacity related to the absence of any formalised innovation processes within the firm. Respondent data indicated that the lack of any formalised innovation processes meant that employees had no means and/or motivation to engage readily with other employees about new ideas, products and services. This lack of structural support for innovation resulted in institutionalised disconnects between employees and their array of potential ideas:

«…we did not really have a product development process to engage with, so we didn't bother.

There was no formal pipeline to promote new product development or any innovative idea within that culture …the process to date was random and ad hoc.

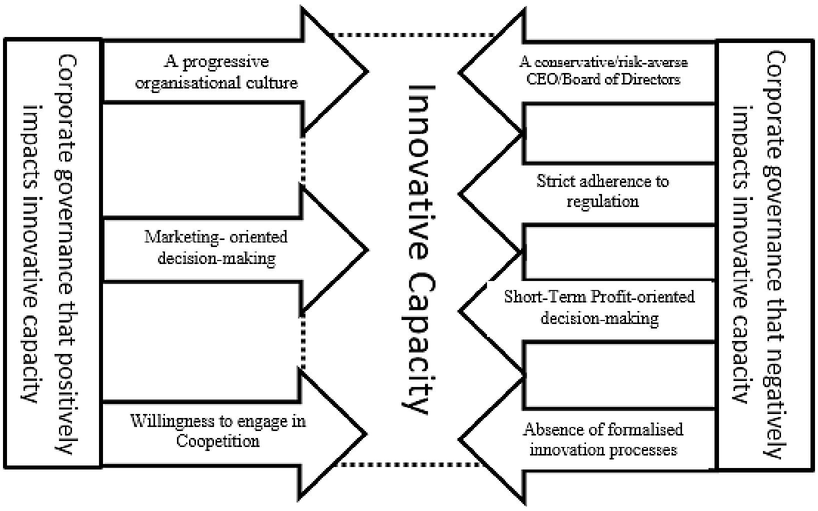
…no formal pipeline to promote new product development or any innovative idea within the culture of their fund and the process to date was random and *ad hoc*».

In addition to this, any innovations that were adopted by the firms with no formalised innovation processes were by necessity *ad hoc* in nature, and not nearly as effective, nor resource efficient, as they could have been.

## 5. DISCUSSION AND CONCLUSION

The exploratory findings have, in part, contributed to a theoretical understanding of the relationship between corporate governance mechanisms and innovative capacity in the Australian superannuation industry. Figure 1 presents a model of this relationship based on the primary and secondary data analysis conducted in this study and suggests two important implications for theory and practice. Firstly, the results suggest that specific corporate governance mechanisms in of themselves did not impact the innovative capacity of superannuation firms in Australia, but rather the underlying philosophy driving their implementation did. For example, each of the senior executives reported that their firm's corporate governance mechanisms served to fully comply with industry regulation – yet despite this, there were differences in the manner in which regulatory compliance impacted the firms' innovative capacity. Firms whose Board of Directors approached their regulatory compliance obligations with a progressive, marketing-oriented stance demonstrated a greater ability to use it to their competitive advantage than did those that possessed a conservative, profit-oriented stance. This underlying philosophy had the same differential effect across all of the corporate governance mechanisms in this study.

**Figure 1.** Modelling the relationship between corporate governance and innovative capacity in the Australian superannuation industry




Secondly, the underlying approaches to corporate governance mechanism implementation did not operate on a mutually exclusive basis; the findings of this study suggested instead that they operated on a continuum (i.e. it was important *how much* the firm's culture was progressive, not simply that it *was* progressive). Similarly, the data demonstrated that it was possible for an individual firm to possess seemingly dichotomous organisational cultures (i.e. be simultaneously progressive and conservative), depending on factors such as type of corporate governance mechanism, time of financial year that a corporate governance issue occurred, shareholder sensitivities/demands, external stakeholder pressure, etc. The study also supported that the continuum notion applied to the other underlying philosophies as well (i.e. that innovative capacity was dependent on the extent to which any particular corporate governance mechanism was underpinned by a marketing/profit-orientation; the *level* of willingness to deviate from industry regulation; the *extent* that there are formalised innovation processes; and the *level* of willingness to engage in coopetition). To sum up, this research provides preliminary support for the notion that the innovative capacity of firms in the superannuation industry is a function of the trade-offs between *approaches* to corporate governance, rather than the corporate governance mechanism itself; all firms must have sound corporate governance mechanisms in place, but it appears the degree to which the philosophies discussed in this paper combine that is the critical link to innovation.

### 5.1. Limitations and future research opportunities

The findings of this study are based on the perspectives of the senior executives in a sample of 20 of Australia's listed superannuation firms. As such, they serve a limited purpose in building our understanding of the relationship between corporate governance mechanisms and the innovative capacity of firms in the superannuation industry. Although this study is limited in its scope, it does represent an initial exploration of the critical relationship that exists between Board-level functions and the ability of a superannuation firm to innovate in the Australian context. Further research is needed, therefore, that focuses on the experiences of other corporate governance actors in the Australian context (e.g. Board members, shareholders, shareholder activists, superannuation employees etc.) would assist in developing a finer-grained model than the one presented here. The complexities of the relationship also deserve further large-scale investigation (i.e. how different national cultures and government regulatory environments affect the relationship), as do the roles of important influencers of corporate governance decision-making (e.g. trustees, the media, shareholders, shareholder activists, financial analysis etc.).

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**Appendix 1.** Processes for data interpretation

| *Tactic* | *Procedure* |
|---|---|
| Noting patterns and themes | When observing phenomena, gestalt psychology holds that people tend to perceive events in their entirety rather than their constituent parts. Therefore, as data relating to the aspects of corporate governance that positively or negatively impacted innovative capacity were interrogated using text-based search functions, recurring patterns and themes were noted in order to consolidate individual facets of the information. |
| Seeking plausibility | Miles and Huberman (1994, p. 246) suggest that drawing inferences "…often happens during analysis that a conclusion is plausible, 'makes good sense', 'fits' … so plausibility, and intuition as the underlying basis for it, is [valuable]." The plausibility of the corporate governance/innovative capacity model (Figure 1) was determined by comparing the emergent data patterns against the independent secondary data that triangulated the CEO interviews data. |
| Clustering | Organising primary and secondary data into clusters aids in its interpretation by grouping themes that have similar characteristics. In this research, the clustering of data culminated in the determination of interconnected themes (i.e. the emergent themes noted in Table 4), which formed part of the second-round coding process. |
| Noting relationships between variables | Determining the nature of the relationship between the independent variable (i.e. the corporate governance mechanisms/approaches/strategies adopted) and the data relating to innovative capacity in the superannuation firms allowed the researchers to ascertain how these variables change directly, change inversely, or demonstrated no relationship at all. |
| Finding intervening variables | An intervening variable is one that theoretically affects the observed phenomenon but cannot be observed directly. When variables in this inquiry seemed to be related but provided an unsatisfactory explanation, the data was interrogated/triangulated further for possible intervening variables. |
| Making conceptual or theoretical coherence | Having gleaned evidence from the data that appeared to form converging patterns and identify relationships, the theory was inducted from that evidence. |

*This table is adapted from Miles and Huberman (1994)*