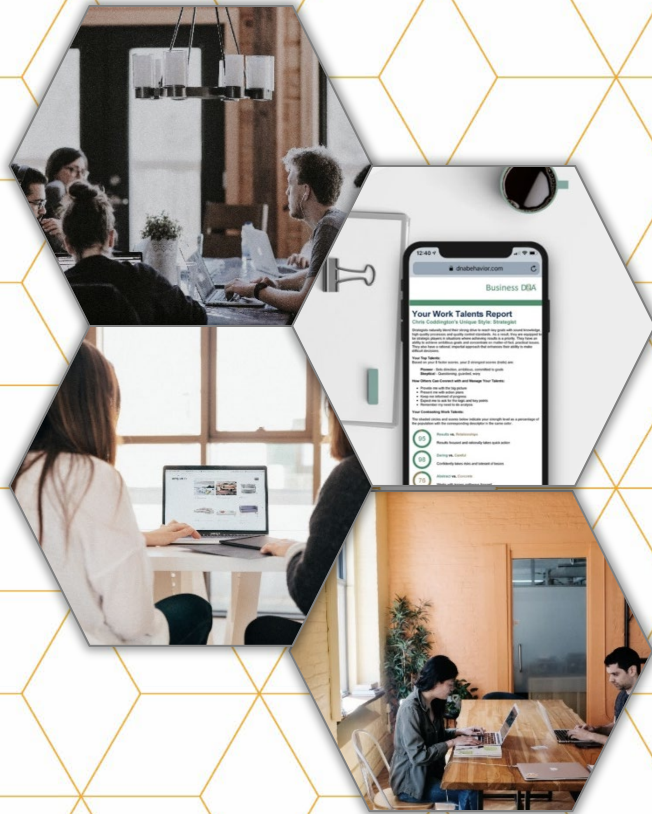

Navigating the Invisible: Measuring and Managing Behavioral Variability in Board Decision-Making

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Navigating the Invisible: Measuring and Managing Behavioral Variability in Board Decision-Making

By Hugh Massie, July 2022

Most organizations don't resolve challenging issues because they cannot see them. It's generally not a lack of know-how. Rather, in scrutinizing board-level decisions, it is the behavioral differences behind the debate and the structure of the process which warrant closer examination.

Board members or other decision-making groups come together not to compromise strategic planning or operational decisions but to contribute fairly and wisely to high-stakes decision-making, fulfilling at least one facet of their fiduciary duties.

What may not be apparent to them is the unseen *behavioral variability* in making these decisions. To observers, it may appear as inconsistency, confusion and lack of cohesion. In reality, the disorderliness reflects biases and random "noise;" invisible and unwanted "guests" appearing in the guise of inherent behavioral styles people bring with them. These are magnified when money or money decisions are involved.

Behavioral variability in decision making and judgment is quantifiable. While many leaders would surmise there is 10 to 15% variability; research of 828 CEOs shows it is over 50% across many types of decisions.[1] Think about the cost to your organization, considering both the errors and the corresponding fiduciary risks.

This costly behavioral variability remains invisible if it is not measured and remains unaddressed. This is where future board decision-making processes need careful structuring to obviate as much inherent behavioral variability as possible. Such variability may be brought into the boardroom by board members, executives, key experts and other brought in to otherwise foster good governance.

Board Decision Variability

Variability means the tendency to shift or change. People are different; they approach decision-making from a range of standpoints. This isn't just about varying opinions on a subject. Rather, when provided with precisely the same information, individuals interpret what they hear, read and see, and arrive at decisions differently because of *inherent natural behavioral style*.

We all have inherent behavior characteristics, some of which we are aware and much of which we may be unaware. We also are all influenced by our own experiences, values, beliefs and education.

While some people have well-tuned intuitive radar, research has shown that it is only 28% accurate.[2] Nevertheless, most experienced leaders feel more empowered if they can exercise their intuition. Therefore, it would be better when faced with high-stakes decisions if decision-making groups such as boards have a structured framework to follow that does not eliminate the use of intuition, but defers it until there has been sufficient cognitive reflection involving a review of the complex data presented, along with independent expert input.

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Adopting a more structured approach is essential for boards if more informed decisions are going to be made. Many boards need to rethink and reshape how they manage themselves in high-stakes decision-making and measure and manage human differences that may be costing their organization far more than imagined.

Three examples of alarming board decision variability shared with me recently:

1. In undertaking fundamental analysis of businesses, research indicates a 41% variability in valuations even though the same company description, cash flow, forecasts, accounts and projections were provided to different analysts assessing the worth.[3]

   Consider: How much could your company be overpaying for an acquisition or even leaving on the table in an asset sale?

2. Three leaders are interviewing a candidate for a senior position. One of the leaders wants to hire the candidate. One doesn't. One is undecided and wants more information. Each has the candidate, the resume and references in front of them. Each understands the role to be filled and the credentials of the candidate. Research indicates there is a 38% variability in selection.[4]

   Consider: Why do the interviewers arrive at different assessments of a candidate's performance capability? Why do they form different impressions from the start? What is the cost of making the wrong hire?

3. Forecasting revenues is always troublesome for companies, as different people naturally have different impressions of what could happen. Research has shown a 71% variability in sales forecasting, which is also similar in forecasting product and operational costs.[5]

   Consider: What is the quality of information that is flowing through? Why are some people always over-estimating and others under-estimating the forecasts? What is the impact on resource allocation for the company and the structural pressure on the business and the team?

The answer to these questions lies in behavioral variability, which drives different interpretations of the same transaction.

As a board member, you have a fiduciary responsibility to ensure a behavioral variability study (i.e., an audit) is undertaken and better decision hygiene processes are implemented. And for implementation to be effective, it must be genuinely adopted top-down.

Without a thorough understanding of the invisible factors at play and their influence on the variability of judgment calls, decision-making will always be inconsistent or, worse, flawed.

Board's Ultimate Decisions Define Organization's Future

Those responsible for shaping the identity and future of an organization may only meet several times a year for short periods, compared to those in charge of day-to-day operations. Still, the board's decisions define the organization's long-term big picture.

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Most board members are selected because of expertise, skills or even reputation. Often, they are on many boards simply because of connections or industry knowledge. However, while their reputation may be known, their behavior and decision-making style seldom is.

It's fair to say that systemic biases, random noise and ego will play a role; maybe even groupthink (the phenomenon that occurs when a group of individuals reaches a consensus without critical reasoning or evaluation) will surface and disrupt sound decision-making.

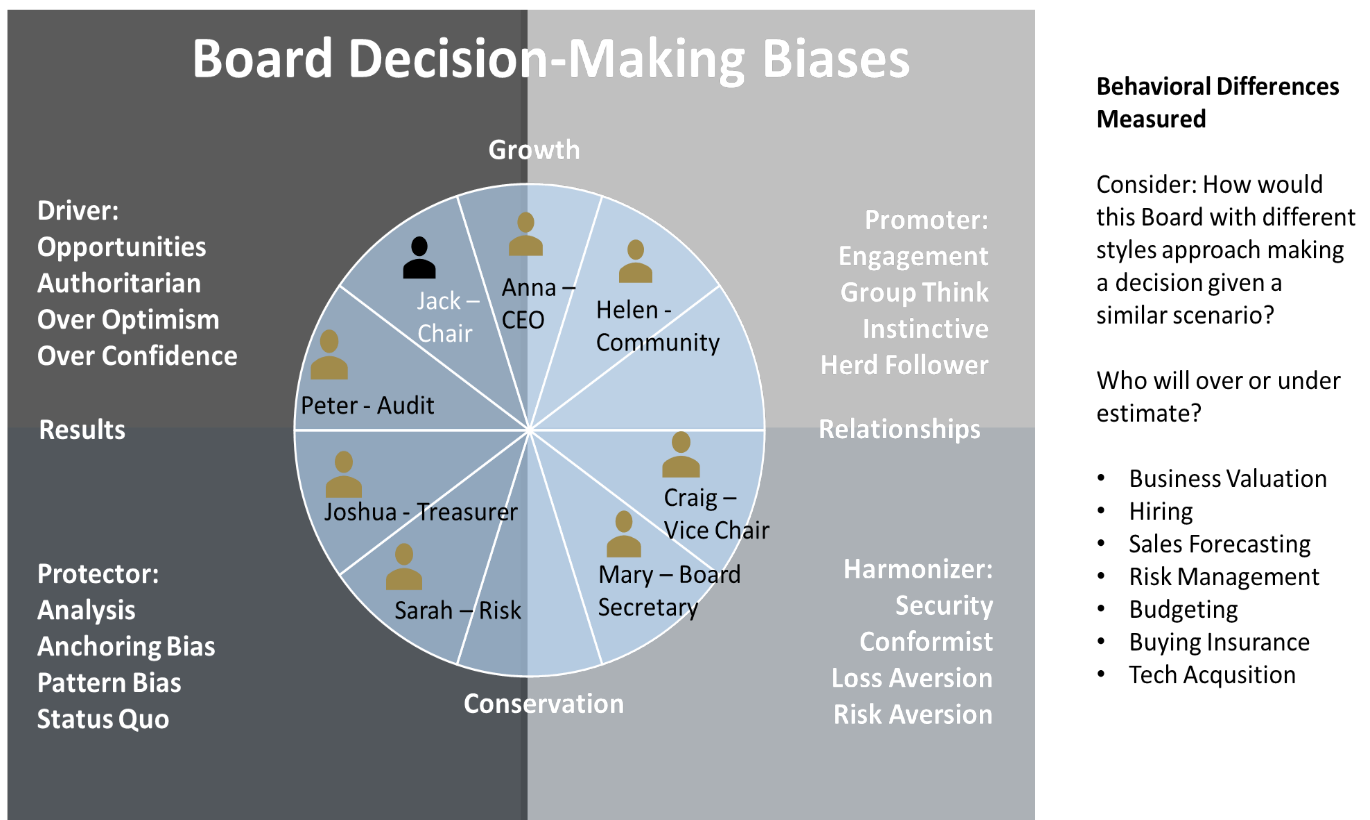
You can begin to see the melting pot of behavioral differences made up of the biases and triggers causing noisy reactions from different board members. These invisible contributors to decision-making need to be revealed, understood and managed.

The primary barrier to addressing human behavior in a board room setting (as an example) is recognizing the consequences of not knowing the behavioral differences of each individual – and what is motivating their decision-making.

With the best will in the world, board members could all face the same problem, detail or regulatory insight and yet come to completely different resolutions.

The most dominant behaviors in **group** settings that influence board dynamics:

- Authority Bias (the Driver) – commanding, needs to control the conversation.
- Group Think Bias (the Promoter) – want to get the group to a consensus.
- Confirmation Bias (the Harmonizer) – willing to hang back, patient, do not confront.
- Status Quo Bias (the Protector) – content with the way things are.



Behavioral Differences Measured

Consider: How would this Board with different styles approach making a decision given a similar scenario?

Who will over or under estimate?

- Business Valuation
- Hiring
- Sales Forecasting
- Risk Management
- Budgeting
- Buying Insurance
- Tech Acqusition

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The most dominant decision-making biases in **individuals** that influence board dynamics:

- Over Optimism Bias (the Driver) – pioneering individuals who may overestimate achieving specific goals or outcomes.
- Loss Aversion Bias (the Harmonizer) – patient people who will have a lower risk appetite.
- Pattern Bias (the Protector) – structured individuals who excessively focus on the wrong data. Note, the opposite is the Instinctive Bias (the Promoter Traits).
- Anchored Bias (the Protector) – overly relying on pre-existing information, may be unwilling to change or think out of the box

Add in random factors influencing board members on the particular day:

- Mood, whether it be good or bad
- Stress or fatigue
- Personal experiences, values, or beliefs
- Ego
- Ignorance

Then the debate gets underway….

Left-brain-anchored individuals with a fear of change clash with the "drivers" who will push for growth and transformation. Right-brain creative members are promoters who want more brainstorming. Those harmonizers who are more compliant and fearful of conflict will shrink from provocative discussions. Those drivers, motivated by their sense of self-importance, ego and ambition, throw verbal grenades into the conversation.

But the risk to the decision-making process is this: Everyone becomes tired of rhetoric and simply concedes to the loudest voice in the room, merely to end the debate. This is where flawed decision-making is birthed.

Benefits of Addressing Board Behavioral Variability

Methodologies and technologies can be embedded inside existing business systems to directly reveal, make visible, measure and manage behavioral impacts of human behavioral differences in decision making.

If behavioral variability can be reduced, an organization could potentially experience benefits in:

1. Gross revenues
2. Cost savings
3. Productivity improvement
4. Risk management (Governance)
5. Hiring and performance management
6. Business process execution

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The impact of human behavioral variability is often experienced at a substantial level when:

1. Different decision-makers make intuitive judgment calls concerning similar operational decisions required daily within the business without (a) appropriately set benchmarks and (b) understandable guidelines, and,
2. When groups make complex decisions (e.g., a board or a team) without a structured process to (a) reduce prejudgments and impressions, (b) address false or inadequate information, and (c) align an appropriate balance of risk and reward.

The problem is that people with different behavioral styles and perspectives tend to capitulate to their intuition without enough cognitive reflection. They will naturally use prejudgments or a preconceived notion of what they want the answer to be. Biases, egos, group think and the loudest voice in the room will all be factors. This can lead to sub-optimal decisions, frustration and ultimately side-conversations that leave all expertise as groups/cliques formulating decisions in the margins.

Leaders and board members must accept that behavioral variability is a substantial, if invisible, problem. While behavioral variability cannot directly be seen in financial statements (just as a robust and sustainable culture cannot be seen), both bias and noise are ever-present and contribute to substantial organizational costs.

To measure, then reduce or eliminate behavioral variability caused by both bias and noise, a study must be undertaken to discover behavioral styles and look at existing decisions. Then, training and systemized processes can be designed and built to provide more structure.

It is essential to understand that diversity of opinion is healthy; behavioral variability can only undermine decision-making when individuals in a group, given the same facts and the exact regulatory requirements, make significantly different decisions without enough management and cross-checking.

Behavioral Variability in DEI

Boards have many fiduciary responsibilities, not least of which is the critical role they play in creating an organization that prioritizes, supports and invests in diversity, equity and inclusion (DEI).

The subject of DEI is highly topical as managing it in today's world is crucial to business growth, recruiting and managing employment-related risk. Further, how DEI is managed by organizations is something that customers, suppliers, partners, regulators and others specifically examine.

Given DEI is inherently about people and the exercise of judgment, there will naturally be a range of different views on the role it plays and how to manage it. Varied perspectives on what is already an emotionally charged topic could cause additional organizational risk if not properly managed.

Clear heads are needed from the board and from senior executives. They must have a greater awareness of different perspectives which come from their own behavioral style and experiences that may be influencing decisions they make about DEI.

Not to put too fine a point on it, but at first some may perceive a focus on behavior variability as a way to sideline DEI. To the contrary; by applying an objective, quantifiable approach to behavioral variability,

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a board (or team or organization) can maximize both DEI and the best possible decisions by every individual.

Behavioral Variability in Hiring

While boards are typically not involved in day-to day hiring, there are key C-Suite players whose involvement is crucial to certain "hires."

How does behavioral variability produce errors in candidate selection? In essence, different interviewers will have different responses to the same candidate having been given the same information. Psychological biases of the interviewer will often steer them to someone who is similar to themselves. (Again, letting that play out can result in same-hiring-same; decidedly not a healthful DEI approach.)

Members of the hiring panel being in a better disposition on interview day also can sway decisions. Likewise, they could form impressions from the rapport-building phase of the interview – senses and intuitions they carry through to decision-making depending upon what they happen to be focusing on or thinking about at that time.

Further, without any insight into the behaviors of the interviewers, it is possible that one member could acquiesce to the louder, more forceful member who steers the interview and final decisions.

The hiring process can be improved if there is a decomposition of the hiring process into interviews which focus on separate discovery goals and decisions about the candidates and about the experts used for each interview. That may mean the board plays a supervisory role, with only board members with relevant expertise involved in hiring.

Behavioral Variability in Change Management

Change management is challenging under the best of conditions. Never more so than the past two years, as leaders work hard to keep businesses afloat and employees engaged in the face of the continuing pandemic and changing economic conditions.

Introducing any change – especially ones of the magnitude of a global pandemic – requires shifting individual habits and behavior within the organization. For example, working remotely for some is exciting; for others, it brings a feeling of isolation. Add to that a wider use of new technology, which is comfortable some, daunting to others.

Definitively knowing the different behavioral styles of all players is helpful so that their motivations and communication preferences are understood, enabling a personalized approach to each person and each communication.

Boards and senior executives will not succeed if change is forced. Thus, with customized questions which appeal to each person's inner motivations (*purpose, passions and values*), sustainable change can succeed. An essential aspect of understanding behavioral variability at a deeper level is that it provides management with insight into those who can manage change and could become peer-to-peer ambassadors for the introduction of changes. Bonus: Leaders who know how to communicate with greater empathy.

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Revealing and Managing Behavioral Variability Differences

Acknowledge behavioral variability as a crucial element that can undermine a board's high-stakes decision-making – unless efforts are taken to reveal, understand and manage said variability.

Without accepting the consequences of failing to understand this variability, any form of discussion leading to important decisions is likely to be imperfect. It is essential to identify and measure the prevalence of bias and noise in your organization to understand how decision-makers reach their conclusions.

New, robust research and methodologies are available to more directly measure the financial impact of human behavioral differences (behavioral variability). Only by adopting and implementing such can prevalent behavioral causes which once seemed invisible be made highly visible and addressed.

Board-member value and contributions will be maximized, as will the follow-on, cascading benefits across the organization.

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[1] Kahneman, Daniel, Olivier Sibony and Cass R. Sunstein. Noise: A Flaw in Human Judgment. Little, Brown Spark, 2021. Pp28-29.

[2] Kahneman, Daniel, Olivier Sibony and Cass R. Sunstein. Noise: A Flaw in Human Judgment. Little, Brown Spark, 2021. p139.

[3, 4, 5] Kahneman, Daniel, Olivier Sibony and Cass R. Sunstein. Noise: A Flaw in Human Judgment. Little, Brown Spark, 2021. p29.

Author:

Hugh Massie, Executive Chairman and Founder, Behavioral Solutions Architect

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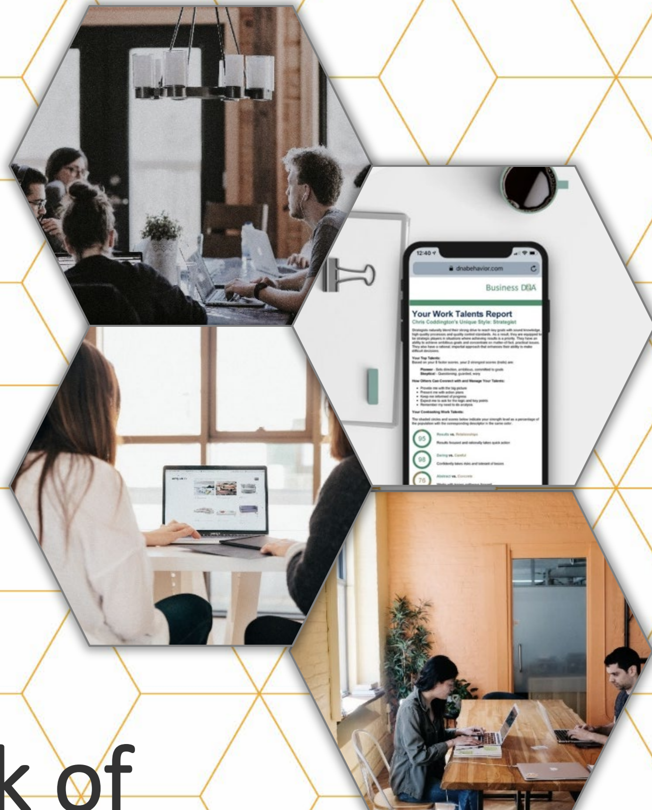

Remove the Guesswork of the Human Behavior Behind Corporate Governance

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Remove the Guesswork of the Human Behavior Behind Corporate Governance

By Hugh Massie, May 2019

With corporations under increased scrutiny to guarantee compliance, improve relationships with management and propel business success, the board's governance responsibilities are becoming more complex. After all, while many lose sight of or gloss over the fact that board members act as fiduciaries, current business climates not only remind us of that, but place increasing weight on that statutory mandate.

Indeed, the time is ripe to re-envision how effective boards are shaped in order to provide a corporate governance framework that satisfies and even exceeds legal, securities, accounting and ethics standards. In fact, as various oversight entities double down on corporate governance, tighter approaches to these areas fall just short of mandatory.

This overdue, more stringent approach should take a resolute "never on my watch" stance to rogue behavior, noncompliance and greed. Thus, a radical re-think of how boards are structured, populated and appointed is in order. Given that, what if, at the crux of this reinvention, is the discovery of why individuals and teams sometimes tend to do a "behavioral flip" when under pressure – within their own lives or on the job?

Corporate Governance – the new way forward

While financial performance is still vital, there is an increasing focus on transparency and accountability. Customers want to know how you do business. They want to know if they can trust you. It's no longer just about the product or service they receive from you. They want to know you are doing the right thing the right way and, possibly, for the right reasons. Is their money and data safe with you? Can you demonstrate you are working sustainably and with respect for the environment?

The answers to these questions, and many more, can be found in the behaviors of the people whose responsibility it is to oversee governance of the business. That's right: Even with so much information available to address corporate governance, there remains a lack of understanding of the behavioral personality of an organization's leaders. What's seen, what's hidden below the surface, what drives actions that might compromise the business. This is the core of governance. You can't control people, but you can understand them and give them guardrails and guidance based on profiles of their inherent behaviors.

For instance, how do you know when vetting a member for the board what their values, ethics, and morals are? What unknown personal and financial pressures might they be facing? What do you know about how these people will behave under pressure? Those behaviors can be identified and measured. And they should be. Why wouldn't you want to have this insight in advance of inviting someone to help shepherd your organization as a board member?

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Scientifically validated behavioral discovery is available and delivers highly reliable insights, robust processes and real-time monitoring systems to better manage behavior *and responses to pressure/stress* through the board and organizational life-cycles, including detailed reports on where compliance risks may exist with specific members.

Think *probing questionnaire* (a powerful behavioral discovery and reporting of insights, revealing a cutting edge and holistic set of behavioral insights addressing risk, spending, decision making and goal drivers) delivered by a tech platform that deliberately removes all situational, cultural and educational biases – so that it consistently and reliably reveals natural behavior. That is, the innate behavior someone may not even realize they revert to. Understanding these natural behaviors is powerful because they cannot be manipulated by the very individual who possesses them. They cannot "game" this discovery process.

And I'm not talking about gaining insights the organization will keep for itself. Information about an individual's strengths, challenges and triggers are shared with that person. They can then better understand themselves and perform at an accelerated and maximized capacity on and off the job. Everyone wins.

You see, we know that human behavior is 93 percent predictable[1] and, therefore, taking a scientific, psychodynamic approach has many payoffs. Understanding combinations of human behavioral factors that trigger emotions when facing key decisions can provide board members, management and other stakeholders with significant insight into the degree to which bias and emotions can skew decision processes.

The idea is that understanding behaviors and inter relationships could be the key to delivering high-quality governance in any organization, rather than being seen erroneously, as it often is, as a soft approach not worthy of investment. Personality assessment methodologies should be uniformly applied to every employee in the business from the top down. From high-performing leaders down through the sales and operations teams to the disgruntled bookkeeper. New hires, existing employees and, yes, board members old and new.

No room for wild-card board members

Board members are of course required to be even more accountable than employees in terms of their oversight, and to hold key executives to account. The expectation is that good governance practice has ensured that all board members are aware of the legal meaning and obligations that go with the role. Why then would you not ensure behaviors are scrutinized, especially when members are likely to face, among other challenges, balancing personal and business interests to ensure there is no possibility of a conflict of interest?

If culture (meaning: an organization's expectations, experiences, philosophy, and values that guide individual behavior; based on shared beliefs, attitudes, customs, and agreed rules) is not clearly defined

[1] (Northeastern University Professor of Physics Albert-László Barabási http://www.northeastern.edu/news/stories/2010/02/network_science.html)

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and ascribed too at the board level, how then, one wonders, might the organization respond. Micro-management is not necessary. But deep due diligence regarding, again, every individual is.

The more board members understand the strengths and behaviors they bring to their roles, the better able they will be to ensure there is a robust strategy in place to install not only the best preventive and guiding practices, but also the best-matched people and teams to make compliance king. Behavioral insights also put them in good stead to deploy appropriate checks and balances, in general and even individually.

For example, if the board has identified, based on behavioral insights, that the CEO is likely to try to unduly pressure other key executives, they'll understand the guardrails needed to ensure that CEO never fails the transparency test or begins to become the ever-dreaded rogue employee.

Likewise, identifying board members' own personality types, revealing those most likely to cross the line, together with the triggers that push them there, could save big dollars and reputations. It's a stronger, more effective position than managing and analyzing the fallout from rogue behavior after a negative event has occurred.

Simply put, knowing, in advance, how potential board members are likely to react under pressure is the key. This information can be revealed and measured. With the use of scientifically based insight gathering, their reaction to situations, their likely behavior under pressure, their hidden agendas, and much more can be understood before they are appointed.

At the heart of this approach is the fact that humans respond to situational cues. If board members are not cohesively aligned under a banner of integrity, honesty and morality, how can they point the organization in the direction of compliance and governance that satisfies the regulatory requirements? Companies scrutinizing their core values, behaviors and the way decisions are made at every level are more likely to satisfy the rules of governance.

Invest in knowing your people

While larger businesses are investing more in cyber security and other monitoring programs, virtually nothing is being put toward identifying and monitoring costly board member (and employee and management) behavior risks.

The problem is that many of these insider threats are already in your business and the situation is gaining momentum without anyone being the wiser. The Global State of Information Security Survey 2015 recommends that 23 percent of the annual spend on business security should be directed to behavioral profiling and monitoring of employees, and this case, board members.

Based on external research, people with the following measurable behavioral traits are more likely to engage in rogue behavior when emotionally triggered:

- Innovative – bright mind, which turns into curious and devious thinking;
- Ambitious – desire for success, leading to cutting corners; and
- Secretive – working under cover and not revealing key information.

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The use of a validated behavioral discovery process can dynamically match people with specific environmental conditions to determine their potential response. Such insights can also discern the degree to which individual responses could create destructive behavior and negative actions toward the business.

You only need look at headlines regarding Wells Fargo, Volkswagen, JP Morgan and the Australian Banking industry, to name but a few, to see the evidence of deviant, sometimes criminal, always destructive behavior, to understand the importance of identifying the triggers that lead to inappropriate activity. The reality is that any person with a weak or temporarily broken character on the wrong team or facing external pressure, can, and will, make flawed decisions and likely become the source of costly negative behavior.

Determining a gatekeeper

When the behaviors and motivations of individuals are revealed, transparency becomes the norm. But who should undertake and monitor this behavior? To be completely transparent, the process must be conducted by an independent body. A consultancy highly qualified in the area of uncovering deeply hidden behaviors. Once the process has been completed, there is much to be said for appointing a culture manager.

The overall objective with a such a position is that they take the lead on all organizational cultural practices. They should provide expertise and support in a range of areas. Importantly, they are answerable to the CEO *and* Board. And while they do not lead a department, they have right of entry to ensure the safety of organizational culture in areas including performance management, employee relations, employee engagement, diversity and inclusion, policy and procedure development, and HR compliance. That is, complete stewardship over corporate culture and governance.

To wit, the person in this role should have the autonomy to liaise with a broad range of internal stakeholders, primarily at executive level, and with stakeholders and customers as needed. They should have the freedom and skills to periodically take the pulse of the organizational culture to establish if intervention might be needed and if corporate governance and regulatory requirements are being adhered too. If you limit their access and authority, you limit their effectiveness, and your program as a whole.

This style of oversight will ensure that senior management is not withholding information from the board and that the board is following basic governance principles.

Implementing improved governance

Where there is currently a board *in situ*, undertaking a review should be set against agreed-upon benchmarks. Benchmarks must set acceptable standards based on predetermined values, as well as levels of talent, and should link directly to the key role responsibilities and deliverables. Benchmarking should also include an inventory of desired attributes and behaviors.

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The review can then be assessed against a framework of commonly accepted best practices and business objectives. This involves building a profile for the board as a whole, followed by benchmarking existing directors against the board benchmark profile. Once the gaps are identified, it makes the process of filling them easier and likely to be more accurate in the selection process.

Six basic steps that might be used to guide your in-development "behaviorally smart" approach to corporate governance:

1. Having profiled every board member, use this insight to openly discuss how they can work effectively together. No two behaviors are the same. Build trust by identifying individuals and working with them to leverage their strengths and talents and manage their limitations is key.
   a. Know the inherent risk takers;
   b. Identify the influencers in the room;
   c. Look for those that resist change and determine how best to bring them along when change is necessary;
   d. Manage the spontaneous individuals; and
   e. Identify the thoughtful decision makers.
2. Have the right balance of talent, skills and industry knowledge to assist the board and ensure there is a balance between those who know the organization, those who have expertise and those who offer a fresh perspective.
3. Keep information up to date and available to the board members. This will ensure decision making is more effective.
4. Use the behavioral insights to identify a board member that could go rogue under pressure and compromise the business.
5. Undertake regular self-evaluation. Question decisions. Learn from mistakes. Constantly frame behavior and performance against benchmarks.
6. Above all, ensure that you continue to gain the behavioural insights of every employee, leader and board member through a consistent, validated process. Any one person who is not (profiled) in this way may be your next weak corporate governance link.

All told, the advantage gained by institutionalizing the behavioral insights process combined with strategic oversight processes and procedures can and will deliver an environment that minimizes compliance challenges.

Author:

Hugh Massie, Executive Chairman and Founder, Behavioral Solutions Architect

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