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

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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.

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.

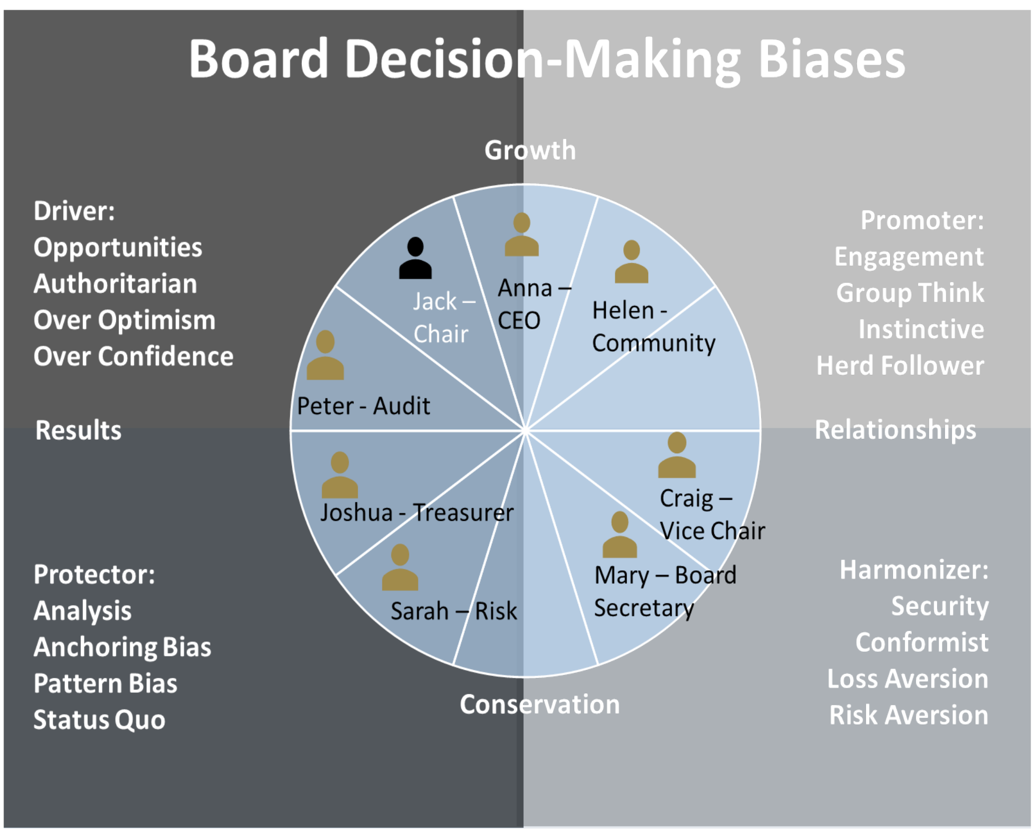
You can begin to see the melting pot of behavioral differences made up of the biases and triggers causing noisy reactions from different board members. These invisible contributors to decision-making need to be revealed, understood and managed.

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

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

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, 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.

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