

[Home](#) > [Journal of Management & Governance](#) > [Article](#)

Behavioral finance in corporate governance: economics and ethics of the devil's advocate

Published: 05 June 2008

Volume 12, pages 179–200, (2008) [Cite this article](#)[Save article](#) [View saved research](#) >

[Journal of Management & Governance](#)

[Aims and scope](#) →[Submit manuscript](#) →[Randall Morck](#) ^{1,2} **3725** Accesses  **74** Citations  **3** Altmetric [Explore all metrics](#) →

Abstract

The Common Law, parliamentary democracy, and academia all institutionalize dissent to check undue obedience to authority; and corporate governance reformers advocate the same in boardrooms. Many corporate governance disasters could be averted if directors asked hard questions, demanded clear answers, and blew whistles. Work by Milgram suggests humans have an innate predisposition to obey authority. This excessive subservience of agent to principal, here dubbed a “type II agency problem”, explains directors’ eerie submission. Rational explanations are reviewed, but behavioral explanations appear more complete. Experimental work shows this predisposition disrupted by dissenting

peers, conflicting authorities, and distant authorities. Thus, independent directors, chairs, and committees excluding CEOs might induce greater rationality and more considered ethics in corporate governance. Empirical evidence of this is scant—perhaps reflecting problems identifying genuinely independent directors.

 This is a preview of subscription content, [log in via an institution](#)  to check access.

Access this article

[Log in via an institution](#) →

Subscribe and save

Springer+

from €37.37 /Month

- Starting from 10 chapters or articles per month
- Access and download chapters and articles from more than 300k books and 2,500 journals
- Cancel anytime

[View plans](#) →

Buy Now

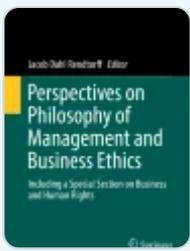
[Buy article PDF 39,95 €](#)

Price includes VAT (Poland)

Instant access to the full article PDF.

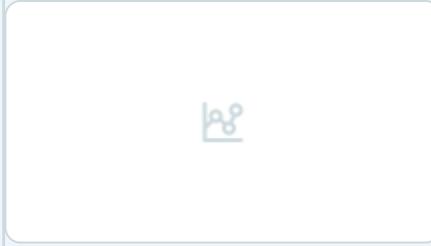
[Institutional subscriptions](#) →

Similar content being viewed by others



Dispositional Attribution of Corporate Executives: Is Self-Interest a Conscious Decision or a State of Mind?

Chapter | © 2017



Internal governance and corporate acquisition activities

Article | 21 February 2021



Some Knowledge-Representation, Group-Decision and Risk-Perception Implications of Board-...

Chapter | © 2019

Explore related subjects

Discover the latest articles, books and news in related subjects, suggested using machine learning.

[Behavioral Economics](#)

[Behavioral Finance](#)

[Behaviorism](#)

[Business Ethics](#)

[Corporate Governance](#)

[Organizational Psychology](#)

[Corporate Governance Dynamics and Board Effectiveness](#)

Notes

1. See e.g. Laski ([1919](#)).
2. See e.g. Hermalin and Weisbach ([2003](#)) for a recent survey.
3. A large strategy literature posits behavioral regularities in boardrooms. For example Westphal and Stern [2006](#), [2007](#) and references therein demonstrate networking effects in director selection. Behavioral explanations of governance issues also enter the finance literature—e.g. Shleifer and Vishny ([2003](#)) on merger waves, Baker et al. ([2007](#)) on capital spending, Kindleberger ([1978](#)) on financial crises, and others.

4. See Bernardo and Welch ([2001](#)) for a discussion of group selection inducing seemingly irrational individual behavior in economics.
5. Such reflexive behavior is appreciated by students of marketing, such as [Cialdini \(1998\)](#), and motivates free samples and “no obligation” gifts as sales strategies.
6. This knowledge is used by, for example, professional pollsters to generate answers that lend the aura of popular support to causes advanced by their clients (see Cialdini ([1998](#))).
7. Shiller ([1995](#)) speculates, based on the anthropology literature, that compliance and herding echo social conventions of polite conversation that enhance group survival odds. Brown and Levinson (1987) argue that such aspects of conversational politeness are standard across cultures, and that real tolerance of dissent requires effort and challenges human nature.
8. Though see Leuz ([2007](#)).
9. See e.g. Hermalin and Weisbach ([2003](#)) for a recent survey.
10. See e.g. Lakonishok et al. ([1992](#)).

References

Adams, R., Almeida, H., & Ferreira, D. (2005). Powerful CEOs and their impact on corporate performance. *Review of Financial Studies*, 18(4), 1403–1432.

Alevy, J., Haigh, M., & List, J. (2007). Information cascades: Evidence from a field experiment with financial market professionals. *Journal of Finance*, 62(1), 151.

[Article](#) [Google Scholar](#)

Amihud, Y., Hauser, S., & Kirsh, A. (2003). Allocations, adverse selection, and cascades in IPOs: Evidence from the Tel Aviv stock exchange. *Journal of Financial Economics*, 68(1), 137-158.

[Article](#) [Google Scholar](#)

Anderson, L., & Holt, C. (1997). Information cascades in the laboratory. *American Economic Review*, 87(5), 847-862.

[Google Scholar](#)

Arya, A., Glover, J., & Mittendorf, B. (2006). Hierarchical reporting, aggregation, and information cascades. *Managerial and Decision Economics*, 27(5), 355.

[Article](#) [Google Scholar](#)

Asch, S. (1951). Effects of group pressure upon the modification and distortion of judgment. In H. Guetzkow (Ed.), *Groups, leadership, and men*. Pittsburgh: Carnegie Press.

[Google Scholar](#)

Axelrod, R. (1984). *The evolution of cooperation*. Basic Books.

Baker, M., & Wurgler, J. (2007). Investor sentiment in the stock market. *Journal of Economic Perspectives*, 21(2), 129-151.

[Article](#) [Google Scholar](#)

Baker, M., Coval, J., & Stein, J. (2007). Corporate financing decisions when investors take the path of least resistance. *Journal of Financial Economics*, 84(2), 266–298.

[Article](#) [Google Scholar](#)

Banerjee, A. (1992). A simple model of herd behavior. *Quarterly Journal of Economics*, 107(3), 797–817.

[Article](#) [Google Scholar](#)

Bernardo, A., & Welch, I. (2001). On the evolution of overconfidence and entrepreneurs. *Journal of Economics and Management Strategy*, 10(3), 301–330.

[Article](#) [Google Scholar](#)

Bikhchandaqni, S., Hirschleifer, D., & Welch, I. (1992). A theory of fashion, custom, and cultural change. *Journal of Political Economy*, 100(5), 992–1026.

[Article](#) [Google Scholar](#)

Black, B., & Coffee, J. (1994). Hail Britannia? Institutional investor behavior under limited regulation. *Michigan Law Review*, 92, 1999–2088.

[Article](#) [Google Scholar](#)

Blass, T. (2000). The Milgram paradigm after 35 years: Some things we know about obedience to authority. In T. Blass (Ed.), *Obedience to authority—current perspectives on the Milgram paradigm*. Mahwah, NJ: Lawrence Erlbaum Associates.

[Google Scholar](#)

Blass, T. (2004). *The man who shocked the world: The life and legacy of Stanley Milgram*. Basic Books.

Brown, P., & Levinson, S. (1987). *Politeness: Some universals in language usage*. Cambridge University Press.

Cialdini, R. B. (1998). *Influence: The psychology of persuasion*. Quill.

Crossland, P., & Smith, F. (2002). Value creation in fine arts: A system dynamics model of inverse demand and information cascades. *Strategic Management Journal*, 23(5), 417-434.

[Article](#) [Google Scholar](#)

De Vany, A., & Lee, C. (2001). Quality signals in information cascades and the dynamics of the distribution of motion picture box office revenues. *Journal of Economic Dynamics & Control*, 25(3/4), 593-614.

[Article](#) [Google Scholar](#)

De Vany, A., & Walls, D. (1996). Bose-Einstein dynamics and adaptive contracting in the motion picture industry. *Economic Journal*, 106(439), 1493-1514.

[Article](#) [Google Scholar](#)

De Waal, F. (2005). *Our inner ape: A leading primatologist explains why we are who we are*. Penguin.

Drehmann, M., Oechssler, J., & Roider, A. (2002). Herding and contrarian behavior in financial markets: An internet experiment. *American Economic Review*, 95(5), 1403-1426.

[Article](#) [Google Scholar](#)

Fama, E. (1980). Agency problems and the theory of the firm. *Journal of Political*

Economy, 88, 288–307.

[Article](#) [Google Scholar](#)

Fama, E., & Jensen, M. (1983). The separation of ownership and control. *Journal of Law and Economics*, 26, 301–325.

[Article](#) [Google Scholar](#)

Festinger, L. (1957). *A theory of cognitive dissonance*. Stanford University Press.

Fourd, A. (1964). *His majesty's opposition, 1714–1830*. Oxford University Press.

Gergen, K. J. (1973). Social psychology as history. *Journal of Personality and Social Psychology*, 26, 309–320.

[Article](#) [Google Scholar](#)

Glaeser, E., & Shleifer, A. (2002). Legal origins. *Quarterly Journal of Economics*, 117(4), 1193.

[Article](#) [Google Scholar](#)

Gul, F., & Lundholm, R. (1995). Endogenous timing and the clustering of agents' decisions. *Journal of Political Economy*, 103(5), 1039.

[Article](#) [Google Scholar](#)

Hermalin, B., & Weisbach, M. (2003). Boards of directors as an endogenously determined institution: A survey of the economic literature. *Economic Policy Review—Federal Reserve Bank of New York*, 9(1), 7.

[Google Scholar](#)

Herman, E. (1981). *Corporate control. Corporate power*. Cambridge University Press.

Hobbes, T. (1651). *Leviathan, or the matter, forme, and power of a commonwealth ecclesiasticall and civil*. London: Andrew Crooke.

[Google Scholar](#)

Hostettler, J. (2006). *Fighting for justice: The history and origins of adversary trial*. Waterside Press.

Janis, I. (1972). *Victims of groupthink: A psychological study of policy decisions and fiascoes*. Republished as *Groupthink: Psychological studies of policy decisions and fiascoes*, Houghton-Muffin, 1982.

Jensen, M. (1993). The modern industrial revolution, exit and the failure of internal control systems. *Journal of Finance*, 48(3), 831-880.

[Article](#) [Google Scholar](#)

Jensen, M., & Meckling, W. (1976). Theory of the firm: Managerial behaviour, agency costs and ownership structure. *Journal of Financial Economics*, 3, 305-360.

[Article](#) [Google Scholar](#)

Kahneman, D., & Tversky, A. (2000). *Choices, values, and frames*. Cambridge University Press.

Kang, D., & Sorensen, A. (1999). Ownership organization and firm performance. *Annual Review of Sociology*, 25, 121-144.

[Article](#) [Google Scholar](#)

Kindleberger, C. (1978). *Manias, panics and crashes*. New York: Basic Books

[Google Scholar](#)

Kübler, D., & Weizsäcker, G. (2003). Information cascades in the labor market. *Journal of Economics*, 80(3), 211-229.

[Article](#) [Google Scholar](#)

Kübler, D., & Weizsäcker, G. (2004). Limited depth of reasoning and failure of cascade formation in the laboratory. *Review of Economic Studies*, 71(2), 425-441.

[Article](#) [Google Scholar](#)

Lakonishok, J., Shleifer, A., Thaler, R., & Vishny, R. (1992). The structure and performance of the money management industry. *Brookings Papers on Economic Activity*, 1992(1), 339-392.

[Google Scholar](#)

Laski, H. J. (1919). The dangers of obedience. *Harper's Monthly Magazine*, 159, 1-10.

[Google Scholar](#)

Leuz, C. (2007). Was the Sarbanes-Oxley Act of 2002 really this costly? A discussion of evidence from event returns and going-private decisions. *Journal of Accounting & Economics*, 44(1/2), 146.

[Article](#) [Google Scholar](#)

Leuz, C., Triantis, A., & Wang, T. (2007). Why do firms go dark? Causes and economic consequences of voluntary sec deregistrations. *Journal of Accounting and Economics* (forthcoming).

Mace, M. (1986). *Directors: Myth and reality*. Harvard Business School Press.

Marosi, A., & Massoud, N. (2007). Why do firms go dark? *Journal of Financial and Quantitative Analysis*, 42(2), 421.

[Article](#) [Google Scholar](#)

Martin, J., Lobb, B., Chapman, G., & Spillane, R. (1976). Obedience under conditions demanding self-immolation. *Human Relation*, 29(4), 345.

[Article](#) [Google Scholar](#)

Merritt, A., & Helmreich, R. (1996). Human factors of the flight deck: The influence of national culture. *Journal of Cross-Cultural Psychology*, 27, 5-24.

[Article](#) [Google Scholar](#)

Milgram, S. (1963). Behavioral study of obedience. *Journal of Abnormal and Social Psychology*, 67, 371-378.

[Article](#) [Google Scholar](#)

Milgram, S. (1974). *Obedience to authority*. Harper and Row.

Miller, A. G. (1986). *The obedience experiment: A case study of controversy in social science*. NY: Praeger.

[Google Scholar](#)

Morck, R., Shleifer, A., & Vishny, R. (1989). Alternative mechanisms for corporate control. *American Economic Review*, 79(4), 842-852.

[Google Scholar](#)

Noth, M., & Weber, M. (2003). Information aggregation with random ordering: Cascades and overconfidence. *Economic Journal*, 113(484), 166–189.

[Article](#) [Google Scholar](#)

Ocasio, W. (1994). Political dynamics and the circulation of power: CEO succession in U.S. industrial corporations, 1960–1990. *Administrative Science Quarterly*, 39, 285–312.

[Article](#) [Google Scholar](#)

Rao, H., Greve, H. R., & Davis, G. F. (2001). Fool's gold: Social proof in the initiation and abandonment of coverage by Wall Street analysts. *Administrative Science Quarterly*, 46(3), 502–526.

[Article](#) [Google Scholar](#)

Romano, R. (2005). The Sarbanes-Oxley Act and the making of quack corporate governance. *Yale Law Journal*, 114, 1521.

[Google Scholar](#)

Rosenstein, S., & Wyatt, J. (1997). Inside directors, board effectiveness, and shareholder wealth. *Journal of Financial Economics*, 44(2), 229–251.

[Article](#) [Google Scholar](#)

Schurz, G. (1985). Experimentelle Überprüfung des Zusammenhangs zwischen Persönlichkeitsmerkmalen und der Bereitschaft zum destruktiven Gehorsam gegenüber Autoritäten. *Zeitschrift für Experimentelle und Angewandte Psychologie*, 32, 160–177.

[Google Scholar](#)

Shiller, R. (1995). Conversation, information, and herd behavior. *American*

Shivdasani, A., & Yermack, D. (1999). CEO involvement in the selection of new board members: An empirical analysis. *Journal of Finance*, 54, 1829–1853.

[Article](#) [Google Scholar](#)

Shleifer, A. (1999). *Inefficient markets—an introduction to behavioral finance (Clarendon Lectures in Economics)*. Oxford University Press.

Shleifer, A., & Vishny, R. (2003). Stock market driven acquisitions. *Journal of Financial Economics*, 70, 295–311.

[Article](#) [Google Scholar](#)

Shleifer, A., & Vishny, R. W. (1997). A survey of corporate governance. *Journal of Finance*, 52(2), 737–784.

[Article](#) [Google Scholar](#)

Surowiecki, J. (2004). *The wisdom of crowds*. Doubleday.

Tarnow, E. (2000). Self-destructive obedience in the airplane cockpit and the concept of obedience optimization. In T. Blass (Ed.), *Obedience to authority—current perspectives on the Milgram paradigm*.

Weisbach, M. S. (1988). Outside directors and CEO turnover. *Journal of Financial Economics*, 20, 431–460.

[Article](#) [Google Scholar](#)

Westphal, J., & Stern, I. (2006). The other pathway to the boardroom: How

interpersonal influence behavior can substitute for elite credentials and demographic majority status in gaining access to board appointments. *Administrative Science Quarterly*, 51, 169–204.

[Google Scholar](#)

Westphal, J., & Stern, I. (2007). Flattery will get you everywhere (especially if you are a male Caucasian): How ingratiation, boardroom behavior, and demographic minority status affect additional board appointments at U.S. companies. *Academy of Management Journal*, 50(2), 267–288.

[Article](#) [Google Scholar](#)

Zhang, I. X. (2007). Economic consequences of the Sarbanes-Oxley Act of 2002. *Journal of Accounting & Economics*, 44(1/2), 74.

[Article](#) [Google Scholar](#)

Acknowledgements

I am grateful for helpful comments and suggests by seminar participants at the University of Alberta, Århus University, Fu-Jen Catholic University, Hong Kong University of Science and Technology, the Journal of Management and Governance Symposium at the Università Cattolica Sacro Cuore of Milan, the National Bureau of Economic Research Universities Conference on Behavioral Corporate Finance, and the University of Toronto. I am especially grateful for specific suggestions from Malcolm Baker, Terry Burnham, Lorenzo Caprio, Joseph Fan, Steve Kaplan, Richard Ruback, Andrei Shleifer, Henry Tosi, Ivo Welsch, and Jeff Wurgler. This research was funded in part by the Social Sciences and Humanities Research Council.

Author information

Authors and Affiliations

University of Alberta School of Business, Edmonton, Canada

Randall Morck

National Bureau of Economic Research, Cambridge, MA, USA

Randall Morck

Corresponding author

Correspondence to [Randall Morck](#).

Additional information

This work was partially undertaken while a Visiting Professor at Harvard.

Rights and permissions

[Reprints and permissions](#)

About this article

Cite this article

Morck, R. Behavioral finance in corporate governance: economics and ethics of the devil's advocate. *J Manage Gov* **12**, 179–200 (2008). <https://doi.org/10.1007/s10997-008-9059-4>

Received

01 April 2007

Issue date

May 2008

DOI

<https://doi.org/10.1007/s10997-008-9059-4>

Accepted

19 May 2008

Published

05 June 2008

Keywords

[Behavioral finance](#)

[Corporate governance](#)

[Agency problems](#)

[Information cascades](#)

[Herding](#)

[Opposition](#)

Search

Search by keyword or author



Navigation

Find a journal

Publish with us

Track your research