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Behavioral Finance in Corporate Governance - Independent Directors, Non- Executive Chairs, and the Importance of the Devil's Advocate

Randall Morck

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WORKING PAPER 10644

DOI 10.3386/w10644

ISSUE DATE July 2004

REVISION DATE October 2007

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 often 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

rationality and more considered ethics in corporate governance. Empirical evidence of this is scant - perhaps reflecting problems identifying genuinely independent directors.

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Acknowledgements and Disclosures



Citation and Citation Data



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Randall Morck, 2008. "Behavioral finance in corporate governance: economics and ethics of the devilâ€™s advocate," *Journal of Management and Governance*, Springer, vol. 12(2), pages 179-200, May.

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Supported by the Alfred P. Sloan Foundation grant #G-2023-19633, the Lynde and Harry Bradley Foundation grant #20251294...

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Contact Us

1050 Massachusetts Avenue
Cambridge, MA 02138
[617-868-3900](tel:617-868-3900)
info@nber.org
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