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Renee M. Jones
Boston College Law School, renee.jones.2@bc.edu

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By [Renee Jones](#) August 3, 2017

Recent news of sexual harassment and other legal controversies at Uber and throughout Silicon Valley serves as a vivid reminder that irresponsible and unethical conduct continues across the corporate landscape. Revelations of serious transgressions by senior corporate leaders belies a central assumption underlying contemporary corporate law theory. Much of corporate law is premised on rational actor theory – the idea that the law should be designed to leverage each person's propensity to act in his rational self-interest. Corporate theorists have invoked this idea to promote a legal regime that relies on a system of incentives to cajole, but not command, corporate executives to act in the interests of shareholders and society.

Despite its broad acceptance, the assumption that corporate executives always behave rationally is not well-supported by empirical evidence. Behavioral economists have demonstrated, for example, that people often act in a predictably irrational manner. Observable cognitive biases such as over-optimism often lead us to stray far from the path of rationality. In response to this critique, rational actor theorists contend that the number of irrational actors in the corporate world is likely so small that their potential impact on corporate conduct can safely be ignored. They further argue that the economic equivalent of a natural selection process will prevent irrational actors from reaching positions of authority before they can significantly influence their corporations.

My forthcoming article, *The Irrational Actor in the CEO Suite: Implications for Corporate Governance*, challenges this analysis. It explores how policies based on the rational actor model are likely to play out when we accept the possibility that a non-trivial number of senior corporate executives have personality traits consistent with an irrational approach to risk. The article draws on psychology and neuroscience research that shows risk-related decisions are dominated by our emotions, rather than a rational thought process. More important, research shows that many individuals have a dysfunctional approach to risk that leads them to engage in self-destructive conduct. I adopt the term "antisocial risk takers" to describe those with a propensity to act in ways that are inimical to their own interest and the interests of society.
The article reviews research in psychology and neuroscience into why some people engage in antisocial risk – actions in which the expected costs outweigh the expected benefits. Researchers have identified a trait labeled impulsivity that correlates with various forms of anti-social risk. Psychologists regard impulsivity as a stable personality trait that can affect one's behavior in a variety of settings. Studies show that antisocial risk takers – smokers, substance abusers, and gambling addicts – systematically make disadvantageous choices in lab-administered gambling tasks. Antisocial risk takers also tend to discount future rewards and punishments more steeply than control subjects.

Scientists probing the biological basis of risk taking conclude that a common neural mechanism underlies various forms of antisocial risk. They focus on the brain's dopamine reward system as playing a key role in the development of addiction. The same brain mechanisms that contribute to addiction influence our approach to financial risk. Neuroscience studies of financial decision-making, including studies of professional traders, connect biomarkers consistent with a moderate approach to risk with long-term investment success. These studies conclude that excessive risk taking and excessive caution are both associated with investment mistakes.

A separate line of research explores the impact of CEO personality on corporate conduct. These studies focus on two CEO personality traits, psychopathy and narcissism, believed to contribute to recent major corporate scandals. Researchers have found that a surprising number of corporate managers have personality traits linked to antisocial risk. One well-known study found that 4 percent of a sample of 200 managers from seven major companies met the clinical definition for psychopathy – a rate four times higher than among the general population. Another study found a higher incidence of certain personality disorder traits among a sample of British executives than among a comparison sample of psychiatric patients and individuals incarcerated as criminally insane. Other studies link high levels of narcissism in corporate CEOs to high-risk decisions, performance volatility, and fraud. This research shows that individuals with high levels of psychopathic and narcissistic traits do manage to attain positions of authority in firms where they can affect corporate policy and strategy. It therefore seems critical for investors, directors, and regulators to closely monitor executive conduct and remain vigilant for signs of unethical behavior and excessive risk.

Of greater concern from a policy perspective is the danger that corporate governance practices premised on rational actor theory have made the corporate environment more inviting for individuals with high levels of antisocial traits. Consider, for example, incentive compensation schemes, like performance bonuses, option grants, and trading commissions. These approaches link an employee's compensation and wealth to short-term corporate returns. Such policies will appeal most strongly to impulsive individuals who favor immediate rewards over larger, delayed returns. As previously discussed, psychologists link impulsivity to a range of self-destructive behavior, including substance abuse, problem gambling, and the failure to comply with social norms. Thus, the widespread adoption of incentive compensation schemes may have the effect of attracting seriously troubled individuals to firms. As individuals with high levels of antisocial traits are drawn to corporations, their attitudes and actions will likely drive away more grounded individuals, leading to an ethical downward spiral.

I conclude by recommending policies and practices corporations can adopt to prevent antisocial risk takers from rising through their ranks, starting with consistent resume verification and reference checks to prevent imposters from gaining entry to firms. Firms also should vigorously enforce conduct codes and maintain a comprehensive system for performance evaluations to root out unethical and unscrupulous employees. I also identify several forms of executive behavior that appear to correlate with fraud. Drawing on accounts of the conduct of corporate executives embroiled in scandal at firms like Enron, WorldCom, Tyco, and Bear Stearns, I urge investors, directors, and enforcement officials to pay close attention to reports of substance abuse, improper workplace relationships, and violations of law by senior executives. Such flagrant instances of personal misbehavior may be an early warning sign of fraud. The recent reports of aberrant executive behavior at Uber and other Silicon Valley firms provide additional data points for future analysis, and additional reason to doubt the prescriptive utility of rational actor theory.

This post comes to us from Professor Renee Jones at Boston College Law School. It is based on her recent paper, "The Irrational Actor in the CEO Suite: Implications for Corporate Governance," available here.