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A Study of Independent Director's Reputation Incentive Mechanism Based on the Principal-Agent Theory

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ABSTRACT

This paper applies principal-agent theory to research into the incentive compatibility problems of the independent directors (IDs). The traditional fixed-pay system could preserve the independence of IDs, however, lacking of in-centives, the performance-related incentive mechanisms have great impact on IDs' independence which is the core of the system. This paper considers reputation incentive mechanism (RIM) as an effective way to solve this dilemma. The results, after our study, show that appropriate RIM can maintain IDs' independence as well as their incentive compatibility. Furthermore, taking the market-signal theory as reference, this paper sets up a model to introduce another function of RIM, which can help the company to identify the different roles of IDs.

KEYWORDS

reputation incentive mechanism, independent directors, principal-agent relationship, market signal

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