EXIT, VOICE + LOYALTY
exit, voice & loyalty

• Economist Albert Hirschman’s famous (1970) analytical framework of ‘exit, voice and loyalty’

• Applies equally to investing in shares, political life, consumer behaviour and private life

• How will stakeholders react to decline in the performance of firms, organisations, states, and other individuals?
examples

- Will they exit the relationship? – sell the stock, quit the club, buy another firm’s product, change boyfriends?

- Will they just show loyalty despite declining satisfaction?

- Will they use voice – ie. complain to bring about change?

Under what conditions is each response more likely?
LOWLY WORD

I AM THE BEAT OF A THOUSAND PURPLE BUTTERFLIES

-MANA
failing organisations

- History shows that most public & private institutions go through periods of under-performance, some fail, and others are reformed.

- Economics has historically focused on exit – market signals from investors selling shares or customers changing brands – which provokes reform.

- Political science has historically focused on voice – protest or electoral change that leads to improved governance.

- Hirschman has identified the crucial importance of recuperation mechanisms to deal with ‘repairable lapses’.

- Usually better to fix an organisation that build again from scratch; and great social costs in failing firms & institutions.
to err is to be human,
to not do anything about it is pathetic
Hirschman has identified the vital inter-dependence of the exit & voice options in the case of firms and other private organisations.

If everyone just quit there would be considerable instability and misallocation of resources (resources – capital, human, knowledge – can be perfectly and instantly reallocated)

If nobody could quit then voice would have no impact

Therefore there can be an optimal mix of exit and voice to stimulate recuperation mechanisms – responses to decline
nations & exit

- increasingly firms can leave their home base in response to lower operating costs, or lower corporate tax rates abroad

- much criticism of multinational firms centres on this ‘footloose’ element, and their calculated use of foreign domiciles etc for tax minimisation

- in politics, complete exit means going into exile.. which has been common. Prominent political leaders like Kim Dae Jung, Iran’s Ayatollah Khomenei returned from exile to take national leadership

- Hirschman posited that the relative ease of going into exile for Latin American military leaders - as other countries offered the same language and close cultures - might have been a factor in the high rate of coups (in contrast to Japan etc)

- exile is a costly exit though so the right to exercise voice is demanded
share market: exit + voice

• Small investors are unlikely to have the economic incentives to closely monitor a firm’s management and to actively express voice

• Even if they did they can be readily ignored by management unless they influence major investors

• But they can sell easily in liquid markets (frequently traded shares) and will be price takers

• Very large shareholders find exit more difficult because large scale selling will be price making – downwards – unless other market participants do not share their negative view of the firm’s prospects

• (remember that shares prices reflect expectations – at risk - of a firm’s future earnings, discounted to present value)
problems with exit

• Managements that are lazy or self-serving might welcome exit over voice from ‘troublesome’ investors or customers

• Limited competition (for investors, customers) might give comfort to bad managements

• However, if there is sufficient exit that results in a share price fall that might alert hitherto loyal investors to the need for closer monitoring and ultimately voice

• (relates to a key insight of economics that markets prices send signals to economic actors – ie. transmit information)

• Large institutional investors, managing small investors’ capital, in share markets can become an effective vehicle for both exit and voice – providing governance pressures