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Voice-Exit Mechanism and Corporate Governance

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Abstract

The voice-exit mechanism is a critical area of research due to its significant implications for corporate decision-making accountability and transparency. A thorough understanding of the advantages and disadvantages of this mechanism can lead to the development of more effective strategies to improve corporate governance and increase shareholder value. Academic and business literature have thoroughly debated and analysed the notions of voice and exit mechanisms in corporate governance. Conventional approaches to corporate governance have depended on exit mechanisms to hold management accountable for its actions, such as shareholder activism or selling shares. On the other hand, recent research has emphasised the importance of voice channels, such as conversations with management and exercising voting rights, as practical methods of enhancing corporate governance. Additionally, with recent developments in the asset management industry's size and organisational structure, where "keeping" and "selling" stocks are frequently mutually inclusive rather than exclusive, the corporate governance function of capital markets is now increasingly through share transactions. Because new realities must be adequately analysed and included in corporate governance codes of conduct, the single voice and exit paradigm must be abandoned in such situations in favour of alternative frameworks that adapt to these realities. The investigation of the voice-exit mechanism and corporate governance is significant as it explores the methods through which shareholders can manifest their dissatisfaction with a company's performance regarding corporate governance. This paper's study background and methodology depend on a literature survey, a comparative analysis of academic research, and expert opinion on corporate governance procedures. They conclude with proposals for a more balanced corporate governance approach that includes both voice and exit alternatives. By enabling stakeholders to offer helpful input to strengthen corporate governance and foster a more open and responsible cor-

porate governance culture, a more balanced or complementary voice, exit mechanisms can aid businesses in making educated decisions and enhancing performance.

Keywords

Voice-Exit Mechanism, Corporate Governance, Balanced Approach

1. Introduction

The seminal work of Ballantine et al. identified the challenges posed by the separation of ownership and control in institutions (Ballantine et al., 1932). The separation of ownership and management generates conflicts of interest between shareholders and agents, resulting in an agency issue that must be addressed through corporate governance. Corporate governance is the collection of principles, policies, and processes that guide a company's management and control. Corporate governance is an essential component of business, and stakeholders in a company, such as shareholders, management, and the board of directors, interact through corporate governance processes to guarantee the firm's long-term success (The Chartered Governance Institute UK and Ireland, 2022). By ensuring that businesses function in a transparent, responsible, and accountable manner, effective corporate governance helps to build long-term value for all stakeholders. Nevertheless, the degree to which corporate governance tools enable stakeholders to engage in governance determines how effective such mechanisms will be. In order to increase stakeholder participation in corporate governance, voice-exit mechanisms, one such strategy that enables stakeholders to hold firms responsible, have grown in favour in recent years.

Additionally, corporate governance has grown in importance as corporations fail to fulfil their obligations to shareholders and other stakeholders, which results in increased scrutiny and regulation. Conventional corporate governance methods rely on exit strategies, such as stock sales or shareholder activism, to make management answerable for its deeds. This strategy has drawn criticism for its drawbacks since it may be expensive, time-consuming, and ineffectual at bringing about substantive change. The significance of voice methods in enhancing corporate governance has recently come to light in a study. The ability of shareholders to participate in discussions with management and use voting power to influence corporate decision-making is referred to as the discourse power mechanism. Since it provides for greater accountability and openness, this method is more effective in producing good change.

Contrary to popular belief, institutional investors can only restrain a company's management in one of two ways: by holding their stake and actively participating in board decision-making, or by selling their stake and hoping that a sufficient number of shareholders follow suit so that the threat of an acquisition and a

change in management or management strategy becomes a reality (Lysandrou & Stoyanova, 2007). The voice-exit system, however, has certain drawbacks. Stakeholders may require additional information, resources, or influence to use their voice or exit effectively.

Moreover, voice-exit mechanisms could only be successful in businesses with influential shareholders or with lax legal protections that restrict investor rights. For instance, Jensen and Meckling (1976) contend that the success of shareholder activism depends on how well-informed and equipped shareholders are to exercise their rights. Similarly, Miceli et al. (2008) emphasise the significance of exposing corporate malfeasance, but they also point out that whistleblowers may experience reprisal from their employers or other stakeholders.

In order to enhance corporate governance through voice-exit mechanisms, it is imperative to adopt more balanced or complementary strategies that take into account existing constraints and support effective stakeholder participation. This paper begins by reviewing previous research directions and main contents in the second section. The third section explores the concept, determinants, and influence of voice mechanisms on corporate governance. The fourth section discusses the background, concept, influencing factors, functions, and shortcomings of exit mechanisms. In the fifth section, through a comprehensive and comparative analysis of voice and withdrawal mechanisms, it provides a range of management methods that can suit the different needs of the company. Furthermore, this paper believes that these mechanisms can complement each other in corporate governance and offers balanced suggestions accordingly.

2. Literature Review

2.1. Theoretical Framework

In this paper, a search was conducted on Google Scholar using the keywords Voice-Exit Mechanism, Corporate Governance, Voice Mechanism, and Exit Mechanism to identify relevant literature for the main analysis. Four articles were selected based on their relevance and citation count. The search revealed that previous studies did not fully explore the interplay between voice and exit mechanisms as complementary and complete mechanisms. Therefore, this article aims to fill this gap by building upon the previous research results on these two mechanisms.

The first set of keywords used in the search was Voice-Exit Mechanism and Corporate Governance. In the article titled "The Anachronism of the Voice-Exit Paradigm: Institutional Investors and Corporate Governance in the UK" by Lysandrou and Stoyanova (2007), it is suggested that the role of capital markets in corporate governance is now played out more through the gravitational pull of stock deals than through hostile takeovers. The authors argue that holding and selling stocks are often mutually inclusive behaviors rather than mutually exclusive behaviors. Although the interplay between exit and voice patterns has been found to be inclusive, it has not been studied in depth.

The second set of keywords used in the search was Voice Mechanism and Corporate Governance. McCall and Philosophy Documentation Center (2001) emphasized the importance of employee participation in decision-making through the mechanism of voice. They defended the idea of strong participation rights for employees in corporate governance.

The final set of keywords searched for on Google Scholar was "Exit Mechanism and Corporate Governance". In the article titled "Blockholders and Corporate Governance" by Edmans (2014), it is emphasized that major shareholders play a governance role by either voicing their opinions or selling their shares. Although both voice and exit mechanisms have been studied independently, the interplay between these two mechanisms has not been explored in depth. Moreover, the existing studies assume that the same large shareholder is involved in both mechanisms, but in reality, different large shareholders have expertise in different strategies. This literature gap creates a need to investigate the complementary relationship between voice and exit mechanisms in corporate governance. Therefore, this paper aims to fill this research gap by exploring how firms use voice and exit mechanisms in different corporate governance contexts.

2.2. Gaps in the Existing Literature

Despite the considerable amount of research on voice and exit mechanisms, the literature has several common limitations. Firstly, the majority of studies have focused on either voice or exit mechanisms independently. Secondly, while some studies have explored the complementarity of these two mechanisms, they have not been studied in depth, nor have they been linked to different corporate governance contexts. Therefore, this research aims to address these gaps by first elaborating on the voice and exit mechanisms based on previous research results. It will then explore the voice and withdrawal mechanisms as a complete and complementary mechanism, innovatively discussing and analyzing how these two mechanisms can work together in different corporate governance situations. Finally, the research will propose a balancing method to manage the interplay between these two mechanisms. By doing so, this research will contribute to a more comprehensive understanding of the role of voice and exit mechanisms in corporate governance.

3. Shareholder Engagement Channel: The Voice Mechanism

3.1. The Concepts of the Voice Mechanism

In a limited liability company, the voice mechanism of shareholders is divided into two categories: traditional voice mechanism and new voice mechanism.

The traditional voice mechanism theory emerged in the 80 s of the last centuries, when the US capital market, which has a sound legal and regulatory system, has the highest stock liquidity and economic efficiency, so its development model has become the object of emulation by various countries. The theory of voice mechanism emerged under the wave of capital market reform set off by various

countries, which advocated that reform intended to improve stock liquidity may harm corporate governance.

The theory of new occurrence mechanism takes corporate governance theory as the core and believes that increasing stock liquidity is conducive to the initiative of large shareholders and, consequently, corporate governance. The new voice mechanism theory has two classic theoretical models for the different assumptions about whether uninformed traders can observe shareholder behaviour. The first model holds that stock liquidity favours the formation of large shareholders (Maug, 1998). The second model assumes that outside investors can observe the behaviour of significant shareholders and that higher stock liquidity makes the stock price contain more information about the behaviour of significant shareholders.

3.2. The Determinants of Voice Intensity

The block size is directly proportional to the voice. Larger shares allow investors to receive a larger share of benefits, which can offset the cost of voice. Therefore, larger shares incentivise investors to monitor their investments and voice (Shleifer & Vishny, 1986; Edmans, 2014; McCahery et al., 2016).

However, a shareholder may still choose not to voice his, even if he has sufficiently large shares, which depends on the stock's liquidity (Edmans, 2014). As mentioned above, traditional voice mechanisms argue that increased stock liquidity reduces investors' transaction costs in the capital market. Thus, in times of poor firm operations, investors will exit rather than voice (Coffee, 1991; Bhide, 1993; Back et al., 2013). Norli et al. (2015) found that stock liquidity is positively associated with shareholder activism in the new voice mechanism. The increasing liquidity increases the number of additional shares that can be purchased at a price below the firm value, and shareholders profit from these shares (Shleifer & Vishny, 1986).

The expertise of investors can also influence the intensity of voice. As investors become more knowledgeable and experienced in equity investing, we can see more public action or voice when dissatisfaction arises (Tasci & Ozdemir, 2017; Iliev et al., 2021).

3.3. The Impact of the Voice Mechanism on Corporate Governance

The price at which significant shareholders buy a stock represents a price that does not reflect regulatory efficiency. When the significant shareholders play a supervisory role and have a positive effect, the improvement of the company's operating and governance environment will gradually be reflected in the stock price so that significant shareholders can enjoy the benefits of supervision. High liquidity means that the majority shareholders can buy a large number of stocks with low transaction costs so that they will make more profits (Faure-Grimaud & Gromb, 2004). Maug (1998) used the initial shares of institutional majority shareholders as an endogenous variable and found that high stock liquidity can

motivate shareholders to exert activist behaviour. The theory represented by Faure-Grimaud and Gromb (2004) assumes that external investors can observe the behaviour of large shareholders and that high stock liquidity can increase the behaviour information of large shareholders in the stock price, thereby incentivising large shareholders to implement more decisions that increase corporate value.

However, Bhide (1993) came to a different conclusion, arguing that increased liquidity does not motivate major shareholders to supervise. Major shareholders often sell shares directly when the company has negative news or operating results that do not meet expectations. Back et al. (2013) show that when shareholders own a large amount of equity in the company, high liquidity increases the risk of equity diversification and reduces the willingness of major shareholders to supervise internally, which is not conducive to corporate governance.

Furthermore, whichever voice approach an investor chooses is always costly. This creates the free-rider problem (Shleifer & Vishny, 1986). Based on the rational man assumption, shareholders tend to pay as little as possible to enjoy the benefits of governance, i.e. to engage in a free-rider mentality. In this case, some shareholders and even large shareholders may adopt a negative attitude towards governance, reducing the overall efficiency of corporate governance.

In addition, the voice mechanism is challenging to implement for some shareholders. Firstly, shareholders' expertise limits their ability to voice. Many shareholders are good at assessing the current value of a company through past information but weak at presenting forward-looking information (Dow & Gorton, 1997). Secondly, the block size prevents shareholders from voicing. Most shareholders hold only a small number of shares, reducing their motivation to participate and the effectiveness of their voice (Helling et al., 2020; McCahery et al., 2016).

Investor conflicts of interest also hinder institutional investors' voice. Due to the high reliance on the company's other businesses, mutual fund managers' positions in corporate governance are more biased towards management (Davis & Kim, 2007). Moreover, business relationships make it profitable for fund managers to obtain valuable information.

As discussed above, voice mechanisms are suitable for corporate governance, but some investors do not want to or cannot voice. Admati and Pfleiderer (2009) and Edmans et al. (2013) argue that investors can still execute governance through the exit when voice mechanisms fail.

4. Shareholder Engagement Channel: The Exit Mechanism

4.1. The Concepts of the Exit Mechanism

4.1.1. The Background of Exit

Management needs to focus on the company's long-term interests and the short-term stock price to ensure that management actions meet the interests of shareholders. When the people who run a company differ from the ultimate own-

ers, their management is inadequate to maximise its value. For example, they may need to put in more effort, invest for the long term, or withdraw too much in salaries and perks. The root of the agency problem is that managers need more shares in the company. Thus, large shareholders who can afford to bear the costs of supervising managers can play an essential role in governance. Major shareholders can manage through direct interference, also known as "voice".

However, when voice mechanisms are hard to enforce, shareholders can manage managers by selling their shares, an alternative corporate strategy called "exit".

4.1.2. What Is Exit

The implication of "exit" is that if the manager's actions destroy value, shareholders can punish the manager afterwards by selling their shares to drive down the share price. Until then, the threat of exit would prompt managers to seek to maximise value. However, it is essential to note that rather than maximising enterprise value, block holders may extract private gains by manipulating one company to purchase services from another company they own at inflated prices for private gain.

Suppose a significant shareholder realises that the company's management is not making decisions in the best interests of shareholders. In such circumstances, shareholders may be tempted to exit rationally rather than try to take radical action. Exit is another expression of activism, although it may seem inconsistent with activism. Major shareholders can influence management decisions and lower the price of the target company by implying threats to sell their shares.

4.2. The Threat of Exit

The decline of the target company's stock price caused by the threat of exit has a constraint effect, but if the major shareholder has incurred additional costs in the exit process (for example, transaction costs), does the threat of exit still effectively constrain the manager? In addition, non-block holders (investors with an equity stake of less than 5%) exit threats have yet to be addressed in previous studies. So, a precise analysis of the critical factors influencing exit will help to understand the impact of the threat of exit.

4.3. The Factors to Exit

Both internal and external factors affect exit. There are two internal factors to take into account. The stage of development is the initial internal component. Enterprises in rapid development are more optimistic about their future development prospects. Therefore, the most effective way to exit is an IPO. Equity transfer will be an effective exit if the enterprise is in a mature stage with stable development, primarily through share repurchase. Secondly, the reputation of the venture capital institution. High-reputation venture capital institutions have rich investment experience and relationship networks. They are familiar with the IPO exit process and can pass the review in the most effective way to achieve the

purpose of listing. Moreover, a high reputation will attract following investors, which can alleviate IPO discounts and achieve the exit of venture capital with a higher share price.

The external factors are uncontrolled. The first is economic prosperity. When the economy is prosperous, investors are confident in the capital market, providing an opportunity for venture capital to exit via IPO at a high rate. Most venture capitalists choose equity transfer when the economy is in recession, and the capital market is sluggish. Information asymmetry also plays a role. Since start-up companies have a different strict information disclosure mechanism than listed companies, external investors may underestimate the company's value due to their lack of understanding of its products and markets.

4.4. The Defect of Exit

However, exit as a corporate governance device sometimes works for multiple reasons. Firstly, the strength of exit governance relies on shareholders' reactions. According to Cvijanović et al. (2022), "open-ended institutional investors such as mutual funds react strongly to an informed block holder's exit, leading to correlated exits that enhance corporate governance." Conversely, if no one responds to the exit, it is considered a failed corporate governance strategy. Secondly, even if other investors agree to the exit, they will not react or participate in corporate governance, which means being free riders (McCahery et al., 2016). Taking mutual funds with diverse portfolios, for example, they can only get part of the extra value after their exit. At the same time, other stakeholders gain as free riders and retain their shares of the company (Jackson, 2008).

Last, the motivation for exit is not necessarily for corporate governance but for personal profit. According to Jackson (2008), stakeholders and managers may make a deal to address underperformance by an active takeover market. Although it seems to destroy shareholder value, the latter gets protected via ample opportunity to exit at a "near-guaranteed eventual premium investment".

As mentioned before, exit is limited to varied factors and with defects. Hence, in corporate governance, voice and exit "tend to be mutually inclusive rather than exclusive acts" (Lysandrou & Stoyanova, 2007).

5. Comprehensive Comparative Analysis of Voice-Exit Mechanism

5.1. Selection Tendency between the Voice and Exit Mechanism

Undoubtedly, a more effective management mechanism can obtain more rational people's tendencies, and the effectiveness is mainly linked to the number of shares held by investors and the company's performance. The comparative research method explores the propensity mode and reasons for investors' participation in corporate governance. The results show multiple stable solutions for the exit-or-voice mode of the coordination game, leading to the diversity of governance modes. The outcome of the game depends on the power structure within

the firm, which in turn is related to the dominant model in the financial system. For the dominant model in financial institutions, long-term institutional investors generally dominate, including rising sovereign wealth funds, which can be considered universal owners. Strategic asset allocation for long-term investors prompts them to maximise the aggregate long-term value of all firms across the economy, integrate additional financial risks associated with intangible assets and long-term liabilities, and use voice rather than exit in corporate governance. Compared with long-term investors who are others-centred and have strong psychological ownership, self-centred short-term legal owners are more likely to choose to exit to achieve the purpose of managing the company in disguise.

For example, the voice mechanism is more effective when shareholders hold a substantial stake in the company and the company's management is responsive to shareholder input (Cuñat et al., 2015). However, the exit mechanism is more effective when shareholders own fewer company shares and company management is less sensitive to shareholders' opinions (Admati & Pfleiderer, 2009).

Another study found that the voice and exit mechanisms complement rather than substitute mechanisms for corporate governance (Liang et al., 2018). The study found that the voice mechanism is more effective when the company's performance is poor, and the exit mechanism is more effective when the company's performance is good. The study also found that the two mechanisms interact with each other, such that the effectiveness of one mechanism depends on the presence or absence of the other.

5.2. The Proposed Balanced Approach

To achieve a better balance between voice and exit mechanisms, some scholars have proposed a complementary approach that combines both strengths. This approach suggests that rather than treating voice and exit mechanisms as mutually exclusive, they should be seen as complementary tools that can be used together to achieve better corporate governance outcomes.

5.2.1. Enhancing Shareholder Voice

Enhancing shareholders' voice is the first step in developing a better balanced or complementary voice-exit mechanism. Shareholders need to have a stronger voice in corporate decision-making processes.

One example of enhancing shareholder's voice is the "loyalty voice" framework proposed by Hart and Zingales (2017) in their paper "Companies Should Maximise Shareholder Welfare Not Market Value". According to the loyalty voice framework, shareholders loyal to a firm and with a long-term investment view are more likely to utilise voice mechanisms to keep the corporation responsible. In contrast, shareholders focused on the short term are more likely to employ exit mechanisms. The authors propose that firms may develop a more balanced and effective voice-exit mechanism by fostering shareholder loyalty and boosting long-term investment.

Another example of enhancing shareholder's voice is the "voice and loyalty" model proposed by Albert Hirschman in his 1970 book "Exit, Voice, and Loyalty: Responses to Decline in Firms, Organisations, and States" (Hirschman, 1970). Hirschman proposes that in cases where exit methods are inefficient or impracticable, stakeholders can express their concerns and influence change using voice channels. However, Hirschman contends that for voice mechanisms to be effective, stakeholders must also have a sense of loyalty or commitment to the organisation, giving them a stake in its success and a motivation to devote time and effort to expressing their opinions.

As for how to enhance shareholder's voice, this can be achieved by implementing a range of measures, including:

- More information accessibility for shareholders: Shareholders should have access to accurate and timely information on the company's operations, financial performance, and strategic direction. This information should be given in a clear, succinct, and understandable way.
- Enhancing shareholder rights: Shareholders should be able to vote on significant matters such as the board of director appointments, CEO remuneration, and large transactions. Shareholders should also be able to offer resolutions and appoint directors.
- Increasing shareholder engagement: Businesses should regularly communicate with their shareholders, allowing them to ask questions, offer comments, and voice their concerns. Annual general meetings, investor forums, and other types of participation can help with this.

5.2.2. Improving Exit Mechanisms

The second step in developing a better balanced or complementary voice-exit mechanism is to improve exit mechanisms. Shareholders need a meaningful exit option if dissatisfied with the company's performance or governance, which can be achieved by implementing a range of measures, including:

- Enhancing the corporate control market: Businesses should not be immune to market influences. Shareholders should be allowed to sell their shares and redirect their cash to other productive uses if a firm is underperforming. This can be accomplished by maintaining a healthy market for corporate control.
- Offering shareholders fair value: If shareholders decide to sell, they should be compensated fairly. Making sure that the share price accurately represents the company's worth rather than being artificially inflated or deflated would help achieve this.
- Transparency and fairness must be ensured: Exit procedures must be visible and fair, with explicit regulations.

6. Conclusion

In conclusion, there is no ideal solution to deal with the two problems of stakeholder agency checks and balances of power and voice-out corporate governance. Several forms of corporate governance occur depending on various nations' busi-

ness cultures and legal frameworks. The emergence of institutional investors in the global financial sector has the potential to alter the current governance structure. Because of their scale and diversification, institutional investors are generally unable to utilise exits as a form of control, which forces them to evaluate the long-term worth of the enterprises in which they invest.

Nevertheless, since their stake in either corporation is small, direct voice control is immaterial. They must express broad ideals while forming the board and its subcommittees, which have considerable authority. A scientific exit mechanism also impacts the company's overall management level in a complex market economy, which is essential for the stability of the social and economic order and the preservation of shareholders' interests. If these recommendations are to be effective, they must be regularly improved upon in response to significant alterations in the financial and economic environment.

As a result, future research must analyse the problems in the shareholder voice-exit mechanism based on the company's development status, clarify the scope of the shareholder voice-exit mechanism's application, and promote the formation of a high-quality development system for the company. The complementary nature of discourse power and the exit mechanism also helps to develop a more balanced and successful corporate governance structure. Businesses may foster positive stakeholder discussion and work together to create better outcomes for all parties involved by developing loyalty and voice mechanisms.

Conflicts of Interest

The authors declare no conflicts of interest regarding the publication of this paper.

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