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Deliberative Democracy and Corporate Governance

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A COMMENTARY ON Jeffrey Moriarty (2014), "The Connection Between Stakeholder Theory and Stakeholder Democracy: An Excavation and Defense," ***Bus & Soc*** 53(6): 820–852, http://doi.org/10.1177/0007650312439296

ABSTRACT

Jeffrey Moriarty argues for a return to a robust notion of stakeholder theory involving direct procedural voting by stakeholders. He asserts that such voting offers the best possible chance of restraining firm behavior and taking into account all stakeholder interests. I argue, however, that Moriarty proceeds with an overly narrow conception of democracy, ignoring problems that arise from procedural voting. Specifically, paradoxes in voting procedures, the tyranny of the majority, and the inefficacy of representation advantage well-organized and moneyed interests. A stakeholder democracy may in fact undermine the very interests that Moriarty seeks to promote.

THE NOTION THAT firms should advance the interests of all stakeholders, and not just shareholders, has led to a vibrant conversation on how or whether to change corporate governance to better fit this ideal. Jeffrey Moriarty's (2014) article on stakeholder democracy fits within this trend and serves as a call to return to the original vision of stakeholder theory. Moriarty observes that early versions of stakeholder

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theory boldly advocated for what he terms "stakeholder democracy," that is, requiring firms to give all stakeholders formal voting rights for their boards of directors. However, more recent iterations have settled less radically for a mere balancing of interests undertaken by a firm's officers or for weaker voice rights. Moriarty's piece calls for a return to the earlier, and he argues, more robust version of stakeholder democracy.

Here, I suggest that Moriarty's constricted view of democracy, as defined by procedural voting, inadequately addresses a growing literature in democratic theory and social choice theory which both point to the inadequacies of procedural voting and advocate for a more holistic understanding of democracy. According to such analysis, Moriarty's stakeholder democracy may serve to advantage organized, moneyed, and connected interests at the expense of diffuse and less well-off groups.

Moriarty begins his argument by mapping out the shift in stakeholder theory away from strong claims of democratic participation to an agnosticism about how to best balance all stakeholder interests. He then lays out an argument for stakeholder democracy on the grounds that

> stakeholder theory's distributive goal of balancing stakeholders' interests is more likely to be achieved in a stakeholder democracy than under current corporate governance arrangements (Moriarty 2014: 832).

He rests this argument on a theory about human behavior as fundamentally self-interested, and thus in need of redirecting incentives to become other-regarding. Moriarty takes accountability through democratic voting to be just the sort of incentive that would require management to promote stakeholder interests. After setting out his claims about the importance of stakeholder democracy, Moriarty defends it against critiques, reducing arguments against stakeholder democracy to disparagements of stakeholder theory in general. Thus, Moriarty claims that stakeholder theory necessarily entails claims of stakeholder democracy.

Moriarty's argument rests on the key notion that interests are best accounted for by means of democratic voting. However, the research on voting shows that this is not the case in particular circumstances, and it may be that these circumstances are more likely to be present in just the sort of organizational contexts which Moriarty describes. First, Moriarty describes a scenario in which each of the classic stakeholder groups – this is, employees, consumers, suppliers, community members, and shareholders – elect representatives to the board of directors, who then make decisions for the firm. According to empirical evidence, voting, in order to function effectively, requires large numbers of participants, because small numbers can create a volatile voting situation where one or two votes can dramatically shift an outcome (Grandiori 2001). This requirement may not be met in elections, for instance, for the suppliers' representatives, who could be quite few in number. Further, voting procedures can create "voting paradoxes," according to Arrow's theorem, by creating cyclical preferences, opportunities for strategic voting, and the ability to influence elections through agenda setting. Cyclical preferences arise when individual preferences are not single-peaked, creating intransitive communal preferences. While in politics intransitive preferences are often avoided through the use of a liberal–conservative spectrum, which allows options to be ordered, it is not clear that corporate decisions are similarly amenable to a linear arrangement. In order to prevent the problem of cyclical preferences, options must be restricted, which means that agenda setting becomes important (Farber and Frickey 1991). Those who control the agenda can shape the outcome. Finally, any voting system can be subject to strategic voting, where individuals will not vote their original preferences in order to better themselves. Strategic voting situations benefit those who are well-organized and well-informed, and in a corporate situation, highly vested interests could promote strategic voting for their own benefit.

These problems of agenda-setting and voting paradoxes arise within political democracy, but unlike in the firm context, political parties, constitutional structures, and separation of powers mitigate such effects in politics. Specifically, in the corporate world, one might imagine such effects to be exacerbated because corporations would not have the well-established party structures that make political voting reasonably stable. Democratic theorists have long noted that parties limit the number of options, provide cues for ignorant voters, and bundle together positions that are consistent (Lupia and McCubbins 1998). In the absence of parties, individuals with resources and connections across multiple stakeholder groups could coordinate the selection of multiple directors. Such a situation only benefits the highly organized, the moneyed, and those with concentrated, as opposed to diffuse, interests.

While Moriarty's scheme does not consider procedural problems related to the nature of voting itself, his proposal also inadequately addresses the democratic problem of the tyranny of the majority. In a brief paragraph, Moriarty (2014: 830) raises the question about majority power but dismisses the need for "checks and balances" with the rationale that the political rights provided by the state and the legal rights guaranteed by contracts provide sufficient protection against such abuse. However, this account ignores the ways in which democracy privileges the interests of the well-connected and wealthy. Moriarty portrays the stakeholder groups as monolithic, but in reality they constitute diverse interests. One can easily imagine employees or the community, for instance, having a range of opinions and interests when it comes to firm's behavior. The formalization of stakeholder input can allow for the suppression of minority views by creating a false clarity about a stakeholder group's interests. In particular, the appearance of fairness created by voting easily allows both the board of directors and management to simply ignore these minority perspectives once the votes have been cast. As feminist critics of democracy often point out, voting is not enough to ensure equality (Mendus 1992). The push for voting as the only voice often leaves the marginalized without any voice, except for a worthless and losing vote. Moriarty implicitly argues that a voting procedure will allow heretofore unrepresented interests, such as the community, suppliers, and consumers, to assert power in corporate governance. Such introduction of new groups into corporate governance may be seen as analogous to promoting the involvement of women and minorities in politics. However, because simply granting a vote to minorities often still leaves them subjugated to the majority, minorities have moved to advocate for deliberative influence over their fellow citizens. Sometimes, raising awareness is more effective than casting a vote. Further, political minority groups have often found the unelected, undemocratic elements of political democracy, such as the media, courts, and bureaucracy, to be more agreeable to their interests than democratically elected legislatures or popular referenda. Since his commendable aim is to give voice to new interests, Moriarty might accomplish his goals more effectively by reconsidering the role of the "works councils, advisory boards, quality circles, straw polls, and the like" which he explicitly dismisses as viable options (Moriarty 2014: 827). Such mechanisms could create the much-needed voice opportunities and checks and balances that benefit minority interests politically.

Moriarty's stakeholder democracy rests on representation as a way to safeguard interests. However, the evidence from political science does not suggest that voting on representatives provides a particularly strong form of accountability. The statistics on Congressional incumbency alone should serve to indicate that accountability is often weak. Recent research by Gilens and Page (2014) confirms the well-known theory of democracy put forward by Joseph Schumpeter in the 1940s, namely that representatives are not particularly responsive to the average voter. Rather, as Gilens and Page show, economic elites control American politics. Asymmetries among the various stakeholder groups, with some being more concentrated and others more diffuse, would exacerbate this bias towards wealth and organization in a stakeholder democracy. Further, non-elected institutions, such as the media and the courts, which act as correctives to support representation in a political democracy, will not be as available in a corporate situation.

In political democracy, the average voter has little incentive to gain knowledge to vote effectively, or even at all, in elections (Caplan 2008). Turn out for non-presidential elections is low, and there is no reason to think that elections for representation with a firm would not be even lower among at least some stakeholder groups, especially given that some studies suggest that people vote primarily out of civic duty, rather than self-interest (Campbell 2006). This rational ignorance means that those who do vote rely heavily on the cues provided by parties and the sensationalism of campaigning to choose a candidate. Recent data on shareholder voting has only 27% of investors exercising their influence over corporate governance, and shareholders clearly stand to gain or lose from the firm's performance (Egan 2014). Other stakeholder groups, such as the community or consumers, would exhibit lower turnout and even higher levels of voter ignorance. This leaves elections open to manipulation by the well-organized and wealthy, all the while masquerading under the ostensible fairness of democratic elections. To encounter the challenges of implementing a stakeholder democracy in corporate America, one need look no further than local school board elections. Non-partisan in much of the country, school board elections draw abysmally low voter turnout (less than 9% by some estimates), leaving those organized interests with high stakes, such as teachers' unions, to dominate the outcome (Moe 2006). While it may appear that all stakeholder interests would be balanced and represented in a stakeholder democracy, lessons from political democracy suggest that such optimism may be misguided. The veneer of democracy may provide management and directors with a rationale to ignore other, potentially more important, forms of deliberative and non-voting participation.

Moriarty rightly argues that stakeholder theory should pay closer attention to issues of corporate governance. However, he focuses on democratic voting as providing the best way to ensure that various stakeholder interests are accounted for, when formal voting procedures could in fact reduce the very balancing of stakeholder interests that Moriarty advocates. In politics, a range of non-elected, constitutional, and social institutions, including the media, courts, bureaucracy, federal layers of government, and separation of powers, temper the ills of democratic voting. Introducing voting in corporate systems without such a framework could create less accountability on the part of management, who might now feel absolved of the moral claims of stakeholders, once the votes have been cast. As democratic theorists from James Madison to contemporary deliberative democrats recognize, democratic voting does not necessarily create a just system.

A more capacious attitude towards democracy might take the lessons of democratic theory into account in four key ways. First, such an approach would promote voice opportunities, ranging from employee exit interviews to consumer boycotts, as legitimate and vitally important democratic expressions. Second, a broad approach to democracy would depend on checks and balances, both within the firm and outside, as necessary to promote all stakeholder interests. This could include traditional constraints like contracts, government regulation, and inter-firm competition, as well as forums and feedback mechanisms to enhance transparency and the potential for advocacy by consumers, the community, and suppliers. Third, this perspective would recognize that in some situations voting actually reduces representation, especially in cases of low turnout, scarce information, diffuse interests, and strong elite influence. Fourth and finally, a more robust approach to corporate democracy would consider the fiduciary role of management to be a form of representation that should be augmented and actively theorized. Stakeholder theory would do well to draw on the lessons learned from political democracy when seeking to democratize corporate governance.

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