Book Review of *Exit, Voice, and Loyalty* of Hirschman

Yun Zhang

In his book *Exit, Voice, and Loyalty,* Hirschman addresses the question how an organization could discern its wrongdoings and come back to the right track. The author is motivated by the observation that "under any economic, social, or political system, individuals, business firms, and organizations in general are subject to lapses from efficient, rational, law-abiding, virtuous, or otherwise functional behavior". It is beneficial to the whole society if these lapses could be reverted and efficiency restored.

As correctly pointed out by the author, this question has long been ignored in the competitive market paradigm of neo-classic economics. Neo-classic economics allows no room for individual firms in a competitive market to make even a single mistake: once the product of one particular firm deteriorates, consumers will immediately notice this change and switch to other firms. Hence, the deteriorating firm could not survive. Competitive market paradigm doesn't even bother to consider the question how the ailing firm could be revived, because it assumes that failing firms' market share and resources could be efficiently taken up and utilized by other healthy firms. However, the competitive market paradigm is much too restrict: it is an exception rather than a universal law. The very existence of monopoly and oligopoly power in reality forces us to appreciate the question posed by Hirschman.

Exit and voice are identified as two ways by which the ailing organizations could discern their deterioration. Taking a business organization which sells a particular consumer product as an example. Once the quality of its product starts to fall (due to chances), at least some of its customers would detect this change and stop buying it (or switch to its competitors). As a result, sales and revenue decrease. Management of the firm in question is forced to look for answers. Although at the first glance this looks much similar to the predictions of neoclassic economics, there is one difference: neoclassic economics requires that the deterioration is quickly known to all the customers in the market, and as a consequence, the sales of the faltering firm would immediately drop to zero. Although this indeed forces the managers to realize that something is wrong, they can not do much about it because the firm is basically broke by the immediate huge loss. However, exit, in Hirschman's view, doesn't necessarily mean that all the customers would discern the deterioration: only those who are more quality-alert notice the quality change. It is quite possible that sales drops, but the drop is not big enough to wipe off the firm. As a result, a reasonable amount of exit enables the management to detect the problem, and address it consequently.

Exit is a viable solution for the customers as long as there are some outside options available to them. For example, in the previous example, outside options mean that there are at least some competing firms those quality-alert customers could turn to. Then what about a monopoly market? In such a market, if the product is a necessity, exit is no longer a viable solution to the customers: no matter how low the quality is, customers still need to buy from the monopolist. Then in this case, the management could not notice the deterioration from the customers' exits. However, the customers, with nowhere to go, could utter their discontent directly to the management. Hirschman calls this way of catching management's attention "voice". In general, voice requires the customers to put up with the deterioration of the product for a period of time and the uncertainty of whether the ailing firm could come back to track.

Hirschman then discuss the interactions between exit and voice. Roughly speaking, when both exit and voice options are available to the customers, customers would probably choose exit over voice: exit only requires them to search for better alternatives. Once a better alternative is found, exit would certainly lead to welfare increase. On the contrary, voice involves calculated decisions and uncertainty. Customers would choose voice if they believe that the management would seriously consider their voice, and chances that the ailing firm revives are good. This leads to an interesting conclusion. That is, voice is more easily to be heard a monopoly market in a competitive market.

By this interaction between voice and exit, Hirschman offers a neat explanation for the worsening of the public school system. The explanation is based on the assumption that the wealthy parents are more education-quality alert than others. Once the quality of a public school falls, it is those wealthy parents who first discern the quality change. Since they always have the options to send their children to private schools, they would not bother to voice their concerns to the public school. Instead, they simple exit and send their kids to private schools. Hence, the public school is quickly deprived of its most quality sensitive consumers and unable to hear voice from them. Furthermore public schools could not discern the deterioration from enrollment change either (because students from wealthy families only constitutes a fraction of the student population). As a result, the public school could not detect its own wrongdoing in a timely fashion. By contrast, if a private school starts to deteriorate, with nowhere else to go, those quality alert parents would not hesitate to utter their opinions. Hence, private schools could quickly detect and address their problems.

Another interesting example of this sort is the disadvantaged minority groups. Traditionally, American society values individual upward mobility along the social ladder. For example, “a successful individual who starts out at a low rung of the social ladder, necessarily leaves his own group behind as he rises: he passes into, or is accepted by, the next higher group. He takes his immediate family along, but hardly anyone else… he may later finance some charitable activities designed to succor the poor or the deserving of the group and neighborhood to which he once belonged. But if an entire ethnic or religious minority group acquires a higher social status, this occurs essentially as the cumulative result of numerous, individual, uncoordinated success stories and physical moves of this kind rather than because of concerted group efforts”. This kind of mobility enables a few talented to quickly exit their group, and consequently leave less opportunity for them to voice the problems to their group fellows.

The previous two examples show us that the presence of exit option can greatly reduce the chances that voice will be heard. Hirschman then introduces the concept of loyalty. Loyalty represents a feeling of attachment to an organization of which one is a member. The presence of loyalty effectively increases the cost of exit. As a result, it enables the customers or members to stay with the faltering organization for a while, hence reducing excess exit. Loyalty is different from faith. Instead, loyalty is a calculated and somewhat rational behavior. Being loyal to an organization means one believes that, “over a period of time, the right turns will more than balance the wrong ones”. With exit being held at bay, customers or members are more likely to invoke their voice options. The faltering organization could not afford ignoring dissenting voices for long. The reason is that although loyalty can delay exit for a while, it can’t do so indefinitely. As stated above, loyalty is a calculated behavior. Once the loyalists are convinced that the organization they are associated with is truly doomed and its deterioration is irreversible, they would exit for sure though the exit costs are huge. Hirschman calls this as the loyalists' threat of exit. It is this threat that catches organization's attention to the wrongdoings.

However, we are cautioned by Hirschman to loyalists' self-deception behavior. Self-deception is more likely to happen in organizations which impose severe initiation or severe punishment for exit. With high cost of entry or exit, customers or members of the ailing organization are unwilling to observe the downsides. They prefer living in the deception that everything is fine and OK to facing the cruel reality that the organization is going down. As a result, in this case, both exit and voice are suppressed.

In the end of the book, Hirschman focuses on the normative analysis. That is, what is the effective way for a faltering organization to address its faults. He claims that different kind of organizations would trigger different responses (exit vs. voice) from their customers/members. For example, deterioration in the education quality of a public school is likely to trigger exit. However, on the other hand, different forms of organizations are sensitive to different responses. Again, a public school is more sensitive to complaints from students' parents than dropping in enrollment. As we can easily see, the continuing deterioration of the public school system is because the response it arouses, through its decline, is not the response it would easily appreciate. So one remedy we can think of here is to align the two sides: either encouraging parents to switch from exit to voice, or making the public school system more alert to drop in enrollment.

In short, this book addresses a question that has long been ignored by the competitive market paradigm of neo-classic economics. Hirschman's view is especially pertinent to organization theory. Business firms are viewed as a result of incomplete contracts and transaction costs. In other words, we don't have a competitive market as a yardstick to evaluate most of branches' performance within a firm. As a result, a firm would have to resort to exit and voice to detect its fault and consequently correct its wrongdoings.

One omission of this book is that it assumes that the complaints voiced by customers or members are always helpful for the organization to find its fault. However, if we view customers or members as self-interested parties whose interests are not totally in line with the organization as a whole, then the organization would face the problem how to distinguish "true" voice which are helpful for addressing deficiency from "noisy" voice which are totally motivated by self-interest behavior on the part of the customers or members. The same logic also applies to exit. For example, the turnover rate increases maybe not because there is something wrong with the organization, but because some employees can't align their short-term self-interest to the organization's long-term goal which could be quite sound.