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Going political? Towards deliberative corporate governance

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Abstract

Current challenges in corporate governance increasingly require a deeper appreciation for the political nature of corporation, and a reflection on the assumptions behind dominant governance practices. This article suggests that the emerging theoretical models in economics and finance, which clearly recognize the role of all stakeholders, are limited by their narrow conception of politics. Building on an historical survey of corporate governance models, and on the literature on deliberative democracy and political corporate social responsibility, I suggest that a deliberative corporate governance approach would help design better governance practices. I illustrate this idea with a case of shareholder engagement and conclude with the implications for other governance practices.

Keywords Corporate Governance · Theory of the Firm · Deliberative Democracy · Deliberative Governance · Shareholder Engagement · Corporate Social Responsibility

There is widespread agreement that corporate governance needs reforming, as the dominant "financialized" model (Admati 2017) is not working. Yet, despite frequent attempts to address this problem with regulatory changes (only in the US context, Sarbanes–Oxley in 2002, and Dodd-Frank in 2010), numerous problems remain. One problem with regulatory responses is that they tend to be reactive, and the governance challenge evolves as new actors and practices emerge. Another related problem, which I will address in this paper, is that the dominant theories of governance have not provided regulators, corporations, and all the relevant stakeholders and actors in the field, with a conceptualization that would help design better governance institutions and practices.

Despite much debate and theoretical ferment around this topic in economics and finance (Hart and Zingales 2017a, b; Magill et al. 2015), most of these attempts

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are primarily concerned with an important problem (control and monitoring) that is already relatively well-understood. But many corporate governance challenges today emerge around complex, ambiguous issues such as globalization, financialization, digitalization, climate change, inequality. These grand challenges (Ferraro et al. 2015) are eminently political, but do not immediately translate into clear, measurable interests for most of the parties involved (shareholders, managers, workers, citizen, NGOs, etc.), and yet corporations need to take key decisions on them which will have consequences for all stakeholders. Existing theories in economic and finance, I argue, fail to offer a solution to the key problem that governance faces today: offering long-term strategic and political guidance for corporations in a context of complexity and ambiguity.

Business ethics and CSR scholars, on the other hand, have long recognized that the corporation is a political actor (especially as globalization has eroded the regulatory power of the state) and it should embrace its politicization with responsibility, “contributing to global regulation and providing public goods”(Scherer and Palazzo 2011: 901). Building on the political philosophy of Jürgen Habermas (1996), this perspective advocates for the development of deliberative democracy practices to engage civil society in this process of private regulation. A deliberative conception of democracy specifies a set of ideal procedures for reaching a collective decision which are both legitimate and correct in furthering the common good (Cohen 1989; Freeman 2000: 382; Knight and Johnson 1994: 285). Unfortunately, this perspective has been discussed primarily within the CSR debate, and its insights have not influenced current governance practices, which remain anchored in agency theory.

In this paper I suggest that deliberative democracy might offer the key to a more thorough theoretical development in the theory of the firm. This cross-fertilization might allow to re-conceptualize corporate governance from an exclusive focus on control and conflict mediation, towards a more deliberative approach that explores how corporations can design systems to more effectively engage society and the public.

1 Novel challenges in corporate governance

Given the multidisciplinary nature of the corporate governance debate, where economists, legal scholars, political scientists, sociologists, and management theorists have all advanced their theories and conducted empirical work, it is not surprising that even the definition of the phenomenon varies across fields and authors (Aguilera et al. 2015; Aguilera and Jackson 2010). In this paper, building on Blair (1995: 3), I will consider within the scope of corporate governance research studies that explore the legal, cultural, and institutional arrangements that affect what corporations can do, who can legitimately control them, how that control is exercised, and how the risks and returns from corporate activities are allocated.

Despite this broad definition, most corporate governance research has primarily focused on studying different mechanisms to align the interests and behavior of managers to the ones of shareholders. Walsh and Seward (1990) distinguished between internal and external corporate control mechanisms. Internal mechanisms are specific to the focal firm, and include its board of directors, ownership distribution, and managerial incentives. External mechanisms originate outside the focal firm, and include the legal system, the market for corporate control, external auditing, rating organizations, stakeholder activism and the media (see Aguilera et al. 2015 for a recent review of this literature). While empirically studying these external mechanisms helped open up the box of corporate governance, most studies remain grounded in the existing dominant theories of corporate governance (agency theory, stakeholder theory, team production theory) or in dominant organization theories such as institutional theory or resource dependence theory.

The practice of corporate governance, instead, presents us with novel situations that challenge our theoretical tools. Take for instance the growth of the responsible investing phenomenon, whereby asset owners and investment managers increasingly scrutinize their investments for their environmental, social, and governance track record (Arjaliès 2010; Sjöström 2008; Jonsson 2009; Marti and Gond 2017; Yan et al. 2018). On January 12, 2018, BlackRock CEO Larry Fink sent a letter to CEOs of public companies telling them that their responsibility is not only to deliver profits but also to make "a positive contribution to society." Blackrock, the largest asset manager in the world, with more than $6 trillion in assets under management, was now publicly endorsing a stakeholder view of the firm, which so far seemed off-limit for investment managers because a strict (and debatable) interpretation of fiduciary duty obliged them to maximize shareholder value.

Take shareholder activism, which was traditionally purely focused on increasing shareholder value in the short-term. On Dec, 12, 2012, Bill Hackman, a famous activist investor, took a short position on Herbalife claiming that the company was a pyramid scheme, because its business model relied primarily on recruiting new associates, rather than selling more to consumers (Vandebroek et al. 2014). Hackman was ultimately unsuccessful in taking the company down, but in 2016 Herbalife settled a related complaint with the Federal Trade Commission, paid a $200 million fine, and fundamentally restructured its business (Greisman 2016). On January 6, 2017, JANA Partners, a New York–based activist hedge fund, and the California State Teachers' Retirement System (CalSTRS) sent a letter to Apple's board of directors, asking the company to find ways to help parents "to ensure that young consumers are using your products in an optimal manner." The request was not motivated by potential negative impact on shareholder value but with the mounting evidence that the overuse of iPhones was harming kids.

But investors are not the only actors going political, especially in the United State, where CEOs have started to take public positions on political issues, with Tim Cook (Apple) publicly opposing a bill in Indiana that would discriminate against same-sex couples, or Merck's CEO Kenneth Frazier, who resigned from President Trump's business advisory council after the President failed to condemn neo-Nazi protests (Chatterji and Toffel 2018).

These episodes raise important questions: Should investors go beyond narrow interpretation of fiduciary duty and encourage CEOs to tackle environmental and social issues? Should CEOs take position on political issues? Should board of directors discourage this behavior? Are these actions perceived as legitimate by the public?

2 Limitations of current corporate governance theories

Corporate governance research has been dominated for more than two decades by agency theory and its (implicit) theory of the firm as a nexus of complete explicit contracts (Fama and Jensen 1983; Jensen and Meckling 1976). Research from an agency theory perspective starts from assuming a conflict of interests between ownership (shareholders) and managers, and devise monitoring and control solutions to ensure management's objectives are aligned with the ones of shareholders (Dalton et al. 2007). It is important to emphasize that the reason why shareholders are assigned decision-rights (and thus are the ones who should be "protected" from managers' malfeasance) is that all other stakeholders provide their services to the firms by signing complete contracts, and thus their interests and rights should be easy to protect by writing contracts that cover all future contingencies (Kim and Mahoney 2010; Klein et al. 2012; Rajan and Zingales 1998; Zingales 2000).

However, this contractarian theory of the firm has been criticized from three different angles. Sociologists and political scientists studying the historical evolution of corporate governance forms have criticized the functionalism of the contractarian approach, which assumes that observable corporate governance arrangements are the "efficient" result of market selection, and suggested that political processes played a key role (Davis 2005; Fligstein 1990; Roy 1997). Organization theorists, instead, criticized the under-socialized nature of the theory, advocated for a socially situated perspective, and empirically explored how managers and investors' actions are shaped by ingratiation, persuasion, social learning, reciprocity, and other social processes (Westphal and Zajac 1998, 2013; Zajac and Westphal 2004).

Finally, stakeholder theory suggested that in order to create and distribute economic value across stakeholders, executives should not focus solely on the interests of shareholders (Freeman 1984; Parmar et al. 2010). Originating in business ethics, and from a pragmatist perspective, stakeholder theory was never meant to be an alternative theory of the firm, but rather as a "framework" or a "genre" of management theories, advancing "a practically useful and morally rich way to think about the disciplines of business" (Parmar et al. 2010: 431). In some sense, despite being highly criticized, or simply ignored, by economists and finance scholars, stakeholder theory has ultimately succeeded in putting stakeholders front and center of the current debate in the theory of the firm (Hart and Zingales 2017a, b; Magill et al. 2015; Ormazábal 2018).

Recent theorizing on the theory of the firm starts from an internal criticism of agency theory and suggests that the firm is a nexus of *incomplete* contracts, which "typically implies that the firm has many different providers of resources and capabilities contributing to the value-creation process but with varying degrees of overlap in commitment and alignment of incentives" (Zingales 2000). For instance, human resources are not residual claimants, but not all possible contingencies can be contractually specified, and thus their fate, as much as the one of shareholders, depends on managerial decisions they cannot influence.

Relaxing this basic assumption of agency theory has far reaching consequences for our understanding of corporate governance. Shareholders should not be the sole residual claimants of the firm, because the relationship between the firm and other stakeholders is not completely regulated by explicit contracts, and the consequences of management action do not affect only shareholders but all stakeholders. This approach provides a language to reconcile the insight and contribution of stakeholder theory (Freeman 1984) and team production theory (Blair and Stout 1999) with the logic of mainstream theory of the firm in finance. In team production theory, stakeholders invest in firm-specific resources, but relinquish control over those resources to the board of directors, which becomes a mediating hierarchy between stakeholders, and is tasked with deciding on how to best balance often conflicting stakeholders' demands in the interest of long-term viability of the corporation (Canals 2010).

The current ferment in economics and finance around the theory of the firm can potentially be revolutionary (Hart and Zingales 2017a, b; Magill et al. 2015), and accelerate the legitimation of the emerging governance practices and institutions that should facilitate this process of harmonizing stakeholder interests and ensuring long-term sustainability. Furthermore, as "incomplete contracting requires more negotiation among actors ex-post, […] process issues and behavioral approaches will become more salient as well" (Huse et al. 2011: 6). Yet, while these issues become more salient, they remain outside the scope of the theory, and therefore the process through which the harmonization could be achieved remains somewhat mysterious.

Furthermore, the theory assumes that all the actors involved have a clear understanding of what their interests are, and that the problem is essentially one of conflict of interests, rather than of collective decision-making. Nevertheless, in many of the novel governance challenges outlined above, actors operate in a context of uncertainty and ambiguity, and they are often struggling to figure out what their interests in the matter really are. Under conditions of ambiguity, the key governance challenge is not one of monitoring and accountability, but rather one of creating opportunities for actors to explore emerging issues, understand the impact they can have for them, and deliberate which actions the corporation should take.

In sum, while recent efforts in corporate governance research are slowly accepting the idea that corporate governance is fundamentally a political process, their interpretation of what political means is rather limited. To explore how corporate governance could be more thoroughly political, I turn now to an historical survey of the corporate governance model through a political lens.

3 The historical evolution of corporate governance models: from family to management, to public governance

It was customary for agency theorists and contractarian theorists of the firm to refer to Berle and Means (1932)'s prescient observation in the *Modern Corporation and Private Property* that, because of increasing ownership fragmentation, the management of the firms had been divorced from its ownership and this separation was enabling management to pursue "prestige, power, or the gratification of professional zeal" (Berle and Means 1932: 122), rather than corporate profitability. This pathology was not the only, and perhaps not even the most important concern of Berle and

Means. As Mizruchi (2004) clarified, "Berle and Means' concern about the separation of ownership from control was not only about managers' lack of accountability to investors. It was also a concern about managers' lack of accountability to society in general."(Mizruchi 2004).

> The rise of the modern corporation has brought a concentration of economic power which can compete on equal terms with the modern state… Where its own interests are concerned, it even attempts to dominate the state. The future may see the economic organism, now typified by the corporation, not only on an equal plane with the state, but possibly even superseding it as the dominant form of social Organization. The law of corporations, accordingly, might well be considered as a potential constitutional law for the new economic state, while business practice is increasingly assuming the aspect of economic statesmanship (Berle and Means 1932: 357).

Their main concern thus was with the concentration of power, rather than with the danger managerialism posed to the fate of the corporation, and with the search for arrangements that maximized the welfare of the community, rather than the ones on owners or managers. Community, and the common good, were more important than both property rights and control: "Neither the claims of ownership nor those of control can stand against the paramount interests of the community. […] When a convincing system of community obligations is worked out and is generally accepted, in that moment the passive property right of today must yield before the larger interests of society" (Berle and Means 1932: 31X).

This reading of Berle and Means (1932) is consistent with the work of Gomez and Korine (2008), who start from the premise that "corporate governance is but a particular case of the much more general subject area of modern governance" (Gomez and Korine 2008: 307), and focus on what makes corporate governance arrangements legitimate. They start from the philosophical foundations of modern liberalism, and interpret the historical evolution of corporate governance arrangements through this lens. From this perspective, the key question is one of legitimacy: "what gives the right to direct a corporation?" (Gomez and Korine 2008: 18). As in political governance in a liberal society, they argue, corporate governance key challenge is to generate cooperation and a cohesive organization by harnessing the freedom and autonomy of the individuals who contribute and are affected by it. As legitimate democratic governance is achieved when the freedom citizens enjoy does not translate into tyranny over the rest of society, legitimate corporate governance requires a balance between the freedom of entrepreneurial direction and its democratic control, which ensures it will benefit all of society. Thus, legitimate corporate governance regimes always result from the balancing of two forces: the entrepreneurial one, which provide autonomous impetus and direction to corporate activity, and a counterweight which limits its scope, preventing concentration of power and ensuring that corporate activities do not result in harms to society.

In their historical survey of corporate governance models, Gomez and Korine (2008) went beyond the traditional periodization, and distinguished three models: familial governance, managerialist governance, and public governance. Under familial governance, which goes from the institutionalization of the corporate persona until the 1920s, the individual founder-entrepreneur maintained full control of the corporation, and shareholders played a passive role as providers of funds, with little influence on the entrepreneur. Even in this model, where apparently the entrepreneur had complete control over the corporation, their power was constrained by a countervailing institution: the family. The 1800s bourgeois family emerged during that time as a central institution in society, and in corporations the family metaphor extended also to the employees of the corporation, and to its internal organization. Under this governance model, the entrepreneur was not solely accumulating wealth, but ensuring the long-term viability of the corporation and the family associated with it. Embedding the corporation in the family institutions, the authors suggest, was the key source of legitimacy under this model.

Managerialist governance, which started to emerge in the 1920s and lasted until the 1970s, is usually associated with the need to finance ever larger industrial projects, and thus a growth in the shareholding base that could not be managed by pre-existing familial governance models (Chandler 1990). In addition to these exogenous factors, Gomez and Korine (2008) suggested that this process was facilitated by an endogenous process: the disintegration of the family ideology as the principle legitimating family control. As the bourgeois family lost its status as a role model for society, it could not operate anymore as a legitimate counterweight to the power of the entrepreneur.

As corporations grew in size, a new cadre of managers with technical skills and abilities took the reins of corporations from the founders/owners who were not seen any more as the most legitimate actor to guide corporate actions: the entrepreneurial force was now in the hands of managers. Shareholders, who were not a central actor under familial governance, remained at the periphery of corporate governance, and labor unions became the main counterweight to managerial power, with the state arbitraging between them. The German corporate governance law of 1915, which introduced mandatory employee representations on the corporate supervisory boards, can be interpreted as a legal interpretation of the dominant managerialist governance model of the time.

The economic shock of the 1970s, the increasing financialization of the economy, and the declining legitimacy of bureaucratic technocracy and of labor unions, contributed to the legitimacy crisis of managerialist governance, and the rise of shareholders as the torchbearer of the entrepreneurial function. Agency theorists undoubtedly played an important role by crowning shareholders as the most legitimate “entrepreneurial” force to ensure the long-term survival of the corporation. But while they might have thought they were just swinging the pendulum back towards ownership, after a temporary managerialist delusion, most historical reconstructions suggest that they were ushering in a new era in corporate governance: it is only in the 1970s that shareholders acquired that central role in corporate governance which is taken-for-granted today!

In this model, financial markets take over the entrepreneurial function from management. Even if shareholders are not ultimately taking strategic decisions, financial markets provide a continuous real-time test of these decisions, and CEOs need to carefully listen to their signals. Shareholders are not homogeneous though, and we can distinguish a group of active shareowners, who directly engage in corporate governance, from more passive and fragmented investors, who refrain from engaging in governance but can still influence corporate behavior through their trading decisions. Despite, or perhaps especially because of, the diversity in interests and view of shareholders, one of the key features of democratic corporate governance is the public provision of standardized information to financial markets. The drive towards transparency that corporations have experienced since the 1970s offers a stark contrast with the secrecy (or rather the highly valued discretion) of familial governance, and the limited circulation of information under managerial governance.

The continuous public provision of information enables the shareholders' exercise of the entrepreneurial function, but also nurture a growing system of a novel countervailing force. If shareholders are now exercising the entrepreneurial function, who functions now as a counterweight? Gomez and Korine (2008: 220) suggest that public opinion, intended as the media manifestation of the "collective sentiment of broader society" has become the new counterweight. Thus corporate issues such as executive pay, internationalization strategies, environmental impact, and international taxations are debated by citizens, and financial markets have become particularly sensitive to reputational crisis (Durand and Vergne 2015; Kölbel et al. 2017; Lange et al. 2011).

The empirical evidence on the role of media in corporate governance supports the idea that public opinion is central to governance processes. Media contributes to monitoring by operating as watchdog, helping identify cases of accounting and governance malfeasance, but also by deterring it through reputational mechanisms (Dyck and Zingales 2002). Management research has established how media coverage can shape strategic change trajectories (Bednar et al. 2013), IPO's legitimacy (Rindova et al. 2006), and the impact of social movement protests on corporate value (King and Soule 2007).

While the role of the media and centrality of public opinion is relatively well established, this emerging public governance model is still under construction. Gomez and Korine (2008) suggest that transparency of information, representation, and debate, are the key feature of this governance mode, but they fall short of explaining how representation and debate would unfold in practice. Also, while they provide a theoretical rationale for why a democratic corporate governance form is more *legitimate*, their theory fails to explain why it would be more *effective*. To address these limitations, we need to turn to the literature on deliberative democracy, which can provide a useful model for the construction of democratic corporate governance institutions and practices

4 Towards deliberative corporate governance

Political philosophy has long recognized that democratic governance is more than just the aggregation of individual preferences (Knight and Johnson 1994), and that deliberation, that is the process by which "individuals sincerely weigh the merits of competing arguments in discussions together," (Fishkin 2009) plays a crucial role in democratic processes:

> Majority rule, just as majority rule, is as foolish as its critics charge it with being. But it is never *merely* majority rule […]. The means by which a majority comes to be a majority is the important thing: antecedent debates, the modification of views to meet the opinions of minorities […]. The essential need, in other words, is the improvement of the methods and conditions of debate, discussion and persuasion.(Dewey 1984: 365)

Deliberative democracy refers to political decision-making rules where policies "are produced in a process of public discussion and debate in which citizens and their representatives, going beyond mere self-interest and limited points of view, reflect on the general interest or on their common good" (Bohman 1997: 5). Scherer and Palazzo (2007, 2011) were the first to apply these principles to corporations, especially Multi-National Corporations, to responsibly and legitimately exercise their global political role, as states progressively lost regulatory power in the wake of globalization. Scherer et al. (2013) suggested that political CSR was only the first steps towards the democratization of corporate governance, which they consider necessary to maintain the legitimacy of corporations.

While deliberative democracy is a vast area of research in political philosophy and political science (see Bächtiger et al. 2018 for a recent survey of the field), its most influential treatment is grounded in the work of the German philosopher Jürgen Habermas. In "Between Facts and Norms", Habermas (1996) develops a model of democracy distinct from the dominant liberal and republican models, shifting the focus from the formal processes through which public opinion is expressed (voting), to the informal discursive processes through which public opinion is formed. Habermas (1996) distinguishes two realms of politics in society. The formal one, in which collective decisions are taken, is the traditional mix of institutionalized politics in parliaments, governments, political parties, and elections. The informal one is a more complex network of civil society organizations, movements, and arenas where all members of a political community engage in debates, forming opinion on various matters that eventually will translate in political decision. Deliberative politics, he argues, "lives off the interplay between democratically institutionalized will-formation and informal opinion-formation" (Habermas 1996: 308).

Why would we expect actors to participate in these deliberative processes? For Habermas (1996), participation stems from humans' propensity to engage in dialogue with fellow humans and to coordinate group's action through discourse: a form of action he called *communicative action* (Habermas 1984). In *strategic* action, individuals are oriented towards their individual successes, their actions are reduced to purposive interventions in the world, following rules of rational choice, and revealing a strategic attitude, i.e. they aim to influence the behavior of their opponents in the actor's benefit. By contrast, in *communicative action*, "the agents involved are coordinated not through egocentric calculations of success but through acts of *reaching understanding*. In communicative action participants are not primarily oriented to their own individual successes; they pursue their individual goals under the conditions that they can harmonize their plans of action on the basis of common situation definitions. In this respect, the negotiation of definitions of the situation is an essential element of the interpretive accomplishment required by communicative action" (Habermas 1984: 285). As such, communicative action essentially aims at eliciting rationally motivated consensus,[1] i.e. agreement that is not based on calculations of individual benefits but on the power of arguments.

Habermas's (1984) conceptualization of communicative action points to a fundamental difference in assumptions between a deliberative democracy approach, and both agency theory and stakeholder theory: the latter's reliance on self-interested strategic action as the only form of action. Communicative action is also the reason deliberative democracy is not only justified in terms of legitimacy, but also on epistemic grounds. That is, deliberative democracy produces better decisions because, in principle, these decisions are not the outcome of weighing preferences based on interest, but of a process of weighing arguments and collectively assess which course of action might improve the common good.

Beyond Habermas's (1984) initial conceptualization, the political science debate on deliberative democracy has led to identify a number of conditions that are necessary for this process to work: access to information for all participants, representations of all the major positions, sincere weighing of the merits of the arguments, and equal considerations of all positions (Fishkin 2009: 34). Other perspectives relax these procedural conditions, and consider deliberation "a dialogical process of exchanging reasons for the purpose of resolving problematic situations that cannot be settled without interpersonal coordination and cooperation" (Bohman 1997: 27). What remains crucial across these perspectives is the idea that democratic processes are not limited to techniques to aggregate preferences but should extend to the conditions under which these preferences are formed.

But what would deliberative corporate governance look like? I believe that deliberative corporate governance can provide a theoretical lens to make sense of the numerous experiments in democratizing corporate governance which are already happening. To better illustrate how deliberative governance might work in practice, I will rely on a recently published study of the shareholder engagement process on the issue of climate change between the Interfaith Center for Corporate Responsibility (ICCR) and Ford Motor Company between 1998 and 2009 (Ferraro and Beunza 2018).

5 An illustration of deliberative corporate governance: shareholder engagement between ICCR and FORD

Shareholder engagement is a form of shareholder activism (Goranova and Ryan 2013), whereby investors directly engage with the top managers (and board members) of the corporations in which they invest. While most forms of shareholder

[1] The term "consensus" masks an important ambiguity: for Habermas (1984), making oneself understood to someone else and reach an agreement with someone are two sides of the same coin: "reaching understanding (*Verstiindigung*) is considered to be a process of reaching agreement (*Einigung*) among speaking and acting subjects" (Habermas 1984: 287). Communicative action thus aims at achieving understanding with regards to the situation and the planned course of action.

activism aim at increasing shareholder value, shareholder engagement, while still justified from a fiduciary duty perspective, aims at changing corporate policies on Environmental, Social and Governance (ESG) issues (Goodman and Arenas 2015). Originating in the 1970s, after a successful lawsuit against the SEC position that corporations could omit social issue proposals from their proxy statements, this practice was only used by few actors primarily in the US (CalPERS, CalSTRS, TIAA-CREF) and the UK (Hermes) until the growth of responsible investing in the 2000s (Arjaliès 2010; Sjöström 2008; Yan et al. 2018) led mainstream investment managers such as Blackrock, Invesco and many others to adopt it.

As the practice diffused, academic research has been called to evaluate its effectiveness in changing corporate policies. Most of this research tends to focus only on the publicly visible part of the engagement process: the filing of shareholder resolutions. Not surprisingly, studies focused on proxy proposals do not provide consistent results: some studies show positive outcomes such as disclosure of greenhouse gas emissions (Reid and Toffel 2009), and superior environmental performance (Lee and Lounsbury 2011). Other studies suggest that shareholder resolutions reduce corporate social performance, as firms divert resources away from it to invest into political activity to defend themselves (David et al. 2007). The literature tends to assume that the effectiveness of engagement depends on the reputational threat shareholders exercise in the process. This mechanism is consistent with the evidence in social movement theory on the effectiveness of protests and boycotts (King and Soule 2007), whose effectiveness is mediated by their media coverage (King 2008), and with the evidence that shareholder engagement affects other investors' risk perception (Eesley et al. 2016; McDonnell and King 2013; Vasi and King 2012).

The focus on shareholder resolutions seems to be misplaced, as much of the action in the process seems to be in the private dialogue. One of the few systematic studies of private dialogue shows a correlation between dialogue and improvements in operating performance, profitability, efficiency, and governance (Dimson et al. 2015). Evidence from the engagement process of TIAA-CREF, a large institutional investor in the United States, shows that resolutions are used when investors cannot achieve their objectives through private negotiation (Carleton et al. 1998; see also Becht et al. 2008). The reason appears to be that, as Van Buren (2007) notes, shareholders use the resolution (or the threat of one) "to engage in dialogue with corporate managers and to attempt to effect social change" (Van Buren 2007: 61, see also Logsdon and Van Buren 2009). The reputational threat posed by resolutions, the authors imply, provides activists with access to corporate boards and executives, but this reputational threat is not the causal agents of change in and of itself (see also Goranova et al. 2017 for a model consistent with this interpretation).

Despite this mounting evidence on the role of private dialogue, if the mechanism behind the process is pure instrumental action and reputational threat, it remains unclear why corporate managers should be receptive to private dialogue. Our study of the engagement between ICCR and Ford suggests, in line with the idea of deliberative corporate governance, that the key to effective shareholder engagement lies in a dialogical process which enables the parties to shift from strategic to communicative action, and thus engage in deliberation (Ferraro and Beunza 2018).

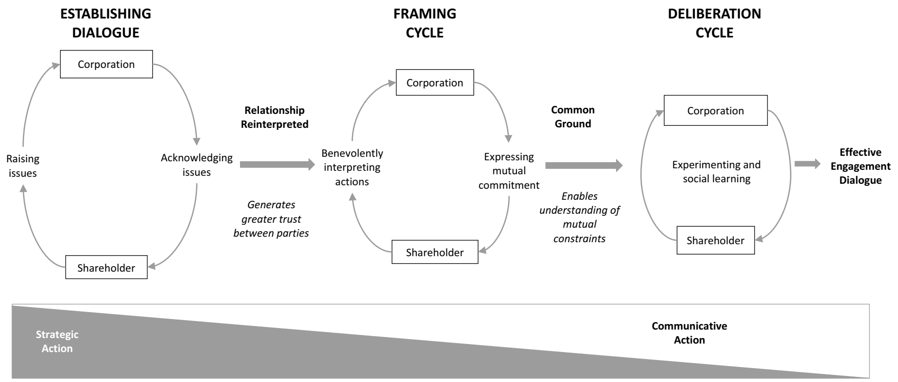

Fig. 1 A communicative action model of shareholder engagement *Source*: Adapted from Ferraro and Beunza (2018)

To understand why private dialogue works, we conducted a longitudinal comparative study of the engagement of ICCR with both Ford and General Motors (GM) on the issue of climate change (Ferraro and Beunza 2018). Ford and GM were very similar across many dimensions, and their position of climate change was very defensive, to the point that both companies were financing a climate change denialist lobbying group (the Global Climate Coalition). Indeed, our analysis started with the shareholder proposals filed to request the two companies to stop funding GCC. The ICCR engagement team was the same, led by Sister Patricia Daly, a nun with the Sisters of Saint Dominic of Caldwell, New Jersey, and director of the Tri-State coalition for Responsible Investment. Yet, despite the initial similarities, the trajectories of the two engagement processes and their outcomes diverge widely, with Ford becoming the US automotive leader on climate change, and GM remaining a laggard on the issue. What explained these outcomes? We show that the difference was in the process, and the mechanisms that led to a successful engagement in Ford case can be interpreted through the lens of deliberative governance. We identified three cycles of interactions between ICCR and Ford, as shown in Fig. 1.

In the first cycle, the two parties initiate a transformation of the relationship from adversarial to collaborative. The exchange in these early stages are purely discursive, with one party raising an issue and the other simply stating that they will be willing to consider it, and yet, we argue, this reciprocal process generates trust in the potential for the relationship to lead to more concrete changes. Trust is crucial, as governance processes evolve over a relatively long cycle, which sometimes goes beyond the tenure of individual managers in both investors and corporations.

The second cycle, is a creative process of identifying a novel frame for the issue, which can operate as a common ground (Clark 1996; Cornelissen and Werner 2014; Loewenstein et al. 2012) for the parties to explore solutions. In the case of ICCR and Ford, this common ground was the idea of “climate risk,” which acknowledged the societal importance of climate change, but reframed it as a corporate risk priority, which makes it possible for corporate managers to explore solutions within existing processes. Once a common ground has emerged, parties have a common understanding of the situation, and thus a deliberative process can ensue. Deliberation has an important experimental component, as it enables parties to explore possible solutions and identify novel, creative ones. In our case, the minutes of the meetings between ICCR and Ford show evidence of collective learning on the challenges of designing and marketing a hybrid vehicle. This learning, over time, translated into better decisions for Ford, and thus ICCR and Ford achieve their goals of reducing climate risk for Ford.

Without a deliberative lens, the whole process would be difficult to understand as neither Ford nor ICCR entered it with a clear understanding of the climate change issue, nor with much clarity on whether specific actions on climate change by Ford's management would further or hinder their interests. A deliberative model of shareholder engagement, we suggest, would help researchers go beyond the reputational threat mechanism, and explain why despite the important role media exposure plays as a reputational mechanism, most institutional investors prefer to be discreet about their engagement activities. Of course, this case also suggests that unlike deliberative democracy, deliberative corporate governance might not be conducted under the same norms of publicity, and a key challenge in designing these institutions will be to define the proper scope of inclusiveness.

6 Conclusions: putting deliberation at the core of corporate governance

A deliberative governance approach is not limited to further our understanding of shareholder (and stakeholder) engagement (See also, Gilbert et al. 2011; Mena and Palazzo 2012; Unerman and Bennett 2004), but represent a first step towards the development of a theory of corporate governance (and implicitly of a theory of the firm) that can better address the challenges we face in a world characterized by both financialization and deep social concerns about the role of corporations in society.

From a theoretical point of view, deliberative governance address both the major shortcoming of the current theoretical development in economics and finance, and the limitations of the historical approach of Gomez and Korine (2008). In relation to the former, deliberative governance offers ideas for the design of the political institutions and practices that should accompany the incomplete contracts approach (Zingales 2000). This approach puts politics at the core of corporation, as shareholders are not automatically in control of corporation, and therefore deliberative bodies such as the board of directors become more political. Yet, the politics implied in this model focuses on the aggregation of preferences, rather than on their formation.

Gomez and Korine (2008) public governance contributed the idea that public opinion plays a central role in corporate governance, but likewise lacked a theory for how public opinion is formed, and how to "better" guide its formation. If shareholders, as they suggest, are now the guiding entrepreneurial force in the global economy, as their decisions ultimately shape management's strategic decisions, which governance processes should they put in place to ensure long-term value creation? How can the emerging debates around social and environmental challenges be organized so that we can better understand the issues, identify solutions, and implement them in corporations? Deliberative corporate governance might provide a set of principles to design these governance practices.

For instance, Annual General Meetings (AGM) should be redesigned to include more stakeholders, and create more spaces for actual deliberation, beyond the current voting on existing proposals. Critics might argue that these decision-making bodies cannot become more deliberative, as the matter discussed are too technical and lay stakeholders would neither be able to understand, nor contribute to the deliberation. Yet, this criticism, and similar ones that have been raised in relation to deliberative democracy, stems from the fact that current governance institutions might not provide yet the transparency and access to information and expertise necessary to engage in deliberation. In principle, there is no reason why better informed stakeholders with a strong commitment to the long-term viability of the corporation should not be able to engage in a deliberative process with the management on any key strategic issue.

A deliberative corporate governance approach would also contribute to bring ethical issues to the front of the governance discussion. Lacking a language and practices to discuss ethical issues, current governance practices tend to either treat these issues from a purely legal view (compliance), or shift the issue at the individual level, whereby individual values and character are the main barrier against malfeasance. In the dominant corporate governance theories there is little guidance on how a board of directors could structure an inclusive debate on the ethical consequences of corporate decisions. Ethical issues can only be addressed once corporations introduce deliberative processes whereby "messy" political and ethical issues can be debated.

Beyond corporate malfeasance, the deliberative governance approach I sketched is consistent with various calls for conceptualizing management theory from a pragmatist foundation (Farjoun et al. 2015; Ferraro et al. 2015; Wicks and Freeman 1998) especially as corporations are increasingly asked to help address grand challenges in society. Pragmatism thinking in organizational theory has emphasized problem-solving and collective learning under conditions of complexity and ambiguity. This pragmatist foundation make deliberative corporate governance particularly suited to address the grand challenges that corporations are increasingly asked to face: climate change, poverty, and inequality, among others.

In conclusion, some could object that adopting a deliberative governance approach would take corporations towards dangerous forms of corporate governance populism, where masses of short-term oriented stakeholders will take the reins of corporations, and jeopardize their long-term viability. Of course, any form of deliberative governance, but more broadly any form of democracy, requires a dose of trust in human abilities to raise above their immediate interests. Writing in 2018, when nationalist and populist parties are in government in the United States, India, Poland, Hungary, and Italy (just to name a few countries), it would be wise to consider the possibility that our political institutions lost legitimacy because they failed to include its citizens in deliberating over important decisions, and ultimately it was too little deliberation, not too much that opened the door to populism.

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