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The Role of Bi-Level Social Networks in Building Mass Consumer Finance Markets in Russia

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Economic sociology boasts substantial literature documenting the presence and importance of social ties in enabling and facilitating exchange in contemporary markets (e.g., Baker 1984; Granovetter 1985; Uzzi 1996; White 2002). But this literature is lacking in two important respects: (1) only a few of these accounts address the ties connecting sellers and consumers (and those that do are usually limited to small business and venture capital banking, see, for instance Uzzi 1999 and Mizuchi/Stearns 2001); and (2) to the best of my knowledge, none of these sources claim that networks are essential in constituting *mass* markets.

The first oversight reflects a more general trend in economic sociology (at least its structural wing) of placing the center of its intellectual gravity in matters of production rather than consumption. The second is at least in part indicative of the usual way in which networks are theorized – as a set of ties connecting nodes of the same level (either individual actors or organizations). I am going to demonstrate that when conceived of as ties that link both firms and actors, networks have been playing a key role in bringing about the mass consumer finance market in Russia.

The material for this article is part of the author's forthcoming book on the emergence of the Russian credit card market. Empirical data comes from fieldwork in Moscow, Russia in 1998-1999 and 2003-2005, which included interviews with representatives of banks, bank associations, companies that process card transactions and credit card networks, participation in card-related conferences and workshops, analyses of bank materials, industry publications and current periodicals.

The Twin Problems of Uncertainty and Complementarity

What do credit card markets teach us about consumption and the role of networks in constituting mass markets?

Emerging credit card markets are faced with two problems, uncertainty and complementarity (Guseva 2005). Uncertainty is the problem that exists in many markets and may even be ubiquitous in all markets (Beckert 1996), so I won't elaborate on it beyond what is obvious: that issuing a credit card (or extending a loan, more generally) is a beginning of a long-term relationship between the bank and the client, and lenders are uncertain about the repayment of borrowed amounts.

The problem of complementarity warrants a closer look. Economists and management scholars postulated the existence of demand-side increasing returns (DSIR) markets, where the value of each additional product to consumer increases with the number of items already in use by others (Katz/ Shapiro 1985; Saloner et al. 2001). Examples of such markets include markets for telephones, faxes and other means of communication that presuppose connectedness and compatibility. For example, owning a telephone if none of your friends or acquaintances owns one is useless, but getting one when there are others you can call is beneficial since you are joining an already existing group of users. In addition, each additionally produced (and purchased) device increases the value of owning the already existing ones. In other words, phone owners continue reaping benefits from owning their devices with each additional phone user added to the group. Once the number of users reaches a critical mass stage (Granovetter 1978), new members start joining in a snowballing fashion. The network starts growing on its own, attracting new members by virtue of its sheer size.

This logic is applicable to emerging credit card markets as well, except that there the value of owning a card does not increase directly with the number of those who

already have cards, but indirectly: more cardholders means that more merchants would be willing to accept cards, and this, in turn, will attract more individuals to sign up to become cardholders. Credit card markets are therefore two-sided markets (Rochet/ Tirole 2004; Rysman 2006; Armstrong 2006): markets that through an intermediary (in this case, a bank that issues cards) connect two groups, merchants and consumers; each of the groups is sensitive to how well the intermediary performs in the other one.

Cardholders and merchants are said to be mutually complementary, as one group cannot function without the other, and the growth in each group makes joining the other one more attractive (Milgrom et al. 1991). The two groups have to be recruited simultaneously; reaching a critical mass stage by one group sends a positive feedback to the other group and encourages more of them to join. Therefore, no cardholders – no merchants, and vice versa. Unless the vicious circle is broken, the market simply would not take off. Once a positive feedback is received, numbers of cardholders and merchants start growing in a complementary fashion: “As more consumers have a particular card brand and more merchants take that card brand, it becomes harder and harder for other merchants *not* to take that card brand” (Evans/Schmalensee 1999:151, emphasis is mine).

Quite paradoxically, the two problems, complementarity and uncertainty, seem to require contradictory solutions (Table 1). The problem of uncertainty requires careful pre-screening, and it can be time-consuming (if pre-screening uses experts to conduct in-depth analyses of prospective borrowers’ cases); thus, it only allows for a slower market expansion. In addition, pre-screening narrows down the pool of potential applicants by weeding out “poor risks,” and yeilding a smaller number of “suitable” cardholders. Slower market expansion and smaller pool aggravate the problem of complementarity. In other words, careful screening prevents card issuers from quickly reaching critical mass of cardholders necessary for getting merchants’ interested, and therefore, from achieving positive feedback and ultimate market success. Moreover, in emerging markets, which usually lack necessary formal institutions such as credit bureaus, lenders have to resort to social networks to pre-screen and monitor prospective borrowers. This sets natural limitations on the size of the issuers’ clientele and further prevents lenders from solving the problem of complementarity. If one *is* too careful in screening, the market

might never develop. On the other hand, if one is *not* too careful and issues cards quickly but indiscriminately in an attempt to solve complementarity, market expansion can bring ruin: card issuers might be faced with mounting defaults and fraud.

	<i>Uncertainty</i>	<i>Complementarity</i>
<i>Solutions</i>	Careful pre-screening	Quickly issuing cards <i>en masse</i> in order to attract merchants
<i>Consequences</i>	Smaller pool of potential customers, slower market expansion	Card issuing in the absence of pre-screening aggravates the problem of adverse selection, and can jeopardize future economic soundness of the market

Table 1. Contradictory solutions to uncertainty and complementarity problems in an emergent credit card market

Card issuers in emerging markets have to carefully balance between these two competing pressures – to jumpstart the market and to control uncertainty. Of the two problems, complementarity is temporary. It is only important initially and becomes irrelevant once the card acceptance network is established and the demand for cards becomes self-generated. Card issuers always strive to issue more cards, but in established markets this becomes part of the usual market competition. Unlike the complementarity, the challenge of uncertainty is permanent. As much as it has to be solved by each new debutante on the card issuing scene, existing card issuers are also regularly revising their screening and monitoring approaches to react to market changes, to accommodate their new products or to appeal to new consumer groups.

Why Has Consumption been Downplayed in Economic Sociology Literature?

Recent surge of interest in the study of concrete markets among economic sociologists ranges from industrial production markets (White 1981; Burt 1992; Fligstein 2001; Podolny 2005), to biotechnology (Powell et al. 1996; Podolny 2005) to labor markets (Granovetter 1995[1974]; Fernandez et al. 2000; Yakubovich 2005), to financial exchange markets, such as securities and stock and bond markets (Baker 1981; Abolafia 1996; Zuckerman 1999; Knorr-Cetina/ Brugger 2002; Mackenzie/ Millo 2003; Podolny 2005), and even markets for art, photography, wine and book publishing (Powell 1985; Aspers 2001; Podolny 2005; Velthuis 2005).¹ But hardly any attention has been paid to the problem of constructing consumer demand. In this sense, most economic sociologists are not much different from neo-classical economists who assume that firms and markets emerge in response to existing niches. For example, Swedberg (2005) in the recent edition of *The Handbook of Economic Sociology* discusses Harrison White's position on the social construction of markets: "If businessmen are correct in their calculations, they will be able to locate a niche in the market for their products, which their customers acknowledge by buying a certain volume at a certain price" (Swedberg 2005: 245; see also Zuckerman 1999 for a critique of a position that ignores consumer side). The irony of such a position is that the argument about social constitution of markets is made with an assumption of consumer demand existing objectively and independently, waiting to be tapped by an entrepreneur with a vision. White's own words establish the focus of his work even more squarely away from demand and consumption: "Markets are tangible cliques of producers watching each other. Pressure from the buyer side creates a mirror in which producers see themselves, not consumers" (1981: 543).

Competition is undoubtedly the essence of the market that distinguishes it from other ways of organizing economic activity. Nevertheless it is a mistake to think of markets exclusively through the prism of producers struggling for a bigger market share. While this project focuses mainly on the banks' vision of the market, its problems and ways to solve them, what I hope to demonstrate is that consumers' collective behavior decides the shape and the ultimate fate of the market, and that

they should not be downplayed as mere objects of banks' competition.

Traditional emphasis on production "with no more than occasional gestures towards consumption" (Zelizer 2005: 332) reflects a deep-seated problem in contemporary sociology. Frenzen, Hirsch and Zerillo attribute it to the historic context in which both economics and sociology developed – a period "when the industrial production was still young and manufactured goods were still commodities for which consumer demand greatly exceeded the available supply," resulting in scarcity and allowing to take high consumer demand for granted (Frenzen et al. 1994: 403). But modern production capacities outstrip consumers' ability to consume, isolating the problem of demand and bringing it to the forefront.

Ezra Zuckerman (1999) raises the issue of consumer demand in his work on securities markets – mediated markets, where demand depends on financial analysts' perceptions of different products. They are the main shapers of demand even though it is mass consumers that eventually buy securities, and it is to these market critics that producers pay the most attention. Zuckerman's main question is how consumers evaluate alternative products on the market, and his answer is that they rely on critics, who legitimize them and put them in appropriate categories of already existing products.

While Zuckerman engages with a problem rarely addressed by economic sociologists, his work reflects another prevalent trend in the literature, namely the focus on the functioning of already existing markets, rather than on the process of emergence of entirely new markets. Even a couple of sociological studies with promising titles, like Harrison White's *Where Do Markets Come from?* (1981) or Mitchell Abolafia's *Making Markets* (2001) concentrate exclusively on what existing markets are rather than on how new markets are built. As a result, there is little opportunity to ask a question of how producers generate demand for entirely *new* products – those that cannot be easily fit into an existing category.

In established markets, the problem of consumer demand shifts to product differentiation. For instance, it is no longer necessary to build consumer demand for credit cards in the United States market. Strong consumer demand exists for this category of products. They have been long established as the instrument of everyday use, enabling such long-distance transactions as car

rentals, hotel bookings and Internet purchases. Yet, different card issuers (banks or multinationals) are competing within the accepted category of cards, offering various perks in order to entice consumers to switch to their particular card brand or a specific card product.

It is in new emerging markets that the problem of building consumer demand can be particularly acute. Viviana Zelizer's work (1978) on the rise of life insurance in the 19th century America explicitly addresses the problem of initial consumer resistance to an emergent market. Potential consumers of life insurance considered it culturally unacceptable to put a price tag on human life. Life insurance policies challenged the prevailing distinction between sacred (life) and profane (monetary value), and exemplified the difficulty of building demand for a new product. What eventually made life insurance sell was the process of "sacralization" – "the transformation of the monetary evaluation of death into a [secular] ritual" (1978: 605). The notion of "good death" started to involve financial arrangements for family members left behind. Life insurance money was portrayed as a source of remembrance and a way to achieve immortality in the eyes of living relatives. This was a cultural solution to the problem of constituting demand. New cultural frames helped change initial negative perceptions of life insurance (see also Chan 2006 on the rise of life insurance in China).

In the case of the Russian credit card market, one sees similar obstacles and more. In addition to cultural resistance, such as distrust of banks, traditional reliance on savings and cash to pay for purchases, and informal no-interest borrowing from friends and family, there was also strategic resistance, namely the barrier of complementarity. Not only were prospective Russian consumers wary of or uncomfortable with non-cash payments or bank-procured credit, but they were also resistant because there were still too few merchants (or merchants of a wrong kind – large hotels and high-end boutiques) accepting cards. Merchants, in turn, were reluctant to sign up, waiting for consumers to obtain cards first.

How Networks Help Build Mass Markets

Historically, while social networks were the skeleton of local exchange, as mass national markets emerged, networks started to break down under the pressure of

greater geographic, social and cultural distances between transaction parties. They were replaced by other forms of governance, such as formal institutions and professions that enabled transactions between strangers sharing little or nothing in terms of social circles or culture (Zucker 1986).

My argument is that in Russia networks help construct mass markets thanks to their unique ability to help sellers both access and assess their prospective consumers. The reason that traditional approaches to networks are unable to account for the presence of networks in mass markets is that the analysis is always restricted to relations between nodes of the same level – individuals or organizations (either informal interpersonal relations between producers/ entrepreneurs or power/ property relations between firms, on the latter point see Stark 1996), never combining the two. Moreover, interorganizational ties are often reduced to interpersonal ones (through interlocking directorates, for instance). When some scholars allow for the variability in the type of the tie (Granovetter 1985; Powel et al. 1996; Uzzi 1996), relations are still between nodes of the same level. Yet, such uni-level networks can only capture a partial snapshot of a mass market, which is by definition a market where large firms (organizations) produce goods or services for mass consumption (therefore, for consumption by a large number of individual actors). For instance, an analysis of interorganizational ties between banks and employing organizations does not capture the role that ties between organizations and their employees could play in facilitating card dissemination.

It is precisely when we conceive of networks as combining nodes of two different levels – both organizations and persons, that they can be viewed as contributing to the creation of a mass consumer market. Organizations usually have relationships with large groups of individuals, whether their employees ones or customers ones. If producers can persuade organizations to provide them with access to these individuals, they would instantly reach scores of potential buyers.

Two particular strategies exemplify Russian banks' use of networks in building mass consumer finance markets: salary projects and consumer lending in retail locations. Salary projects are agreements between banks and large or medium-size enterprises to have all their employees' salaries directly deposited to banks, while employees are issued bank debit cards (usually with an overdraft fea-

ture). Salary projects are usually administered to the bank's current corporate customers, but can also be used as a bait to attract new corporate customers. Such salary direct deposit agreements were the principal way of card dissemination in Russia in the 1990s, allowing banks to quickly increase the number of cardholders (Guseva 2005).² However, despite the impressive rate of growth in the number of cards, few cardholders used them for non-cash transactions. The majority made a stop at the ATM first and then headed to stores armed with cash. This deprived banks of merchant discount³ and sabotaged their attempts to solve the complementarity problem (since merchants were not part of the picture).

Thus, even if successful in disseminating cards to thousands of individuals banks could still fail in solving the complementarity problem. Even with cards in their wallets consumers still preferred cash over plastic, and saving over borrowing. Consumer culture indispensable for the success of credit card markets includes willingness to go into debt, willingness to borrow from banks, and readiness to pay interest. If by the time that credit cards appeared on the American stage (in the late 1950s, [Nocera 1994]), American consumers had already developed these dispositions (Nugent 1939; Mandel 1990; Calder 1999), among the Russians, traditional preference for cash and resistance to borrowing at an interest prevailed. Mass distribution of cards in the 1990s, even if looking impressive in VISA reports, was nevertheless failing to prompt a revolution in buying. Arming individuals with cards was not enough to make them spend.

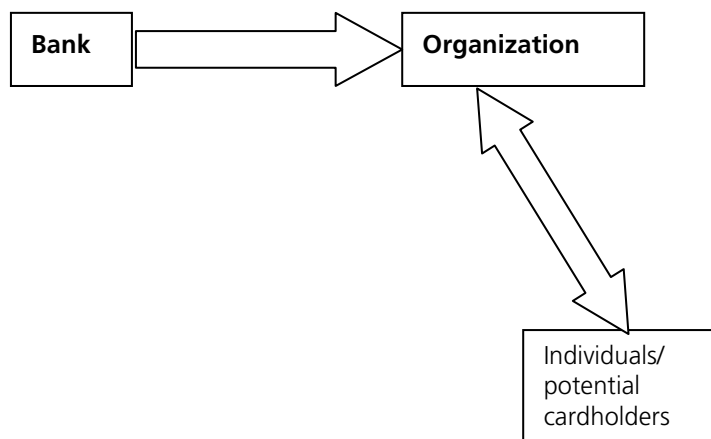
Starting in 2001-2003, Russian banks developed an alternative strategy of mass card distribution – that is of offering credit cards to short-on-cash consumers in large consumer electronics or furniture chain stores or shopping malls. The credit card market benefited from the recent spectacular growth in household lending in Russia, which was a result of the overall economic growth, rising living standards, increasing disposable income, and the expansion of the retail industry.

Unlike salary projects, lending in retail locations brought three parties essential to a credit card market – banks, cardholders and merchants, together in the same place, making individuals interested in cards and available for banks, and making merchants central to consumers' decisions to obtain cards and to use them to shop.

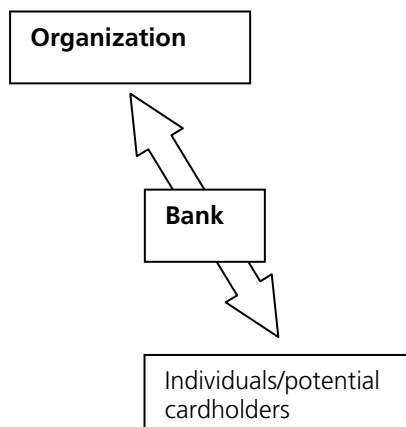
Capitalizing on retailers' ability to attract customers in their shops and in malls utilizes what I call a *locational* benefit of bi-level networks: in order to reach mass customers a company needs to identify a way that they can be targeted as a group. While retailers only assist banks in providing access to prospective cardholders without helping to pre-screen them, in the case of card-issuing through employing organizations (salary projects), employers do not only provide access to prospective customers, but also help banks in managing the problem of uncertainty. In this arrangement, employing organizations amplify the usual ability of social networks to reduce uncertainty by channeling information, and producing greater transparency and trust. Organizational structure anchors individuals firmly in intra-organizational relations, both vertical and horizontal, making it easier to monitor them. I call this a *relational* benefit of bi-level networks.

Only when networks are viewed as tying together both organizations and persons, can we start appreciating how existing roles and relations are recalibrated to assist current needs. For example, an existing relationship between "a corporate bank" and "a firm, which is this bank's corporate client" can be transformed into a relationship between "a retail bank" and "an employing organization that makes its employees available to the bank as potential customers." Likewise, in situations when holders of salary cards could use them in factory-owned stores and eateries, an employer-employee tie is reformulated as tie between a retailer and consumers.⁴

An important question to address is how banks manage to make organizations interested in providing them with access to individuals. Arrangements with retailers can range from zero (banks open their booths in large malls without a specific agreement with any of the stores) to bilateral agreements to issue co-branded cards (usually with large stores, such as IKEA), which also offer various loyalty perks (discounts, promotions, etc.). Salary projects presuppose well-specified agreements signed by both the bank and the employing organization. While in both cases banks start with using organizations as a middleman that provides access or "introduces" them to their potential cardholders, banks end up successfully reformulating their own role as middlemen between companies and individuals (Figures 1 and 2).

Figure 1. Bank Approaches an Organization (Phase 1).

In the case of salary projects, banks offer their services as cashiers regulating wage payments between companies and their workers, and freeing employers from transporting, securing and dispensing cash. In the case of consumer credit projects, banks enable purchases that otherwise would not happen since consumers lack cash, freeing merchants from the need to finance purchases themselves. In contrast to churches or professional societies that also have access to large groups of individuals and could put banks in contact with their members, retailers need banks as much as banks need retailers. Thus, in both cases of consumer credit and salary projects, the arrangements between banks and organizations are framed as mutually beneficial: banks get access to prospective customers, and companies are rid from providing services for which they are not suited professionally.

Figure 2: Bank Positions itself as a Middleman (Phase 2).

These strategies are not limited to emerging markets in transitional contexts. There are plenty of examples of sellers turning to organizations to both reduce uncertainty and facilitate access to mass consumers in modern capitalist societies such as the US. This includes marketing cards on university campuses or next to airline terminals (especially those with mileage programs), relying on lists provided by credit bureaus to send out pre-approved applications,⁵ and selling group insurance policies through employing organizations. In the latter example, employers do not only help insurance companies to access prospective consumers, but also reduce the problem of adverse selection and help them turn uncertainty into quantifiable risk. This suggests that new markets can emerge by capitalizing on already existing markets. Specifically, Russian credit card market has been relying on labor and retail markets.

The idea of analytically tying both organizations and individuals in the same network is borrowed from organizational literature, which treats both of them as actors (Scott et al. 2001), however, downplaying relationships between them. I focus on ties between them because they are sought after by banks and other companies struggling to create new markets. These ties are not necessarily meaningful social relationships like the ones linking friends or colleagues. Organizations, even if they are our employers, usually do not know us intimately, but they possess some information about us, and have a certain degree of control over us. At the very least, we need them to provide services or goods. We come to organizations to fulfill these needs, and this is why our ties to organizations become such valuable assets for market makers that strive to reach their prospective customers. Access that organizations provide can involve different degrees of coercion. For example, applying for a credit card in a store where one just saw an item that is too expensive to be paid for in cash, is entirely voluntary. Employees, on the other hand, have no choice if their administration has signed an agreement with the bank to carry out a salary project at the enterprise.

Conclusion

The task of explaining how the Russian credit card market is being constructed would not be adequately done without a reference to bi-level networks that combine both individuals and organizations. Such networks play a key role in helping build mass consumer markets be-

cause they help banks access and sometimes even assess their potential customers.

In the context of post-communist transition, bi-level networks offer an alternative mechanism of market-building, especially when “right” institutions that support mature markets in the West are not yet available. Rather than conjuring markets out of thin air in an orderly response to perceived opportunities as the neoliberal logic seems to be suggesting, Russian market makers create markets out of the existing fragments of social structure – networks and organizations which are recalibrated and fitted to new uses (Stark 1996; Sedaitis 1998; McDermott 2002).

Bi-level networks expand our understanding of the role of networks in markets, and highlight the need for economic sociology to pay greater attention to the matters of consumption.

Alya Guseva is Assistant Professor of Sociology at Boston University. Her work explores the role of networks, institutions and culture in the development of mass financial markets in the post-communist world. She has published in *American Sociological Review*, *Socio-Economic Review*, *American Journal of Economics and Sociology*, *Social Science Research* and *Theory and Society*. She is completing work on a large collaborative project comparing emerging credit card markets in several countries of East-Central Europe and Asia. Her book *Into the Red: The Birth of the Credit Card Market in Post-communist Russia* is forthcoming with Stanford University Press.

Endnotes

1 For an overview of approaches to markets in neighboring disciplines and current research on markets in economic sociology see Lie (1997), Swedberg (1994) and Swedberg (2005).

2 Prior to the rise of salary projects, salaries were paid in cash and few banks had large household customer base.

3 A percentage of sales merchants pay to banks for the privilege of accepting cards in their locations.

4 Incidentally, this fluidity of roles is one of the socialist legacies when employing organizations did not only provide workers with jobs, but also with recreation, deficit goods, healthcare and daycare, exemplified in particularly in the Chinese “iron rice bowl.”

5 This suggests that besides their traditional function of reducing uncertainty (by assisting in screening, monitoring and sanc-

tioning of borrowers), credit bureaus also help banks gain access to groups of borrowers.

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