

# FINANCIAL MARKETS, MONEY, AND BANKING

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Lisa A. Keister

*Department of Sociology, Ohio State University, Columbus, Ohio 43210-1353;*  
*e-mail: Keister.7@osu.edu*

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■ **Abstract** The study of financial markets, money, and banking is largely considered the purview of economics. Yet sociologists have contributed greatly to understanding financial relations since the early history of the discipline. This review begins with an overview of classical sociological approaches to financial markets, money, and banking and then describes how research in these areas exploded in recent decades. I describe the current state of research on money, relations among firms and banks, and interlocking directorates. I consider the ways financial relations shape firm behaviors and processes, and I describe the growing body of work that treats financial markets as outcomes. I discuss research on the transformation of financial systems during transition from state socialism, and I conclude with a discussion of a growing literature that combines studies of financial markets and social stratification.

## INTRODUCTION

The study of financial markets, money, and banking has again begun to play a central role in sociological research. Simmel, Marx, and Weber all wrote important works on these subjects (Marx 1963, Simmel 1978, Weber 1927, 1978), but sociologists paid these topics little attention after Weber (Swedberg 1993). Between World War II and the late-1970s, only a handful of studies addressed issues related to finance (see, for example, Katona 1957, Lieberman 1961, Merrill & Clark 1934, Merrill & Palyi 1938, Parsons & Smelser 1956, Smelser 1959). Yet, Stinchcombe's *Economic Sociology* (1983), followed closely by Granovetter's (1985) work on embeddedness, began a revival of economic sociology as an important subfield. Since the early 1980s, the study of markets has become increasingly common in sociology, and the study of financial markets, in particular, has emerged as an enormously rich area of sociological research.

Research on financial markets and banking in sociology is diverse, but it is unified by the assumption that a financial market is a social system (Adler & Adler 1984, Baker et al. 1998, Mizruchi & Stearns 1994b). This research spans several major topical areas including studies of money, firms and relations among firms, markets as outcomes in their own right, economic development, transitions from state socialism, and social stratification. Underlying research in each of these areas,

however, is the notion that financial relations are social relations and that a financial market is a structure of ongoing and relatively stable exchange ties among buyers and sellers of financial resources.

In this chapter, I survey sociological research on financial markets, money, and banking. I begin with a brief overview of classical sociological approaches to these subjects, but I focus on modern treatments and more current research. Excellent reviews have already explored research on economic sociology in general (Baron & Hannan 1994, Carruthers & Babb 2000, Swedberg 1990, 1991, Zelizer 2001a), sociological approaches to markets (Lie 1997, Swedberg 1994), and sociological studies of money and financial markets in particular (Baker & Jimerson 1992, Mizruchi & Stearns 1994b, Zelizer 2001b). My objective is to focus more exclusively on the study of financial markets and banking than is possible in a general review of research in economic sociology and to update the focus of previous reviews of research on financial markets. Although I do draw on research from outside sociology, I make no effort to comprehensively represent research from other disciplines.

## CLASSIC APPROACHES TO MONEY AND BANKING

Early sociologists clearly recognized that money has social meaning, and several excellent reviews detail the nature of early thinking in this area (Giddens 1990, Mizruchi & Stearns 1994b, Zelizer 1992, 1994, 2001b). Money is a medium of exchange that has value because members of a society agree that it has value (Tobin 1992). Prior to the development of paper money, market exchange occurred through barter. Money simplified the complexities inherent in negotiating barter relationships and, once its value became accepted, increased efficiency by allowing producers to specialize. Precious metals and other substances that had both use value and exchange value first replaced barter, and eventually paper money became the standard means of commodity exchange. As Mizruchi & Stearns (1994b) point out, the development of modern nation states that were willing to back the value of money was critical to the development of paper money as it is known today. However, it was not until 1863 that the United States adopted a single, unified currency and currency continued to be backed by its value in gold until 1968 (Zelizer 1994).

Among the early sociologists, Simmel (1978) was perhaps most concerned with money itself, and his work influenced both Marx and Weber (Turner 1986). Central to Simmel's discussions of money is the idea that the historical development of money economies in place of systems of barter was part of the movement from *gemeinschaft* to *gesellschaft* (a community based on personal or on impersonal relationships, respectively) relations. Thus, Simmel viewed money as both a cause and a consequence of the prevalence of more impersonal relations. For Simmel, money corrupts and completely transforms social bonds into impersonal, instrumental relations. Marx shared Simmel's perception of money as impersonal, but he emphasized the role that money plays in creating and maintaining alienation. He argued that money is an impersonal method of exchange that has power because it

allows people to control things they otherwise would not control and to be things they otherwise would not be (1963). According to Marx, money will increasingly pervade social life (1964) and create alienated social exchange (1973).

The difference between the use value and exchange value of money was also central to Weber's thinking. Weber (1978) emphasized the consequences of money, including increased indirect exchange, hoarding, the concentration of power, and the growth of debt relations. His notion of money is largely consistent with the notion of money used in neoclassical economics, but he was more somber in his writing about money than most economists. Weber wrote, for instance, that "money is the most abstract and 'impersonal' element that exists in human life. The more the world of the modern capitalist economy follows its own immanent laws, the less accessible it is to any imaginable relationship with a religious ethic of brotherliness" (1971:331).

Early sociologists also addressed issues related to financial markets and the organizations that operate within these markets. In even the earliest writing on financial markets and banking, sociologists conceptualized the market as a system of ongoing social interactions and banks as key intermediaries in these interactions. Yet sociologists also emphasized that the financial market is a source of power and an arena in which corporate control is created and played out (Mizruchi & Stearns 1994b). As a result of rapid economic expansion in the late nineteenth and early twentieth centuries, private bankers routinely supplied capital to entrepreneurs, which established private lenders as both powerful and central to financial markets in the United States and Europe (Lamoreaux 1991, 1994, Smelser 1959). This pattern raised interest among researchers in the concentration of power associated with capital and led many to express concern about the control that access to capital garnered (Bell 1960, Hilferding 1981, Lenin 1975, Weber 1978).

A related body of literature was spawned by Berle & Means' now-classic work on the separation of ownership and control of corporations. Berle & Means (1968) argued that as corporations began to issue stock to raise capital, individuals owned smaller shares in companies. As a result, ownership of the corporation was increasingly separated from the daily control of the firm, which was passed to managers. A number of important critiques of this work as well as studies defending the Berle & Means thesis emerged (Burch 1972, Kotz 1978, Larner 1970, Zeitlin & Ratcliff 1988). Critics charged that stock dispersal allowed banks to control corporations (Allen 1976), while studies such as Larner's (1970) investigation of the largest U.S. companies showed that no single owner controlled more than 10% of a company's stock. The resulting literature fueled interest in corporate governance and the role of banks in the governance of firms (see below).

## MONEY

Sociological research following World War II paid almost no attention to money, financial markets, and banking. An important exception is Parson & Smelser's (1956) attempt in *Economy and Society* to define economic sociology as a subfield.

In this work, Parsons & Smelser viewed money as a mediator between production and exchange, but they also emphasized that money is a cultural object (pp. 106–7) with unique social functions (p. 71). Reminiscent of Weber's distinction between class and status was their point that money has both purchasing power and social meaning. They observed that historically the development of currency was necessarily associated with the erosion of self-sufficient forms of production and the advent of the division of labor. Extending these ideas beyond Weber and foreshadowing Zelizer's arguments that multiple monies are central to advanced capitalist economies, Parsons & Smelser also identified different types of money and defined these in relation to boundaries among various subsystems in the economy.

Indeed Zelizer's work on multiple monies and the social meaning of money has provided the basis for the bulk of recent microlevel research on money in sociology (Zelizer 1993, 1994, 1998). Zelizer's work is unique in its focus on the content of relations and the process by which people encounter and interact with economic processes (1979, 1987). She argues that money is neither culturally neutral nor socially anonymous. Rather, in advanced capitalist economies money has multiple meanings, depending on the nature of the social context in which it is used (1993:197). Zelizer (1994) explored the earmarking of money and the changing nature of money given its context, and she argued that the way money is used also contributes to its meaning. For instance, the recipient of a birthday check is not expected to buy groceries with it. Zelizer (forthcoming-a) ties her own work directly to Smelser's when she proposes an answer to one of Smelser's early questions: How do new forms of differentiation arise and how do they change? Attesting to the similarity of their work, Zelizer finds that the answer lies in the fact that culturally embedded people invent new commercial circuits that fit the needs of the context.

In her recent work, Zelizer has begun to explore in greater depth the meaning of money in intimate relations. She explores the conditions under which people combine intimacy and monetary transactions and concludes that monetary transfers within intimate relations cannot be reduced to another form of market exchange, to the expression of cultural values, or to the product of coercion and power differentials (2000, forthcoming-b). Rather, she decides that people "pour unceasing effort into distinguishing qualitatively different social relationships—including their most intimate ties—from each other by means of well-marked symbols, rituals, and social practices" (2000). Consistent with her former research, Zelizer concludes that in intimate ties, forms of payment distinguish the nature and breadth of relations in which people are engaged.

The work that Carruthers and his co-authors have done on culture and money is similar to Zelizer's work in its microlevel orientation. Carruthers & Espeland (1991) address claims that double-entry bookkeeping increased rationality and furthered the development of capitalist modes of production. They argue that while this accounting method may have increased rationality, the rhetorical side of double entry is also important. In a piece that addresses the social meaning of money more directly, Carruthers & Babb (1996) argue that because people attribute value to a

medium whose physical traits are unrelated to its worth, money is most effective when it is taken for granted. Carruthers & Espeland (1998) are even more similar to Zelizer in their starting point when they argue that the meaning of money is defined by how it is used. Carruthers & Espeland move beyond Zelizer's work, however, to develop a set of systematic ideas for the study of money that incorporate both the origin and destination of the currency. Opportunities for extending and testing these ideas are abundant both historically and in modern conceptions and uses of money.

A related stream of literature with a more macrolevel orientation is Baker's work on the sources of money and its distribution across relations. Baker (1987) asks a question that recalls Zelizer & Carruthers' work on the meaning of money: What is money? But Baker's answer is structural rather than cultural. He emphasizes that a financial market is a social structure defined by interactions among the actors in the market, and he explores power differentials among nongovernmental financial institutions, financiers, and other financial organizations. Baker argues that more powerful actors will be more central, or closer to the core of the network, while less powerful actors will tend to be more peripheral. As a consequence, he proposes that the assets used by those in the core are closest to money. This proposal holds empirically in Baker's test, and these ideas have the potential to inform understanding of the meaning of money in other contexts as well. Baker himself has used a similar notion to understand the euro and the European cultural divide, and similar extensions in other contexts would contribute to a refined and more precise sociological understanding of money (2000).

## FIRMS, BANKS, AND INTERLOCKS

Interest in power and questions about corporate ownership and control have made the relationship between banks and firms one of the most active areas of sociological research related to financial markets. Earlier arguments that banks controlled corporations were questioned by scholars who observed the power managers appeared to have in directing daily operations (Mintz & Schwartz 1985). Mintz & Schwartz's model of financial hegemony, largely a response to these arguments, suggests that banks and other financial institutions have power because they shape the environment in which nonfinancial organizations function and because they reserve the right to intervene in corporate affairs even if they seldom do. Critics of this model have drawn on the widely accepted fact that firms have a "hierarchy of preferences" regarding borrowing and nearly universally prefer to use retained earnings before borrowing (Donaldson 1961, 1969, Myers 1984). This suggests that corporations are not forced to borrow from banks (Baran & Sweezy 1966); rather, they borrow to capitalize on interest rates, tax benefits, and other financial opportunities (Herman 1981, MacKie-Mason 1990, Modigliani & Miller 1963).

This controversy spawned a number of studies of the determinants of firm borrowing. Mizruchi & Stearns (1994a, 1993a,b) argued that firms will borrow when interest rates are low if borrowing is elective, but borrowing will be a function of the amount of cash the firm has available if borrowing is not discretionary.

Consistent with the latter, they have found that firms with high cash reserves borrow less than those with lower reserves at all interest rate levels. They find that firms borrow more when they have a representative of a financial institution on their board, suggesting that the firms' connections with banks are important. They also show that firms that share board members (particularly bank representatives) and other traits (such as CEOs with similar educational backgrounds) are likely to borrow similarly (1999). In a related study of firm capital structure, Baker (1990) demonstrated that the availability of external funds also shapes firm borrowing. He showed, for example, that firms use a number of investment banks to minimize dependence on a single source of funds. Yet as Mintz & Schwartz (1985) argued, it is difficult for corporations to remain independent of banks. Firms tend to rely on several financial institutions for financing, and because these banks typically interact with each other, firms cannot play them against each other.

While the related subject of interlocking directorates was studied from early in the twentieth century (Mizruchi & Stearns 1994b), research on overlapping board memberships did not expand rapidly until the 1970s. In the 1970s and 1980s, researchers showed that interlocks were pervasive and banks and other financial organizations were central to these interlocks (Allen 1978, Davis & Mizruchi 1999, Dooley 1969, Levine 1972, Mariolis 1975, Mintz & Schwartz 1981, Mizruchi 1982, Sonquist & Koenig 1975). An important controversy in this literature was, and still is, whether bank centrality in interlocks necessarily implies power. In the resource dependence view, banks have power because they control resources (Pfeffer 1987, Pfeffer & Salancik 1978). This perspective also anticipates that the firm will try to co-opt the source of the resources to reduce dependence, although this may actually reduce independence because the two organizations then share interests.

Recent evidence suggests that the centrality of banks in corporate interlocks declined precipitously between the early 1980s and the mid-1990s as large firms began to rely less on commercial banks for capital (Davis & Mizruchi 1999). Debate about the influence these ties have on firm outcomes is also the subject of continued debate. Some critics contend that interlocks are not influential because boards of directors actually do little (Galbraith 1967, Herman 1981, Mace 1971). Others point out that ties broken through death or retirement are seldom replaced or reconstituted, suggesting that the interlocked firms are not invested in the relation (Koenig et al. 1979, Ornstein 1980, Palmer 1983, Palmer et al. 1983). Still others have argued that what is more interesting than interlocks with banks is the process by which firms construct strategic choices. The focus should, therefore, be on what the firm does (Fligstein & Brantley 1992).

Acknowledging that firms began to rely less on commercial banks for capital in the 1980s and 1990s gave rise to research on the sources of firm finance. An extensive body of literature in economics documents changes in business finance over the life cycle of the firm (see Berger & Udell 1998 for a thorough overview). This research documents that firm size, age, and access to information shape the sources of firm finance. Very small firms rely on insider finance and angel finance (from high net worth individuals who provide direct funding to new businesses).

For medium-sized firms, venture capital (provided through more formal channels than angel finance) is more common, and larger firms with known track records rely on public equity. From the early stages of firm formation, trade credit and other forms of capital are also important. Berger & Udell (p. 623) illustrate the combinations of capital types that appear across the firm life cycle. Sociologists have begun to contribute in important ways to research on the acquisition of each of these forms of credit, demonstrating, for instance, that firms respond differently to uncertainty depending on its source (Podolny 2001), that firms vary in their experience of the liability of newness (Sacks 2002), and that there are important differences in the institutionalization of financing practices (Suchman 1995) in the venture capital industry. Sociologists have also made important contributions to understanding the acquisition of trade credit (Uzzi & Gillespie, forthcoming) and use of rotating credit associations (see Biggart 2001 for an excellent review).

## FINANCIAL RELATIONS AND FIRM OUTCOMES

While there are many unresolved debates in research on interlocking directorates, there is considerable evidence that interlocks, particularly those involving banks, shape a number of firm outcomes. Highly indebted firms or firms with declining profits appoint more bankers to their boards (Dooley 1969, Lang & Lockhart 1990, Mizruchi & Stearns 1988, Pfeffer 1972, Richardson 1987). Banks whose officers are central to social networks make broader investments than those whose officers are not as well connected (Ratcliff 1980). The type of financial institution on a firm's board affects the firm's capital structure (Stearns & Mizruchi 1993a,b). Firms that share a director make similar political contributions (Mizruchi 1992), and sharing a director increases the propensity that firms will adopt similar takeover strategies or engage in takeovers themselves (Davis 1992, Davis & Greve 1997, Haunschild 1994). Critics charge that it is difficult to decipher cause and effect in these relations. For example, greater debt may lead to more interlocking with banks wanting to track management behavior rather than the interlocks shaping the debt (Fligstein & Brantley 1992). However, recent studies have shown that some of the empirical controversy surrounding the effect of interlocks could be resolved if they are studied as spatial phenomena, distinguishing local from nonlocal (Kono et al. 1998), or in countries where interlocks are less likely to form because a firm is in financial decline (Keister 1998a, Meeusen & Cuyvers 1985).

Aside from the role that interlocking directorates may play, financial relations shape firm outcomes in other important ways. Several studies, for instance, have examined the effect of financial institutions on firm strategies and structures. Early research held that banks are deliberately confrontational with firms because the banks have an interest in controlling corporations, while the corporations seek to reduce dependence on banks (Mintz & Schwartz 1985, Mizruchi & Stearns 1994b). One potential by-product of this relationship is that while firms prefer to make decisions about allocating funds within the corporation, banks may attempt to determine which subsidiaries of a corporation receive credit. Some have argued

that banks might actually invite corporations to create conglomerates for a couple reasons (Kotz 1978). First, conglomerates may lessen competition in an industry and increase the borrower's profits, and second, the creation of the conglomerates can increase the value of the bank's stocks. Yet empirical evidence suggests that firms whose stocks are largely controlled by banks are actually less likely to adopt the multidivisional form than those controlled by managers (Palmer et al. 1987, 1993). Among late adopters, as well, management-controlled firms are more likely than bank-controlled firms to adopt the multidivisional form (Palmer et al. 1993).

Financial institutions also affect mergers and takeovers. While early studies found no effect of bank interlocks on ownership or merger activity in the 1970s (Fligstein & Brantley 1992), more recent research shows that the likelihood of acquisition is a function of the firm's dependence, the positions of its managers and directors in the ownership structure, and the overall structure of the business elite (Palmer et al. 1995). Perhaps most interesting, firms with bank interlocks are more likely to be taken over in a friendly, rather than predatory, way (Palmer et al. 1995). Critics argue that this work may show the importance of economic and resource dependence influences in mergers, but that the evidence does not demonstrate the importance of an interlocked elite (Fligstein 1995). In a similar debate, Fligstein & Markowitz (1993) found that firms with bank officers on their boards were more likely to be merger targets and that firms seek bank officers to fill board seats to encourage a sale of the firm when it is in financial trouble. Yet Davis & Stout (1992) found no relation between bank interlocks and the risk of takeover. Similarly, Davis et al. (1994) found that institutional ownership did not influence merger activity, but that it did reduce the rate of conglomerate acquisitions. Both data and timing issues explain these differences, reflecting changes in the role of banks and institutional investors over time (1994b).

A growing body of literature demonstrates the role of financial market networks in other firm behaviors. Uzzi & Gillespie (1999), for example, show that capital structure can change given a firm's network ties. They demonstrate that firms with both embedded and arm's length ties in their network of bank relations increase their likelihood of getting a loan, reduce the interest rates they pay, have less collateral taken, and pay larger spreads on their loans (Uzzi 1999, Uzzi & Lancaster 2001b). Firms with embedded ties to their bankers are also more likely to take profitable early-payment trade discounts and to avoid costly late-payment penalties (Uzzi & Gillespie, forthcoming).

## FINANCIAL MARKETS AS OUTCOMES

As Baker et al. (1998) observed, sociologists tend to assume that markets exist and seldom make the market itself the subject of inquiry. Barber (1977) called this the absolutization of the market. Sociologists study a number of phenomena that assume a financial market such as interfirm competition (Baum & Mezias 1992, Burt 1992, Carroll & Hannan 1989), firm births and deaths (Hannan & Freeman 1986, 1989), entrepreneurship (Aldrich 1999, Thornton 1999), and innovation



(Powell et al. 1996, Rogers 1995, van de Ven & Garud 1987). Sociologists have also contributed to understanding nonmarket ties, such as long-term interfirm alliances, or ties that develop and work because they supersede and thus avoid the market (Granovetter 1995, Gulati 1995b, Keister 2000a, Powell et al. 1996). White's (1981) theory of the market does treat the market as an outcome. In this theory, which distinguishes production from exchange markets, buyers in aggregate value their total array of purchases. The theory has not spawned as much research as it might have, but recently scholars have begun to explore White's ideas empirically (Larson 2001).

Another important exception is Baker et al.'s (1998) study of the continuity and dissolution of market relations. This study explicitly defines the market as an "intertemporal process of economic exchange between buyers and sellers" (p. 150) and proposes an explanation of the conditions under which interfirm rules of exchange are followed, not followed, transgressed, or transformed. The authors show that these outcomes are a function of power, competition, and institutional forces. While not explicitly a theory of financial markets, the value of this model to understanding the emergence and transformation of financial relations is great, and possibilities for extending the model to other organizations, contexts, and times are substantial.

A related, and growing, body of literature seeks to explain markets by identifying the determinants of interfirm relations, including financial relations. Experimental research shows that when uncertainty is high, partners in dyadic exchange relations continue to trade even when lower prices are available elsewhere (Kollock 1994, Lawler & Yoon 1993, 1996). Empirical research on firms also shows that when uncertainty is high, managers trade with those they dealt with successfully in the past to avoid malfeasance and opportunism (Hagen & Choe 1998, Powell 1990). They also target firms with whom their partners are connected because they can more easily ascertain information about the trustworthiness and reliability of these potential partners (Gulati 1995a, Rousseau et al. 1998, Sitkin et al. 1998). Once a set of relations has coalesced into a relatively stable network, the network serves as a source of information on the reliability, competencies, and needs of potential trade partners (Gulati 1995b, Gulati & Gargiulo 1999, Gulati & Zajac 2000, Keister 2001). There is also evidence that firms will pay a relatively significant cost to trade with a known partner when uncertainty is high (Keister 2001).

Similarly, bankers rely on colleagues with whom they are strongly tied for advice and support when uncertainty is high. Yet transactions in which bankers use relatively sparse approval networks are more successful than those involving dense approval networks. This creates an important paradox: the tendency to rely on those they trust creates conditions that render deals less successful than they might otherwise be (Mizruchi & Stearns 2001). Somewhat contrary to other research in this area, Baker & Faulkner (2001) explore the use of within-network exchange (using preexisting social ties with a sales representative as the basis of a financial exchange) and search embeddedness (using preexisting social ties with a prior investor). They find that only half of investors used prior social ties while the other half invested large sums of money with strangers without the advice of prior

investors. The surprising finding suggests that more research is needed to specify the conditions under which networks are used.

One approach that might hold some clues is qualitative research on financial market processes. Abolafia (1996) uses field research to examine how insiders negotiate a constant tension between short-term self-interest and long-term self-restraint in stock, bond, and futures markets. Smith (1981, 1999) uses similar methods to study the psychology of Wall Street insiders by classifying types of actors such as the efficient-markets believers and transformational-idea adherents. Similarly, Levin (2001) uses ethnographic data collected on the trading floor of a midwestern commodities exchange to investigate the salience of gender in the workplace. Each of these pieces offers insight that could enlighten future theory development about market processes and could guide additional empirical work on the origin and functioning of financial markets.

Another way in which financial markets become outcomes in sociological research is when researchers problematize changes in the market over time. The rise of the institutional investor has attracted attention in recent years (Mizruchi & Stearns 1994b:327–28). Between 1965 and 1990, the proportion of the average firm's equity that is controlled by institutional investors increased from 18% to 47% (Useem 1993). There is evidence that institutional investors force firms to adopt strategies that are more shareholder oriented (Davis et al. 1994, Useem 1993). Institutional investors reduce rates of conglomerate acquisition (Davis et al. 1994) and shape how top management manages (Useem & Gottlieb 1990).

An important outcome of financial relations is the setting of prices. Sociologists have been interested in market crises for some time (Abolafia & Kilduff 1988, Kindleberger 1978, Mizruchi & Stearns 1994b:329). More recently, issues related to price setting outside of market crisis have attracted more attention. Baker (1984a,b) found that patterns of relations among traders on the floor of a securities exchange affected both the direction and magnitude of price volatility. Baker & Iyer (1992) generalized these findings to develop a mathematical model of financial markets as networks. This stylized model explores the way that patterns of financial relations affect price volatility and trading volume. Using the model, Baker & Iyer demonstrate that importance of network structure in shaping market behavior even where investors are homogenous and the information flowing through the system is random and unbiased. As Baker and his co-author observe (1992:323), this model could be usefully extended in a number of ways theoretically, empirically, and using simulation models. Indeed, researchers have been extending these ideas—not always explicitly, but the underlying ideas are similar.

Carruthers & Stinchcombe (1999) study the process by which heterogeneous claims on income streams related to various assets become homogenous commodities understandable to buyers and sellers. The somewhat cognitive bent of their work is evident in their assertion that to understand this process, “one must account for what buyers, sellers, and market makers need to know about the homogeneity, in order to be willing to take the going price in an auction as all they can,

and all they need to, know about commodified claims on income streams” (p. 354). Uzzi & Lancaster (2001a) also observed that price formation can be understood as social, but their approach is more structural. They argue that the embeddedness of market transactions provides actors with information and informal governance benefits that shape prices by adding unique value to transactions. These studies both highlight the important information that sociological theory might add to understanding prices and price formation and suggest that further research on prices could be very fruitful.

## FINANCIAL MARKETS DURING ECONOMIC TRANSITION

The role that financial institutions play in economic development has attracted attention from economists and a handful of sociologists for decades (Cameron 1972, Cameron et al. 1967, Lamoreaux 1986, Levine 1997, Makler 2001). Sociologists have largely explored how social relations and long-term interfirm alliances allow firms to overcome market failure and to cope with poorly developed markets in these contexts. For example, an extensive literature on business groups has explored how nonmarket relations underlie many transactions, particularly financial transactions, in Asian and Latin American economies (Gerlach 1992, 1997, Granovetter 1995, Hamilton & Biggart 1988, Hamilton 1991, Keister 2000a, Lincoln et al. 1992). Social relations bind the firms in the groups (Granovetter 1995, Keister 1998c, 2001), and the groups, in turn, shape firm performance and other outcomes (Guillen 2000, Keister 1998c, forthcoming, Lincoln et al. 1996).

Recently, the development of financial markets in transition economies in Eastern Europe and China and of the East Asian financial crisis has raised interest to a new level among sociologists (Carruthers & Halliday forthcoming; Fox 1995; Keister 1998b, 2000a; Makler 2001). While this research explores a number of issues that are beyond the scope of this review, one area in which research is growing explores the development and transformation of financial arrangements. In both transition economies and economies that experienced a recent financial crisis, a central question is the degree to which firms rely on the state versus other sources for capital. In socialist economies, the state has monopolies in most industries, and firms interact with state officials by bargaining for resources. During transition, firms drastically reduce their reliance on state capital and begin borrowing from alternative external sources. This transformation of the state’s relationship with firms is necessary to reduce state monopolies in most industries and to end the system of bargaining between the state and firms that can lead to soft budget constraints and undermine reform (Kornai 1986, Naughton 1992, Walder 1986). Restructuring the financial relationship between the state and firms also facilitates financial market development by increasing firm autonomy and creating incentives for firms to seek external funding (Walder 1995). In turn, a developed financial market encourages innovation and entrepreneurship (Dalzell 1987, Lamoreaux

**TABLE 1** The nature of firms in the survey

<b>Firm characteristics (% of firms in the sample)</b>			
<i>Ownership</i>		<i>Level of subordination</i>	
State-owned	54.13	Central ministry	6.25
Collective	29.00	Province	6.88
Stock	11.51	Municipality	49.75
Joint venture	2.63	County	7.38
Private	1.50	Other	29.75
Other	1.25		
<i>Firm location (province)</i>		<i>Firm age</i>	
Jiangsu	26.75	Less than 20 years	46.88
Sichuan	24.50	21–40 years	21.51
Jilin	25.38	Greater than 40 years	31.63
Shanxi	23.38		

*Source:* 2000–2001 survey of Chinese firms, funded by the National Science Foundation, National Bureau of Asian Research (NBR), and the Luce Foundation. Principal investigators include Mark Frazier, Lisa Keister, David Li, and Barry Naughton. The Chinese Academy of Social Sciences administered the survey to 800 companies, including 433 SOEs and 367 firms with other ownership structures (e.g., collectives, stock-owned, joint ventures, and privately owned companies).

1994), permits the efficient allocation of resources, facilitates privatization, and prevents capital flight (Demirgücs-Kunt & Levine 1996, Ratcliff 1980) (Table 1).

While firm borrowing from nonstate sources is critical to a large-scale economic transition, the degree to which this has actually occurred in the transition economies is uncertain because data are scarce. One exception is a recent study of firms in China. Table 1 presents basic characteristics of the firms included in the sample. Table 2 shows that Chinese firms have indeed begun to find other capital sources but that the financial transition has been slow and is far from complete. While markets were relatively local even a couple decades into China's reform, firms had definitely begun to acquire capital from a variety of sources. Because capital markets were slow to develop and because managers were relatively unfamiliar with market-based forms of acquiring capital (e.g., issuing public debt and trading on stock markets), the acquisition of capital from nonstate sources became common, but it did so slowly. Continued government regulation of some financial instruments and regional variations in opportunities to use certain instruments also shaped firm financial decisions. Reformers encouraged markets to form in certain regions before others, and special economic zones and special trade regions allowed markets for certain financial instruments to develop more quickly in some areas. As a result, some firms simply had access to capital markets earlier than others. Yet Table 2 shows that firms in this sample did begin to reduce their dependence on central government budget allocations and to acquire capital from other sources. Between 1994 and 1999, funds received from central and local governments declined considerably, while funds from other sources such as retained earnings grew rapidly. Debt issues, borrowing from other firms, investments

**TABLE 2** Percent of corporate funding from various sources

Source of capital	1994	1995	1996	1997	1998	1999
Central budget allocations	0.49	0.21	0.17	0.15	0.15	0.14
Local budget allocations	0.48	1.34	0.49	0.42	0.19	0.31
Bank loans	22.45	19.81	17.55	14.18	12.71	12.25
Public debt issues	0.25	0.03	0.07	0.01	0.01	0.00
Debt to other firms	1.15	0.27	0.28	0.48	0.40	0.58
Other firms' investment	0.63	1.02	0.91	0.83	0.67	0.67
Retained earnings	74.19	77.32	80.50	83.94	85.80	86.03
Other	0.36	0.00	0.03	0.07	0.07	0.02
Total	100	100	100	100	100	100

Source: 2000–2001 survey of Chinese firms (see Table 1 for details).

Note: Other sources include stocks and direct foreign investment or foreign bank loans.

received from other firms, and capital from other sources really have not become particularly significant sources of funding for this group of companies.

## FINANCIAL MARKETS AND INEQUALITY

The study of financial markets and the study of social stratification are typically considered separate subfields in sociology. Yet distributional outcomes of financial markets are at the heart of many studies of money and banking, and an important and growing body of literature directly studies these outcomes. Research on wealth necessarily explores the role of financial markets in creating and maintaining inequality. Because this literature has been reviewed elsewhere (Keister & Moller 2000, Spilerman 2000), I do not discuss it in detail. However, the particular role of financial markets in shaping wealth inequality is worth noting. Until the 1980s, Americans typically kept the majority of their wealth in housing and cash assets (Caskey & Peterson 1994, Keister 2000c). Tax incentives and the need for shelter encouraged families to first build home equity and use only excess savings to make other investments. As a result, only the wealthiest Americans owned stocks and other relatively risky financial assets. However, the increasing availability of mutual funds in the 1980s and 1990s made stock ownership much more common, and by the mid-1990s, stocks and other financial assets accounted for a much larger portion of Americans' portfolios, particularly if pensions invested in stocks are included (Keister 2000c).

During the 1980s and 1990s, the stock market boomed, and naturally, those who owned stocks experienced the benefits of this growth. Yet even though stock ownership has become more common, the ownership of financial assets is still much more concentrated than the ownership of other assets. As a result, only a small minority of the population actually enjoyed the economic growth of the

1990s. Racial differences in stock ownership, for instance, are pronounced (Conley 1999, Keister 2000b, Oliver & Shapiro 1995). While the average family kept 6.8% of their assets in stocks in the mid-1980s, white families (families with a white household head) kept 7.1% of their assets in stocks. In contrast, Hispanic families kept 2.2% of assets in stocks, and black families kept 0.9% in stocks. Thus, whites experienced the majority of the gains in the stock market boom (Keister 2000c).

Related to this is research that suggests that asset accumulation can help low-income families if they have access to the financial institutions and receive targeted financial education to promote saving (Beverly & Sherraden 1999, Keister 2000b). It is clear that minorities are less likely than whites to own a host of assets, are more likely to have debt, and are more likely to declare bankruptcy (Conley 1999, Keister 2000c, Keister & Moller 2000, Oliver & Shapiro 1995, Sullivan et al. 2000). There is some evidence that discrimination accounts for at least part of this difference. Conventional lenders neglect poor and minority communities, and these populations are served only by fringe institutions (Caskey 1994, Moulton 2000, 2001). There are also financial barriers to advancement that are evident in the difficulty minorities have becoming entrepreneurs because minorities are likely to receive lower capitalization (Bates 1997) and to face discrimination in bidding processes, lending, and supplier networks (Bostic & Lampani 1999, Feagin & Imani 1994, Uzzi 1991).

However, the degree to which discrimination accounts for racial differences in well-being is still the subject of heated debate, and discrimination in real estate lending has perhaps received the most attention (Turner & Skidmore 1999). Turner & Skidmore's collection of essays is an extremely thorough assessment of the evidence. The volume documents that discrimination in home mortgage lending takes two forms, differential treatment and disparate impact. It also demonstrates that in many cases it is difficult, if not impossible, to disentangle the two. The studies provide evidence that loan officers give minorities less information about loan products, spend less time with them, quote them higher interest rates, and deny them loans more often than whites. Some of these differences may be attributable to legitimate underwriting standards, and the authors acknowledge that it is difficult to demonstrate with certainty that discrimination is the cause. Yet the volume also demonstrates that there is considerable room for additional research into these important questions. In particular, additional evidence exploring the role of advertising, outreach, referrals, and loan administration would perhaps improve understanding of the causes of differences in lending.

## **ASSOCIATIONS AND OVERLAPS: CONNECTIONS AMONG THESE LITERATURES**

As this review demonstrates, research on financial markets and banking in sociology is diverse, but the streams of literature that comprise this subfield are inter-related in important ways. Perhaps the most important association among these literatures is the common assumption that systems of financial relations are social

structures. That is, nearly all sociological research on money, financial markets, and banking at least implicitly assumes that financial relations are social relations. This does not imply that there are no boundaries around the subject. Rather it suggests that sociologists can (and do) usefully inform studies of a subject most often associated with another discipline. Because of the unifying assumption underlying research in this area, sociologists in the major topical areas discussed above usefully extend knowledge about social interaction developed in other subfields of the discipline to improve understanding of banking and finance. Likewise, findings from the study of financial markets are now being extended in useful ways to other domains within sociology.

In addition to drawing on a common set of assumptions, the broad subfields within the study of money, financial markets, and banking inform each other in important ways. Those who conceive of money, for example, in terms of social relations (Baker 1987) also explore the network characteristics of financial markets (Baker 1990, Mizruchi 1992). Sociological definitions of money, which usually include some notion that money is neither culturally neutral or socially anonymous (Zelizer 1993, 1994), also influence to a large degree the types of questions sociologists chose to address within the study of financial markets and banking. Sociologists are more inclined, for example, to study issues of power and influence, interfirm relations, and the importance of uncertainty given their shared notion of money as social. Of course, as the range of topical areas included here suggests, there is room for integrating these disparate issues even further. Exploring the effect that different conceptions of money have on studies of financial markets would be an interesting first step. Similarly, research on the intersection of corporate power and the financial aspects of stratification would be informative.

## CONCLUSIONS

While banking and financial markets are still largely considered in the domain of economics, perhaps this review illustrates that sociologists are indeed contributing in very significant ways to understanding the nature of financial relations and related institutions. From classical writings about the nature of money and financial institutions to current research spanning the spectrum from firm-bank relations to banks in transition economies to the financial origins of inequality, it is clear that sociologists are contributing to understanding money, banking, and finance. This review opened with a discussion of classical works on these subjects. It then surveyed more current research on relations among firms and banks, interlocking directorates, and the effect of financial relations on firm outcomes. I then described two exciting and growing bodies of literature, one that treats financial markets as outcomes and another that extends many of these same ideas to understand the role that finance plays in economic transition. I concluded with a brief description of research that explores the distributional impact of financial markets. Given the large number of areas in which further research could be fruitful, it is clear that previous research on money, banking, and financial markets in sociology is foundational.

Building on this foundation will both challenge and advance sociology and simultaneously expand understanding of a set of institutions that is among the most critical components of all societies.

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