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Markets as Politics:

A Political-Cultural Approach to Market Institutions\*

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## Abstract

I use the metaphor "markets as politics" to create a sociological view of action in markets. I develop a conceptual view of the social institutions that comprise markets, discuss a sociological model of action in which market participants try to create stable worlds and find social solutions to competition, and discuss how markets and states are intimately linked. From these foundations, I generate propositions about how politics in markets work during various stages of market development-- formation, stability, and transformation. At the formation of markets, when actors in firms are trying to create a status hierarchy that enforces noncompetitive forms of competition, political action resembles social movements. In stable markets, incumbent firms defend their positions against challengers and invaders. During periods of market transformation, invaders can reintroduce more fluid social-movement-like conditions.

## Introduction

Most key insights of the sociology of markets have been framed as reactions to neoclassical economic views of the functioning of markets. White (1981) suggested that stable production markets were only possible if actors took one another into account in their behavior, contrary to the basic assumption of the neoclassical economic view which stresses anonymity of actors. Granovetter (1985) extended this argument, suggesting that all forms of economic interaction were centered in social relations, what he called the embeddedness of markets. Various scholars have presented evidence that market embeddedness produced effects that economic models could not predict (Burt 1983; Zelizar 1983; Baker 1984; Fligstein 1990).

The empirical literature has failed to clarify the precise nature of the social embeddedness of markets. Granovetter (1985) argued that network relatedness is the most important construct. Burt (1983) proposed that networks stand in for resource dependence. Podolny (1993) uses networks as a cause and consequence of the creation of a status hierarchy. Fligstein (1990) and Fligstein and Brantley (1992) argued that the social relations within and across firms and their more formal relations to the state are pivotal to understanding how stable markets emerge. Campbell and Lindberg (1990) and Campbell, Hollingsworth, and Lindberg (1991) took a similar approach and

focused on the emergence of what they call governance structures in industries. Institutional theory in the organizational literature argued that institutional entrepreneurs create new sets of social arrangements in organizational fields with the aid of powerful organized interests, both inside and outside of the state (DiMaggio 1989; DiMaggio and Powell 1991).

These latter perspectives have been buttressed by studies on comparative industrial organization (Hamilton and Biggart 1988; Chandler 1990; Gerlach 1992) that show how state-firm interactions in various societies have produced unique cultures of production. Industrial countries are not converging towards a single form (Fligstein and Freeland 1995). Instead a plurality of social relations have been observed that structure markets within and across societies. These observations have challenged the neoclassical economists' view that markets select efficient forms which, over time, produce converge to a single form.<sup>1</sup>

To push this debate forward, sociologists must go beyond documenting the shortcomings of the neoclassical model. Thus, in this paper, I begin to structure a new view from the existing literature. The basic insight is that the social structures of markets and the internal organization of firms are best viewed as attempts to mitigate the effects of competition with other firms. I outline a political-cultural approach and I use the metaphor "markets as politics" to discuss how these social structures come into existence, produce stable worlds, and are transformed.

The "markets as politics" metaphor has two dimensions. I view the formation of markets as part of state-building. Modern states with capitalist economies create the institutional conditions for markets to be stable. I identify what institutions are contested and view their construction as a political project undertaken by powerful actors. Great societal crises, such as war, depression, or the entry of a nation into modern development are pivotal to understanding a society's economic development. Once in place, these "rules" of market-building and market intervention are keys to understanding how new markets develop in a society.

Second, I argue that processes within a market reflect two types of political projects: the internal firm power struggle and the power struggle across firms to control markets. These are related "control" projects (White 1992). The internal power struggle is about who will control the organization, how it will be organized, and how situations will be analyzed and responded to. The winners of the internal power struggle will be those with a compelling vision of how to make the firm work internally and how to interact with the firm's main competitors. I use a social movement metaphor to characterize action in markets during market creation or crisis.

The production of market institutions is a cultural project in several ways. Property rights, governance structures, conceptions of control, and rules of exchange define the social

institutions necessary to make markets. Economic worlds are social worlds; therefore, they operate according to principles like other social worlds. Actors engage in political actions vis-a-vis one another and construct local cultures to guide that interaction (Geertz 1980).

An important purpose of this paper is to bring together the versions of economic sociology that stress institutions with those that stress networks and population ecology. I use the metaphor of "markets as politics" as the unifying construct which focusses on how social structures are produced to control competition and organize the firm. My approach combines key features of the other perspectives, but fills in what I consider to be important shortcomings of those theories. Institutional theory in the organizational literature is concerned with the construction of rules. But it lacks a theory of politics and agency. Networks are at the core of markets to the degree that they reflect social relations between actors. The major limitation of the network approaches is that networks are sparse social structures and it is difficult to see how they can account for what we observe in markets. Put another way, they contain no model of politics, no social preconditions for the economic institutions in question, and no way to conceptualize how actors construct their worlds (Powell and Smith-Doerr 1994). Population ecology has usually taken the existence of niches or markets as a given, which would seem to be antithetical to a more social

constructionist approach. However, Hannan and Freeman (1985) have argued that niches are social and political constructions, and they discussed how boundaries are formed. I elaborate such a perspective, but with a more explicitly political model.

#### MARKETS INSTITUTIONS: SOME DEFINITIONS

My focus is on the organization of modern production markets (White 1981). *Markets* refer to situations in which some good or service is sold to customers for a price that is paid in money (a generalized medium of exchange). The first problem for developing a sociology of markets is to propose theoretically the social institutions necessary as preconditions to the existence of such markets. *Institutions* refer to shared rules, which can be laws or collective understandings, held in place by custom, explicit, or tacit agreement. These institutions-- what can be called property rights, governance structures, conceptions of control, and rules of exchange-- enable actors in markets to organize themselves, to compete and cooperate, and to exchange.

*Property rights* are social relations that define who has claims on the profits of firms (akin to what agency theorists call "residual claims" on the free cash flow of firms (Jensen and Meckling 1974; Fama 1980)). This leaves open the issues of legal forms exist; the relationship between shareholders and employees, local communities, suppliers, and customers; and the role of the



state in directing investment, owning firms, and protecting workers. Unlike agency theory, I argue that the constitution of property rights is a continuous and contestable political process, not the outcome of an efficient process (Roe 1994). Organized groups from business, labor, government agencies, and political parties will try to affect the constitution of property rights.

*Governance structures* refer to the general rules in a society that define relations of competition, cooperation, and market-specific definitions of how firms should be organized. These rules define the legal and illegal forms of how firms can control competition. They take two forms: (1) laws and (2) informal institutional practices. Laws called antitrust, competition, or anticartel laws, exist in all advanced industrial societies. The passage, enforcement, and judicial interpretation of these laws is contested (Fligstein 1990), and the content of such laws varies widely across societies from allowing cooperation or mergers between competitors to enforcing competition.

Market societies also develop more informal institutional practices which are embedded in existing organizations as routines and are available to actors in other organizations. Some mechanisms of transmission are professional associations, management consultants, and the exchange of professional managers (DiMaggio and Powell 1983). These informal practices include how

to arrange a work organization (such as the multidivisional form), how to write labor and management contracts, and where to draw the boundaries of the firm. They also include current views of what constitutes legal and illegal behavior of firms.

The purpose of action in a given market is to create and maintain stable worlds within and across firms that allow firms to survive. *Conceptions of control* refer to understandings that structure perceptions of how a market works, that allow actors to interpret their world, and act to control situations. A conception of control is simultaneously a worldview that allows actors to interpret the actions of others and a reflection of how the market is structured. Conceptions of control reflect market specific agreements between actors in firms on principles of internal organization (ie., forms of hierarchy), tactics for competition or cooperation, and the hierarchy or status ordering of firms in a given market. A conception of control can be thought of as "local knowledge" (Geertz 1980). The state must ratify, help create, or at the very least, not oppose a conception of control.

*Rules of exchange* define who can transact with whom and the conditions under which transactions are carried out. Rules must be established regarding shipping, billing, insurance, the exchange of money (i.e., banks), and the enforcement of contracts. These rules become even more important across societies. As with property rights, governance structures, and

conceptions of control, states are essential to the creation and enforcement of rules of exchange.

#### THE MODEL OF ACTION

The key insight of the perspective I propose here is that there are two forms of potential sources of instability in markets: (1) the tendency of firms to undercut one another's prices and (2) the problem of keeping the firm together as a political coalition (March 1961). Market actors try to control both sources of instability to promote the survival of their firm. The goal of a conception of control is to erect social understandings whereby firms can avoid direct price competition and can solve their internal political problems.<sup>2</sup> These problems are related, and the solution to one will be part of the solution to the other.

The potential of price competition to undermine market structures is always there. Stable markets may last from a few years to decades. In some classically competitive markets, such as restaurants and barber shops, stability has never emerged. Even in these markets, actors try to differentiate their products to form niches to protect them from price competition (for example, restaurants serving high-priced California cuisine). My claim is not that actors in firms are always successful at creating stable shelters from price competition, but the politics

of markets and the social organization of markets involve attempts to do so.

Market actors live in murky worlds where it is never clear which actions will have which consequences. Yet, actors must construct an account of the world that interprets the murkiness, motivates and determines courses of action, and justifies the action decided upon. In markets, the goal of action is to ensure the survival of the firm. No actor can determine which behaviors will maximize profits (either a priori or post hoc) and action is therefore directed toward the creation of stable worlds.

Issues of internal organization revolve around producing stable (reproducible) social relations. The intraorganizational power struggle is about actors within the organization making claims to solve the "critical" organizational problems (Pfeffer 1981; March 1961). Actors need to have a coherent view of organizing that allows them to simplify their decision-making processes. Those actors that convince or defeat others will be able to define, analyze, and solve problems in their own terms. They will also be the leaders of the organization (Fligstein 1987). Once in place, a firm-specific conception of control operates as a corporate culture.

What are some of the common competitor-oriented strategies used to control price competition? Actors often try to cooperate with competitors to share markets. Cartels, price controls, creating barriers to entry, limiting production, patents,

licensing agreements, and joint ownership of production facilities are all tactics that firms use to divide markets. A related tactic is to involve the state in regulation or protective legislation that increases the odds of firm survival.

Actors simultaneously use two internal principles of organization to indirectly control competition: (1) integration and (2) diversification which is often accompanied by producing multiple divisions in the organization. Integration can be vertical (the merger of suppliers or customers) or horizontal (the merger with competitors). Vertical integration prevents others from threatening valued inputs or outputs. The integration or merger of a large share of an industry means that a few firms can control the market by tacitly agreeing not to threaten one another's position through a price war. They often publicly announce pricing and production decisions so that other firms can follow suit.

Diversification implies entering new markets to increase the probability of firm survival. It begins with the differentiation of a single product on the basis of quality or price (White 1981). To the degree that firms are not competing because their products differ, price competition will not threaten firm existence.<sup>3</sup> Through diversification, a firm that produces multiple products can reduce their dependence on any one product, and hence, increase the likelihood that the firm will survive. This allows the firm to grow larger which increases firm

stability as well. Firms search for new markets because there can be huge gains to the first mover. Such gains help stabilize the firm. If markets fail to materialize or market conditions deteriorate, a diversified firm can exit a failed market without threat to the larger corporate entity. The production of multiple products introduces internal control problems and actors are constantly reorganizing around variations of the holding company and multidivisional form (Fligstein 1985; Prechel 1994).

Actions to control competition can be thought of as a cultural tool kit (Swidler 1986). Actors are prepared to take what they can get and work toward a more stable market situation. In this way, conceptions of control are inspired solutions based in the pragmatics of experience (Padgett and Ansell 1992).

Conceptions of control refer to broader cultural conceptions in which these "tool kit" tactics are embedded. Actors in two different markets might use product diversification, but one might view it as diversifying the financial portfolio (a financial perspective) while the other might see it as carrying a full line of goods (a marketing perspective) (Fligstein 1990). Conceptions of control also allow actors to interpret what a particular strategic move by competitors might mean.

Actors stick with the conception they believe works. After some period of time, others will recognize some key set of factors and begin to imitate them. But these factors are rarely articulated before the fact; they become accepted or common

knowledge only after they operate to produce stability for some firms. Such tactics and conceptions create cultural stories that can be used over and over again to justify an action or produce a new one.

#### STATE-BUILDING AS MARKET-BUILDING

One implication of my metaphor, "markets as politics", is that states play an important role in the construction of market institutions. Why are states so important? The organizations, groups, and institutions that comprise the state in modern capitalist society claim to make and enforce the rules governing economic interaction in a given geographic area (Krasner 1988).<sup>4</sup> Capitalist firms could not operate without collective sets of rules governing interaction. While most modern discussions of state-building have focused on welfare and warfare, modern capitalist states have been constructed in interaction with the development of their economies, and the governance of economies is part of the core of state-building (Fligstein 1990; Hooks 1990; Campbell et. al. 1991; Dobbin 1994; Evans 1995).<sup>5</sup>

Property rights, governance structures, and rules of exchange are arenas in which modern states establish rules for economic actors. States provide stable and reliable conditions under which firms organize, compete, cooperate, and exchange. The enforcement of these laws affects what conceptions of control can

produce stable markets. There are political contests over the content of laws, their applicability to given firms and markets, and the extent and direction of state intervention into the economy. Such laws are never neutral. They favor certain groups of firms.

My argument is that it is likely that states are important to the formation and ongoing stability of markets. How they will be important and to what degree is a matter of context. Some states have greater capacities for intervention than others, and the likelihood of intervention depends on the nature of the situation and the institutional history of the state (Evans, Skocpol, and Rueschmeyer, 1988; Laumann and Knoke, 1989).<sup>6</sup>

Property rights define the relation between an economic elite and the state. Business elites struggle to keep states from owning property, but they want states to enforce property rights.

States differ with regard to their rules for cooperation and competition. Some allow extensive cooperation between firms, particularly in export markets (e.g., Germany) while others restrict the ability of firms in similar industries to cooperate (e.g., the United States). All states restrict competition to some degree by not allowing certain forms of predatory competition or by restricting entry into certain industries by using trade barriers (both tariff or nontariff) and regulation. The political processes that generate these rules often reflect the organized interests of a given set of firms in one market. A



good working hypothesis is: One way to produce stable markets is to get the state to intervene to restrict competition. This is a "normal" firm strategy.

One important dimension of state involvement into markets is captured by the distinction between direct intervention and regulation. Interventionist states (e.g., France) are involved with making substantive decisions for many markets. They may own firms, direct investment, and heavily regulate firm entries, exits, and competition in markets. In contrast, regulatory states (e.g., the U.S.) create agencies to enforce general rules in markets, but do not decide who can own what and how investments proceed. Both strategies of intervention can be captured by firms. States can either intentionally or unintentionally upset the status quo of a given market by changing rules.

Below I advance some propositions about the interactions between states and other organized societal groups under different social conditions. These propositions imply research agendas that have been only partially exploited.

Proposition 1: The entry of countries into capitalism pushes states to develop rules about property rights, governance structures, and rules of exchange in order to stabilize markets for the largest firms.

The timing of entry of countries into capitalism has had huge effects on societal trajectories (Westney 1980; Chandler 1990; Fligstein 1990; Dobbin 1994). For countries just establishing modern capitalist markets, creating stable conceptions of control is more difficult precisely because

property rights, governance structures, and rules of exchange are not well specified. Firms are exposed to the ravages of cutthroat competition and demand that the state establish rules about property rights, governance structures, and rules of exchange. Creating these new institutions requires the interaction of firms, political parties, states, and newly invented conceptions of regulation.

Proposition 2: Initial regulatory institutions shape the development of new markets because they produce cultural templates that affect how to organize.

The shape of these initial regulatory institutions has a profound effect on subsequent capitalist development. Indeed, any new markets that come into existence do so under a given set of institutions. One can observe that as countries industrialize, the demand for laws or enforceable understandings is high, and that once they are produced, they are stable, and demand for laws lessens.

As new industries emerge or old ones are transformed, new rules are made in the context of the old rules. Dobbin (1994) has argued that societies create "regulatory styles." These styles are embedded in regulatory organizations and in the statutes that support them. New rules follow the contours of old ones. States are often the focus of market crises, but actors continue to use an existing set of laws and practices to resolve crises. Proposition 3: State actors are constantly attending to some form of market

crisis or another. This is because markets are always being organized or destabilized, and firms are lobbying for state intervention.

In normal times, change in markets will be incremental and dependent upon the construction of interests of actors in and around the state.<sup>7</sup> Having stable rules is often more important than the content of the rules. However, rules do embody the interests of dominant groups, and state actors will not intentionally transform rules unless dominant groups are in crisis. Because of their central place in the creation and enforcement of market institutions, states will become the focus of crisis in any important market. Given the constant turmoil inherent in markets, one can expect the state to be constantly attending to some form of market crisis.

Pressure on states can come from two sources: other states (and by implication, their firms) and existing markets that can be constructed either locally (within the geography of the state) or globally (across states). As economic interdependence across societies has increased, there has been an explosion of cross-state agreements about property rights, governance structures, and rules of exchange.

Proposition 4: Laws and accepted practices often reflect the interests of the most organized forces in society. These groups support wholesale transformation of institutions only under crisis circumstances like war, depression, or state collapse.

The possibility for wholesale transformation occurs when

there is an economy-wide failure of existing rules. Wars, depression, and possibly international economic competition can undermine society-wide arrangements. Massive economic crises will bring about political demands for changes in the rules.

These propositions illuminate the kinds of problems confronting the late-comers to capitalist social relations in Eastern Europe. The international organization of markets means that firms in developed product markets are poised to invade these societies and take over the local product markets. Moreover, there exist few market institutions, such as property rights, governance structures, or rules of exchange, to guide actors in new firms (Stark 1992; 1996; Burawoy and Krotov 1994).

It is interesting to consider Hungary more closely. Stark (1992; 1996) found that state actors in Hungary have turned state owned ministries into corporations. The government holds the bulk of stock in these corporations, although control appears to have devolved to managers. Eventually, state actors appear willing to have firms sold off to private interests. Complicated patterns of shareholding have developed whereby the state owns all of some firms and parts of others. What is particularly interesting is how managers have responded to the problem of competition.

Stark (1996) documents that managers have reorganized firms into complex structures in which large firms incorporate satellites of smaller firms in which the large firms hold equity shares. Firms have taken up two tactics. First, they have taken

ownership stakes in firms producing similar products and have tried to control both the inputs and outputs of production. Second, groups of firms with related and unrelated products have joined together. These are the two tactics, integration and diversification, I earlier described that are used by firms to avoid direct competition.

There are a number of problems that this particular combination of nascent property rights and conceptions of control engenders. State actors have recently forced western-style accounting standards to attract western investment, which has resulted in many bankruptcies (Stark 1996). As a result, the state is pressured to prop firms up. Moreover, the state is the holder of equity and debt, and making the financial situation more precarious makes it harder to appeal to western investors. It is not clear whether integration and diversification, will produce stable outcomes. The problem is that these strategies may not be able to stand up to invasion by western firms, particularly given the financial problems firms face.

While my approach cannot say how these transformations will turn out, it suggests how to study these processes. One begins by locating a set of policy changes in property rights, governance structures or rules of exchange, and then tracking how these policies restructure social relations in markets. This would include detecting emerging conceptions of control and whether or not they produce successful outcomes for firms. If firms fail,

there will be demands for new institutional changes.

One potential objection to my focus on states is that it fails to deal with the fact that the world economy is now truly global. But I believe that this state-centered approach is quite useful in analyzing so-called global markets. A market is "globalized" if there are a small number of participants who know one another and operate across countries with a common conception of control. Automobiles, computers, software, and pharmaceuticals may fit this definition. The emergence of these markets depends on cooperation between firms and states to produce rules of exchange and provide guarantees that firms can compete and expropriate profits.

One hypothesis is that the increases in world trade produce demand for more of these agreements and greater extensiveness of these agreements. The European Union, the North American Free Trade Area, and the recently completed GATT Treaty can all be analyzed according to whether or not they consider issues around property rights, governance structures, and rules of exchange. They can also be broken down by sectors that involve or do not involve exporters to see if rules tend to apply more or less exclusively to those sectors (Fligstein and Mara-Drita forthcoming).

One arena in which agreements have not occurred is the creation of a world market for corporate control. It is very difficult to engage in hostile takeovers in any society except

the United States and Great Britain. Earlier I suggested that property rights were at the core of the relations between national elites and states. Most national elites have resisted having transfer property rights transferred to the highest bidder because they would lose power. States remain players in the creation of the global economy because their elites depend on them to preserve their power and guarantee entry to global markets.

#### THE PROBLEM OF CHANGE AND STABILITY IN MARKETS

There are three phases in market formation: emergence, stability, and crisis.<sup>8</sup> My concern is to specify how actors' perceptions of the current social structure affects the tactics they use to seek stability for their firms. It is here that the second part of my metaphor, "markets as politics," comes into play.

In any market, participants can usefully be distinguished in terms of their size relative to their market. Large firms control more external resources than small firms, including pricing from suppliers, financial assistance, and legitimacy, and they may possess control over key technologies or large customers (Pfeffer and Salancik 1978; Burt 1983). As a result, it makes sense to distinguish market participants as incumbents and challengers (Gamson 1975). Incumbent firms are large and actors in those

firms know their major competitors and frame their actions on other large competitors. Challenger firms are smaller and frame their actions in terms of the largest firms. But, they will experience the world as a given-- one out of their control.

Differing conditions of market stability produce different kinds of politics. A stable market is defined as a situation in which the identities and status hierarchy of firms (the incumbents and the challengers) is well known, and a conception of control that guides actors who lead firms is shared. Firms resemble one another in tactics and organizational structure. Politics will reproduce the position of the advantaged groups.

In new markets, the politics resemble social movements. Actors in different firms are trying to convince other firms to go along with their conception of the market. If they are powerful enough, they try to force their view. If there are many different firms of equivalent size, then the possibility for alliances around conceptions of control are possible. Conceptions of control may become political compromises that bring market stability to firms.

Markets in crisis are susceptible to transformation. On rare occasions, the push for change may come from within the firms in a market. More frequently, firms invade the market and transform the conception of control. This can look like a social movement, in the sense that the invading firms are trying to establish a new conception of control and in doing so are likely to ally



themselves with some of the challengers or existing incumbents.

The most fluid period in a market is during its emergence. The roles of challengers and incumbents have yet to be defined, and there is no accepted set of social relations. It is useful to explore the metaphor of a social movement and its application to an emerging market. The ability of groups in a social movement to attain success depends on factors similar to firms trying to produce a stable market: the size of groups, their resources, the existence of a political opportunity to act, state actors willing to negotiate grievances, and the ability to build a political coalition around a collective identity (Tarrow 1994; Snow, Rochford, Worden, and Benford 1980; McAdam 1982).

A new market spawns the growth of new firms as well as entrance of firms operating in other markets just as a political opportunity creates new social movement organizations. Firms are trying to take advantage of a market opening in the same way that organizations in social movements try to take advantage of a political opportunity. In a new market, the situation is fluid and is characterized by multiple conceptions of control proposed by actors from various firms. A stable market requires the construction of a conception of control to promote noncutthroat ways to compete that all can live with and that state actors can accept. A conception of control operates as a kind of collective identity that many groups can attach to in order to produce a successful market.

Proposition 5: At the beginning of a new market, the largest firms are the most likely to be able to create a conception of control and a political coalition to control competition.

At the origination of a market, all interorganizational relations must be constructed. Markets are the outcome of an institutionalization project which is the equivalent of discovering a conception of control (DiMaggio 1989). In this way, markets are social constructions. Making these institutional projects successful is inherently a political project. Actors need to find conceptions of control to signal to other firms in the moment of market formation what one's intentions are. One can predict that the largest firms in an emerging market are likely to create a conception of control and persuade others to go along with it because of the perceived advantages that size entails.

Proposition 6: Power struggles within firms are over who can solve the problem of how to best organize the firm to deal with competition. The winners of the struggle will impose their organizational culture and design on the firm.

A firm's internal power struggle depends on actors coming up with coherent conceptions of control that they can impose on others within the firm. The internal power struggle is likely to be most intense during the emergence of markets. Different groups believe that they hold the solution to the problem of how to organize the firm to best deal with competition. Those actors that win impose their organizational design and culture on the firm. Internal firm

structure and who controls the firm result from the conception of control that deals with the problem of market competition. These conceptions of control are available to other firms and help produce a stable status hierarchy of firms. Proposition 7: Through intended and unintended actions, states can thwart the actions of firms to create stable conceptions of control.

All conceptions of control are built around current understandings of legal and illegal market behavior. Firms avoid conceptions of control that are illegal, but occasionally find themselves scrutinized by government officials. More frequently, state regulation of economic activities changes the balance of power in a market away from one conception of control and towards another. This occurs in regulated markets such as drugs, food, telecommunications, utilities, banks, and media.

Proposition 8: The "liability of newness" in new markets reflects, in part, their lack of social structure and a conception of control ie., it reflects participants' inability to control competition.

It is at the emergence of markets that competition and price mechanisms exact their greatest toll. With no established conception of control to structure nonpredatory forms of competition, price has its strongest effect (Stinchcombe 1965; Hannan and Freeman 1977). There is a tendency to blame business failures on a lack of resources or the inability of managers to construct organizations that reliably deliver products. I argue that part of what is going on is the lack of a social structure

to control competition. Markets in which a conception of control never emerges continue to have relatively high rates of firm death, while markets that are able to produce conceptions of control stabilize at lower death rates.

Proposition 9: New markets will borrow conceptions of control from nearby markets, particularly when firms from other markets choose to enter the new market.

New markets are born in close social proximity to existing markets. Earlier, I argued that diversifying products is a way to produce more stable firms. Entering new markets does not require confronting entrenched interests and does not directly threaten the stability of the firm. If new markets succeed, then firm stability is enhanced. The differentiation and creation of new products is most frequently the spinoff of existing products. The start of a new market is not random, but is shaped by existing conceptions of control, legal conceptions of property and competition, and the existing organization of related markets.

To illustrate these principles, it is useful to consider examples. The creation of the U.S. steel industry is a clear case of firms struggling to create a social structure to control competition.<sup>9</sup> In the nineteenth century, firms in the steel industry faced the problem that their industry was susceptible to huge price swings because of its role in the railroad industry and building trades, and these price swings were devastating because of the large amounts of fixed capital invested in the industry. There was a great deal of incentive to find legal

mechanisms to stabilize prices (Hogan 1970).

The basic problem for the steel industry was to discover a conception of control that controlled competition. Cartels and monopolies were illegal in the U.S. (Thorelli 1955). The choice that remained was to integrate firms to control the market. My proposition that the largest firms in the market are the leaders in such efforts is historically accurate in this case (Hogan 1970).

During the turn of the century merger movement, the largest industrial corporation in the world emerged: the U.S. Steel Corporation. The merger created a large corporation that controlled inputs into the steel-making process as well as divisions that produced outputs for every segment of the market. The company controlled more than 65 percent of the market for steel and 75 percent of the industry's iron ore reserves (Hogan 1970). In spite of being in a strong position, the firm found itself confronted by wild swings in product demand and unstable prices well into the twentieth century. It faced a dilemma in enforcing its position against its competitors. If the firm vigorously pursued price cutting to gain monopoly control over the industry, it would find itself a target of antitrust authorities; if it did nothing, it found its large investment threatened.

U.S. Steel began to pursue an alternative tactic. It posted its prices and production schedules and defended them by

decreasing production in the face of aggressive competitors (Fligstein 1990). U.S. Steel tried to cajole others into going along with its prices by threatening to use its control over inputs and its huge capacity to produce. If all behaved "reasonably," then some price stability could result. This strategy worked to stabilize steel prices from 1904 until the depression in 1929 (Kolko 1963).

U.S. Steel's strategy of integrating production, setting prices, and daring others to undercut them was ratified as a legal way to control competition when it won its antitrust lawsuit in 1920. This conception of control spread in social movement-like fashion during the 1920s merger movement, when oligopoly structures emerged in all of the core metal making and petroleum industries (Eis 1978). This structure proved durable in the U.S. steel industry and lasted until the 1960s (Hogan 1970).

It is useful to examine an emerging industry where there is not yet a conception of control and apply the perspective advanced here to predict an outcome. The biotechnology industry has sprung up from common technologies that developed at major universities. To figure out which conceptions of control are contenders for organizing the industry, one asks: "What problem of competition would a social structure need to resolve?" One way to control competition is patent laws. Firms who discover a product first can extract monopoly rents from their investment in that product, thereby avoiding competition. The game is to find

new products that can be patented. Two competing conceptions of control can be identified to take advantage of patent laws.

Powell and Brantley (1992) have argued that the critical problem for biotechnology firms is to control the supply of scientists who have the knowledge about the products. They view a network organization as a stable conception of control because it is a political compromise in which scientists may be able to leave a firm with knowledge of products, but firms have extensive organizational ties so that they will not have to depend on just one or two scientists for information or products. If the arrangements one firm has with other firms are alliances, then the collapse of any given alliance will not necessarily lead to a collapse of a given firm, either by denying it products or information. If a given scientist leaves, firms will presumably have a number of other scientists or alliances who can take up the slack. In this way, a networked firm oriented toward producing patents to control competition might prove stable.

Two other features of the biotechnology industry imply an alternative conception of control (Barley, Freeman, and Hybels 1992; Powell and Brantley 1992). Most biotechnology products must undergo extensive testing by the Food and Drug Administration. Firms need money to survive this period of testing before bringing products to market. Thus, the state, through FDA regulation of the market, shifts the competitive conditions in the market from the discovery of new products to the ability to

survive the testing and approval process. Once through the testing phase, firms will have to reliably produce, market, and distribute the product. This creates a second arena of competition that relies on production and marketing expertise.

These two competition problems imply that a different conception of control might emerge. I suggested earlier that one source of conceptions of control were nearby markets. The drug industry has extensive experience with the same testing and production processes used by the biotechnology industry, and is built on the creation, production, and control of proprietary drugs. I predict that to the degree that surviving the testing process and producing and marketing the product are pivotal, biotechnology firms will be tempted to form alliances with drug companies. Moreover, drug companies would be tempted to buy out the most successful of the biotechnology firms. The drug companies' conception of control (integrated firms that produce drugs with monopoly patent rights to eliminate competition to gain back the cost of producing the drug) would dominate.

A more hybrid form could emerge that would focus on maintaining the network organizations by keeping the discovery of products separate from the production and distribution of those products. This has advantages for both drug companies and biotechnology firms. The biotechnology firms maintain some control, while the drug companies lower their risk.

There is evidence that all three conceptions of control are



practiced (Barley et. al. 1992; Powell and Brantley 1992). The earlier discussion might predict that the most likely outcome is a merger between the two industries, whereby large biotechnology companies become drug companies or divisions thereof. The largest players in the market are the drug companies; their conception of control solves competition problems in the pharmaceutical industry; they already have negotiated the legitimacy of that solution with states. The problem of controlling the defection of scientists would be more ephemeral to solving the problem of getting products through the patent process.

Proposition 10: In markets with stable conceptions of control, there is a great deal of agreement by market participants on the conception of control and the status hierarchies and strategies it implies.

Once a stable market emerges, the roles of incumbents and challengers are defined and the power structure of the market becomes apparent. Actors in firms throughout the market will be able to tell observers who occupies what position and what their central tactics are. They will be able to make their actions contingent on their interpretation of those tactics.

Proposition 11: Incumbent firms pay attention to the actions of other incumbent firms, not challenger firms, while challenger firms focus on incumbent behavior.

A stable world depends on social relations between the largest firms. The central players will generally ignore challenger organizations under most circumstances because they pose little threat to the overall stability of the market. If these organizations live up to their name and begin to challenge

the existing order, incumbent organizations will confront them and attempt to reinforce the governing conception of control.

Proposition 12: Firms in stable markets continue to use the governing conception of control, even when confronted with outside invasion or general economic crisis.

The major force that holds a market together over a period of time is the ability of the incumbent firms to continue to enforce a conception of control vis-a-vis one another. Incumbents are constantly trying to edge one another (and challengers) out for market share, but they refrain from direct confrontation that might prove the ruin of all. These actions will be guided by the existing conception of control (i.e., the conception of what is a reasonable action). This requires actors to frame action for their firm against their competitors and to have the resources (power) to make it stick. They know the identity of the important firms in the market, they try and make sense of their moves, and they respond to those moves.

This accounts for the relative stability of established markets, both in the identities of the participants and their tactics. To produce a stable order where firms survive is a relatively difficult problem. Once stability is attained, actors in firms are loathe to engage in actions that undermine their incumbency. If challengers shift tactics or invaders come into the market, incumbent firms continue to engage in the same kinds of actions that produced the stable order in the first place. Incumbent firms may allow some redefinition of who is an

incumbent and who is a challenger, but they will remain committed to the overall conception of control that lessens competition. To break down the stable order could potentially bring more chaos than would enforcing the "way things are done". Actors are also cognitively constrained by a conception of control. Their analysis of a crisis will be framed by the current conception of control and their attempts to alleviate the crisis by applying "the conventional wisdom".

The case of the Japanese *keiretsu* illustrates how a stable conception of control has withstood both political and economic assaults. Japanese *keiretsu* are families of firms in different industries that share ownership ties. The overall structure of the *keiretsu* is to cement important interdependencies and allow various *keiretsu* members to survive economic downturns. Often banks are at the center of *keiretsu* and they function as an internal capital market for the firms.

The *keiretsu* show high growth, high investment, and relatively low, but stable profits (Aoki 1988). In economic downturns, *keiretsu* structures allow workers to be transferred across firms rather than being laid off (Lincoln, Gerlach, and Takahashi 1992). This exerts downward pressure on profits, but secures employee loyalty. When firms within the structure are experiencing economic troubles, managers in other firms respond by helping to reorganize the troubled firm (Gerlach 1992).

After World War II, *keiretsu* were reformed from prewar

economic conglomerates (*zaibatsu*) that were family controlled. The *zaibatsu* were broken up during the American occupation, but began slowly to reform in a looser manner (Hadley 1970). Since World War II, they have been directed by state actors to enter new markets, and they have proved adept at producing new products (Johnson 1981).

The *keiretsu* structure contains firms with activities spread across a wide spectrum of industries and markets. The *keiretsu* structure, as a conception of control, does not directly control competition in a given market. Its advantage is how it stabilizes competition across markets. It has been noted that within given product markets, the firms from different *keiretsu* compete quite vigorously (Aoki 1988).

The *keiretsu* structures operate to mitigate competition across markets in a number of ways. First, firms tend to purchase goods and services from inside the *keiretsu*. This means that some markets are captive and price competition is held down. Second, if a given firm faces an economic crisis, the other firms will attempt to support it. Management expertise, capital, and the ability to place workers with other firms during slumps, mitigate short-run competitive processes. Third, the focus on market share implies that firms invest for the long run and expectations for short-run profits are not high which gives managers latitude in dealing with competitive conditions. Fourth, because of the ownership relations between firms and banks, the cost of capital

tends to be lower (see Gerlach 1992 for a review of the literature). One can see the intimate connection between the problem of trying to control competition externally and the internal social organization working to solve that problem.

Recently, two forces began to close in on the *keiretsu*. First, the U.S. government applied pressure to open up Japanese markets, part of which was directed against the *keiretsu* structures (Gerlach 1992). The U.S. wanted to break open the procurement arrangements of the *keiretsu* and demanded that the Japanese open their financial markets and allow a market for corporate control to develop. Second, the economic downturn of the early 1990s has put pressure on the permanent employment system of the *keiretsu*. It has been more difficult to pass workers onto other firms in the *keiretsu*. The managers who controlled the *keiretsu* have been able to use their traditional methods to fight off these attacks. They were politically connected enough to fight off reforms within Japan and economically able to endure a long recession (Gerlach 1992).

Proposition 13: Market crisis is observed when incumbent organizations begin to fail.

Crisis comes to markets when the largest firms are unable to reproduce themselves from period to period. This can be caused by three kinds of events: (1) decrease in demand due for the firm's products can result from bad economic conditions or a shift in buyers' preferences, (2) an invasion by other firms can upset the conception of control and introduce procedures which force a

reorganization of the market, or (3) the state can intentionally or unintentionally undermine the market by changing rules.

Incumbents rarely become innovators because they are busy defending the status quo; market transformation is precipitated by invaders. The reorganization of a market around a new conception of control resembles a social movement and is very much like what occurs at the formation of markets. Invading firms can form alliances with existing firms around a new conception of control, or a compromise conception of control, and this makes the reorganization of the market more predictable than it was at market formation.<sup>10</sup>

Proposition 14: Transformation of existing markets result from exogenous forces: invasion, economic crisis, or political intervention by states.

One of the key features of capitalist society is the dynamic interplay of markets, whereby some markets are emerging, others are stable, and still others are in crisis and undergoing transformation. I propose an exogenous theory of market transformation that views the basic cause of changes in market structure as resulting from forces outside the control of producers, due either to shifts in demand, invasion by other firms, or actions of the state. Incumbent firms will respond to these destabilizing forces by trying to reinforce the status quo.

Markets are connected in a wide variety of ways. Firms rely on suppliers, capital markets, labor markets, and customers as well as on states for their stability. It follows that these

market and state forces are always interacting and thereby producing potential problems for an existing conception of control in a given market. Crisis in relations across markets can undermine existing agreements by threatening the well-being of all firms, either by withholding key resources or through the direct invasion of firms from nearby markets.

Proposition 15: Invaders are more likely to come from nearby rather than distant markets.

This argument parallels the argument about where new markets come from. Firms seek stability by finding new markets. The invasion of an existing market can occur in a couple of ways. First, firms in closely related markets enter existing markets where they can successfully introduce a new conception of control to increase their advantage. Second, firms might enter into the same product market in different geographic areas, thereby undermining a local stable order.

Proposition 16. When firms begin to fail, the intraorganizational power struggle heats up, leading to higher turnover of top personnel and greater activism by boards of directors and nonmanagement shareholders. New sets of organizational actors attempt to reconstruct the firm along the lines of the invaders.

Conceptions of control are used by actors in incumbent firms to ward off market crises. The internal firm power struggle will become more intense as market crises become more pronounced and the reigning conception of control proves to be inadequate to deal with the crisis.

Consider the example of the transformation of the finance

conception of control as the guiding principle in the market for corporate control in the U.S. during the 1980s. The financial conception of control dominated the actions of many large U.S. firms between 1950 and 1970 (Fligstein 1990). This view held that firms were composed of assets that could be deployed and redeployed by financial actors within firms in order to promote firm growth. The major tactics of this conception were the use of financial tools to internally monitor divisional performance, and the use of mergers to buy and sell divisions that produced diversification for firms (Fligstein 1990). These tactics solved the competition problems of large firms by allowing them to exit and enter businesses and stabilize the overall corporate structure. Firms were the principle actors in the market for corporate control as they sought to use the stock market to add to or subtract from their "portfolios."

What crisis made this conception of control no longer viable for large corporations? The high inflation rates during the 1970s meant that interest rates were high, stock prices were low, and the value of assets was inflated, thereby making returns on investments poor (Friedman 1985). The financial conception of the firm, with its focus on the profitability of product lines and market diversification, suggested that "good" managers would deal with these problems by keeping debt low and funding investments from cash generated internally. The market for corporate control was in crisis because managers were not reorganizing their



assets, even though corporate profits were low. This presented a new opportunity for actors to seek a new rationale to reorganize the market for corporate control.

What was this "new" conception of control, and who were its proponents? Davis and Thompson (1994) have argued that the language of "shareholder value" and the discourse that blamed managers for being ineffective spread amongst institutional investors in a social movement fashion in the early 1980s. The financial strategy of holding undervalued assets, funding investment internally, and keeping debt low was viewed as a problem. This language was allied with "agency theory" from economics (Jensen 1989) to emphasize that if managers were not going to maximize shareholder value, then they should be replaced by management teams who would.

Institutional investors are a heterogeneous group and include investment bankers and representatives from pension funds, mutual funds, and insurance companies. They were from a closely related industry, financial services, and they invaded the turf of financial managers who controlled the largest U.S. corporations. Their goal was to force these managers to redeploy their assets to reflect how the 1970s had affected their balance sheets. They wanted managers to sell off overvalued assets, assume debt to keep firms disciplined, and to remove layers of management to save money. They also forced managers to focus their business by buying up competitors and selling off their

most diversified assets (Davis, Diekmann, and Tinsley 1994). They, of course, benefitted by making money on organizing and executing mergers.

Research shows that firms that were merger targets tended to ignore financial reorganization to increase "shareholder value" (Davis and Stout 1992; Fligstein and Markowitz 1993). Useem (1993) has shown how managers adopted this language and the behaviors it proscribed. The merger movement of the 1980s resembled a social movement whereby, some financial executives and the various actors within the financial services industry discovered a common language and produced a conception of control to reorganize the market for corporate control.

The federal government played both direct and indirect roles. The Reagan Administration passed a huge tax cut that produced windfalls for corporate America in 1981. The Administration expected firms to reinvest that capital in new plants and equipment, but instead firms bought other firms. The Administration also announced that they would not vigorously enforce the antitrust laws (Fligstein and Markowitz 1993). Davis and Stout (1992) argue that the Reagan Administration became a cheerleader for the shareholder value conception of control.

The shareholder value conception of control is related to the finance conception of the firm, but it uses a stark discourse that only recognizes the rights of one group: those who own stock. All other concerns are subordinated to maximizing the

returns for owners. The attention of top managers is focused on evaluating their product markets, but more importantly how the financial markets evaluate their stock price.

How does this new conception of control affect competition in the market for corporate control? If managers are paying attention to shareholder value in a narrow sense, they will be less likely to become merger targets. To the degree that the "game" is to avoid becoming the object of acquisition from outsiders (i.e., mergers), managers with a narrow focus are likely to maintain control. I hypothesize that the managers who win the internal power struggle will be those who can claim to maximize shareholder value. This process explains the spread of these tactics to most large firms during the 1980s.

### Conclusions

Markets are social constructions that reflect the unique political-cultural construction of their firms and nations. The creation of markets implies societal solutions to the problems of property rights, governance structures, conceptions of control, and rules of exchange. There are many paths to those solutions, each of which might promote the survival of firms. I have sketched how states and markets are interconnected and what actions produce various outcomes. I have extracted general principles by which these outcomes can be understood. I now

relate this framework back to current perspectives in economic sociology: networks, population ecology, institutional theory, and the problem of constructing action. While these perspectives differ, I believe that the political-cultural approach I have advanced here unites many of the positive features of each.

Network perspectives have been used to document a large number of social relationships in markets. They have indexed resource dependence, status hierarchies, brokering, channels of information, and trust relations. I have argued that stable markets reflect status hierarchies that define incumbents and challengers and that market leaders enforce the market social order and signal how crises are to be handled. These complex role structures in markets operate through networks. My view of markets takes seriously the problem of how states interact with markets to produce general rules by which social structures can be formed. It also makes market structures easier to observe, takes into account the role of actors' intentions in the production of market structures, and makes more sense of how firms are likely to behave under different market conditions.

Ecological approaches have focussed on the problem of how firms establish a niche, the population dynamics of firms, and the process of legitimation of firms in a niche. A political reading of these processes is consistent with the approach I developed here. The liability of newness results, at least partially, from the lack of social structure in a market and the

social movement-like search for such a structure. Legitimacy is bestowed by states on markets. A "stable" market for an ecologist resembles one in which a conception of control is shared. Similarly, as in ecology, the transformation of markets results from external sources of change.

Much of the perspective developed here is latent in institutional theories and the organizational theories they rely on. My approach focuses more than most institutional theories on political processes, both in the formal structuring of institutions by the state, and in the formation, stability, and transformation of markets. But the goal of action is to build stable markets, a view I have adopted from institutional and organizational theory.

I have tried to take the problem of agency quite seriously and to predict how actors' choices depend upon market structures and sets of rules. I have argued that what goes into these choices is more open to contestation during fluid market conditions, and that Padgett and Ansell's conception of robust action (1992) captures how actors come to take advantage of such situations. To this, I have added the broader notion that conceptions of control capture an important aspect of how actors frame action vis-a-vis one another. Conceptions of control are shared cognitive structures within and across organizations that have profound effects on organizational design and competition.

The metaphor of "markets as politics" is the theme used to

unite these ideas. I have shown how this view makes possible a unified approach to the study of markets-- an approach that focuses on the political processes that underlie market interactions. Ultimately, however, the usefulness of any metaphor is in the research it generates and the intuitive and counterintuitive insights it creates.

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## Footnotes

1. Finance economics, agency theory, and transaction cost theory are all attempts to specify how profit maximizing social relations evolve to govern firms and industries. Some proponents argue that all firms in every market (defined in product or geographic terms) will ultimately converge (Jensen, 1989), but others are prepared to recognize that preexisting social relations might provide additional efficiencies (Williamson, 1991). Evolutionary theory (Nelson and Winter 1980) and path dependence arguments (Arthur 1989) can be used in a very similar way to account for the dynamics of real markets.

2. In White's (1981) model, this is done by firm's watching one another's pricing and production behavior and then deciding to differentiate their product from their competitors. The main difference between White's argument and the argument proposed here is that I want to view this process as a political process as opposed to an economic one.

3. White's (1981) model is very close to what the population ecologists would call firms trying to create a "niche." The search for a niche is an attempt to avoid direct competition by differentiating your product from those of your competitors.

4. One could argue that markets for illegal goods develop and that this negates the arguments about the role of states in

markets. My view is that illegal markets depend on states in a great many ways as well. For instance, illegal markets use many of the commercial channels that were set up by legal markets (e.g. shipping and banking). The definition of a market as illegal implies much about how it is likely to be organized. Hence, the conception of control governing illegal markets will not be ratified by states, but will be a reaction against them.

5. Much of this discussion is inspired by the recent literature in political science that defines itself as historical institutionalism (March and Olsen 1989; Hall 1989; Steinmo, Thelen, and Longstreth 1992).

6. This perspective does not imply that the state is pivotal for every economic process. Even in societies where states have a history of intervention, state involvement is variable and its effects are variable as well. The state's role depends on which market is being discussed and the current conditions in that or related markets.

7. The purpose here is not to develop a theory of the *forms* of states, but only to note their potential influence on market formation through their power to make the rules that govern all forms of social activity in a given geographic area.

8. My view of markets is roughly consistent with the idea of



organizational fields, in that a market consists of firms who orient their actions towards one another (DiMaggio and Powell, 1983). I have elaborated this view by considering how markets are constructed and the roles that conceptions of control and politics play in this process.

9. I do not mean to imply that markets and industries are the same thing. Markets involve buyers and sellers of a commodity whereby industries refer to producers of similar commodities. Another issue is that most large firms participate in many markets. For instance, there are a number of markets where steel is sold. The firms who produce the product often sell into different markets. Since the basic product is similar across the markets (although its end use may be different; i.e., rails, automobiles, bridges) and the participants in these markets take one another into account in their actions, it is useful to speak of the steel industry. The general abstract dynamics discussed within markets can be played out across producers of some product or set of related products.

10. Invader organizations or new actions by challenger organizations do not necessarily produce a new conception of control. Actions can be oriented toward shifting the identities of challengers and incumbents within a market, and thereby preserving the basis of the noncompetitive order. It is only when

the situation is fluid (i.e., the market is in crisis) that it is possible to create a "social movement" around a new conception of control.