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Joel M. Podolny: Status Signals

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Introduction

AN EMERGENT PERSPECTIVE FROM AN EMERGENT FIELD

WE ARE ALL FAMILIAR with the popular image of the academic researcher, high atop an ivory tower in serene and sublime contemplation. While this image provides fodder for those who are critical of the alleged detachment of higher education from practical concerns, it also is probably one of the initial attractions for those who choose academia as a profession. Certainly, I found the image strongly appealing when I decided to pursue a Ph.D. more than fifteen years ago. However, in the intervening years, I have come to the conclusion that academic research has all the serenity and sublimity of a wrestling match. Ideas and research findings do not float in through the tower window on a breeze; rather, like Gulliver's Lilliputians, they tug, pull, taunt, and elude easy capture. An idea that seems downright insightful on one day turns out to be completely wrongheaded the next. Sometimes one happens upon an unanticipated empirical finding that suggests a promising research path; however, after a week or longer, the promising path turns into a dead end. Often there is the challenge of pulling together what initially seemed to be a disconnected smattering of findings—some of which were anticipated and some of which were not. In order to be able to make significant progress, one is forced to transform sublime contemplation into active obsession, allowing half-formed ideas and initial findings to keep a grip on one's thoughts long enough that one can finally discern a pattern or clarify a concept. If one begins to believe in the mirage of well-specified ideas flowing in through the window on a breeze, there are well-meaning colleagues and blind reviewers to quickly and unsympathetically bring one back to one's senses.

Since roughly 1990, I have been wrestling with understanding how various facets of the concept of status relate to the market. Usually, we think of status in the context of relations among individuals or groups of individuals—for example, the pecking order among cliques in a U.S. high school, the deference displays in medieval courts, or the restrictions and constraints on interaction in a caste society. We think of status less often as a property that firms possess. Sometimes we might make passing reference to status distinctions among firms—noting for example that a bank is particularly prestigious, a law firm is a “white-glove firm,” or that a brand has “class.” Yet, even in those instances when we acknowledge status differences among firms, we generally do not

give much attention to understanding how these status distinctions arise, are maintained, or are changed over time.

Like others, I had not given the concept of status in markets much thought, but when I was a graduate student at Harvard, I read a book on the investment banking industry by Robert Eccles and Dwight Crane called *Doing Deals*. In one of the chapters, the authors observed that investment bankers obsess about how their status compares with the status of other banks. As I discuss in chapter 3, the investment banking industry is unique in that it has “tombstone advertisements” that serve as tangible indicators of firm status in this industry. However, the more that I thought about Eccles and Crane’s observation on the status obsession itself, the more that it seemed that this obsession was probably not unique to investment banks. As I looked at books and articles on different industries—from accounting to fashion to toys—it became clear that firms, like individuals, are deeply concerned with their status. However, none of these industry studies provided much in the way of systematic information about the underlying causes, consequences, and mechanisms related to those distinctions. Nonetheless, because sociologists had thought deeply about the concept of status among individuals, it seemed reasonable to try to extend and apply sociological thought on status to understanding the way in which status operates in the market.

I started along this path after being excited and inspired by the research that had emerged in economic sociology during the 1980s. Since Harrison White asked in a provocative 1981 *American Journal of Sociology* article “Where do markets come from?” a large number of sociologists have been seeking to demonstrate that the operation of the market can be better understood if it is conceptualized as a social mechanism. For example, White conceived of the market as a structure in which the production volumes and revenues of producers could be better understood if one modeled producers as occupying interdependent roles. According to White, producers do not perceive demand curves; rather, they perceive the choices of other producers and pick a pricing/volume combination that places them somewhere between those producers acknowledged to be slightly lower in quality and those slightly higher in quality. By way of analogy, White (1981) observes that shortly after Roger Bannister broke the four-minute mile—a record many considered unattainable—a number of others did the same. While there clearly are alternative explanations for the quick followers on Bannister’s achievement, such as improvements in training and diet, the analogy is nonetheless relevant insofar as it helps connect White’s market model to sociological accounts of the role structures within groups. For example, in *Street Corner Society* (1981), a famous ethnography of a city street gang, William Whyte (1981) observed how the bowling scores of group members were constrained by their position in the social pecking order of the gang. In markets, as in athletic competitions or social groups, “what is possible” is in large measure socially defined by qualitatively differentiated

peers looking to each other for cues regarding appropriate aspirations and performance.

While there is general agreement that economic sociology is one of the burgeoning subfields within the discipline, there is a clear lack of consensus regarding the scope of the “new economic sociology” (Swedberg 2003). I would assert that a defining characteristic of economic sociology as it is currently unfolding is that it draws on sociology’s broader corpus of analytical constructs to rethink the operation of the market.

One branch of the “new economic sociology” seeks to make clear that the existence of a market mechanism for the allocation of resources is not the inevitable consequence of individuals pursuing their own interests but is instead the consequence of collectivities pursuing a common interest (typically at another collectivity’s expense), dominant cultural understandings, as well as state action. This line of research has deep historical roots in Polanyi’s classic work *The Great Transformation* (1944) but has gathered new momentum through the work of Dobbin (1994), Carruthers (1996), Beckert (2002), and Fligstein (2001).

In addition to this line of research exploring the institutional underpinnings of the market, there is a second line of research—the line of research into which this book falls—that focuses on how a market actually operates. At its most fundamental level, the market is a mechanism for matching. However, what determines which buyers are matched with which sellers? What determines the terms of trade—price, quality and quantity of effort—that arise between a particular buyer and seller?

In the standard general equilibrium model of economics, the mechanism for matching and setting prices is what has come to be called the “Walrasian auctioneer,” who sets prices so that the market clears (i.e., there is no excess demand at the set prices for goods). The Walrasian auctioneer—named after the French scholar who is considered the father of general equilibrium economics—is simply an analytical convenience, an assumption that is necessary for the general equilibrium model to make predictions about prices. However, since the Walrasian auctioneer does not exist in real markets, basic questions about the market’s operation remain: What does determine who exchanges with whom? What are the determinants of the terms of trade?

I think it is fair to say that economic sociologists have not developed a parsimonious account of a matching mechanism to serve as an alternative to the Walrasian auctioneer. However, they have emphasized several aspects of the market’s operation that do affect the patterns of exchange and the terms of trade. For example, Espeland and Stevens (1998) highlight processes of commensuration, whereby qualitatively dissimilar goods are made comparable through the establishment of a common metric. Zelizer (1994) shows how culture and institutions shape the “mental accounts” that we reference when we calculate what we are willing to pay for particular goods and services, and

even what we think should carry a price at all. Above all, however, economic sociologists emphasize networks of relations between individuals and corporate actors. One of the cleanest demonstrations of the effect of social networks on market outcomes is Wayne Baker's (1984) analysis of the floor of the commodity exchange in Chicago. Economic models of markets generally posit that market efficiency increases with the number of participants and that one of the manifestations of increasing efficiency is a reduction in the volatility of prices. However, Baker argued that individuals do not have the cognitive capacity to process countless buy and sell offers. Accordingly, when the number of traders of a particular commodity increases beyond some threshold, the market tends to fragment into distinct groups of traders who focus primarily on the buy and sell orders within their clique. Such fragmentation increases price volatility; in effect, cognitive limitations cause actors to rely on personal networks for information, and this reliance on personal networks influences the operation of the market. Mizruchi and Stearns (2001) show how a similar reliance on personal networks in a context of uncertainty affects the terms that relationship managers in banks are willing to provide to corporate clients.

More generally, networks are central analytical constructs in the "embeddedness" tradition within the new economic sociology—first articulated by Granovetter (1985) and subsequently developed by others, such as Raub and Weesie (1990), Portes and Sensenbrenner (1993), and perhaps most notably by Uzzi (1997). In the embeddedness tradition, social ties among market actors are seen as conduits for information about exchange opportunities and conduits for trust; stronger social relations allow for the sharing of more complex information between buyer and seller than simply price and quantities, ultimately allowing for a better match of interests. Padgett and McLean (2002) have recently extended and enriched the embeddedness perspective by arguing that particular patterns of exchange relations can be understood as manifestations of logics that transpose from one context to another. So, for example, the pattern of relations defined by marriage may come to be seen as an appropriate pattern for exchange relations in a particular market, with strong implications for who can exchange with whom.

Networks are also central to Burt's (1992) theory of structural holes, in which an actor's autonomy from exchange partners depends on the degree to which the exchange partners are themselves disconnected from one another. To the extent that the actor's exchange partners are disconnected from one another, the actor is able to obtain highly favorable terms of trade for the information and resources that the actor provides.

As these and other scholars show, ideas about social networks are central to the new sociological rethinking of the market. In each of the cited references, networks are important to markets in a particular way. They shape outcomes insofar as they are conduits for the flow of information or resources; metaphorically, they are channels or "pipes" through which "stuff" flows. So,

in Baker's study, networks are conduits for the flow of information about buy and sell offers.

While this research certainly makes a compelling case that networks influence patterns of exchange and terms of trade by serving as pipes for the flow of information and research, there is another way in which network ties can be relevant to market outcomes. Not only can a tie between two actors facilitate flows between those two actors; that tie can also be relevant to market outcomes when others in the market make inferences about the qualities of those two actors on the basis of the tie. For example, in a study of day care centers, Baum and Oliver (1992) argue that consumers' perceptions of a day care center are strongly influenced by whether the day care center has a tie to a legitimate institution like a church or school. The significance of the tie does not hinge on information or resources that pass between the day care center and the legitimate institution but on third parties' perceptions of the tie and the inferences that those third parties draw about the quality of the day care center based on its presence.

Insofar as the presence or absence of a tie between two actors becomes the basis on which third parties make inferences about underlying qualities of those actors, the overall pattern of relations in a market becomes an important guide to market actors as they seek out exchange partners and decide on appropriate terms of trade. If the metaphor of a pipe is appropriate for the first characterization of network ties, then the metaphor of a prism seems appropriate to this second characterization because ties serve as the basis for splitting out and inducing differentiation among one set of actors as perceived by another. In effect, the pattern of ties becomes the lens through which the differentiation in the market is revealed.

As I shall discuss in more detail shortly, an actor's status is fundamentally a consequence of the network ties that are perceived to flow to the actor. Accordingly, in highlighting the relevance of status for markets, I have sought to broaden the way in which the field has come to understand the relevance of networks to market outcomes—to encourage sociologists to look to a focal actor's ties as a fundamental basis on which others (not necessarily connected to the focal actor) make inferences about the quality of that focal actor. Put simply, I have sought to highlight the importance of networks, not simply as conduits for the flow of information and resources, but as constituent elements of identity.

Status is, of course, not the only aspect of identity that is influenced by an actor's network of relations; nor is status the only aspect of identity relevant to market outcomes. For example, Rao, Davis, and Ward (2000) look at how firms affiliate with either the NASDAQ or New York Stock Exchange to affect how others perceive them. A particularly provocative demonstration of how an actor's pattern of relations becomes the informational basis on which third parties make inferences about the qualities of the actor comes from Zuckerman

(1999, 2000), who examines how the conceptual categories of financial analysts affect the divestitures and stock prices of firms. A financial analyst at a securities firm does not follow and predict the performance of all firms. Instead, the analyst focuses on some particular subset of firms that conforms to an institutionalized cognitive category within the profession. A category such as food stocks may be institutionalized, but a category like entertainment might not. Zuckerman argues that analysts are less likely to track firms whose portfolio of assets cuts across the boundaries of these cognitive categories, because such boundary spanners lack a clear reference group for the purpose of evaluation. In effect, one can think about a firm's acquisitions and diversifications as constituting its pattern of exchange relations across and within categories, and the analysts make inferences about the firms based on that pattern. A lack of attention from analysts translates into a lack of attention from the investment community, which in turn gives rise to an increase in the cost of capital. Therefore, even if there is an economic justification for a portfolio of assets cutting across these boundaries, a firm is penalized by the capital markets for having a pattern of exchange relations that is inconsistent with the institutionalized categories of the market. Insofar as Zuckerman's work underscores how a firm's pattern of exchange relations shapes how that firm is perceived, Zuckerman's work also underscores the prismatic function of market networks—where the pattern of ties induces identities.

Nevertheless, while there are other aspects of market identity that can and should be explored in order to better understand the operation of the market mechanism, the central premise of this book is that there is considerable analytical leverage from an explicit focus on status.

In 1993 I published my first paper using the concept of status as a lens with which to examine market competition. The paper appeared in the *American Journal of Sociology* and was titled "A Status-Based Model of Market Competition." From the time of that article, I have—either alone or with collaborators whom I recognize more fully in the acknowledgements—considered the relevance of status in a diverse array of market contexts: investment banking, wine, semiconductors, shipping, venture capital, and currently Formula 1 racing. The results of the studies have now appeared in a number of journal articles or books chapters.

Although each of these markets afforded an opportunity to turn a clear analytical lens on one or two particular facets of status, none alone provided an opportunity to articulate the full set of relevant questions or to highlight the methodological concerns common to almost any investigation of status processes in markets. Moreover, given that different markets required different measures of status, it was not always obvious to others or even to me how the various studies related to one another.

In bringing together the results of these various empirical studies, I have tried to construct a whole that is greater than the sum of the parts. Though I provided a formulation of the status-based model of market competition in the

1993 paper, my thinking has evolved over the years as a result of the studies that followed. At the same time, other scholars have conducted research that furthers our understanding of status and related constructs.

Because my own thinking has evolved and because there has arisen considerable related work, this book has multiple objectives. The first is to more clearly articulate the concept of status as a signal. In particular, there are some important differences between my conception of a signal and the conception of a signal in the economic literature. I work through these distinctions most clearly in chapter 2.

The second objective of this book is to more clearly integrate findings from various papers that I have authored or coauthored. In integrating the various studies, I seek not only to elicit a richer appreciation of the status dynamics within markets but to highlight the interdependence of status distinctions that arise in the market and those that arise in other domains, most notably in the social sphere and in the domain of technological innovation among corporations. As I shall discuss in more detail, one of the distinctive features of status is that it “leaks”; an actor’s status is affected by the status of those with whom the actor associates. Similarly, status leaks across different domains in which the same actors may interact. For example, the status that leaders of firms possess in the social sphere can spill over and have consequences for the status of the firms with which those leaders are associated. Therefore, while the first empirical analyses in chapters 3 through 5 focus exclusively on status dynamics within the market, chapters 6 and 7 broaden the scope of inquiry to demonstrate the market consequences of status distinctions that arise in related, interdependent domains.

A third objective of this book is to pose an orienting set of questions for the examination of status dynamics in markets and to highlight some recurring empirical concerns that arise in exploring those status dynamics. Some of the most central analytical questions include the following:

- What are the primary market mechanisms by which a status ordering in the market is sustained?
- How do status distinctions in other related domains spill over into the market and influence market competition?
- What inequalities in economic rewards are engendered by the status ordering?
- What environmental conditions determine whether the engendered economic inequalities are greater or less?

Some of the recurring empirical concerns are

- identifying central deference acts from which status distinctions arise;
- modeling the effect of signals besides status on which market actors could rely to make inferences about the quality of potential exchange partners.

A fourth and final objective of this book is to relate my work on status to the work of others. Over the years, I have been asked how my conception of status

relates to the economic concept of reputation or the marketing concept of brand. In chapter 1, I discuss the difference between status, on the one hand, and reputation and brand, on the other. In chapter 2, I discuss hypotheses and predictions that follow from a conception of status but do not follow from the prototypical conceptions of reputation and brand. In addition to clarifying distinctions between my understanding of status and related constructs from other academic fields, I also aim to clarify connections and draw distinctions between my work and other work within my own field of sociology. Since the publication of “A Status-Based Model of Market Competition,” a number of other sociologists have found status to be a useful construct in their own research on market dynamics. Throughout this book, I try to integrate the research of these scholars with my own. There is also, of course, a rich tradition of work on status outside of markets. In addition to appearing as an important theme in classic works by Weber (1948), Veblen (1953), and Blau (1964), among others, the concept of status figures prominently in an experimental tradition known as expectation states theory (Berger et al. 1977), and in a recent paper Gould (2001) develops a provocative formal model of status hierarchies in groups. While these writings have had a strong effect on my thinking at a general level and therefore exert an influence on ideas throughout this book, I provide a particularly focused discussion of the similarities and differences between their conception of status and my own near the end of chapter 2. I also try to establish more explicitly connections to other perspectives in economic and organizational sociology, such as the “embeddedness” tradition (Granovetter 1985), Ronald Burt’s (1992) theory of structural holes, and organizational ecology (Carroll and Hannan 2000), as well as a rather diffuse literature on the evolution of technology (Hughes 1987; Pinch and Bijker 1987). Even though these other research traditions are not centrally concerned with status dynamics, they do draw attention to features of firms and markets that are relevant to a full understanding of status dynamics within markets. Accordingly, it seems appropriate to integrate their insights with mine. Therefore, after laying out the core theoretical arguments in chapters 1 and 2 and offering empirical analyses in chapters 3 through 5 that focus solely on status dynamics within the market, I present analyses in chapters 6 through 9 that draw on these other literatures for a more multifaceted understanding of status dynamics in markets. Chapter 6 focuses on how status distinctions associated with the evolution of an industry’s technology affect the status dynamics of the market. Chapter 7 links a concern with status dynamics in markets to the embeddedness perspective on markets. Chapter 8 relates a concern with status dynamics to organizational ecology, and chapter 9 considers the relevance of status to market competition in conjunction with Burt’s theory of structural holes.

I am confident that a thoughtful reader will be able to quibble with a particular operationalization or offer an alternative explanation for a given finding. I certainly know I had my own concerns with some of the empirical analyses;

indeed, the concerns that arose in one study typically paved the way for the study that followed. In writing this book, I have tried to highlight the complementary nature of the various empirical examinations; my aspiration is that the reader's concerns about a particular analysis will be assuaged by encountering the other analyses. Even if the reader finishes the book with residual concerns, these need to be set against the payoff of the diverse array of market phenomena that are glimpsed more clearly through the lens of status. To the extent that the lens helps us to focus on aspects of market phenomena that are otherwise obscured by the dominant images of markets, I feel comfortable that this book constitutes a contribution to the emerging field of economic sociology.