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REVIEW OF LITERATURE AND THEORETICAL DIMENSIONS

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3.1 Introduction:

In order to achieve a clear understanding of the current state of the literature on financial markets in general and individual investor behavior in particular and thereby identify concepts that might be relevant for the behavior of investors, an extensive literature study was performed. Scientific journals in Sociology, behavioral finance, marketing, economics, and social-psychology were filtered for concepts such as (individual) investor behavior, investors’ needs, conformity behavior, social influence and stock market dynamics, herding processes, informational cascades and a variety of financial market facts.

Man as a social animal manifests his behavior at different settings. It has been the quest of sociologists to understand the myriad facets of human relationships and analyze the effects of society on man and vice versa. Economic activities are one such area where human relationships are exhibited in all their various forms. As such, this behavior has garnered attention of Sociologists.

Market as an arena of social activity has most often construed and studied only partially. Studies on the economic activities of buying and selling that takes place in this predestined area termed market has taken precedence over the social actors who are instrumental in bringing about this activity in the first place. Further the propositions like actors in the market are rational
animals is sought to be reviewed here. Just as there is no human being who can live alone so are there no human beings who do not enter into an exchange at any point in their lives.

Markets are more than sites for transactions. Financial markets have often been seen by economists as efficient mechanisms that fulfill vital functions within economies. But do financial markets really operate in such a straightforward manner? Is there no role to play for the social factors? The stock market server as an excellent vantage point to explore these aspects since it is supposed to be dwelt by ‘rational beings’. It would be interesting to bring out the social factors that operate behind this so call ‘rational action’ in this arena.

3.2 Sociological studies on financial markets:

Financial markets have been subjected to sociological inquiry since long. This section traces the studies made on financial markets from sociological perspective. The history of sociological interest in securities markets and their kindred commodity futures markets runs the same course as the general history of sociological interest in markets.

The rise of quantitative financial theory in financial economics from the 1950's onwards has led to an academic specialization on financial markets rather focused on economic modeling and poorly attentive to sociological aspects which play a very prominent role. In the 1980's a number of economic sociologists developed empirical investigation on the social structure and cultural characteristics of financial markets. Such pioneering research works included the contributions from Wayne E. Baker, Mitchel Y. Abolafia and Charles W. Smith was based on methods such as ethnographic observation or Social Network analysis.
Adler and Adler (1980) have analyzed the stock market from a social psychological perspective; Burk (1982), conducted an institutional analysis of the American stock market; and Baker has focused on the stock options market. Similarly, Abolafia (1996) and Baker have analyzed various characteristics of the contemporary futures markets (Baker 1981).

With reference to the study on market by Sociologists, it can be observed that these studies did not happen all of a sudden. It was not even an off shoot of an event or episode that triggered such studies. It took sufficient time for the Sociologists to make a shift in their focus from the conventional anthropological and ethnographic studies on aspect like community, culture to other institutionalized activities like market. From the 1980's onwards, a number of economic sociologists developed empirical investigation on the social structure and cultural characteristics of financial markets. Research works in this area includes the contributions from Douglass (1977), Baker (1981), Tolbert and Zucker (1981), White (1981), Abolafia (1984), Uzzi (1996), Grullon and Ikenberry (2000), Barber and Odean (1999), Ryan (2004), and Zuckerman (2004).

Classical roots to works on the markets in general and financial markets in particular can also be noticed. One can find Sociologist exploring the general way that market operates. Some of these studies are Weber's approach, works addressing markets as "networks" and "markets as parts of fields." Parsons and Smelser also provide valuable insights.

Karl Marx, talking about individual and their different interests identifies that the interests of different individuals is not about individual interests but rather it is all about 'class interests'. Marx spoke of 'social
individuals’ to emphasize the fact that individual always connected to other people.

Weber was especially interested in the markets and he tried to develop what he termed Sociology of 'the market'. Weber’s writing demonstrates his belief that stock exchanges fill a crucial role in the modern capitalist machinery and they can be organized in very different ways, depending on the state of the state, experience of the businessmen in operation on stock exchanges and so on. He emphasized the legal and ethical dimension of the dealings in the modern stock exchange, but was also fascinated by its political role - its role as a "means to power" in the economic struggle among nations. Weber argued that the price on the market is a result of economic struggle price struggle" (1947), the struggle over prices, he explained, has two aspects that must be separated. On the one hand, there is a "struggle of competition" between those who are potentially interest in an exchange; and on the other hand there is an 'interest struggle" between the two parties who end up in an exchange.

Durkheim speaking about different kinds of economic institutions considers stock exchanges to be institutions relating to exchange. Durkheim opines that it is impossible to separate the economic element from social life and ignore the role of society. As opposed to economic man, he writes, "real man--the man whom we all know and whom we all are--is complex in a different way: he is of a time, of a country; he has a family, a city, a fatherland, a religious and political faith; and all these factors and many others merge and combine in a thousand ways, converge in and interweave their influence without it being possible to say at first glance where one begins and the other ends".
Analyzing the role that interest plays in economic life, in *The Elementary Forms of Religious Life*, Durkheim stresses "the principal incentive to economic activity has always been the private interest" Durkheim (1912). This fact, however, does not mean that economic life is purely self-interested and devoid of morality: "We remain [in our economic affairs] in relation with others; the habits, ideas and tendencies which education has impressed upon us and which ordinarily preside over our relations can never be totally absent". But even if this is the case, the social element has another source than the economy and will eventually be worn down and disappear if it is not periodically renewed. It can only be renewed if people forget about the economy and come together in collective activities, just for the sake of being together. If this is not done, society will wither away-and eventually so will the economy.

Economic actions of two actors who are oriented to one another, Weber argues, constitute an economic relationship. These relationships can take various expressions, including conflict, competition, and attempts to impose one's will on the other (power). If two or more actors are held together by a sense of belonging, their relationship is "communal"; and if they are held together by interest, it is "associative" Weber (1925), Economic relationships (as all social relationships) can also be open or closed. Weber also made conceptual distinction between exchange and competition. Social action in the market begins, according to Weber, with competition and ends up in exchange. He used such terms as "market struggle," and he spoke of "the battle of man against man in the market" (1925; 1978; 93, 108). Weber was very interested in the interaction between the market and the rest of the society.
Talcott Parsons developed the notion that sociology deals with its value aspect of the means-end relationship of social action ("the analytical factor view"). In the 1950’s Parsons recast his ideas on the relationship of economics to sociology (1956). Parsons and Smelser note that the economy itself can be understood as a subsystem, which interacts with the other three subsystems (the polity, the integrative subsystem, and the cultural-motivational subsystem).

Polanyi speaking of economic actions says they become destructive when they are "disembodied”, or not governed by social or noneconomic authorities. Polanyi’s general argument is that rational self-interest is, among other things, far too unstable to constitute the foundation of society—the reason being that an economy must be able to provide people with material sustenance on a continuous basis. There exist three forms of integration or ways to stabilize the economy and provide it with the unity that it needs: **reciprocity**, which takes place within symmetrical groups such as families, kinship groups, and neighborhoods; **redistribution**, the allocation of goods from a center in the community, such as the state; and **exchange**, the distribution of goods via price-making markets (1957; 1971). In each economy, Polanyi specifies, there is usually a mix of these three forms and their corresponding institutions: the family, the state, and the market. Prices and trade may also differ, depending on which form of integration is involved.

Lie (1997), considers the various theoretical schools of thought in order to discuss the transition from planned economy to market and globalization. He notes the difficulties of theorizing about the historical and institutional complexity of markets. Fligstein and Dauter (2007), in their work titled “Sociology of Markets” note the vibrancy of the field of sociology pertaining to markets during the last 25 years. They show how an agreement has emerged
about the consideration of markets as social structures characterized by social relationships between firms, works, suppliers, customers and governments.

Kahneman and Tversky (1979), found that contrary to expected utility theory, people placed different weights on gains and losses and on different ranges of probability. They found those individuals are more distressed by prospective losses than they are happy by equivalent gains. Some economists have concluded that investors typically consider the loss of $1 twice as painful as the pleasure received from a $1 gain. They also found that individuals will respond different to equivalent situation depending on where it is presented in the context of losses or gains. Researchers have also found that people are willing to take more risks to avoid losses than to realize gains.

Le Roy and porter (1981), attack the efficient Market Hypothesis by arguing that there is more volatility in the market even though all market participants have access to the same information, which is further incorporated in the price.

Westphal et al (1997), show that decision-making criteria increasingly deviates from efficiency considerations as policies become institutionalized through cumulative adoption or the reduction in uncertainty about market value that results in increasingly positive market reactions.

People do not always behave rationally and although departures from rationality are sometimes random, they are often systematic. For example, far more people overestimate, rather than underestimate, their driving ability (Barber and Odeon 1999). In recent years, it has been identified that the ways in which people systematically depart from optimal judgment and decision-making are more of aspects of human nature. Another study
conducted suggests that loss aversion - the tendency to be more sensitive to losses than to gains - and narrow farming - the tendency to focus on narrowly defined gains and losses - play an important role in determining how people evaluate risky gambles.

Hong et al. (2001), conducted a study wherein they proposed that stock-market participation is influenced by social interaction. According to them any given "social" investor finds the market more attractive when more of his peers participate. They tested this theory and found that social households those who interact with their neighbors, or attend the church - are substantially more likely to invest in the market than nonsocial households, controlling for wealth, race, and education and risk tolerance.

Zuckerman (2004), develops and tests a theory of social structural factor responsible for variation in level of market activity. He emphasizes that the interpretation of material information I problematic and that market participants do not converge on a single, best interpretation, as assumed by the efficient market hypothesis. The social structure, he continues is the system of classificatory distinctions made by market participants in the course of valuation of a particular stock. He further argues that to ascertain how a piece of information should be interpreted, market participants first note what type of asset is under consideration and then interpret the available news as it would interpreted when applied to other members of that asset class. Prices, according to him merely reflect the information that is revealed and interpreted outside the market. Market activity itself plays a limited role in determining market outcome. His works illustrates how structural sociology helps understand the structural bound on market efficiency.
3.2.1 Literature pertaining to the sociology of finance:

Some of the recent studies in the field of sociology of finance include those which have the financial system at centre of analysis. These studies contribute greatly to the understanding of financial markets by delineating the social structure of the markets. They also speak about the markets in terms of the relations of the various actors. Instead of focusing predominantly on the price mechanism as is the case in studies conducted from the economics perspective, sociology gives deeper insights. The studies conducted from economic perspective consider markets to be perfect mechanisms, but reality is far from perfect. This is the fact that sociology tries to bring out. It considers the social aspects of the financial mechanism. Finance, is a social construct and hence, a sociological understanding of the field world prove to be more useful than what could be achieved by considering just a model. This fact is emphasized by various studies.

Carruthers and Kim in their work "The Sociology of Finance"(2011), focus on the economic crisis in the US financial system which occurred between 2008-2010. They point out the changes in the financial system post crisis period and show the bank operations shift from the traditional originate-and-hold model to originate-and-distribute model. This has led to greater global interdependence. Changes not just in macro levels but also micro level have been observed. Changes were seen in household's exposure to stock market increase when compared to pre-crisis period. This research reveals the importance of politics for many financial market developments, various implications for corporate governance, the continuing significance of social factors within finance and the role of theoretical and material devices in shaping financial practices. This research work gives key directions for future
research focus on finance in relation to social inequality, informal sectors, valuation and social networks.

Keister (2002), in the article “Financial Markets, Money and Banking” makes a review of the contributions of sociologists to the understanding of financial relations since the early history of the discipline. The review begins with an overview of classical sociological approaches to financial markets, money, and banking and then describes how research in these areas has exploded in recent decades. The study, having traced the classical roots, further describes the current state of research on money, relations among banks and firms and interlocking directorates.

3.3 Social Network studies:

Social networks have come to take a prominent place in sociological analysis. A social network is a “structure of relationships linking social actors” studying social relationships have always been at the heart of sociological understandings of the world. Simmel suggested that it was the nature of ties themselves rather than the social group per se that lay at the center of many human behaviors in his attempt to understand the transition from agrarian to industrial society.

Sociological research continued to develop, making heavy use of Durkheim and referring less often to Simmel’s network perspective. However, in the 1930’s J. L. Moreno (1934), a psychiatrist and a prolific writer, published *Who Shall Survive? Foundations of Sociometry, Group Psychotherapy, and Sociodrama*. This work marked the major reemergence of the social network metaphor into sociology and equally important across the social sciences and into social policy. Working within the context of a girls’ school of the time, Moreno and his colleagues developed sociometric
techniques that mapped the relationships among individuals (e.g., Jennings 1943; Moreno and Jennings 1938). The goal was not only scientific but pragmatic with Moreno (1934), using network data to develop “interpersonal therapy”, discussing its use with national leaders, including then President Franklin D. Roosevelt (Pescosolido, 2006).

Analysis of the effect of the individuals’ ties to the larger community on boundary maintenance within the family have been largely restricted to investigations of the effect on intra-familial relations of membership in adolescent peer groups.

Barnes (1954), however, introduced the idea of a social network to describe an order of social relationships which he felt was important in understanding the social behavior of the Parishioners in Bremnes and which was not subsumed by structural concepts such as groups based on territorial location or on occupational activities. He later used the concept to draw the distinction between the type of social network which would characterize a community like that of Bremnes and the type which would be characteristic of a classical tribal society. The interest here is in the morphological features of the network itself and their implications for social behaviour rather than in the flow of communication through the network, though communication-flow is not excluding by Barnes’s approach.

Bott’s study of conjugal roles in London families (1955;1956; 1957). In this study she correlated the morphological characteristics of the networks of the families she was studying with the allocation of conjugal roles within the family. The attractive feature of Bott’s study was that her dependent variable (conjugal roles) was not patently connected with her independent variable (‘closed’ or ‘open networks of the couples). In this exploratory study of 20
London families, Bott, developed a hypothesis concerning the consequences of the external social networks in which husbands and wives are involved for conjugal role organization. She noted that if family members maintain ties with a network of friends, neighbors, and relatives who know one another and interact apart from the family members, the members of this social network can develop norm consensus and exert pressure on the network’s members. Two individuals who are members of such close-knit networks when they marry and who, after marriage, continue to be drawn into network activities, can afford a conjugal role organization based on a clear differentiation of tasks with few shared interests or activities. If either needs instrumental assistance, he or she can call upon other members in the extra-family social network. The network’s continuing emotional support also lessens the expressive demands each spouse needs to make of the other.

Phillip Mayer (1964), and his colleague Pauw (1963), specifically used the idea of social network to elucidate the behaviour of different types of migrants and of settled townsmen in the South African town of East London. They have concentrated on the important point made by Bott, that the behavior of people who are members of a ‘close knit’ group of friends is likely to be considerably influenced by the wishes and expectations of these friends as a whole, while those whose acquaintances do not know one another may behave inconsistently from time to time without involving themselves in embarrassment.

Mayer (1966), used the idea of a social network somewhat differently. He traced the chains of influence through which a candidate in an election solicited support and showed how the successful candidate was able to reach a particularly extensive body of potential supporters in this way.
Granovetter (1973), deals in his empirical study Getting a Job with the transaction activity of search, namely, job search of professional technical and managerial workers. In his sample, personal contact is the predominant method of finding out about jobs. Thus, the relevant factors of finding a job would be social. Job finding behavior is "... heavily embedded in other social processes that closely constrain and determine its course and results.

An important concept in the literature is on social influence are processes of conformity: that is adjusting one's behavior or thinking to match those of other people or a group standard (Sherif, 1936), and Cialdini and Goldstein (2004). There has been a considerable amount of research on social influence in general and conformity influence in particular (summarized by e.g. Cialdini and Goldstein, 2004). The relevance of this behavior in an investment setting, however was suggested by Dc Bonclt (1998: 835).

Cialdini, Tillman and Pontell (1997), in their work “the savings and loan debacle, financial crime and the state” point out the savings and loan crisis of the 1980’s as one of the worst financial disasters of the 20th century and argue that much financial fraud of the sort that contributed to this debacle constitutes “collective embezzlement”. This collective embezzlement may be the prototypical corporate crime of the late twentieth century.

Riain (2000), considers how states and markets shape one another at the national and world-systems levels and how globalization is transforming that relationship. This process is illustrated through a model based on the expanding international markets through a series of controls on trade and capital flows. The study shows how globalization has undermined many of the controls by states enabling them to increasingly integrate themselves into the local and global networks.
Pager and Shepherd (2008), present a picture of racial discrimination in employment, housing, credit and consumer markets. They show that persistent racial inequality exists in various forms even today. Though it is not overt and widespread as before; it does exist even to this day in various levels in less readily identifiable ways. The work reviews the literature on discrimination, with emphasis on racial discrimination and provides some of the key debates in the study of discrimination.

Conning and Morduch (2011), make a study that puts a corporate finance lens on microfinance. It interesting to study the network among microfinance participants where the social background of the participating actors is quite similar and hostile sometimes. The quarrel, trough and understand throws a better light on this. The study explains the role of various actors like the government agencies and socially minded investors in supporting the microfinance endeavour which aims to democratize global financial markets.

3.4 Social networks studies pertaining to the stock markets:

Socio-economic system such as the financial market behaves like a complex adaptive system (Markose, 2005). Social networks are known to exhibit characteristics of complex systems such as connectionist networks, distributed decision making, control and self-organization (Cilliers, 1998). In a social network, an actor does not exist in isolation, but in a fabric of relations that leads to emergence or social structure due to interactions and response to contingent information in dynamic fashion.

Baker (1984), studies a national securities market from the social networks perspective by defining the stock options market as a social
structure represented by the networks of actors who traded options on the floor of a major securities exchange. He shows that trading among actors exhibited distinct social structural patterns that dramatically affected the direction and magnitude of option price volatility. His work shows that in large markets, restrictive micro networks generate well-differentiated macro networks both large size and differentiation impede communication among actors, a fact which results in exacerbated option price volatility. In small markets, restrictive micro networks generate less differentiated market structures. Both small size and less differentiated markets are conducive to efficient communication which results in dampened option price volatility.

Burt views markets as networks of social contacts between actors and assumes the existence of positive transaction costs. Competition is the struggle of actors for profitable positions within market networks. Competitors profit from "information benefits" and "control benefits" In-formation benefits result from access to valuable pieces of information and knowing whom to bring it to; from timing in the sense of being informed early; and from referrals to players "...you do not know personally but are aware of you" (Burt R. S., 1992).

Podolny (1993), deals in his article "A Status-based Model of Market Competition" with the two transaction activities "search" and "inspection" given positive transaction costs. His analysis aims at, what economists call, qualitative competition among experience goods. Product quality is "signaled" by producers' status in the market. He has used networks as a cause and consequence of the creation of a market status hierarchy.

Zukerman, using networks perspective, argues that the efficiency of the price-setting process in the stock market is contingent on the coherence
of a stock's position in the industry-based classificatory structure that guides valuation. While this structure helps investors interpret ambiguous economic news, it is imperfect because stocks vary in the extent to which they are coherently classified, as revealed by the stocks' position in the network of coverage by securities analysts. He shows that incoherent stocks are traded more often because such stocks are more likely to be subject to differences in the interpretive models used to understand material information; and that both volume and volatility are higher for incoherent stocks because convergence on a common interpretation relies more heavily on self-recursive market dynamics. More generally, the approach advanced in this paper illustrates how structural sociology may illuminate the structural bounds on market efficiency (Zuckerman, 2004).

Yenkey in his study examines how investors of varying levels of wealth, experience in and proximity to Kenya's emerging stock exchange take advantage of short term profit opportunities in a politically manipulated market characterized by significant early gains in IPO share prices by using networks perspective (Yenkey, 2010).

Researches on social networks have demonstrated large networks which display a scale-free power-law distribution for node connectivity (Barabasi & Albert, 1999). These Studies imply that there are many persons with only a few links to others and only a few persons with many links to others (Lynch, 2001), (Ofek, 2003; Sharma, 2005; Valliere & Peterson, 2004).

Network modeling of social interactions has attracted researchers from diverse disciplines including the sociologists and physicists. Historically, much or the work by sociologists focused on static cross section of networks, while the physicists attempted to model the network dynamics to understand the
network processes (Scott, 2011). Networks as a fundamental medium for the emergence and diffusion of information have been studied by Steeg and Lerman (Steeg & Lerman, 2011).

**3.5 Theoretical perspectives:**

The system being explored for the present study has a very strong theoretical understanding. Market both in a place and as an institution has several theoretical framework exploring the functioning patterns.

Theoretical foundations form the basis for exploring any given phenomena, with the available understanding. However, no single theoretical framework can explain any given phenomena and even of such attempt is made such explained would be limited and not complete.

Hence, attempts to understand the network among financial market actors, is made from the available theoretical perspectives.

**3.6 Structural functionalism:**

Market being an institution has evolved from a larger social system and has emerged as a off shoot from the family institution. As a result, market is a sub system as explored by T.Parsons, systems theory.

Financial markets happen to be the sub-sub system i.e, with in society (system), market (sub- system) and financial market (sub-sub system). Even then the sub system cannot function without actors or agents who perform designated role and duties in that system. The structure has changed as lots of specialization has come into being parts and agents have changed both in terms of content and form, similarly, the functioning patterns have all seen new forms.
If one looks from Giddens structuration point of view new profession and new activities have got into newer structure leading to yet another form of structuration as it gets structurated every time.

**3.7 Conflict perspective:**

Markets always had binary opposite roles to be performed by active vig producer and consumer and similarly, buyer and seller. They don’t meet with common, agenda but a conflicting agenda of profile making, but the rational does not explain the win situation, though it is perceived to be.

Conflicting continuously persists leading to a newer equilibrium in spite of just apposed aspirations and interest. The Rational choice theory also fails to explain this phenomenon, where a rational being survives in the market. But on what costs and by what means, and this continues as a process and is never ending. With these ups and downs of gain and loss are addressed as corrections or achieving new equilibrium.

What is interesting and conflicting furthermore is the same role playing people known as ‘investors’ (both buyer and seller) are enacting but the difference is the timing, stocks/scripts, communication and the advice by the informed performer. All these things happen with a sense of interaction which is more symbolic and market has its own language.

**3.8 Interactionists perspectives:**

Interaction happens at all levels and with all actors involved. Market is volatile hence demands constant interactions, constant understanding, constant sharing and analysis the changing scenario.

The interaction is complex that it is a game of trust, loyalty yet cheating. Because, people are investing money to make money at the cost of
others’ money. So, whose money who investors others money. So whose money who invests and who reaps is a big question? So much of technicalities more the common man forms understanding the integration of market operation.

However, the theory explains a bit, the theory of reciprocity explained by Karl Polyani, in the Great transformation, the theory of embeddedness; by Mark Granovetter explain a lot. All these are seen at present in this study from social exchange and more from Network theory of actions.

The different theoretical perspectives further augment with the primary data from the field. The data is presented with the appropriate perspective and explained further is the chapters that follow. The review of literature has been the base for understanding the markets. It shows the gaps in the studies conducted so far. Dimensions that have not been explored yet and dimensions which throw light on the market pattern are studied for the conservative markets and for new models that are emerging.