

# Economic Action and Social Structure: The Problem of Embeddedness

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# Undersocialized View

- aka anarchy/rationality/utilitarianism
- All agents act rationally and for their own self interests
- Social relations are messy and cause friction within the system



# Requirements for an Ideal Market

1. All agents have imperfect information
  - No one knows the entire picture
2. No two agents have prolonged interaction
  - No social interactions

# Oversocialized View

- Behavior is fully constrained by social norms (an external force)
- Obedience is not perceived to be a burden

→ The oversocialized view is the same as the undersocialized view except the governing rules in the oversocialized view are social norms

# CONTINUING EDUCATION

# Embeddedness

Social relations in modern society play an important role in governing the behavior of people within social networks.

# How is it that daily economic life is not riddled with wrongdoing?

- Opportunism by guile or trickery is not suppressed by a self-regulating market.
- How can we avert wrongdoing?
  - Wrongdoing can be averted by mechanisms that make it costly for people to engage in wrongdoing
  - Assume some degree of trust is always present



# Embeddedness reduces wrongdoing

- Networks of relations that formulate individual identity
- Preference to conduct transactions with people whom are known
  - History of transactions are important
  - Over time, social relations become stronger and carries more expectation of trust

As a class, we all decide to collude and commit a crime. Unfortunately, we are caught. Each of us has a choice: cooperate or deny. What do you choose?

# Trust increases opportunity for wrongdoing

- More trust means more gain from the wrongdoing
  - Ex. Con artists, Theranos
- Force and fraud are most efficiently pursued by teams
  - Ex. Corruption in politics
- Coalitions can cause more disorder than atomic behavior alone
  - The fewer ties between the two groups the more “warlike” it becomes

# Transactions in Markets and Hierarchies

## **Hierarchical**

- Within a firm
- Uncertain
- Frequent
- Require substantial transaction-specific investments
  - Money, time, or energy that cannot be easily transferred.

## **Market Interface**

- Between two firms
- Straightforward
- Nonrepetitive
- Require no or little transaction-specific investment
  - E.g. one-time purchase of standard equipment

# Repeat Business

- Trustworthy behavior is enforced by group pressure
- Repeat business discourages any party to seek an advantage in a transaction
- Reputation of fairness
- Business relations spill over to social ones

“Be kind to secretaries and  
the people who work at the  
front desk”

# Conclusion

- Social relations mediate complex transactions and generates a standard of behavior between organizations
- With much trust comes great opportunity for wrongdoing
- You do what your friends do

## Side notes:

- Networking is important for your career
- Be nice to support staff

# Discussion Questions

- What role does influence play?
  - Some people are more important than others (secretaries/ maintenance)
- The null case
  - What about those who don't really integrate themselves into the network? Are they losing out or is there some status quo where you neither benefit nor lose?
- Popularity vs credibility in the spread of misinformation
  - If the Director of the FBI tweeted that 2FA was good, but Oprah tweeted that it is terrible, who would be believed more?