

THE REGULATORY ENVIRONMENT AND THE MARKET FOR NON-STANDARDIZED GOODS: FINDINGS OF INTERVIEW RESEARCH ON SMALL ENTERPRISES IN THE HUNGARIAN CONSTRUCTION INDUSTRY

TIBOR KUCZI¹–LILLA TÓTH²

ABSTRACT In this paper the behavior of economic actors with goods of uncertain quality is examined from the perspective of the sociology of markets. The analysis uses the findings of in-depth interviews conducted in 2011 and 2012 amongst small and medium-size company entrepreneurs working in the construction industry.

In the Hungarian construction industry neither formal rules nor vocational chambers are able to create a safe environment for entrepreneurs. Nevertheless, networks created as a result of a series of micro-selection steps might be able to encourage the enforcement of the quality of services, the observation of deadlines and what is more, ensure payment discipline. In this market, the typically high level of risk that exists can be reduced by relationships. Networks also reduce the cost of transactions since a major part of the services in this field could only be standardized at significant cost.

KEYWORDS entrepreneurs, construction industry, market regulation, non-standardized goods markets, uncertain quality goods

1 Tibor Kuczi is Professor at the Corvinus University of Budapest, Institute of Sociology and Social Policy; e-mail address: tibor.kuczi@uni-corvinus.hu

2 Lilla Tóth is senior research fellow at the Corvinus University of Budapest, Institute of Sociology and Social Policy; e-mail address: lilla.toth@uni-corvinus.hu

INTRODUCTION

The authors conducted research in two settlements of the central region of Hungary in 2011 and 2012³. The interviews were conducted with company owners, managers and self-employed entrepreneurs and represented various construction industry trades⁴. We were interested in the procedures for cooperation that were created between the actors in the economy, and how they could manage to prevent and mitigate the effect of the economic recession with the help of their network and trust relations. During this research effort we found that the crisis had fundamentally reshaped the formerly-established relations of entrepreneurs. On the one hand, as a result of shrinking demand, a few of them were only able to get orders if they could make transactions outside of their networks which ensured the safety of their business. On the other hand, ‘internal splits’ had occurred inside their networks of relatives, close friends and acquaintances mainly because of financial non-performance. Additionally, several of them had closed their enterprises and gone abroad to work and had abandoned their networks.

The withdrawal and exchange of the actors modified not only the formerly-established networks but – of course, not independently – disarranged supply. Unreliable and at the same time barely controllable (in terms of quality) services appeared on the market. As a consequence of sharp competition, entrepreneurs sometimes appeared offering unrealistic low price and unfeasibly short deadlines for completing work. We highlight later in the paper that prices lost their role of carrying information (which was already unreliable) and construction industry services became more uncertain in terms of quality.

Thus the networks of entrepreneurs changed significantly as an effect of the economic crisis. The turbulent changes observed urge us to analyze not only the crisis mitigation effects of the relationships but to make an attempt to explore the logics of network formation at a more abstract level. Besides this, the recession made it more evident that the operation of the construction industry segment of the market – and the operation of other service markets

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4 The research field was Albertirsa, where Lilla Tóth started to conduct research from the beginning of 1990 in several waves. Her findings have been published in various journals (Tóth 1999; Tóth 2005; Tóth 2006). We met 16 entrepreneurs in Albertirsa (four of them had also been interviewed previously). Besides these respondents, there were four entrepreneurs interviewed in Pilis close to Albertirsa.

as well – has characteristics which also exist in periods of prosperity which are less salient but become emphasized in times of crisis, and in this way become more visible. Quality is not equally measurable and standardizable for all kinds of goods (North 1990); on the contrary, there are goods and services about which it cannot be stated with complete certainty that they are worth their price. For instance, if we are lucky we may never realize how amateurishly pipework has been fitted in a wall. The fact that customers in certain segments of the market buy ‘a pig in a poke’ increases the cost of transactions, which has an impact on the organization and operation of these markets and influences the behavior of actors (not only buyers but also sellers who offer better quality services).

In this paper we first discuss the situation of the Hungarian construction industry. Later, using our interview experience we analyze the regulatory environment of that particular market segment. In the second part of the paper, we introduce several characteristics of the non-standardized goods market segment.

THE CRISIS IN THE HUNGARIAN CONSTRUCTION INDUSTRY

The construction industry and its related trades have their own special risk factors. Even nowadays, despite the improvements in technologies and procedures, most labor in construction project is seasonal, which – because weather imposes strict deadlines and conditions – implies significant extra expenditure (organization, overtime, irregular shifts). A further risk is that investment is primarily transaction-specific and service companies cannot sell the results of their work to anyone else. This transaction-specific feature applies to the customer as well – after a certain period of time they can change partners only at significant cost.⁵ In the construction industry the creation of the end product always happens in newer and newer “workshops” which are connected to the construction site through the participation of economically independent enterprises whose work is characterized by very strong interdependency and a badly-performing unit – that often does poor work that cannot be corrected – may destroy the quality of the end product.

Additional uncertainty is generated by the fact that the order of the different phases of work is rather rigid (tiling should be preceded by installation of wires into the wall, etc.). Planning ahead is hampered by the fact that the

5 On the cost of changing partners, see Gereffý –Sturgeon 2005.

different phases of work are done by independent enterprises which are often involved in other projects and have various working cultures. As a result, the danger of not meeting deadlines is always present, and when this happens it upsets not only the final deadline of the given project but the timetables of co-entrepreneurs as well.⁶

The relatively high proportion of private orders in the construction industry probably fosters the prevailing presence of ‘black’ labor which hampers regulation in that segment market. ‘Chain debt’ – the many decades old practice of non-payment of subcontractors – and corruption⁷ make orientation in the market more difficult. Because of the above-mentioned risks there is an increased need to control actors and exclude persons who have infringed norms and/or who are unqualified.

In the Hungarian construction industry market the legal framework of the sector is defined by ‘Étv’ (Act LXXVIII of 1997 on the Formation and Protection of the Built Environment, amended on 1st January 2011 and on 1st January 2012 respectively). Maintenance of quality and the meeting of standards are to be ensured by the fact that most construction industry work is possible only with a permit, partly through the approval of plans by the various responsible authorities (National Disaster Management, State Public Health Office, National Nature Conservation, etc.). Certain work tasks on the construction site should be completed according to working drawings and relevant professional standards. The ‘construction record’ is an important document about the construction for which records are kept about the tasks accomplished by the participants involved in the project on a particular day.⁸

The responsible technical manager employed by the contractors, and the technical controller representing the investors are crucial elements of the regulation and quality assurance procedure. Their competence must be proven by practical experience and references. Their official license to practice and their authorization are given by vocational chambers and organizations which provide guarantees to consigners. The technical manager carries out the function of internal auditor; he or she approves the construction work

6 Eccles (1982) depicted the characteristics and high cooperation needs of the construction industry in the same way (see his research into the American construction industry).

7 http://www.transparency.hu/uploads/docs/CPI2012_map_and_country_results.pdf
Downloaded: 30/12/2012.

8 Decree 313/2012. (XI.8.) on the Documentation and Information Centre of Construction and the National Construction Register mandates the use of E(lectronic) – construction records; that is, E-construction logs. The entries of the E-construction record cannot be changed later and thus they decrease the opportunity for corruption. Construction and other authorities and the National Tax and Customs Office also have direct access to E-construction logs.

with his/her signature. The technical controller takes over the work from the contractor for the investor, provided that it is in accordance with plans, contract, and standards.

Thus it may appear that construction industry work is well-regulated and sufficiently documented. However, in practice the professional considerations of the actors responsible for the quality can be overwritten by loyalty towards employers and certainly by personal self-interests as well. When savings need to be made, or when under pressure, the contractor often dispenses with quality standards and the technical manager who is loyal to his employer usually demurs, especially when he is directly or indirectly motivated to do so. In doing this he also takes a risk as he might lose his technical managerial license, though there is only a very small chance of this. In theory, the technical controller is employed by the investor in principle so that he accepts a piece of work only when the prescribed quality has been reached. In practice, the consigner often expects him to make various claims about the dubious quality of the work in order to that they can make excuses not to pay the contractor. However, there are also cases when they will accept work of questionable quality in return for slush money from the counter party. According to our interviewees, local technical controllers can be bribed with only a few exceptions. Only entrepreneurs, well-provided with capital, are able to influence technical controllers, but these entrepreneurs are not necessarily in need of orders offered under poor financial conditions.

Public procurement tenders mostly benefit larger companies and their owners will not suffer losses, even when demand/prices are low. It often happens that tenders are won with an unrealistically low bid; it is known from the very beginning that it is not possible to complete a project at the required quality, and to pay rates, taxes and contribution extras for the amount that is bid. Several primary contractors solve that problem by deciding in advance not to pay their subcontractors off. It often happens that a primary contractor, knowing in advance that he will not pay, pre-plans his own bankruptcy and business closure, leaving no legal successor. According to one of our interviewees, “first, the end of the food chain starves to death”. In these cases – since there is a written contract and the completion of work is documented – there is a legal remedy available. In the service market for private individuals there is no such option since the interested parties do not enter into a contract, do not register the works completed in a record and they rarely employ a technical manager.

The case is more favorable when a new property is built, since it is bound to be registered which implies that the work of the entrepreneurs working on the site should be legal as well. However, refurbishments and small re-building

projects are outside the official area of control so in these cases informal regulation, which could make unwritten agreements enforceable, is especially important

Since the transition the Hungarian construction industry market has been characterized by two types of market crises; the first of which is market turbulence (Laki 2011). Until the second half of the first decade of the new millennium, more and more actors appeared in the growing markets and they did not always comply with existing rules. They reinterpreted and reformed them, thus increasing uncertainty and risk. The present market turbulence in the contracting market is manifested on the one hand by sharp price competition (observe the unrealistically low bids for public procurement tenders), and on the other hand (and in contrast), by the emergence of cartels. The irrationally high prices promoted by cartels will not yield higher, better quality since because of inertia the system continues to work in the usual way. The phenomena of the deterioration of quality and the rise of chain debts indicate the disintegration and dysfunction of tacit regulation.

The state of a county's construction industry is strongly bound to the general investment situation, and increases and decreases in investment have a decisive impact on the construction industry. Whatever the situation may be, the profit to be made is significant, though there is high risk in this sector. There are many investments made into the construction industry, which means the sector appeals to many. In Hungary, demand was the determining driving force for the development of this industry. At the end of 2012 the output of the construction industry was 40 percent less than it was in 2005, while the number of construction enterprises had hardly decreased at all. The number of home construction industry enterprises is approximately 90 thousand. These enterprises are small in term of size and are deficient in funds. According to the interviewers, for small entrepreneurs the most frequent way to escape bankruptcy and unemployment is to get employment abroad. In the home building market the outlook for the future is best characterized by the number of building permits approved, which has decreased to a quarter (nationwide total, 7800) of the amount approved in 1998.⁹

THE SOCIOLOGY OF MARKETS

In his book 'The Architecture of Markets' (2001) Fligstein looked for the answer to the question what factors determine the behavior of economic

⁹ Data source: KSH (Central Statistical Office)

actors. In accordance with the findings of representatives¹⁰ of economic sociology that are considered classics, he questions the fact that enterprises exclusively respond to prices. In his book he gives a wide overview of the different level regulatory environments that shape economic activities. These are partly created by politics. On the other hand, they are also established inside the economic sphere itself. Fligstein works out the latter – relying on Bourdieu’s field theory – from the structural features of the markets. According to his analysis, in each segment of the market the most influential and largest companies are able to maintain their positions since they can impose the rules of the game that they create on other enterprises – basically, limiting competition.

Fligstein’s influential work gave impetus to research designed to explore the sociology of markets. The author and his colleague found it necessary to overview and systematize the rather great number of papers created on this subject matter containing various approaches (Fligstein – Dauter 2007) several years after their original work had been published. In this paper they still interpret the market as a field where transactions are determined by formal and informal rules. Regulation can be created at three levels: the first is the level of formal rules that is the legal environment of transactions; the second includes codes of conduct and recommendations about quality and the qualification of various professional organizations and chambers (or in the case of co-operatives, written rules); finally, the third level concerns tacit agreements.

In the next section we briefly summarize our research experience regarding the above-mentioned levels of the regulatory environment.

Dominant firms dictate the rules of market segments

Following our experience we agree with the above-outlined findings of Fligstein. The competition-limiting activities of dominant firms – due to the serious crisis in the construction industry – do apply to most enterprises because they themselves have an interest in maintaining the status quo rather than in transacting business which might improve their position but which is definitely riskier. Our interviewees – in order to maintain their stability – withdrew without hesitation from business opportunities that offered a

¹⁰ We mention here only the two emblematic and probably the most frequently-cited authors of this approach in order to avoid presenting a long reference list: Coleman 1988; Granovetter 1985.

higher level of profit in favor of transactions that yielded a more predictable level of profit (especially when they did not have enough information about their potential partners). During our interviews it was often mentioned that a certain business seemed to be a good deal and would have provided long-term work, but the respondent did not dare to take it on because they did not know anything about the partner.

At the same time our findings are different from Fligstein's description of the structure of the markets in two ways. On the one hand, not all of the enterprises in the domestic construction industry work according to rules dictated by the biggest companies. Our interviewees, almost without exception, could be characterized by their efforts to try to cut themselves free from the big dominant companies; a goal which they successfully achieved in most instances through organizing themselves into networks. They create and maintain their own network rules and only in the worst cases (for example, if they cannot get orders any other way) do they manage transactions outside of the market segment that is covered by their relationships. As a result of this, the larger companies that have a monopolistic position are able to extend their power only over those enterprises which are excluded from these networks. Additionally, they do so not through limiting and controlling the competition but through doing the opposite: boosting it. They do not limit competition despite the fact that price competition leads to the (for them, negative) selection of other subcontractors, and, in the long run to the deterioration of the quality of the services they provide.

Thus the economic actors in the construction industry market do not behave exclusively according to the rules dictated by the big companies. Two – barely overlapping – market institutions have been developed. One comprises larger companies; the other includes the regulatory environment created and maintained by the networks that contain small and medium-size enterprises. These two fields indicate the distinct and obvious divergence in habits and norms regarding payment discipline, quality, meeting of deadlines, and the timing and coordination of the work of the respective trades.

The level of formal rules

At the beginning of our paper we briefly outlined the legal environment which regulates the market segment of the construction industry. We collected rich material about the potential of formal regulation. Now we highlight only one aspect of this; chain debt, which may be the most serious problem for entrepreneurs. Chain debt has been ranked among the most serious problems

of the construction industry during the last 20 years, yet as a result of the economic crisis the number of people involved, and the amount of irrevocable debts, have both increased.

From the 20 self-employed individuals interviewed, almost all reported to having suffered losses arising through unpaid debt. One of our interviewees estimated that his losses reached 20 percent of his return. The losses suffered naturally depend on turnover and returns; enterprises that provide repairing and fitting services for private individuals logically reported irrevocable losses of 'only' a couple of thousand HUF (10-20 EUR). However, those who belong to these circles are not always secure. For instance, one of the self-employed persons (a plumber and gas-fitter) did not receive remuneration for a job but was unable to escape only with this indignity since the customer ordered further work several months later which the contractor did not dare to refuse, even though he knew that he would not be paid again due to the threat of force characteristic of the mafia. However, this case is not common. It does indicate, however, that the presence of formal rules does not ensure the safety of entrepreneurs.

In our sample, losses of 4-5 million HUF (16-17 thousand EUR) per firm are typical; however, one entrepreneur (specialized in electrical installations and safety appliances) was reportedly cheated out of 100 million HUF by his business partner. The above-mentioned 4-5 million of irrevocable losses are mostly the result of a single case (losses which did not amount to 200-300 thousand HUF were described as 'business as usual' by our interviewees), and did not represent an accumulation of various debts. Occasionally, it also occurred that an entrepreneur suffered 'chain accidents'. For instance, the owner of one of the electrical companies invested all his liquid money – 12 million HUF – into material and wages for the people employed in a major order, yet he did not get compensated for his labor and investment. However, since his invoices were accepted by the customer, his VAT debt rose to more than 6 million HUF, which he was not able to pay off, thus the tax office mortgaged this amount on his house. In order to extricate himself from his troubles he gave up his independence and took up a new position in Germany as an employee at a Hungarian prime contractor. There the contractor gave him wages at the beginning but after a while he was only offered promises. In the end he left the company with 2.5 million HUF of debt outstanding (the same thing happened to another 20 employees). Altogether he is owed approximately 70 thousand EUR, which he has little chance of getting back.

None of the interviewed, despite the fact that they had lost a lot, undertook legal action to recover their assets. They unanimously explained this decision by pointing to poor legal regulation and slow administration of justice. They

considered that their debtors were able to avoid being called to account through with the exploitations of legal loopholes (for example, by declaring themselves bankrupt and launching their businesses again under a different name). The majority could not even afford to enter into a correct and detailed contract that would provide protection because of the transactional costs of this procedure, and because their customers would not consent to this kind of agreement. For example, one of our partners did not get his money in time because his customer always found new faults with his work (which he had done according to plan) could not prove his case due to the lack of a properly detailed contract (moreover, the limited contract that did exist was signed when he was already hard at work on the construction site).

We also asked our interviewees whether they paid their employees or subcontractors when they themselves did not get their money from the primary contractor. Their answer was an affirmative yes which seems plausible since they get orders via their relationships (we return to this issue shortly), and tacit agreements play a significant role in the establishment of the safety of enterprises. As a result of this, nobody takes the risk of squandering his hard-accumulated social capital for the sake of temporary benefits. Of course it occurred that some contractors were unable to pay off their employees since they themselves could not get their money, but these kinds of delays were understood and tolerated by partners inside the network.

The level of vocational chambers and professional organizations

During the years after the transition chaos characterized several market segments in Hungary. This was due to rocketing demand for certain services and goods which resulted in the appearance en masse of services and goods of doubtful quality. For example, it was possible to travel to western countries after 1989, and there was no obstacle to establishing business relationships with foreign partners either. At this time many people wanted to learn foreign languages – mostly English. As a consequence of increased demand, language schools mushroomed, many of which provided low quality services: they did not employ properly qualified teachers, did not have well-equipped classrooms, and in order to increase their incomes they inflated the number of participants in lessons, etc. The professional language schools – which naturally worked at a higher cost – struggled in this chaos. The market was disorganized and characterized by sharp price competition due to the fact that customers were attracted to schools – since they lacked any other information – primarily because of prices. Finally, the situation was solved by the creation

of a professional organization which issued quality certificates to companies that met professional criteria (e.g. those that had qualified teachers and limited the number of students in groups). Thus customers could choose between service providers not on the criterion of price alone, but through considering information concerning the quality of the service as well (Laki 2006).

In contrast to foreign language teaching, the market in the construction industry remained chaotic after the transition. The reason for this, besides the deficiencies of formal regulation, was the inefficiency of professional organizations (it should be noted that most private customers prefer to buy the cheapest services, and thus even if vocational chambers issued quality recommendations, they would not be accepted anyway). The owner of an electrical company complained that he had little chance of getting orders from private customers since he maintained professional standards and installed materials and parts which were naturally more expensive. As a consequence, he could not compete with enterprises that employed black labor and used cheap Chinese appliances. It is worth noting that customers are not so understanding about poor quality in every market; see for instance the example of language teaching.

It was the unanimous opinion of our interviewees that national vocational organizations do not have any impact on their work; several of them did not even know about the existence of these organizations. Some interviewees raised the idea that these organizations might have an important role if, for example, they could compile blacklists of entrepreneurs who work in a professionally reprehensible way or do not adhere to terms of payment, and this would significantly increase the safety of transactions.

Local professional organizations do not have a substantial effect on the work of those who were interviewed in our small sample. This is on the one hand due to the fact that amongst the 20 interviewed entrepreneurs there was only one landscape gardener and one plumber who lived exclusively through local orders. The others typically got orders from across the entire country and several of them even got work from abroad. Correspondingly, local organizations did not have the correct perspective about their work. On the other hand, as a result of the crisis the recognized and highly-respected entrepreneurs who could have taken a role in professional organizations in relatively high numbers gave up their independence and went abroad to work. At the same time the amount of black labor increased, and vocational chambers were not able to regulate or diminish it. Thus the organizations in the examined settlement, the Hungarian Association of Craftsmen's Corporations (IPOSZ) and the National Federation of Traders and Caterers (KISOSZ) – which were prestigious and influential at the time of the transition – have

became insignificant (Tóth 2007). The membership of the once-250 strong IPOSZ has decreased to 30; those in authority have aged and now it essentially works as a nostalgia or pensioners' club.

The level of tacit agreements

It is today a commonplace in the ABC of economic sociology that networks play a decisive role in economic life. It was surprising to find out that, in the examined construction industry segment, sellers and buyers find each other almost exclusively via their personal relationships. As far as was possible, we asked our interviewees how they had got orders during the last 3-5 years. It rarely occurred that someone had done business with an entrepreneur who was formerly a stranger. Some of them had experimented with advertisements but they had not yielded any results and were regarded as money thrown down the drain. It is important to note that in the construction industry it is not only sellers but also buyers that get services via their acquaintances. For the latter – because of the characteristics of the construction industry market – networks are practically the most significant guarantees of quality of service (we analyze this issue later in connection with the market for non-standard services).

From the literature, Elinor Ostrom (1990) may be the most striking proponent of the idea that is not the state or any other center but local communities that are able to regulate transactions most effectively. Her examples (Swiss forest communities, Spanish and Sri Lankan irrigation communities, etc.) apply to local and/or ethnically homogenous groups almost without exception. It seems that a prerequisite for rule-compliant behavior is the existence of communities with traditions and tight bonds. These rules may be developed historically, but in a stable community they could also be created during negotiation and bargaining, as Ostrom demonstrated in connection with the case of the Alanyan fishermen.

In contrast to the local, closed communities she describes, the circle of construction industry market actors is liable to change: concerning any period of time there are many entrants and leave-takers; some enterprises are launched and others close down and changing partners is a common practice, thus the opportunity for tacit agreements differs from the case of forest or irrigation communities.¹¹

Our observations indicate that, despite such changes, a circle of those who still manage to make repeated transactions can be created. It is important to highlight that not only can strategic relationships be created between these actors – as is known from the literature (Axelrod 1984) – which means more than simply surmounting immediate interests, yielding long term profit and mutual benefits and staying inside an economically rational trust-based framework¹², but utilitarian relations can also be established. The relationships may expand and deepen: communities can develop in a similar way as Ostrom describes. The members of such communities are able to control transactions and impose sanctions against opportunist behavior more effectively compared to communities that operate on the basis of strategic relations. Eccless (1982) called the relatively permanent co-operation strategies of independent enterprises that develop during repeated transactions ‘quasi integrations’ or ‘quasi firms’. In the North American construction industry market that he

11 The common goods analyzed by Ostrom, especially the notion of the ‘commons’ of natural resources and markets, have shared features. Free riders can cause not only a ‘tragedy of the commons’ but a ‘tragedy of markets’ as well when their work results in a loss of general confidence in connection with certain goods and services which results in a drop in demand. Some market segments can also be entered by entrepreneurs who cheat customers and offer services of questionable quality. Competition is not always capable of selecting out free riders (when a product is non-replaceable, or when it is not possible to send reliable signals to customers) and thus there will always be more economic actors who are encouraged to enter a certain area, as we saw in connection with the above-mentioned example of the language schools. In certain cases, competitive markets close down (Bara 1999); for example, Budapest taxi entrepreneurs will not enter other areas despite their losses because their capital (their cars and local knowledge) is not investable in other areas. As a result of this, competition increases in an overpopulated market and incomes decrease, which leads to decreases in quality (cars are changed less frequently, less is spent on technical maintenance). This does not automatically entail the loss of customers, since passengers may recognize only too late when they are making use of the service that quality is poor. Miller (1992) conducted a systematic review of market failures. In this paper – in contrast to Miller – we point out that hierarchy is not the only solution to market failures; problems can also be solved with regulation. There is no generally-applicable recipe for this approach as the state, vocational organizations, networks of entrepreneurs or a combination of these vary by market segment.

12 There is more to this than the notion of trust, as described by Sako (1992). Neither trust in contractual matters nor competencies is typical of business life.

examined he found that in the cases when there was no institutional regulation (with the exception of state, municipal or federal investments where public tenders are mandatory), the relationships between the prime contractor of a construction and his subcontractors was stable and continuous and was rarely established via public tender.

The basis for formation of a community is the fact that, for a certain proportion of sellers and buyers, it is characteristic (as was highlighted by Sahlins [1972:185] in connection with the analysis of exchanges) that giving presents yields friendships, and friendships incite present-giving. These findings, with certain modifications, coincide with our experiences of research. Our interviewees, one after another, said that many of their interactions ended up in friendships, which in turn brought new orders. One of them reported to getting orders in the following way: "I heard about this deal from my friend (we are talking about installing some electrics in a church). Anyway, I met this friend of mine because someone else recommended that I do the electrical work in his house. During the work we became friends. I met a lot of people via fitting who later recommended me to other people. I have lots of friends whom I am going to invite to my 40th birthday party." Our findings are not unique; they reflect the traditional values of rural Hungary. Uzzi concluded with similar ideas about a circle of New York entrepreneurs involved in the fashion business. One of his interviewees stated: "It is hard for an outsider to see that you become friends with these people-business friends. You trust them and their work. You have an interest in what they're doing outside of business" (Uzzi 1997:42).

In his paper Uzzi interprets the relationships of entrepreneurs using the concept of embeddedness, which we only partly agree with. Granovetter (1985) – taking Polanyi's approach – starts from the fact that the relationship between individuals which exists from the beginning and is often institutionalized (for example, kinship) exerts an influence on the economic actions of individuals and on the forms of firms and also industries. As a consequence, individuals who get involved in transactions with each other cannot leave their social networks out of account. These can help them, but they can also be obstacles. However, Uzzi presents cases similar to ours which were characterized exactly by the fact that relations which are clearly economic at the start (seller-buyer, customer-contractor) are step by step embedded in their own social relations by the repetition of actors' transactions; for example, they turn into friendships.

Thus, individuals who undertake transactions with each other form their relationships concerning not only the expected economic benefits but also due to feelings of sympathy and empathy which are in accordance with their

social needs as well. These tighter relationships usually qualify as friendships, and are symbolically reinforced (our interviewees mentioned going yachting together, name-day celebrations, attending the weddings of each others' children), given the proper framework for the development and enforcement of tacit agreements. However, good relations are certainly not the automatic consequences of otherwise correctly-handled transactions; parties that play fair will not necessarily form a friendship. Our interviewees also mentioned partners that they had found acceptable regarding their professional learning and business honesty, but with whom they still avoided closer co-operation; they did not place orders with each other, did not even recommend them to customers and did not mix with them outside business since they had different opinions about family, consumption, etc. That is to say, they lacked the psychological affinity which is a precondition of a good relationship.

The most pronounced feature of the approach of Zelizer's oeuvre¹³ may be that, in human relationships, economic, personal (psychological, emotional) and value elements are simultaneously present, thus individuals repeatedly enter situations where they have to reconcile economic rationality with feelings of sympathy, loyalty, friendship and love. In one of our earlier papers (Kuczi –Tóth 2012) we called those small scale changes of relationships 'micro-selection' which refers to individuals' experiences with repeated exchanges. The essence of these small changes is that actors strive to reconcile the – apparently irreconcilable – economic and social world and thereby establish a certain compromise between them which suits their values, attitudes and business interests. Successful reconciliation which satisfies both parties in the transaction acts to reinforce relationships, while less successful attempts weaken it. For example, it is not indifferent from the perspective of the future of a relationship how the customer reacts when his subcontractor does not meet a deadline. Does he show understanding, or quite the contrary, does he decide that on this occasion he does not want to understand his partner's perspective. Their relationship would not necessarily radically change in the latter case; it might not cease but its intensity would decrease and would be limited primarily to business affairs. However, if the customer shows goodwill, the intensity of the relationship might increase and its content might be enriched.

One of our interviewees told a story, an illuminating example of the failure to reconcile the economic and private sphere as a consequence of the disembeddedness of the network. He related that entrepreneurs that belonged to his wide circle of friends had recommended each other to their customers

13 See the comprehensive volume on her oeuvre (Zelizer 2011).

for a long time. However, this practice had changed recently because several of them had decided that asking for commission would not go to the detriment of good friendly relations. The 'guilty parties' in the course of the time were joined by more and more individuals; mostly those from a younger generation. With favors turning into business relations, loyal gestures naturally declined in frequency and friendly relations, step by step, moved towards relations based on interests. In this example the reconciliation of economic and private spheres can be considered a failure because the changes proved to be counterproductive even from an economic point of view; the group of friends decreased in number (our interviewee also left the group) and the number of recommendations also decreased. Finally, everyone got fewer orders.¹⁴

Since the changes that accompany individual transactions are mostly small scale¹⁵ (for instance, as a result of a positive experience we meet someone more often or under less formal circumstances), they will not continue to result in profound transitions of networks. However, changes, although insignificant in themselves, accumulate in the long run and result in a perceptible transformation of the network.

The tendency to transformation is discernible *ex post*: it might lead to the homogenization of relations; individuals with different values, characterized by different vocational and business approaches may become filtered out from a network or be pushed into a peripheral position.¹⁶

As stated above, in Ostrom's examples the behavior of economic actors is monitored (and sanctioned in case of need), by closed, mostly ethnically homogenous communities. Our interview experiences showed that during the process of micro-selection communities develop which are similar to those analyzed by Ostrom, and which are able to supervise transactions.

14 It has been proven in experiments that when a certain voluntary action (in our case mediation between customers based on friendships) is associated with material incentive, commitment can decrease which can cause decline in efficacy (Frey 1994). Zelizer (2011) pointed out this relationship in connection with nursing.

15 There can be, of course, radical changes as well: transactions can be followed by a split between partners. In the above-mentioned paper this kind of change to a network is called macro-selection.

16 Homogenization is considered to be the typical direction of relationship development (Kim and Aldridge, 2005; Keefer and Knack, 2008). Related to the socialpsychological mechanism of the homogenization works of Thibaut and Kelley [1959] Hartfield, Utne and Traupmann [1979], Grangberg and King [1980], O'Connell [1984], Condon and Crano [1988] can also be mentioned. At the same time it is not indifferent what kinds of reconciliation of the economic and personal sphere the homogenization takes place through. As can be seen in the above-mentioned examples, if homogenization proceeds toward the direction of exclusive economic interest, the economic potential of the network might decrease.

In this process a duality can be observed. On the one hand, tacit agreements are formed during the steps of micro-selection; common standards and norms regarding quality, working culture, payment discipline, fairness that can be expected and private life, family and how free time is spent come into being, and are formulated from transaction to transaction and a group identity is formed. One of our interviewees, a plumber, indicated the identities of his friends as a circle, five-in-hand, creatively denoting that he was talking about mates pulling in the same direction at the same time. On the other hand, selection happens and networks become homogenous in accordance with understood and commonly-accepted norms.¹⁷

Certainly, pleasant human relationships which are regarded as safe are associated with business risk, since entrepreneurs feel it impolite to deal unscrupulously with their relatives and friends during their transactions. It may happen that they do not find the balance in each situation between their economic interests, friendships and relations. The owner of a paint shop limited the value of goods sold on credit to regular customers to 200 thousand HUF, but she made an exception for her brother and gave him 5 million HUF worth of paint, plaster, etc., the cost of which, apparently, she is not very likely to get back. Two other interviewees were cheated by their business partner-friends; others were not paid back by their acquaintances.

It is important to note that our interviewees stated that they tried to do their best to maintain good faith towards their relatives and friends. As long as it was possible, they tolerated deviation from any original agreements. An understanding of another person's problems arises also from the fact that people who are on good terms know each other's circumstances better and thus may find more excuses to extend terms of payment or tolerate late payments (e.g. in cases of recent divorce, unemployment due to illness, etc.). Thus, significant risk might arise from having good relationships but the trust towards the other person – which has developed through micro-selection – gives flexibility to the system since there is no need for detailed contracts and duties and obligations can be adjusted easily to changing conditions.

Almost every one of our respondents had been disappointed at some point. In most cases work and/or materials that had been invested in were not paid for by partners who were regarded as friends at the time. However, contrasting examples also exist – one party in a joint enterprise invested the profits from his own business without his partner's knowledge (the case applied to a retail seller of building materials). At the same time, these failures did not

17 Homogenization – at the level of organizational forms and practices – was introduced by Di Maggio and Powel (1983) as institutional isomorphism.

stop business relations from turning into personal ones. This phenomenon is similar to divorce. An increase in the number of divorces does not mean that the institution of marriage is in crisis. In fact, it shows – in a certain sense – its popularity; after all, people keep trying even after repeated failure.

We have outlined above that in the Hungarian construction industry neither formal rules nor vocational chambers or professional organizations are able to create a safe environment for entrepreneurs. Nevertheless, networks created as a result of micro-selection might be better able to enforce the quality of services, ensure that deadlines are kept, and what is more, ensure payment discipline. In the following section of the paper we examine the market for poorly measurable (non-standardized) goods, and point out that the high levels of risk that are typical of this field can be reduced through relationships, or rather through the existence of convincing quality indicators for enterprises.

THE FEATURES OF THE NON-STANDARDIZED QUALITY GOODS MARKET

Customers' opportunities for getting information vary in each segment of the market. The buying and selling of standardized goods is characterized by the most clear cut situation. If the goods in question are the same in every sense, competition between producers or service providers will be limited to price (Svedberg 2003, Aspens 2010) and customers will orient their decisions based on this factor, since making a comparison between different goods of the same type is unnecessary. However, customers can be exposed to risk even in the case of making purchases of standardized goods as they can make typical mistakes. Bar-Gill (2007), for example, when analyzing the credit card market, proved that customers favor 'bargain' short-term (half year) credit which has a much higher rate of interest after the initial period expires to longer-term but slightly more expensive offers. Individuals mainly take on too much risk with this decision because they erroneously assume that they will be able to refrain from making purchases on credit after the expiration of the favorable interest period. The promise of refunds might also lead to customers making mistakes on the goods market. Customers are prone to choosing sellers who offer products for sale at a higher price with a bonus thrown in which makes the purchase cheaper than the market price when the bonus is cashed in. The sellers base their offers on their experience that there will be enough customers that cannot resist such a favorable offer; however, at the end many customers will not benefit from the refund. Thus, customers can make mistakes even in the market of well identifiable standardized goods where the task is relatively

simple since there is typically a sufficient amount of information. These mistakes cannot be eliminated by market competition which is (also) designed to broaden the information base of customers. Moreover, as is highlighted by Bar-Gill, sellers base their marketing strategies exactly on these mistakes. With the market of non-standardized goods, customers have less opportunity to gather information. Since they cannot obtain clear cut indications about the quality of goods and services (because there are none), they learn too late, only after the transaction, what they have actually paid for. For instance, two estimates for the cost of redecorating may be the same, but the final quality in terms of durability can be significantly different: in one case the paint job may last two years; in the other the flat may only need to be painted seven years later. Here customers' decisions are inevitably more risky compared to purchases made in markets for standardized goods. This kind of uncertainty is also characteristic of a significant number of the transactions that take place in the construction industry market. Before going into detail, we now briefly touch upon the segments of markets of non-standardized goods where uniqueness and the impossibility of comparison with others does not cause any problem, but on the contrary; creates value.

Customers may in certain cases get information about certain goods, despite their uniqueness, and thus they can make their decisions based on sufficient information. For example, it is not possible to define the taste, the fragrance or the characteristic fruity features which are exclusively peculiar to given types of wine based on their chemical composition. Distributors often do not even experiment with providing information and on the label of the bottle they describe a limited number of parameters: alcohol content, sweet or dry character and place of origin. It is hard to make grounded decisions based on this information. However, even the inexperienced customer makes few mistakes if he orients his purchases according to price, since the well-informed minority circles of experts regularly classify these goods which cannot be described in an exact way, and through their coordination a ranking of wines which determines value is created. The experts and the trade press create a hierarchy of goods for this market segment (Benjamin and Podolny 1999), which reduces the risk to the customer. The sale price can be increased by emphasizing/inventing the tradition of the vine-growing region, as Ulin (1995) pointed out in connection with the Bordeaux varietal.

There are numberless similar market segments, though their features vary. They have in common that their prices are not formed by demand and supply but are socially constructed. For example, the prices of dresses coming from *haute couture* salons are influenced by a combination of the prestige of the fashion house, the trade press and high prestige customers (Aspers 2010). On

the market for works of art, the mechanism for price formation is different from the above mentioned, but the price of specific pieces is not determined by supply and demand but jointly by the opinions of inner circles, the prestige of the auction house (the social status of people assembled at the auction, the prestige of the press covering the event), and the identity of the former owner (Thornton 2008). It seems odd, but within the circle of Gabor Romas in Transylvania, the price of silver goblets, originally possessed by the church or noble families and which reflect the prestige of the family, develops similarly in many respects. The prestige of these objects increases transaction by transaction since the prestige of the actual owner is added to the value, so the greater the number of owners the higher the price of the object. During the transaction an ‘expert team’, consisting of relatives who were involved in earlier trades, decides whether the asked-for price, often amounting to 200-300 thousand USD, should be paid (Berta 2012).

In the case of the rather large group of non-standard goods – construction industry services belong here – price-value ratios develop by chance, since quality-related information is missing and social validation of value does not occur. In the absence of these items, the customers may buy a pig in a poke. Uncertainty about transactions stemming from a lack of quality standards affects both sellers and buyers in the same way. It is well known from Akerlof’s (1970) analysis that, on the market for second-hand cars, the customers’ situation is rather risky because of information asymmetry. Customers are not protected from buying cars that have been used to excess, or cars with undiscovered faults. Here, sellers who offer above-average quality come to grief since they cannot reflect their investment in the price, although their cars may be in a better technical condition. Consequently, they leave the market, which means that even those customers who would willingly pay more for a car in a better condition are at a disadvantage.

At the same time, the mechanism that leads to “lemonization”, as described by Akerlof, does not apply to every market segment which lacks clearly defined quality parameters. For example, in the construction industry it is typical, even in the long run, that entrepreneurs that provide both bad and good quality services are equally present; competition does not work to select the former; however, the latter will not leave¹⁸ despite the fact that in most

18 In this vocation the non-regulated market has not become well-regulated, unlike in the case of language teaching or the wine trade. Development of a hierarchy that informs customers and the associated inflation of bad quality goods and services and their removal from markets has not happened. This problem cannot be traced back to the regime transition since other markets segments have turned into well-regulated markets.

cases they cannot find a way to capture their extra costs in the prices of the services they provide. Thus prices do not scatter according to quality, and price indications give false information about the reliability of products and services, as described in Akerlof's model about the early history of the used car market.

For the customer, besides having to deal with non-standardized levels of quality, there exists uncertainty related to the future performance of the seller (DiMaggio and Louch 1998), which is especially significant in the construction industry. According to our interviewees a well-used tactic of builders, tilers, plumber entrepreneurs, etc. is that they direct all their employees to a recently-undertaken construction or flat renovation site. They keep working at full capacity until they reach the point where the customer is completely committed; that is, he can only change partners at a significant cost in time and hassle. Reaching that point the contractor leaves the construction site, leaving only one or two 'dispensable' craftsmen, and the team start work for a newer customer at full capacity. Using this tactic, entrepreneurs manage at their customers' expense to play for time and do not even turn down those customers whom they should, because of their lack of capacity.

The question is how sellers and buyers can succeed on this risky market characterized by misinformation. In the next section of our paper we reveal the answer.

The buyers' strategy: intensive search – transactions among each other

A large number of market segments (the construction industry, health care, cleaning, baby-sitting, etc.) resemble the bazaar trade, as described by Geertz (1992). Their common feature is that information regarding prices, the quality of services and the discipline of payment is limited and poorly distributed and communicated. Consequently, information is highly precious. In this situation intensive searching is typical; the attention of buyers covers only a few products and services but they thoroughly examine these items and they collect information mostly about sellers by making use of their networks¹⁹. Geertz contrasts intensive searching with extensive (survey-type searching) which happens when goods are standardized. On a product market customers strive to find the greatest possible number of sellers and are able to select the most favorable products from a suitably-large sample of offers.

¹⁹ Di Maggio and Louch (1998) call the searching which happens through making use of networks "search embeddedness".

It is common with redecoration projects that craftsmen are not selected on open markets – not selected, for example, via advertisements – and nor are they selected using prices; that is, there is no survey-type search, but prospective buyers try to orient themselves about the competence and trustworthiness of the service provider with the help of acquaintances. Our interviewees, being customers (when they are searching for subcontractors), proceed similarly and as sellers are selected this way by their customers. One of our interviewees, a distributor of steel sections and steel plates for construction, uses his country-wide circle of acquaintances to filter out unreliable buyers. A certain practice has developed with the retailing of building material – entrepreneurs typically do not immediately pay for goods that are purchased, but only after they have generated some income using these materials²⁰. This practice is misused by a number of people; they take materials and do not pay according to the terms of purchasing; moreover, a few of them do not pay at all. Thus, the seller's risk is fairly large, but it can be reduced by collecting information about customers. According to one of our interviewees, he is able to find out almost everything about anyone with the help of his wide circle of acquaintances (including ex fellow-soldiers, school mates, colleagues, etc.). With several phone calls he can find out to what extent a prospective customer is trustworthy²¹.

In the course of our research it came to light that networks are used in the search for reliable partners not only in the SME (Small and Medium Size Enterprise) sector but also in the case of larger companies. Our interviewees stated that they had got orders from large companies such as MOL (Hungarian Oil and Gas Company), Siemens, T-mobile, Philip Morris and DÉMÁSZ (South Hungarian Electricity Supplier Plc.). They had also got recommendations through their personal relationships. During the research the complex system of recommendations became clearer; exchange and selling transactions were happening almost exclusively through the use of personal relationships.

Economic actors use their networks not only to search and obtain information, but they also make efforts to manage their transactions inside their circle of acquaintances. DiMaggio and Louch (1998) empirically-support their proposition that people purchase non-standardized goods of

20 This phenomenon is characteristic of the entire construction industry, thus chain debt mainly develops here.

21 In the presented case the information asymmetry is the opposite of, for example, the used car market, but this does not change the essence of the problem. Either the seller or the buyer can possess additional information; the other party can improve his situation through an embedded search.

high value as far as possible from relatives, friends and from their friends' friends, thereby reducing the risk of transactions. According to our research experiences, this kind of use of networks is characteristic not only of the consumer market but also of transactions between entrepreneurs.

Since Coleman's work (1988) it has been well known that there is a kind of resource that can be accessed through relationships, yet there is less talk of its' risk-reducing role in the uncertain quality goods market. Perhaps it was Landa (1994) who emphasized most clearly that in an uncertain regulatory environment (where the law pertaining to financial matters is underdeveloped), relationships (ethnic relations) serve to reduce the risk of transactions, and correspondingly the cost of transactions. However, the fields of culture and regulatory environments examined by Landa (and the current authors) stand in sharp contrast; there is one general rule that seems to exist: whatever the reason for the uncertainty, economic actors strive to make their transactions with actors from their circle of acquaintances. When transactions are not occasional but recurring (the cases examined by DiMaggio and Louch were of this type), then relations take the form of well structured circles.

Lasting forms of co-operation develop between representatives of the complementary construction industry trades (they carry out orders together, refer customers to each other, etc.) and entrepreneurs who were unknown earlier can enter these circles only via recommendation. On the other hand, these groups are not closed, as people within networks place orders with others outside their network. Those interviewees who proved to be most successful were members of various circles that co-operated with each other. They belonged to three or four circles and they were the least affected by the crises in the construction industry. Belonging to a given circle not only ensures a predictable outcome for a co-operative effort (for example, efficiency-increasing specialization), but it also decreases the uncertainty that accompanies non-standardized services. Our conversation partners laid stress on the following major benefit of their networks: they help avoid the free-riders who represent various trades and who work together on the same construction sites or redecoration projects. For example, a free-rider might use lower-quality material than that ordered, assuming that this will remain undetected if others do their jobs correctly, or might perform a task in the easiest way, not caring about making life more difficult for others. Furthermore, the problem that some entrepreneurs, following exclusively their own self-interest, will perform their tasks at the most convenient times for them, or will leave a project for the sake of a better offer thereby disrupting others' schedules, may be avoided.

Thus the system of recommendations significantly decreases the costs of searching which are otherwise high on the non-standardized goods market, since supply is difficult to assess. Moreover, the cost of entering into a contract also decreases since the network guarantees quality jobs without written contracts. The fact that entrepreneurs who know each other work together on a given construction site or redecoration project is advantageous in terms of organizing and timing tasks and coordinating activities, since they are able to adapt flexibly to changing situations.

The strategy of sellers

If the buyers who search intensively are not able to get information about the quality of non-standardized goods for any reason, then the same thing happens to them as happened to Buridan's donkey. That is, they will not be able to choose between things which are seemingly identical, due to the lack of information (Gambetta 1994). They may try to solve this problem using external means (e.g. by throwing a dice); however, this process is liable to result in rather dubious outcomes with bazaar trade type markets where similar looking goods might be considerably different in terms of durability or utility.

Can sellers that offer truly good quality goods and services help their customers to choose? According to Gambetta, they can: they will endeavor to establish a personal reputation. In the author's example, retailers and restaurant owners will employ the services of mafia-type groups which are most able to make them believe that they are indeed able to provide efficient protection. This symbolic form of capital may play a significant role on non-standardized markets when choosing psychiatrists, attorneys and plumbers, or, if you like, restaurants.

Among the entrepreneurs in our sample there were three who had been contacted by their customers primarily because of their reputations, and getting orders through recommendations came second. One of them (who makes brick tiles) has managed to establish a country-wide reputation. Since he is held in esteem, despite the crisis he is often invited to participate in construction projects for demanding buildings that are intended to be of above average quality. He proudly related that on the occasion of a recent order he worked for a notable company in a large city (Szeged) and he was invited there based on his reputation. Moreover, he does a lot to promote his company's brand; he participates on a regular basis at Construma which is the largest trade fair in Hungary (International Building Trade Exhibition), and he also exhibits his sample walls in several building material shops.

The other entrepreneur is also a tiler; he has managed to create a regional level reputation and can reference works like tiling the operating theatre of a hospital. Investors who need high quality tiling or flagstones put down in the neighborhood of his residence (a circle of approximately 70 kilometers' radius from Budapest to Cegléd) would most likely commission him. The third entrepreneur is a tile stove builder. He has not been in the trade for a long time so when he started building his reputation, he compiled an album of photos depicting his earlier work, amongst other means.

With the rest of our interviewees, recommendations are significant for getting orders; however, at the same time 'quality' is a word that prevailed in their narratives. They talked often and long about this topic without being asked. One of them described the importance of quality for at least a quarter of the time of the (one and a half hour) interview. The most successful entrepreneurs who have a reputation in their trades are indeed held in esteem by architects and the retailers of building materials, from whom they often get their orders.

SOME FINAL COMMENTS

The most important lesson that emerges from our research is that, in contrast to other sectors of the economy, the construction industry did not move away from an initial 'natural' state of chaos towards a well-structured state after the transition. The reason for this is fourfold. There exist: (1) self-employed repair and maintenance individuals who satisfy local demand; (2) networks of small and medium-size entrepreneurs that cooperate with each other and are present on the national market; (3) some big companies, to which; (4) 'roaming' enterprises (those excluded from networks), are connected. Besides political corruption, the behavior of larger firms is also governed by the regulatory environment which often acts in their favor. The law and local regulations do not sufficiently regulate the activities of the self-employed who belong to small and medium-size enterprises. As a consequence, they do not have adequate protection against various risks (e.g. uncertainty related to chain debt). In this sector those enterprises which work as part of a network seem to be more successful because a system of tacit agreements that has developed within their relationships makes their transactions safer.

In summary, networks play a significant role in the construction industry. A significant proportion of the services offered in this market segment could only be standardized at significant cost, and the trading of non-standardized goods entails a high level of risk.

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