



# Information and favoritism: The network effect on wage income in China



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## ABSTRACT

How do social networks matter for labor market opportunities and outcomes? To fill in a gap between network theory and research evidence, we develop a theoretical explanation of how network-transmitted information and favoritism serve as causal mechanisms of wage income in China. In a large-scale Chinese survey, we find that 59% of the 4350 wage earners land on jobs through social contacts from whom the benefits of information and forms of favoritism are gained. Data analysis shows that (1) both weak ties and strong ties are used by Chinese job seekers to obtain information and favoritism to help secure job opportunities, but (2) weak ties are better able to channel job information than strong ties and strong ties are better able to mobilize forms of favoritism than weak ties, (3) information and favoritism equally promote job–worker matching, which in turn increases wage, and (4) favoritism has a stronger effect than does information on job assignment to positions of superior earning opportunity. This analysis demonstrates the non-spurious, causal effect of social networks on wage income in the Chinese context.

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## 1. Introduction

Despite accumulated empirical studies, there remains a gap between theory and research evidence on how social networks may or may not matter for wage income. Under the assumption of imperfect labor markets, variants of network theory (Granovetter, 1973; Lin, 1982; Podolny, 1993; Bian, 1997) argue that the information and influence that are obtained from social contacts will help job seekers secure work of higher status or higher pay. Except for an economics study (Corcoran et al., 1980) and a Chinese survey (Bian and Huang, 2009), however, no sociologists have measured information or influence that is thought to affect job prestige or wage income; instead, they measure the strength of ties between job seekers and social contacts, as well as their characteristics, as proxies to information and influence (see reviews by Granovetter, 1995; Lin, 1999). The problem is that these proxies neither lend consistent results (Bridges and Villemez, 1986; De Graaf and Flap,

1988; Marsden and Hurlbert, 1988) nor survive the test using experimental data (Montgomery, 1992). Because social contacts are homogeneous to one another in personal attributes, argues Mouw (2003: p. 869), the nonrandom acquisition of friendships and other social ties ensures “a positive correlation of friends’ income and occupational status *even in the absence of a causal effect*” (italic added). Mouw’s carefully crafted analysis of several relevant datasets shows that the widely claimed “network effect” on wage income may, after all, be spurious.

This is a serious challenge to an otherwise established network research tradition. In this article, we develop a theoretical model of the network effect on wage income and examine some empirical implications of this model by drawing on evidence from a probability sample of wage earners in urban China. We argue that network-transmitted information and influence that are gained from social contacts during an individual’s job search will have lasting effects on wage income of a landed job career. While network information reduces uncertainties on both prospective employees and employers and thus increases job–worker matching and wage, network influence, in the form of favoritism in the Chinese context and elsewhere, increases the propensity that an individual is assigned to positions of superior earning opportunity and gets high pay. We elaborate this argument before proposing hypotheses to guide our data analysis.

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## 2. Explaining the network effect on wage income: a theoretical model

In a microeconomics perspective, wage is a function of worker productivity, and market equilibrium wages are provided to workers whose qualifications match the expected productivities of the jobs (Javanovic, 1979). Researchers have identified two problems about this neoclassic economic view. First, productivity is unobservable potential of a worker and imperfect information about it exists especially at entry levels of a job career. Therefore, personal networks, among other mechanisms (Stigler, 1961; Akerlof, 1970), will matter when social contacts provide information about prospective workers, who subsequently receive an optimal job assignment and a good pay (Granovetter, 1981). Second, employers may prefer to offer someone a higher-than-market-reservation wage for reasons unrelated to productivity (Simon and Warner, 1992). In other words, favoritism emerges when employers are satisfied with referrals from either entrusted employees (Corcoran et al., 1980) or influential social contacts of the “old-boy networks” (Rees, 1966; Prendergast and Topel, 1996). While both information and favoritism are the resources that flow through the networks of job seekers, they are mobilized through different kinds of social ties.

Information is likely to flow through weak ties. Granovetter (1973) is among the very first to theorize the role of personal networks in flowing labor market information. His “strength of weak ties” hypothesis points to a tendency that weak ties of infrequent interaction or low intimacy are more likely than strong ties to channel non-redundant information across social circles, thus permitting a wider search for a variety of employment opportunities from which a job of higher status or higher pay can be secured. Lin (1982) advances this line of reasoning by arguing that weak ties tend to connect to high-status contacts, whose information about better jobs will pay off for job seekers who obtain jobs through networks of weak ties. In Podolny’s (1993, 1994) reconceptualization, a social contact’s high status confers a positive evaluation of the quality of the job seeker and in such a way serves as a market signal about productive capacity of the new hire. While small-scale empirical studies have established the positive correlations between weak ties and social contacts’ statuses, and between social contacts’ statuses and job-search outcomes (Granovetter, 1974; Lin et al., 1981; Boxman et al., 1991; Coverdill, 1998), these correlations did not survive more rigorous tests using general-population samples (Bridges and Villemez, 1986; De Graaf and Flap, 1988; Marsden and Hurlbert, 1988; Mouw, 2003). In none of these studies, however, information was measured; and the “weak tie-information” link was merely assumed.

Favoritism is another kind of resources that are likely to flow through social ties, strong or weak. While “in-group favoritism” is common among relatives and close friends who expect preferential treatments to each other (Taylor and Doria, 1981), it is also widely observed in the workplace (Prendergast and Topel, 1996). Favoritism emerges when employers accept referrals from employees (Saloner, 1985; Simon and Warner, 1992) or when hiring decisions are influenced by relatives, personal friends, or referrers of high power (Rees, 1966). In the Chinese context, obligations to give or return a favor to someone in need of a job have been prevailing before and after the post-1980 market reforms (Bian, 1994, 1997, 2002, 2008; Bian and Huang, 2009). In imperfect labor markets in China or elsewhere, job assignments and wage offers are oftentimes flexible, and this flexibility creates a social space in which favoritism could operate to influence hiring decisions. While this is the so-called dark side of social capital about unjust access to scarce resources that are distributed as favors through old-boy networks (Portes, 1998), the social tie-favoritism link has not been analyzed in previous labor market studies.

Fig. 1 depicts a causal model about direct and indirect network effects on wage income. The left hand side of the model indicates that a job-seeker’s egocentric network contains both weak ties and strong ties, through which to transmit two kinds of network-embedded resources, information and favoritism. These resources can be mobilized from both weak ties and strong ties, although weak ties may be more frequently to flow non-redundant information about job openings than strong ties and strong ties may be more frequently and more effectively to mobilize favoritism than weak ties. The rest of the model is about the ways in which information and favoritism affect wage income directly and indirectly.

There are several reasons to believe that network-embedded information directly affects wage income. First, weak ties lead to non-redundant information about job openings, which allow for a wider search from which a job of higher pay can be landed (Granovetter, 1974, 1981). Second, employee referrals, which can be obtained through both weak ties and strong ties, contain sufficient information about the qualifications of job seekers, and such information reduces the costs of otherwise a more expansive, formal search, making employers willing to throw the savings into attractive offers to secure best qualified candidates (Corcoran et al., 1980; Fernandez and Weinberg, 1997; Fernandez and Castilla, 2001). Third, inside social contacts of varying tie strengths disclose information about prior hires’ offers and help the job seekers negotiate for higher starting wages (Seidel et al., 2000); because of lacking this sort of information, minority candidates take lower pay (Smith, 2000). Finally, rich insider information about employing organizations, which is made more available through strong ties than weak ties, is found to increase new hires’ abilities to learn quickly in a socially adapted environment, leading to higher salaries of new jobs (Coverdill, 1998; Rosenbaum et al., 1999). Thus, we graph a positive, direct path from network-embedded information to wage income in the upper part of Fig. 1. This path is marked by a dotted line to denote that the direct effect of network information can be weak in China or elsewhere.

The more discussed role of network information in affecting wage income is through job-worker matching. In a perfect labor market, equilibrium wage is provided to workers whose productive capacities match the requirements of the jobs. In reality, however, the problem of information asymmetry exists for both employers and employees about the exact wage level or location of one’s optional assignment (Javanovic, 1979). “Assortative matching” is a labor market response to this problem: while firms differ in tasks and workers differ in their abilities to do these tasks, person-specific information is welcomed and used to sort out workers and match a job’s required tasks to a worker’s ability to do the job (MacDonald, 1980). This person-specific information, though partly available through schools and other institutional channels (Rosenbaum et al., 1999), almost always comes from the networks of social contacts (Saloner, 1985). When employee referrers transmit this information to employers, better job-worker matching is expected, and higher starting salaries and longer stay on the job are the observed consequences of referred workers (Simon and Warner, 1992). In the upper part of Fig. 1, we draw an indirect path from network information to job-worker matching and to wage income. This indirect path is marked by a solid line to denote that the indirect effect of network information on wage income through job-worker matching is strong in China or elsewhere.

Information is not the only mechanism whereby networks of social contacts matter for wage income. Rather, favoritism is probably a parallel process of network influence in the workplace (Prendergast and Topel, 1996). Thus, the lower part of Fig. 1 depicts both the direct and indirect paths from network-embedded favoritism to wage income. The reasoning behind the direct path should be well taken: high wages are offered as personal favors to family members, relatives, or close friends. This scenario is not

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