

Introduction

I received my first three credit cards shortly after setting foot on American soil. I was a foreign undergraduate who had come to spend one year at an American university. Credit card applications only asked for my dorm address and a copy of my student ID. A week later, three “no-annual-fee” credit cards, each with a limit of \$300 to \$500, were rushed to me. I was more surprised than flattered: these companies were willing to trust me with more than \$1,000! How did they know I would not spend it all and go home without paying off my debt? It was 1993, the year when several nonbank companies (GM and AT&T among them) aggressively entered the U.S. credit card market. One of their marketing tools was heavy recruitment on university campuses: get students hooked on cards early, and you will bring up an entire generation of card users. At least in my case, they got it right: fourteen years later, I am still here, diligently paying my bills.

What I did not know back then was that a mature credit card market such as the one found in the United States rests on a solid foundation of stable

working institutions (credit bureaus, statistical scoring of credit, and debt collections), which render trust between the card issuer and cardholder irrelevant (Guseva and Róna-Tas 2001). Institutions do so not only by estimating the risk of default for each applicant, but also by assessing the profitability of prospective customers for the bank. As I see it now, GM and AT&T did not trust me, of course. In fact, they could not trust me because they knew close to nothing about me. But trust was beyond the point. What they did know was that I was a student at a prominent four-year college. So they counted on four years of interest and finance charges with a low probability of default thanks to the “Bank of Mom and Dad.”

About a year later, while traveling in Moscow, I came across advertisements by Russian banks offering Visas and MasterCard. This puzzled me even more. Russia at that time was struggling to stabilize its nascent banking industry and revamp its legal system, which was ill prepared to handle market-related disputes, let alone card defaults or sophisticated card fraud. There were no ready-made institutional solutions such as credit reporting and debt collection. The Russian state was pursuing macroeconomic stabilization, handling periodic market crashes, and trying to avert social and political tensions as a result of plummeting living standards for the majority of the population. In other words, it was preoccupied with more pressing problems than helping a fledgling credit card market on its feet. Issuing cards in such an environment seemed to me a perfect recipe for failure. How did banks know which cardholders would use the cards honestly and responsibly?

This was my initial question when I started my research. Later, I discovered additional problems that emerging credit card markets faced. For instance, despite what the reader may expect, when credit cards first appeared in Russia, they were not swept up eagerly by enthusiastic users. On the contrary, banks faced a serious problem of building consumer demand. Moreover, not only did they have to make the cards appealing to prospective cardholders, but they also had to convince merchants to sign up to accept cards in their shops. As a result, my research question expanded, and it now included a more general focus on the emergence of a completely new market in the transitional context. How was a market for credit cards built entirely from scratch? What sorts of solutions did banks rely on? How were cash-loving, credit-averse Russians, distrustful of private banks, transformed into card-carrying consumers? What was the effect of the ongoing restructuring of Russian financial institutions on the process of market building?

My analysis covers the period from 1988, when the first commercial banks were founded in Russia, to the present. During this period of almost two decades, Russia went from just a handful of banks to having more than two thousand at their peak in 1996; from rare glimpses of Visas in the hands of foreign tourists in the 1970s and 1980s, to the first reluctant card programs in the beginning of the 1990s, and to more than seventy-five million cards issued by Russian banks to Russian customers by January 2007; and from consumers' exclusive reliance on cash to their borrowing more than a trillion rubles at a growth rate of close to 100 percent a year in a recent buying frenzy. How these breathtaking changes occurred in the midst of Russia's postcommunist transition and what obstacles had to be overcome is the subject of this book.

While the book focuses on Russia, the Russian experience is not unique. In the 1990s, credit card markets were springing up in all of the former Soviet-bloc countries of Eastern and Central Europe, with the number of issued cards steadily rising throughout the region (Figure I.1). These countries

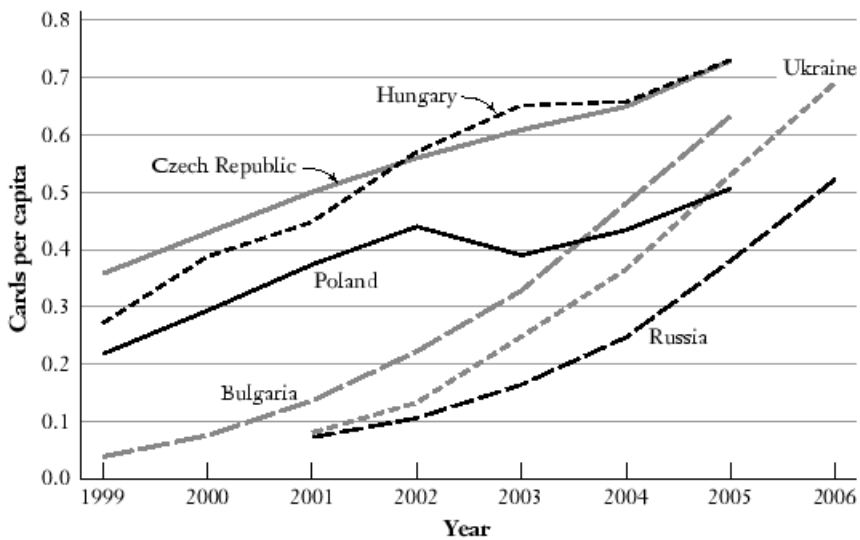


Figure I.1 Number of Cards per Capita in Russia and Select Countries of Eastern and Central Europe from 1999 to 2006

Source: Data from the European Central Bank (www.ecb.int), the Bank of Russia (www.cbr.ru), and the National Bank of Ukraine (www.bank.gov.ua). No data for 1999 and 2000 for Russia and Ukraine. Data for 2006 only for Russia and Ukraine.

share a common past, and their emerging markets face similar problems. Moreover, market actors in these countries frequently draw on similar solutions because they look for them among their shared socialist legacies. Therefore, where applicable I have drawn parallels between what I found in Russia and other Eastern and Central European countries' experiences.

The emergence of credit card markets from the ruins of communism is symbolic of the transition from an economy based on the principle of redistribution to one based on exchange, and from chronic shortages to abundance. Instead of patiently waiting for state-rationed apartments, cars, and electric appliances and saving for years, individuals and households can now go into debt and buy these goods on the open market. Referring specifically to the emergence of revolving credit cards in Russia, a 2002 issue of the Moscow-based magazine *Afsba* gleefully wrote: "This year, full-blown capitalism appeared. We got the opportunity to participate fully in the consumerist orgy like citizens of Western countries" ("Russians Get Taste for Credit as Consumerism Takes Hold" 2003).

Developing markets for credit cards are also part of a larger trend of the global expansion of multinational credit card brands. The very concept of the credit card is global: the name *Visa* illustrates this point perfectly. Credit card companies act as agents of globalization when they seek to expand their card empires from the core Western countries, some of which (such as the United States) are already near saturation, to Eastern Europe, the Middle East, and parts of Asia and Africa (in line with Wallerstein's [1998] world systems theory). The spread of Western popular culture and foreign travel exposes Russian consumers to the idea of credit cards as a necessary attribute of the middle-class lifestyle, challenging the cash-centered view of market transactions and establishing the social acceptability and desirability of bank-procured financing. What this book will demonstrate, however, is that the effect of globalization is not unidirectional. While international credit cards are transforming Russian society and culture, the reverse tendency is also taking place. Principles of card distribution, circulation, and acceptance developed and perfected in the West are undergoing modifications in the process of adapting better to Russia's local realities.

Approach, Data, and Analysis

This is a case study of one emergent credit card market. The Russian postcommunist transition and its implications made Russia a particularly challenging environment in which to build a credit card market. According to Flyvbjerg's classification of strategies for case selection, Russia is an *extreme/deviant* case, which is usually chosen "[t]o obtain information on unusual cases, which can be especially problematic . . . in a more closely defined sense" (Flyvbjerg 2001, 79). Learning about market building in such inhospitable conditions draws attention to the obstacles that developing credit card markets can encounter (from very specific obstacles, such as the problem of simultaneously recruiting both cardholders and merchants, to the most basic ones, such as missing credit bureaus and inefficient courts) without taking anything for granted, and simultaneously enables one to appreciate the resourcefulness of market actors in their quest to establish a working market order.

The data for this book come from several field visits to Moscow, Russia, in 1998, 1999, and 2003–2005, where I conducted semistructured interviews with representatives of banks, bank associations, credit card networks, card-processing companies, and experts of the plastic card market. I also gathered bank application materials and relevant publications in specialized journals and periodicals. In addition to this qualitative data, I collected publicly available quantitative data from Visa, the Central Bank of Russia, and several card industry publications. These data reflect trends at the level of individual banks, credit card brands, and the overall Russian market.

The main goal of this project was to discover what credit card markets are like, and what it takes to build one *de novo*, especially in the challenging conditions of a transitional economy. For this reason, my nonrandom sample that is also almost entirely limited to the city of Moscow should not be viewed as a drawback; the data it yields well serve the goal of uncovering the mechanisms of market building in a postcommunist context.¹

The selection of Moscow as a site is well justified: although the city of Moscow makes up only 6 percent of the total population of Russia, it attracts two-thirds of foreign investment and provides almost a quarter of the country's tax revenues ("Russia's Capital: Beacon or Bogey?" 1997). In addition to being a political capital of Russia, Moscow is undeniably its financial capital. According to the Central Bank of Russia, more than half of Russia's banks

are registered in Moscow, and among the thirty leading banks, only six are not based in Moscow (“1000 bankov Rossii” 2007). In 2004, Moscow and the Moscow region accounted for 28 percent of all bank cards issued in Russia, while St. Petersburg, Russia’s second largest city, only contributed 8 percent (Adrianova 2004).

Additionally, the two time periods during which the interviews were collected (1998–99 and 2003–2005) provided for a longitudinal look at the process of market maturation. I have combined my primary data analysis with secondary accounts of the Russian market from market actors, analysts, and policymakers from across the country. Finally, where applicable, I have compared and contrasted my case with some other countries’ credit card markets to give the reader a sense of how common the social mechanisms that I discovered are.

Anatomy of the Market

Postsocialist transitional countries are unique for studying markets as dynamic systems that emerge, grow, and change, helping to challenge the traditional equilibrium models prevalent in much of economic theory. What makes these emerging market economies particularly fascinating is that they enable us to look at markets at their points of conception and follow them along their developmental trajectories, including failed solutions and abandoned paths that usually are cleansed from organizational and institutional memories. This sociological voyeurism pays off: not only does it provide an opportunity to examine the “hows” of market development, but also the “whys,” as much of market development is path dependent, and examining the early formative stages is essential for understanding what markets eventually become.

Moreover, this examination of the emerging market economies has an important implication for better understanding the domestic market. Few American consumers appreciate the complexity of the American credit card market. Like many other markets in developed economies, this one has become fully institutionalized, with many of its practices and inner logic routinized and taken for granted. It operates like a “black box”: most of the

cardholders and even middle-level bank management are only familiar with “input” and “output” functions, having a vague understanding of what happens on the inside. Consumers are familiar with card applications (or preapproved offers), receiving cards in the mail, using them to pay for retail purchases, including Internet transactions, and paying their monthly bills. But they know little about the instruments card issuers have at their disposal to conduct screening, monitoring, and sanctioning. Various consumer advocate groups are trying to learn more about the process of lending decision making to help those who have been rejected by mainstream card issuers. U.S. national credit bureaus, for instance, have been pressured by these groups and by market regulators to educate consumers about what goes into calculating credit scores and how they can improve their numerical values.

Even issuers themselves often have a vague understanding of what goes into the score. At an early stage of this project, I conducted an informal interview with a card specialist in one of the local San Diego banks, and asked her the main question I was preparing to ask during my subsequent field trip to Moscow: how do banks decide who can be issued a card and who should be denied? Her answer was surprisingly short, but also emblematic of the point I am making. She explained that everything is automated, and the bank uses scoring models to make these decisions. She did not know which factors mattered more than others and could not elaborate on how the model was developed. In contrast, during my interviews in Russia, I was impressed by how much bank employees were aware of the nuts and bolts of card issuance, including the details of screening, verification, and monitoring of transactions. I was lucky that many were willing to share their knowledge with me.

Thus, the Russian credit card market in its formative stages lends itself particularly well to this theoretically grounded and methodologically informed investigation of the principles and logic involved in its creation. At the same time, it promises to shed light on several topics of interest to economic sociologists: the challenges of two-sided markets; the role of networks in market making; the problems of institution building and constituting consumer demand; and the globalization of practices, institutional configurations, and (consumer) culture, to name a few.

Outline of the Book

In the next chapter, “The Architecture of Credit Card Markets,” I build a theoretical framework for the empirical Chapters Four, Five, Six, and Seven. I focus on the structure of credit card markets and the four key problems that their makers face: uncertainty, complementarity, the need to build consumer demand, and the imperative to foster interbank cooperation. I detail how American card issuers handled these problems.

Chapter Two, “Market Building in the Transitional Context,” continues building on the theoretical foundation for the analysis of the credit card market. I recreate key debates on the course of postcommunist reforms in Russia and detail the challenges of building markets and creating institutions. Here I introduce the two main contributions that I am hoping to make in this book: first, to demonstrate that Russian card issuers rely on networks to constitute *mass* markets, and second, to expand the idea of networks to include those sets of ties that connect nodes of different levels, both individuals and organizations.

Chapter Three, “Setting the Stage: Consumer Credit and Banking Before and During the Transition,” places the Russian credit card market in historical perspective, offering a brief overview of the Soviet economic system and surveying Soviet-era (pre-1990) and transitional (post-1990) consumer credit and banking, early card programs, and the particularities of the first plastic cards issued in Russia. The chapter argues that while the Russian economy and society overall were not well prepared for the advent of credit cards, the socialist period produced several legacies that subsequently played key roles in shaping the credit card market.

The next three chapters draw directly on empirical fieldwork: each concentrates on one of the three successive but overlapping card-marketing strategies (elite issuing, mass issuing of salary cards, and mass issuing of cards through retail establishments) and analyzes them within the framework set up in Chapter One.

Chapter Four, “Inner Circles: Card Issuing at the Dawn of the Market,” addresses elite-issuing strategies: distributing cards through personal networks of bankers or by anchoring prospective applicants in their own networks, unrelated to the bank. The three main goals that Russian banks pursued dur-

ing this early period were ruling out fraud, verifying applicants' overall honesty, and most important, establishing reliable channels of communication through which cardholders could be contacted to inquire about or negotiate a late payment. At that time, cards were mostly issued as a status symbol, and banks did not invest in developing card acceptance among merchants.

Chapter Five, "The Stick But No Carrot: Disseminating Cards Through Employers," analyzes the banks' first attempt to develop the mass card market in Russia via salary projects, which became the main channel of card distribution in Russia in the 1990s (and until as recently as 2003 for some banks). Salary projects involved agreements between banks and enterprises to issue cards to all of the enterprises' employees while depositing their salaries directly to card-issuing banks. Employing the lens of uncertainty and complementarity, I discuss the role of employers in helping banks both access and control potential cardholders. I demonstrate how banks rely on networks to mass-issue cards and focus specifically on the networks' *relational* benefits, those that enable banks to use the relations employers have with their employees to reduce uncertainty in lending.

In Chapter Six, "The Carrot, at Last: Will Consumer Lending Lead the Way for Russia's Credit Card Market?," I address the recent boom of consumer lending in Russia and detail why this is the most successful attempt at market building so far. I contrast this method of card issuance with salary projects, which, while managing to increase the number of cards in circulation, did not lead to greater use of cards for retail purchases. Here I further extend the argument developed in the previous chapter on the role of networks in promoting mass markets, but focus on their *locational* benefits, because retail organizations attract consumers but do not help banks screen them. Card issuing at retail locations has been instrumental in increasing the number of revolving credit cards and stimulating card purchases, but it also has underscored the lack of effective prescreening methods.

Chapter Seven, "The Missing Piece of the Puzzle: The Struggle to Institutionalize Interbank Information Sharing and Create Credit Bureaus," addresses the process of debating and passing the law on credit bureaus to help banks screen, monitor, and sanction borrowers and sustain mass lending. I detail the challenges of this process in the context of Russia's highly concentrated and fiercely competitive market and argue that state involvement is

necessary, but that it is also limited in its capacity to promote cooperation between banks. This chapter draws attention to the role that global actors played in articulating the principles of credit reporting in Russia.

In the concluding chapter, Chapter Eight, “The Russian Credit Card Market Through the Lens of Continuity and Change,” I reflect on the major changes experienced by the credit card market since its inception, focusing on the current trends. I then suggest that the Russian credit card market is both a site of continuity with the past and a force bringing major changes to society, leading the Russians out of the communist past and into the consumerist future, out of the red and into the red.