



The Role of Personal Exchange in China's Market Transformation: A Case of Wenzhou Merchants

Conference on Institutions, Institution Analysis, and
China's Economic Transformation

IDE-JETRO

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Prevailing View: Personal Exchange Must Give Way to Impersonal Exchange

- North(1991,p.100)
 - Such societies need effective, impersonal contract enforcement, because **personal ties, voluntaristic constraints, and ostracism** are no longer effective as more complex and impersonal forms of exchange emerge.
- Kranton(1996,p.844)
 - **These relationships** can limit access to goods and services to those who have the **"right connections"** and create incentives for others to form and maintain reciprocal-exchange relationships.

Prevailing View: Personal Exchange Must Give Way to Impersonal Exchange



- Greif (2006, p.222)
 - By fostering impersonal exchange and institutional development, the community responsibility system laid the basis for its own replacement by overarching systems of law-based exchange.
- Kumar and Matsusaka (2007, p.108)
 - Personal networks are inherently limited in scope, local traders have less diversity of partners and division of labor is limited



Prevailing View: Personal Exchange Must Give Way to Impersonal Exchange

- Fei (1948)
 - Differential mode of association,
 - Social relationships are extended from each individual
 - Social morality makes sense only in terms of the personal connections.
- Firbank (1992)
 - China has been a stronghold of the family system and has derived both strength and inertia from it
- Kumar and Matsusaka (2007)
 - It(China) stopped, in our view, because **the dense personal networks that kept the local economy running impeded adoption of market institutions.**



Wenzhou Merchants: A Paradoxical Case

- Various regional merchant groups survived in the planned economy era and thrived greatly in recent 30 years. Wenzhou merchants are the most typical case.
- 1.75 million Wenzhou people doing business in various places of China
- 600,000 Wenzhou people doing business overseas.
- Since 1990s, 252 Wenzhou chambers of commerce have been established within China

Wenzhou Merchants: A Paradoxical Case



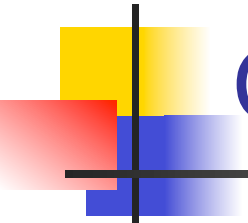


The Scale of Personal Exchanges Continuously Expanded in Wenzhou

- In production side, manufacturing firms continued to increase
 - 6477 (1980) → 131950 (2001) → 140220 (2003)
→ Industrial relocation
- In distribution side, the number of outside Wenzhou people substantially increased
 - 100,000 (1980) → 1540000 (2001)
→ 1750,000 (2003) → 2350,000(2015)

Sectoral Distribution of Outside Wenzhou People

	Apparel	Electronics	Real estate	Wholesale Market	Shoes	Eye wear	Construction Material	Department Store
Number of Chambers	85	81	78	52	48	48	27	25
Province	28	28	25	25	22	20	17	17
Provincial-capital	22	19	20	18	15	11	9	6
Local city	63	62	58	34	33	37	18	19
	Hard ware	Lamps	Mining	Electromechanical Products	Printing	Auto and Motor parts	Valves	
Number of Chambers	30	25	24	23	20	14	10	
Province	13	15	15	13	13	11	10	
Provincial-capital	7	5	5	7	11	9	4	
Local city	23	20	19	16	9	5	6	



The Share of Personal Exchanges Continued to Decline in Wenzhou

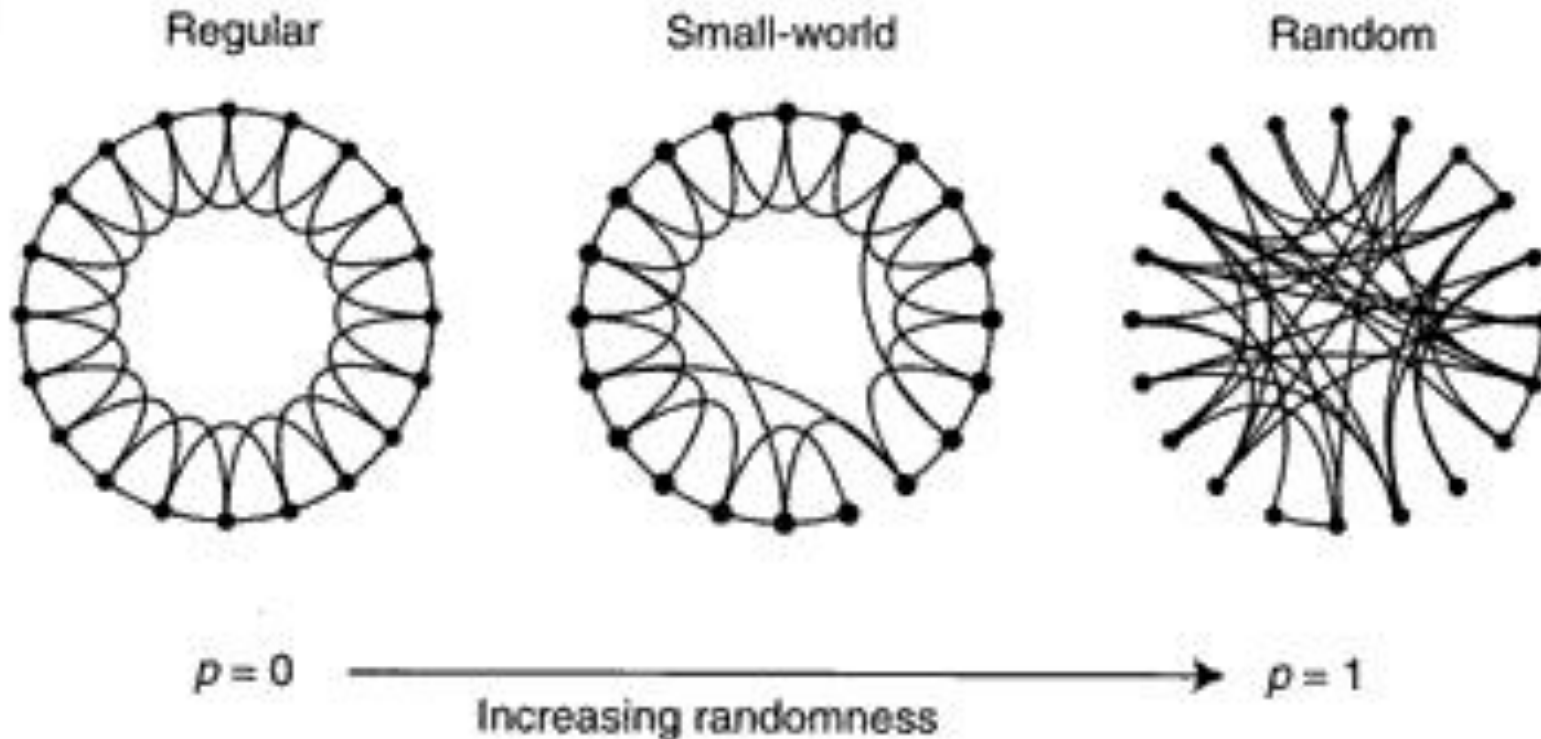
- In 1980s, **almost all of** the Wenzhou products were sold through 100,000 Wenzhou salesmen
- In 2001, The share of sales created by outside Wenzhou people decreased to **less than 45%**.
 - Wenzhou products sold by outside Wenzhou people amounted to 83 Billion RMB. In the same year, the domestic sales of total manufacturing products of Wenzhou was 184 Billion RMB.



Two Lines of Literature Help to Understand this Paradox

- Social network literature on Wenzhou
- Literature on Specialized Markets

Wenzhou Network as a Typical Case of Small World Network (Nishiguchi and Tsujita, 2012)



Four Types of Wenzhou Entrepreneurs (Nishiguchi and Tsujita, 2012)



Jumper

- Search for new opportunities **beyond their usual sphere of experience** by actively seeking out and developing relationships with **strangers and foreigners**

■ Active mover

- Take recourse not only to relationships with immediate relatives and friends, but also to extended networks of the latter's connections, thereby broadening their range of reference to a few degrees of separation.

■ Passive recipient

- Rely upon, and live almost exclusively within the narrow confines of, immediate relations, not infrequently of kinship alone, which significantly limits their range of usable connections.

■ Loner

- Only has **weak social ties with non-community members** while **having no communications with community members**



Features of Wenzhou Network (Nishiguchi and Tsujita, 2012)

- Rich community capital
 - Relational resources only shared between community members
- Jumpers **are deeply embedded with Wenzhou network**, actively sharing new information and opportunities with other community members
- The share of loners is extremely **low**.
 - 7.5% VS. 45%
- People in Wenzhou communities are able to explore a new distant market by only using **a small number of rewiring**, while still **keeping close relations** with the community



Social Network Theory and the Paradox

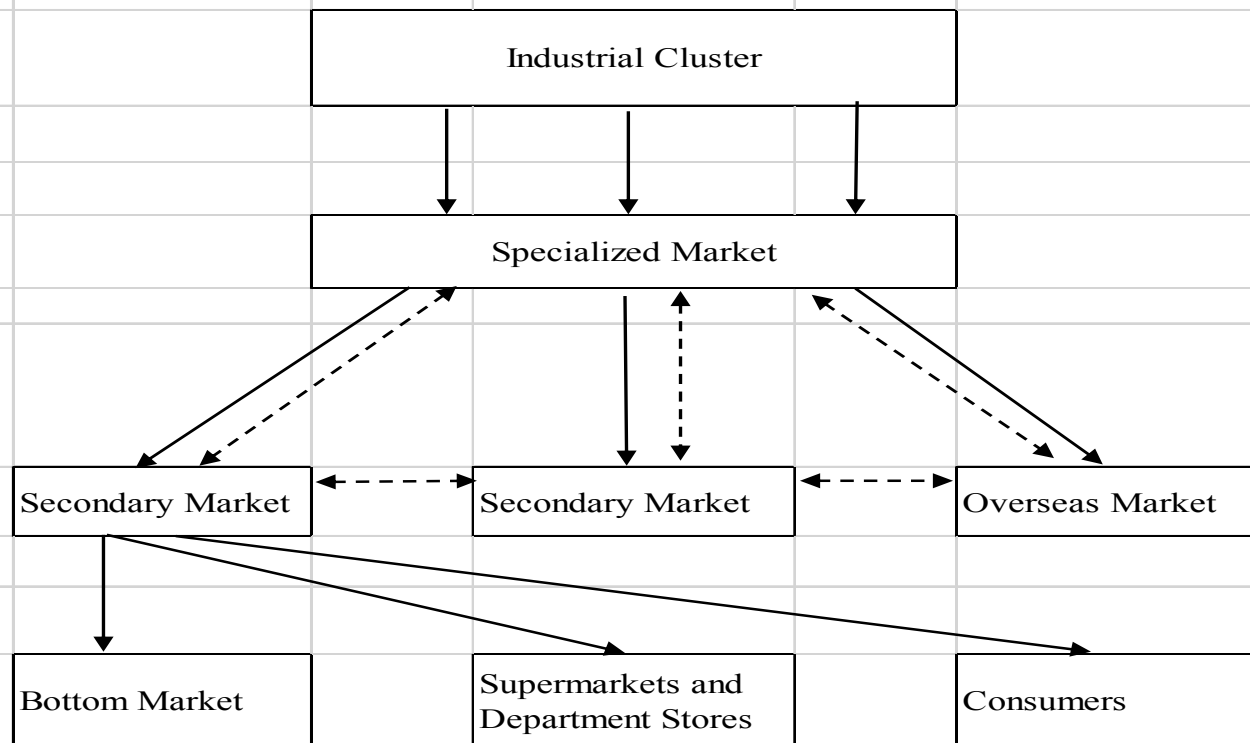
- Jumper is of course a key player in Wenzhou network who on the one hand creates impersonal relations with strangers and on the other hand has strong personal ties with other types of Wenzhou firms.
- However, we still need to explain how other types of Wenzhou entrepreneurs established impersonal relations.
- We also need to explain why such a social network had not made Wenzhou thrive until China started the reform and opening-up policy.



Wenzhou Merchants as Key Players in Specialized Market System

- Wenzhou merchants in specialized markets
 - Yiwu China Commodity City
 - 70,000 booths, 100,000 Wenzhou people, **210,000 daily visitors**
 - Shenzhen North Huaqiang Market
 - 20,000 booths, 55,000 Wenzhou people and **600,000 daily visitors**
 - Chanshu Zhaoshang City
 - 28,000 booths, 100,000 Wenzhou people, **200,000 daily visitors**
- Wenzhou merchants are major players in most of the secondary wholesale markets
- Wenzhou merchants themselves opened 240 marketplaces in China (2003).

Specialized Market System



Source: The Author.

Notes:

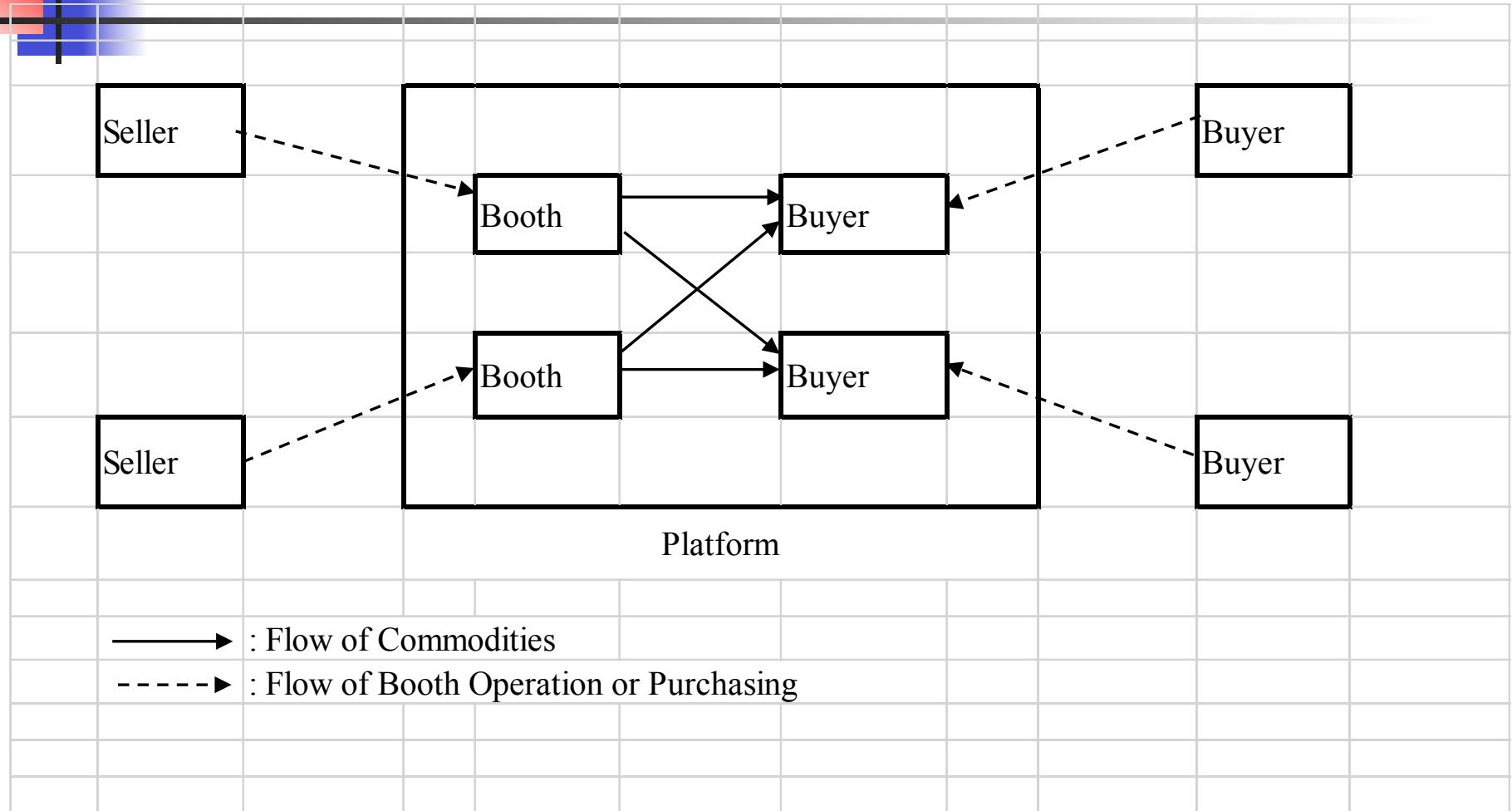
—> : Flow of Commodities

- - -> : Flow of Wenzhou Merchants

Specialized Market System



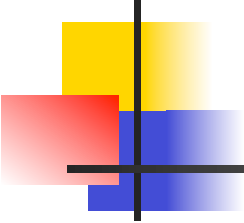
Structure of a Marketplace





A Model on Specialized Market (Ding, Gokan and Zhu 2015)

- Buyers and sellers produce agglomeration through search and matching.
- Forward linkages
 - The increase of sellers in a marketplace means more heterogeneity in the marketplace, thus buyers can have a chance to find more preferable varieties in a marketplace. As a result, buyers' willingness-to-pay increases.
- Backward linkages
 - More buyers in a marketplace provide larger demand for each seller, which result in higher returns per unit of capital in the marketplace.
- These accumulative circular causality reinforce each other, resulting in the emergence of a large marketplace.



Key Factors that Affect the Formation of a Marketplace

- Initial number of buyers and sellers must be large enough to exceeds a critical mass
- Smaller capital requirement for setting up a new firm, transport costs, and search costs (transaction costs) between buyers and sellers help market formation.
- As higher search costs help sellers to avoid tough price competition, an **authoritative third party, instead of sellers,** is required to reduces search costs



The Role of Wenzhou Network in the Model: Critical Mass

- Once jumper finds a marketplace, a large number of Wenzhou people, both as buyers and sellers, will follow him and make use of the market.
- “This is like the ‘frog psychology’ of Wenzhou people. You croak, I croak, and everybody croaks. Then, the market will prosper and expand.”



The Role of Wenzhou Network in the Model: Reducing Capital Requirement

- Mutual support within Wenzhou communities
 - Set up a new business, fund raising, do business outside Wenzhou
- Information and Knowledge sharing between community members and the spillover (through Jumper) to local communities
- Both of these activities helped to reduce capital requirement and enabled more and more small businesses to make use of the marketplace.



The Role of Wenzhou Network in the Model: Intensifying inter-marketplaces competition

- High mobility of Wenzhou merchants intensified inter-marketplaces competition and forced management system in marketplaces to evolve.
- “Like the migratory birds, they are always moving around, searching for markets with higher profits.”



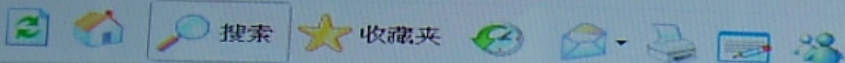
Why Impersonal Exchange Emerged on the Market?

- Increasingly lower transport costs enabled distant buyers and sellers from various areas to make use of marketplaces.
- Third party enforcement by local government enabled impersonal exchange
- Many Wenzhou people have transformed from merchants to market platform managers, who tended to provide market institutions themselves.



Suq as a Reference System (North [1991:103-4])

- “Governmental controls over marketplace activity are **marginal, decentralized, and mostly rhetorical.**”
- “What is missing in the Suq are the **fundamental underpinnings of institutions** that would make such voluntary organizations viable and profitable.”.



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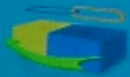
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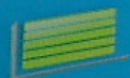
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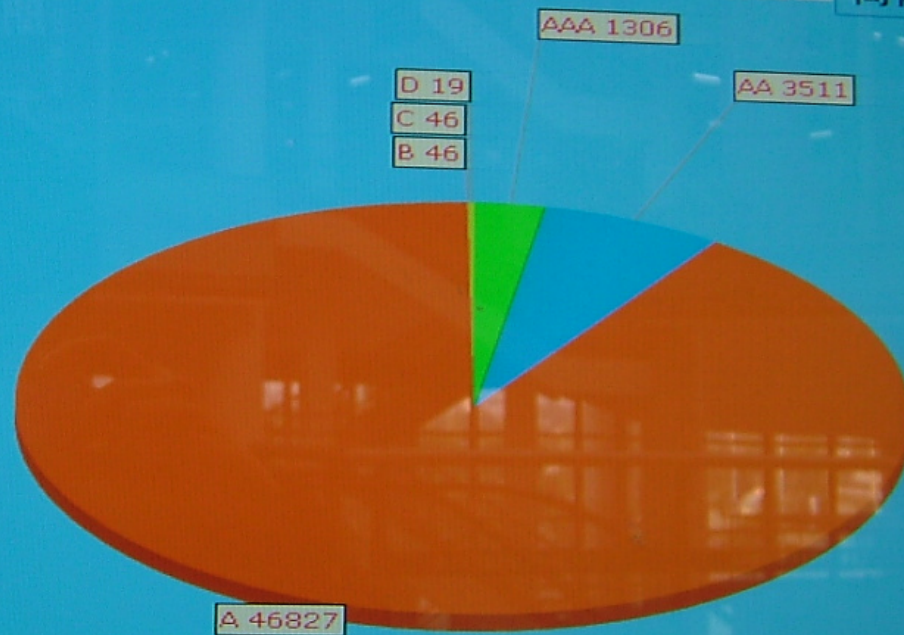


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Conclusion

- Because of its unique feature of small world network, the expansion of Wenzhou network stimulated the great development of specialized market system.
- Third party enforcement by local government and Wenzhou people themselves, and increasingly lower transport costs, enabled people outside Wenzhou to enter this system.



Thank you for the attention!
