Construction of a Credit System in the International Trade of Small Commodities: The Case of Yiwu

Wen Meizhen
Zhejiang Normal University

In Yiwu, Arabic commercial activities and their credit trade model serve as a case for exploring cross-cultural communication issues in the credit system. As the study reveals, shared social network and long-term communication are essential for a cross-cultural credit system. To solve trade disputes, however, requires government's support and social organizations' participation.

Keywords: credit system, international trade, shared social network, Arab merchants in Yiwu

Over past three decades, the rapidly developing Chinese economy has attracted a large number of foreign businessmen to engage themselves in transnational trade activities in China. Their transnational economic behavior and appearance arising from various social phenomena have caught widespread attention from the Chinese society. However, the credit involved behind the economic interactions between cross-cultural groups and the resolution of trade disputes have been neglected by researchers. Some scholars argue that China is a low-trust country, and low trust not only increases the costs of transaction, but also causes obvious damage to the economy and society (Fukuyama, 1995). Therefore, how to deal with the credit problems between cross-cultural groups and trade disputes is an inevitable and urgent problem for not only foreign companies to come in, but also Chinese companies to go out.

Yiwu, known as "the world's largest small commodity city," has established trade relations with more than two hundred countries because of its variety of low-priced small commodities. The trading city also attracted many transnational ethnic groups who resided there (Zhao, 2018). According to the data provided by Yiwu's entry-exit administration, the number of foreigners visiting Yiwu in 2016 was 480,000, and there were about 15,000 foreigners living in Yiwu for more than 6 months. In terms of the population and transactions, Arab traders from the Middle East and North Africa have had a profound impact on the local society.

After the mid- to late-1990s, Arab traders gradually developed a form of trade on credit in the course of long-term cooperation with Chinese suppliers, that is, the buyer and seller do not sign a formal contract, the buyer pays a small deposit or a few percent of the total price to reserve the goods, and then pays the balance according to the agreed time (usually in two months' time or more). This type of trade on credit is different from the formal contract signed through the import and export trading company, as the latter pays for the full amount of goods according to the contract, then the trading company delivers the bill of lading to the buyer, and the buyer clears customs with the bill of lading to pick up the goods. This more formal trading behavior is protected by law, and any violation or breach of contract can be resorted to the law. For the former, as there is no formal contract, once disputes arise, they are generally resolved by the traders on their own, so the cornerstone supporting this credit trading model is the mutual credit relationship between the two parties.

This paper examines the daily business activities and credit trade patterns between Chinese suppliers and Arab merchants in Yiwu, to explore how credit is generated among groups of different cultural backgrounds and how to deal with disputes that occur. It is found that building credit mechanisms among cross-cultural groups requires not only a long-term communication but also the support of a shared relational cluster. In the case of trade dispute resolution, it is necessary to rely on the participation of multiple social organizations, such as various associations (e.g., chambers of commerce) and a large number of mediating organizations (different social platforms) help establish credit and timely risk avoidance. The government's active involvement and intervention are also a strong reliance that guarantees the long-term orderly development of trade exchanges.

THE LAND OF GOLD: THE PATH OF ARAB TRADERS INTO YIWU

According to information provided by the Yiwu government, there were more than 4,000 Arab traders staying in Yiwu at the end of 2016 (defined as residing in Yiwu for more than six consecutive months), compared to more than 10,000 in 2008-2009 during the peak of trade. These Arab businessmen living in Yiwu can be divided into three groups according to their roles. Some act as intermediaries, helping businessmen from their home countries or other countries to search, buy and collect goods in China; some serve their family businesses, usually one or two men in the family was assigned to live in China to build a supply chain, while other family members have stores or trading companies in their home countries or other countries; and some Arab businessmen are expatriate representatives of large foreign trade companies, which have branches or offices in international trading cities (e.g., Dubai), and these companies hire one or two employees from their own country to work as managers in Yiwu.

According to our fieldwork, Arab traders enter the Yiwu market through four main paths. First, through the Chinese goods found in other cities or countries that come out of the Yiwu market, which is also the most important channel for Arab traders. For example, some Arab merchants came to Yiwu before doing business in Dubai, and the Chinese market in Dubai gradually brought them to China. Other Arab merchants are from Turkey, Southeast Asia and Hong Kong. In addition, the Asian financial crisis in 1998 was the main reason for their shifting their business to China. This crisis rendered the markets in Southeast Asia extremely unstable, while Guangdong had already become the world's factory, and the biannual Canton Fair provided a platform to showcase things to a large number of Arab businessmen who learned about Yiwu through it.

Second, from international students to businessmen. Educational cooperation between China and Arab countries has provided opportunities for a large number of Arab students to come to China. After the Bandung Conference, China and Egypt established and strengthened diplomatic relations by sending students to each other. The first four Egyptian students who came to China started a cooperation between China and Arab countries in educational affairs, and that has continued to this day (Li, 2005). These students did not go back to their home countries; rather, they have been using their bilingual skills to work as interpreters for Arab merchants in their own countries and buy goods in China. After accumulating enough wealth, some of the interpreters started their own trading companies. Then, a group of successful businessmen also started to sponsor their brothers or relatives to come to China to learn Chinese and to help them manage their business and expand their trade networks.

Third, via Xinjiang to Yiwu. Cross-border trade between China and Central Asia has always been strong. A large number of traders from Pakistani, Afghan and Russia crossed their borders to buy goods in China and then sell them to the Middle East via Central Asia. Arab businessmen with a keen sense of business followed the Central Asian traders to Xinjiang, but they could not find a depot there that could supply them directly. In order to find a direct source, the Arab traders employed local Chinese interpreters to bring them to Yiwu to find the origins of goods in the supply market.

Fourth, the Arabian traders come to Yiwu through the connections of Chinese students in Arab countries. Some Chinese students went to the MENA countries to study Arabic, and they brought with them small Chinese goods to their the destinations of their study to sell, thus having the opportunity to contact local Arab buyers and eventually developing a cooperative relationship. After graduation, these Chinese students would open their own foreign trade companies to serve Arab merchants or were hired by the latter to handle their business in China.

Arab traders who entered China by different routes have relied on different social capital and had different levels of credit that determined by their social capital. Arab businessmen who moved to China from other markets were better at hedging risks and adapting to the market culture due to their extensive international trade experience, and were also able to establish relationships with Chinese businessmen quickly and maintain credit relationships through repeated trade. Arab businessmen who had studied abroad had a better understanding of the trading culture in Chinese market and laws, and thus they had much lower market entry costs than their competitors. Arab businessmen who come to China through their Chinese students' connections would even gradually develop their employment relationship into a partnership.

NO CAPITAL: THE RISKS OF THE CREDIT BUSINESS MODEL

Regardless of depending on which route to China, Arab traders who wanted to trade on credit in Yiwu must establish a strong social relationship with Chinese suppliers. Of the more than 100 Arab merchants I interviewed, less than 10 percent traded on cash, who could often buy similar goods at lower prices than those who traded on credit, and Chinese suppliers would give priority to cash orders. But most Arab traders still choose credit due to their limited funds. For each order, they only needed to pay 200 yuan or one to ten percent of the total purchase price as a deposit to order the goods. However, many Arab companies would default on their payments or even run away with the goods. Although merchants have complained about this method of trading on credit, it continues to exist.

Credit Method and Its Causes

The mode of trading on credit has been rooted in the market's internal trading logic, but also arisen from the external competitive pressure. Before Arabian traders entered into the Yiwu market, Europe and the United States were their most important trading venues. With the outbreak of the financial crisis in 1998, the purchasing account of the European and American markets showed its weakness, and Chinese suppliers in Yiwu gradually abandoned their reliance on a single regional market so as to expand the markets in the Middle East and Africa. As a result, Arab merchants gradually filled the Yiwu market. Initially, the Arab traders who came to Yiwu were only allowed to make cash transactions, as Egyptian businessman Samir recalls:

> I came to Yiwu for the first time in 1996. At that time, I carried two suitcases, one of which was filled with Arabic cakes. Because there were not many Arab merchants in Yiwu , it was difficult to find halal restaurants, so I had to bring my own food. Another suitcase was filled with RMB, and the transaction method was to pay with cash, and the store or factory would only deliver the goods and settle directly in cash. As I came more often, the Chinese suppliers also got to know my business, and they began to give me credit.[1]

Many merchants, like Samir, began to trade on credit after many trades. Because cash transactions limited the number of orders to a certain extent, Arab traders had to travel frequently between China and Arab countries. To increase sales, an agreement would be reached between Chinese suppliers and Arab buyers to supply on credit and settle the balance after the sale. Because the demand for Chinese goods in the Middle East was so high at the time, even the credit was short-lived and the Chinese sellers were able to recover their money quickly. Chinese suppliers have always played an active role in providing credit during this process.

When Arab merchants bought goods in China, they usually entrusted the transaction to middlemen, who would receive a fee for doing so. These middlemen were based in Yiwu, and they helped order, collect and deliver goods, while also playing the role of guarantors of credit. The Chinese suppliers dealt with the middlemen, who were responsible for collecting the outstanding payments. Since the middlemen were based in Yiwu and had set up offices, Chinese sellers felt that the middlemen were more reliable in their own city than the migrating merchants.

The above is a credit relationship based on long term cooperation between suppliers and buyers with a high level of trust. However, as labor costs increase, commodity prices rise, and competition in the market will become more intense, Chinese suppliers were offering credit even in unfamiliar situations in order to sell more goods and attract more buyers. As a result, credit was extended from familiar buyers and sellers to unfamiliar ones, and developed into an agreed-upon market practice. Chinese suppliers who did not take credit soon lose customers and were then driven out from the market. Only merchants selling very scarce goods were eligible to insist on cash transactions and not be driven out of the market.

Credit Risk: The Phenomenon of People

The credit trading model would incur significant risks, which stemmed in part from uncontrollable natural and political-economic factors, but more often from human factors. Goods between China and Middle Eastern countries were generally shipped by sea, a long distance entailing the risk of uncontrollable natural disasters, such as fires or typhoons in transit. In the event of an unavoidable risk to the shipping vessel, the Arab buyer was unable to fulfill its commitment to pay on delivery and forced to default on payment.

The volatile political and economic environment in the destination countries was also an important reason for arrears. Some Arab countries had been in a highly unstable political and economic environment since the Arab Spring, and the war not only caused a decline in trade volume, but also led to delinquent payments not being collected in a timely manner. Exchange rate instability due to the turmoil could also be a trigger for arrears. For example, in 2014, Egypt suddenly announced a devaluation of the Egyptian pound, causing many Egyptian buyers to pay far more in U.S. dollars than they had previously paid, leading to an outcry from sellers dealing with Egypt in the market.

Many of the bad debts in the market were caused more by human factors. Backlogs and slow sales of products could easily prevent timely payment. Some Arab merchants misjudged the market and bought goods that were not in line with consumer tastes, resulting in a large backlog of products. In some cases, buyers increased their purchases to save money on travel to and from China, and once the market was saturated, the excess goods would not be sold. In some cases, there were delays in shipping, such as long customs detentions, that prevent products from being sold when they were in season, resulting in a large backlog.

The middleman might also prevent the payment from reaching the Chinese seller. Arab traders generally did not pay Chinese sellers directly, but often paid them into the accounts of intermediaries, who in turn paid the Chinese suppliers. However, some middlemen would divert the money for personal consumption or investment in other businesses, or even divert the money from different buyers in a way that "tears down the east wall to make up for the west wall." Once the financial chain was broken, some middlemen chose to flee back to their home countries and never appear in the Chinese market again. This certainly happens in economic downturns.

The last situation is the emergence of professional fraudsters. Some Arabs knew that things in Yiwu could be got on credit, thus they came to start the first few trading activities in the form of cash transactions, to obtain the trust of intermediaries and Chinese suppliers, then they began to buy large quantities of goods and abscond with the goods.

MEDIATION: DIFFERENT STRATEGIES OF CIVIL AND GOVERNMENT

The increasing number of trade disputes over credit had not only disturbed the market order, but also affected the integrity of the whole market. Although the government had been encouraging cash and honest transactions, the credit trading method had been established and could not be changed in a short term. In the credit trade, buyers had an absolute advantage. Delayed payment could allow the seller to guarantee that the goods would remain intact, while in a cash transaction, the buyer was at a disadvantage in dispute resolution if there was a problem with the goods ordered. For most Chinese sellers, the credit model was also good for business if the payment could be collected in a timely manner as promised. Therefore, for the market to develop in an orderly manner, both buyers and sellers, as well as local governments, must take proactive measures.

Civil Self-Mediation

In order to avoid risks, Chinese sellers would often embed purely commercial transactions with Arab traders in their personal social networks. For example, Chinese sellers often traveled to their cooperators' home countries as an excuse to check their background in order to understand a specific situation. Ms. Cai, who dealt with hardware and bathroom products, had visited her customers' homes in Jordan and Lebanon three times. She said:

> I am from Taizhou. My mother's family has a manufacturer of sanitary ware. My husband's family mainly deals with hardware factory products, and I have two stores in Futian. We only do cash business and would rather have lower prices. But in 2013, a Jordanian customer wanted to take credit because he was planning to open another trading company in another city in Jordan. I was hesitant because I thought it was risky even though I had been working with the Jordanian client for many years, but I didn't know the details of the client, and if the new trading company failed, it would lead to delays in payment. In order to learn more about the Jordanian customer's family, my husband and I visited the customer's hometown during the spring of 2013. When we arrived in Jordan, we found that the client owned a large trading company, as described, and that all of his other siblings had their own businesses. After gathering this information and learning the specific address of the client's residence, I agreed to start making credit.[2]

By the time I was in the field in 2016, the client had become Ms. Cai's most important customer, with an annual transaction volume of tens of millions of RMB. Looking back on her initial hesitation, Ms. Cai was proud of her resourceful decision not to reject the client's request because of the change in trading mode, and to maintain a long-term relationship; at the same time, through many visits to the client, she had gained an understanding of her clients' market and culture.

The development of various social media also provided a platform for credit investigation for both buyers and sellers. Chinese suppliers would join a variety of WeChat or QQ groups, such as hometown groups, industry association groups, and various foreign trade groups. When they met a customer who was trading for the first time, or a customer whose background was uncertain, the seller would reveal the information on the customer a chat group to consult with other sellers and asked whether the customer had trade transactions, and how the customer's credit was. Some Chinese sellers would also expose their customers to the group if the latter had poor credit or were seriously delaying payment. Thus social media can provide a faster and more convenient platform for Chinese sellers to conduct credit checks.

In addition to relying on personal relationships between buyers and sellers, many Chinese sellers also seek the help of associations in Yiwu, the most important one being the Chamber of Commerce, in the country of origin of their customers. I was involved in a fraud case involving an Egyptian businessman in China, who was from Alexandria and was lost after purchasing three containers of underwear in Yiwu. The Chinese seller had a good impression of the merchant because of his good credit record and prompt payment in the previous three transactions. However, in March 2016, when it was time to deliver the balance, the merchant could not be contacted at all. The Egyptian merchant had always dealt directly with the seller, so the Chinese seller was unable to investigate the details through an intermediary. After asking around, the Chinese seller finally found Samir, president of the Egyptian Chamber of Commerce, and sent five Chinese sellers with the largest transactions to Samir's office to negotiate. The Chinese sellers provided the Egyptian merchant's passport to Samir, who used his connections with the Egyptian Consulate General in Shanghai to locate the merchant's address and then contacted him through his network of mosques and private networks in Egypt. However, the Chamber of Commerce would only intervene for larger orders and only if the incident would indirectly affect the reputation of the country's merchants as a whole. The Chamber was not available to merchants with small volumes.

"EXTERNAL MEDIATION": EARLY WARNING PLATFORM AND PEOPLE'S MEDIATION COMMITTEE FOR FOREIGN-RELATED DISPUTES

In addition to the participation of individual traders in dispute resolution, the local government had also taken active measures to reduce the friction caused by trading on credit. The Yiwu Municipal Government has established the Yiwu International Trade Integrated Service and Early Warning Platform for Economic Cases, which has two main sections: the first was concerned with complaints and reporting, and the second with credit rating. In the first major section, all individuals involved in trade could report and complain when they did business. The more important function of this early warning platform was the credit evaluation and subjects' information of international trade. International trade companies, Chinese suppliers, freight forwarders and market buyers could evaluate each other through this platform. Entering any of the name of company, address or owner's name on the platform, it would check the credit evaluation, including whether the company had defaulted on payment in the past and what the credit value was. The information on the platform was mainly collected by the government and provided by people involved in the market.

However, the limitations of the platform were also obvious. First of all, not all trading companies' information were available in the platform, only locally registered trading companies or companies reported by people were. At the same time, it was limited to foreign trade companies, and it was also impossible to search for a specific customer. More importantly, some trading companies had a good reputation, but its customers did not have a good reputation, the platform could not always show the complete difference of all customers in a company. In Yiwu, there were many unregistered trading companies, which were often delinquent in payment and bad in reputation.

Another government-initiated dispute mediation body was the People's Mediation Committee for Foreign-related Disputes. The committee was established in 2013 against the background of a large number of complaints from Chinese sellers to the local judicial office as a result of large foreign trade disputes. The most unique feature of the committee was that it employed foreigners as mediators who themselves were involved in solving foreigners' problems via "foreign mediation." Foreigners had a better understanding of their own culture and business rules, and foreigners would also have a stronger sense of trust when they mediated with foreigners. Currently, the Foreign Mediation Committee had 25 staff, who were from 18 countries. In 2016, the committee mediated a total of 294 foreign-related disputes, with a success rate of 96.7%, involving a total amount of 46,913,700 yuan, and having saved a total of 25,766,800 yuan in economic losses for Chinese and foreign businessmen.

The Foreign Mediation Committee was the first dispute resolution institution in China to involve foreigners and had achieved many results, which had been reported by the media as exemplary; many foreign-related institutions had also visited Yiwu to learn from their experience. However, due to limited staff resources, the committee could only select a few cases for resolution although there were a large number of cases declared for mediation each year.

LOW END GLOBALIZATION OR GLOBALIZATION FOR ALL

This study finds that the reciprocal and credit relationship between Arab traders and Chinese sellers is established through market transfers, foreign students and so on. Trading on credit did not emerge overnight, but rather was the result of a deeper understanding between the parties, continuous negotiations and bargaining, and market self-regulation. This type of trading is a double-edged sword: if it can develop in a healthy and orderly manner, both sides can profit, but once one of the sectors is broken, it will lead to unsustainable trade, and ensuing disputes are difficult or slow to resolve through the complex and time-consuming legal procedures. In Yiwu market, the general transaction involves a very large number of objects. For example, a container of small commodities would be connected with hundreds of Chinese suppliers, who need to join together to defend their rights. As long as one of the sellers does not want to participate in a unified appeal, the rights of all concerned will not be properly defended. More importantly, a dispute might involve cross-border and different cultural communities, and it takes time to get the cooperation between two or more countries. Also, the legal costs are very expensive. The Yiwu government can only try to warn Chinese sellers in preventing a risk, but the risk might be completely eliminated. Under this context, the model of hiring foreign coordinators and involving multiple parties has become an acceptable way for all parties to mediate.

Yiwu's transnational trading is highly uncertain, highly risky and multiply-culturally intertwined, both in terms of spatial and human interaction. It has been a long-distance, cross-border and ethnically diverse transaction method between different cultural systems with few and fragile social relationships to rely on. Therefore, while individual traders are relied upon to establish reciprocity and credit relationships in the act of credit, the government's intervention and coordination are also needed.

The economic behavior of African businessmen in China is defined by scholars such as Gordon Mathews in terms of "low-end globalization" which has three characteristics: first, African businessmen in China carry only a small amount of capital; second, the economic behavior of these African businessmen in the low-end globalization chain is mostly illegal or semi-illegal; third, the implementation of low-end globalization relies heavily on personal social ties. Gordon also argues that the actors of "low-end globalization" are often in a gray area outside of the law and thus in an adversarial relationship with the government (Mathew, 2007; 2017). Although the economic behavior of Yiwu Arab merchants examined in this paper characterize some of the "low-end globalization" described by Gordon and other scholars, the government still plays an important role in transnational trade. In fact, rather than passively accepting or repelling the practitioners of low-end globalization, the government has been trying to guide the orderly development of the market through active intervention, thus putting Yiwu's cross-border trade on a normal track.

In sum, the mode of trading on credit, developed in the course of trade between Yiwu's small commodity market and Arab traders reminds us of the innovations that developing countries may bring to international trade as they participate in the globalization process. Yiwu's practice of resisting the risks of credit trade and dealing with related disputes also draws our attention to the new role that governments may play in developing countries. This new role in the private sector is certainly more in line with the spirit of an inclusive globalization than the description of the "low-end globalization" theory.

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Wen Meizhen is an Assistant Researcher at Zhejiang Normal University. She got her Ph.D degree from Australian National University. Her Email is: wenmeizhenbest@126.com

ENDNOTES

1. Fieldwork notes. Time: 16th March, 2016. Place: Samir's office.
2. Fieldwork Notes. Time: 13th October, 2016. Place: Futian Market.

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