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How does the market operate under the condition of capital shortage? A study of social time mechanism of the textile industry of Pu Town

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Abstract

Based on the case of the textile industry of Pu Town, this paper brings in social time mechanism to illustrate how financial activities and continuous operations of the small and medium enterprises (SMEs) under the condition of capital shortage are realized through massive graduated debts and cost allocation in the production chain. Starting with the relational contract, this paper adds the time dimension of contract, which is called social time mechanism, to the dimensions of market power and social relations. Through this social time mechanism, the author expands the meaning of credit and highlights the restriction of repayment capacity and the repayment period on the trading process. The author then uses this model to explain how the two trading parties adopt the capital settlement period developed under this mechanism to adapt to and promote operations and development of the market in the absence of third-party credit guarantees.

Keywords: Debt, Relational contract, Capital chain, Social time mechanism

Research problem

Capital shortage has always been a disturbing problem for the development of small and medium enterprises (SMEs). One of the important factors contributing to the problem is that the current financial system can barely support the development of SMEs. The restriction of the financing environment is rooted in the highly centralized financial system left over from the planned economy during the economy's transformation that was viewed as inappropriate for SMEs (Lin and Li 2001) and which discriminated against SMEs' loans (Lin et al. 2003). In addition, it is rooted in a relatively backward financial system that was designed to support the previous financial system and is incapable of meeting the demands of the numerous labor-intensive SMEs. For example, Fan (2000) argues that it was essential to develop small- and medium-sized local private financial institutions in order to improve the financial system and expand the financing channel of the private enterprises. However, it was not until recently that this kind of financial system for private capital developed. In fact, Growth Enterprise Market (GEM) for direct financing was established after 2000. This financing platform targets high-tech enterprises rather than private enterprises; private capital was not

allowed until the State Council issued 36 guidelines in 2005 titled "Several Opinions on Encouragement of Nonstate-owned Economy Development." Thus, from the beginning SMEs developed under the shortage of financing sources, especially the private SMEs in rural industry.¹

However, in reality, SMEs have made significant progress even in the absence of a regular financial system, which impelled researchers to turn their focus to financing channels outside the regular financial system, such as underground private banks, civil bidding, and even exorbitant usury. Taking nongovernmental finance in Wenzhou as an example, there are nongovernmental loans, industrial loans, and civil bidding (Wang et al. 2004; Zhang 2000; Guo and Liu 2002). Whether through financing channels within or outside the regular financial system, SMEs had to pay certain rates for loans since all these financial services are offered for profit. Thus, the SMEs were under the double restriction of a shortage of regular capital supply channels and the high cost of irregular capital supply (Zhou 2007). The cost of regular capital supply was also considerable. With overcapacity in China's economic sector and the rise of the RMB exchange rate, the profit rate of export-oriented enterprises decreased more and more. Influenced by changes in international marketing conditions, SMEs entrepreneurs who depend heavily on such financing channels tended to experience cracks in the capital supply chain. A large number of entrepreneurs have gone into hiding due to the pressure to repay loans. These SMEs have collapsed on a large scale due to the guarantee chain for the credit warranty system established by banks and massive mutual interenterprise debt. Thus, the causes for the capital shortage were first, that financing approaches were seriously limited and second, SMEs entrepreneurs intended to restrict the scale of financing in order to avoid risks. This raises the question of whether there are any other approaches to tackling the capital shortage problem that emerged in the course of SME operations as market subjects.

Through analytical strategy, loans from the regular financial system and the private financial system can be classified into visible financing channels, that is, financing channels studied by economists that we can directly observe. Obviously, there is another invisible financing channel that can only be found in enterprises' own capital supply chain,² which implies that entrepreneurs realize financing through controlling the capital circulation period in industrial chains as well as the scale of cash flow, making use of minimum expenses to stimulate the operation of the whole production chain.³ In brief, it can be concluded that the scale of cash flow must be minimized and capital circulation speed be improved as much as possible. However, improving capital circulation speed is subject to fixed conditions such as labor intensity, technology, and logistics speed. It is difficult for SMEs to evolve under these situations unless they are making innovations in their technique. Comparably speaking, it is more manageable to minimize cash expenses. This is the invisible financing channel discussed earlier, which refers to the specific phenomenon of structured deferred repayment that occurs among enterprises on a large scale through production chains. In other words, it is cost allocation based on massive graduated debt that definitely motivates the lasting development of SMEs. Nevertheless, economics has not paid sufficient attention to this phenomenon and generally regards it simply as existing debt or deferred repayment.

This paper discusses this borrowing behavior that has received insufficient attention from economics. Although deferred payment or borrowing is a common phenomenon

in social economic life, this paper's focus lies neither on borrowing and lending money, which is essentially of mutual help in daily life, nor on borrowing and lending behaviors in rural areas influenced by borrowing and lending cultures (Geng 2014). Instead, in regard to SMEs' lasting development, it concerns how borrowing and lending money is facilitated with a capital circulation period in the productive process in order to solve the problem of capital shortage. Given that contract theory is one of the most essential dimensions to comprehending the marketing relationship and debts exist among different market subjects, this paper will follow this approach.

The time dimension of contracts: the concept and explanatory dimension

(1) Relational contracts and market power

In the economics literature, contract theory was gradually developed first by Oliver Williamson and later Oliver Hart and finally formed a more systematic theoretical system applied to analyze issues from market and organizational relations to property (Zhou 2003). In order to clarify market integration issues from the perspective of transaction cost, Williamson distinguishes three kinds of contract forms at the level of legal governance: classical, neoclassical, and relational contracts. On the premise of incomplete contracts, relational contracts transform legal governance structure into a concrete bilateral governance structure or governance structure within an organization, thus providing an analytical frame for organizational behaviors and internal governance (Williamson 2002; Zhou 2003; Macneil 1978). Simply speaking, by introducing relational contracts, Williamson brought problems such as asset specificity into interorganizational behavior studies, including threats and possible moral risks after signing a contract. However, Hart insisted that in the incomplete contract the remaining power of assets would be the very key to tackle all sorts of contractual problems (Hart 2006). In this way, he transformed the problem of organizational boundaries studied by Williamson into property assignment.

In fact, both Williamson and Hart imply a hypothesis that transactions among organizations are manageable, while in this paper, capital shortage seemingly conveys a lack of transaction conditions. Thus, different from Williamson and Hart who highlighted the content and implementation of contracts, this paper specifically analyzes the social conditions and internal mechanisms that prepare contracts. Obviously, being in debt is more like a transaction relationship maintained on the basis of relational contracts by constantly adjusting itself in some way. Therefore, from the bilateral governance frame in relational contracts, maintaining contract relations depends on factors other than the rights and interests of both parties. Liu (1999) states that relational contracts implicitly assume the existence of an incomplete but well-functioning legal system, as a result of which some important characters associated with the relation itself have been neglected. This indicates that the relation itself is the fundamental aspect of the contract. For example, Cai and Jia (2009) observe that road and bridge contractors encountered a deficit sequence pattern for payoff because project payment was unable to be distributed in time. In this situation, gradually paying the core labor reflects the importance of relations. However, Ai and Zhou's study (2013) finds that the market can still develop with the condition of capital shortage in the case where borrowing money can

be achieved through compulsory forces of market power (imposed credit) and economic capital transformed by local agents on the basis of the capital of a village community.⁴ They substituted the credit that depended on social relations emphasized by Granovetter (1985) for the imposed credit of market power. Nevertheless, as far as an explanation mechanism, both studies still have to address a core problem, that is, borrowing and lending money essentially involves a capital circulation period while the problem of establishing a relationship between borrowers and lenders through credit that depends on market power and credit that depends on social relations has not yet been solved. Both explanatory mechanisms still seem abstract from the point of view of more fundamental tiny links.

(2) Softening of contract constraints: the concept of property rights and capital payment period

Generally speaking, enterprises need a great deal of liquidity. They will not be in debt unless they suffer radical changes in the macroenvironment, such as a depression. Even if enterprises encounter the challenge of deferred payment, they can resort to a credit guarantee from a third party such as the installment of a commercial bank and acceptance bill commonly used in transactions. In fact, transactions without a third party as a credit guarantee generally use cash in order to avoid risks. There is a great deal of mutual borrowing and lending behavior among enterprises. For enterprises in communities (Zhe and Chen 2004), this behavior is taken for granted as the reason that contract constraints between transaction subjects have been softened compared to transaction relationships in an unfamiliar environment.

Many studies on the transformation of township enterprises focus on the softening of contract constraints. For instance, Liu (1999) explicates how contract constraint relations have softened and how business agents have acquired residual control of property rights from the perspective of re-embedding between the business agent and his/her interpersonal network. For township enterprises, the situation is more complicated. Zhou (2005) analyzes the ambiguous and evolving phenomenon in township enterprises from the view of the relation of property rights, claiming that it is mainly attributed to township enterprises adapting to a complex environment in order to attain resources. Liu (2003) explains the complexity through three dimensions of possession. The softening of property rights constraints proves from another aspect that constraint relations could be softened by resorting to a certain mechanism of the community. This mechanism functioned because economic relations have been embedded into social relations (Polanyi 2013; Granovetter 2008). Therefore for transaction relationships between acquaintances, the trust mechanism is not generally established on the basis of strict contract relations.

As Durkheim (2000) points out in regard to contracts, contract relations can be maintained because of other more fundamental impersonal factors. These impersonal factors are essentially social conventions. Zhe and Chen (2005) hold that social contracts are based on reciprocal relationships implemented in communities. Therefore, the transactions of SMEs in communities are impacted by various social relations and thus influenced by social contracts. In a certain sense, as the foundation of credit, the trust mechanism is also a kind of social contract. In the case of the transactions of YQS

discussed below, he usually reached agreement with the households verbally. Therefore, being in debt is generally dependent on social contracts. What is more, a premise is implied in these social contracts that goods or money can be borrowed, that is, under certain conditions and for a designated period of time, one party can transfer its property to another party free of charge, which has been the essential point for discussing the internal mechanism of realizing contract relations.

The notion of a limited assignment of property indicates that, distinguished from financing within a financial system as well as private financing, being in debt directly minimizes cash input with no need to pay interest. On the other hand, with the time restriction of a social contract, being in debt is indeed limited. Therefore, the reason why borrowing is sustained is that debts can be repaid within the time limit prescribed in social contracts. Timely repayment is equal not only to repayment ability but also to lasting borrowing. Therefore, enjoying good credit does not mean taking on debts easily. It is highly relative that the counterparty with good credit is able to repay with enough financial strength. In market transactions, especially after market practice, the debtor clearly knows that the purpose is to advance money to others with no expectation of gaining interest from the deferred payment. Thus, the only condition they could receive is that the counterparty volunteers to repay within the assigned time limit, usually prescribed by the social contract. Thus, credit refers to repayment ability, as a result of which being in debt is an after-set credit mechanism. This is so even in the case in which there is no third-party credit guarantee.

Credit prolongs the capital settlement cycle, which provides a solution to the problem of capital shortage for reaching a trading contract. However, there is a time limit to social contracts that compels the party with market power to conform to the payment time prescribed in the social contract when passing on capital pressure. Meanwhile, the party with market power attempts to put off the payment cycle as far as possible, which amounts to substituting a short capital circulation period of production and management for a long capital use period of social economic life. By taking advantage of the time difference between these two periods, enterprises are able to bring on stream within the acceptable time limit of repayment with no impact on ordinary social economic life. After repaying, profits produced by a faster economic production cycle can be invested into expanding production in order to realize capital accumulation. In this text, repayment in a timely manner in accordance with social economic production and life capital use period, which is equal to the time limit prescribed in the social contract, is defined as "social time" in order to distinguish it from the economic production and management time period.

(3) Social time mechanism: an explanatory dimension of sociology

Enterprises in communities are able to resort to personalized social capital, embedding trading relations into social relations, with no need of a third-party credit guarantee for deferred repayment. The implementation of market power further strengthens deferred repayment. For example, suppliers in the upstream of the production chain would experience the risk of poor sales if they demanded due payment from downstream firms. Nevertheless, the key to delay in payment is to use the capital spending cycle in social and economic activities. As a result, social time has been the critical link

for exploring the subtle relationship between borrowing money and capital circulation period in the capital chain of the SMEs.⁵

Social time essentially refers to a time unit formed in a certain social or collective life rhythm. In this text, it mainly includes periodic holidays and time points at which significant family events occur. The former typically refers to the Spring Festival that determines the end of a year, and the latter principally includes events⁶ surrounding marriages, funerals, and children's enrollment in school. In addition, it covers routine time arrangements on the basis of social conventions, such as capital settlement in a season and settlement in half a year according to the customs of rural communities.⁷ A large number of studies have focused on social time (Marx 2008; Durkheim 1999; Mead 2002; Giddens 1984). For example, Durkheim (1999, p. 12) argues that "the differences between date, week, month and year are corresponding to the periodicity of rituals, festivals and public ceremonies," that is, "the calendar conveys the rhythm of collective activities and guarantees the functions of the regularity in these activities." Additionally, Hubert (1999) explains how the duration of time is interrupted by the divinity at important time points. As Sorokin and Merton (1938) note, institutions concerning time arrangement are directly related to social cooperation. All of the above studies constitute the essence of social time as defined in this paper. It can be seen in the text that rhythm and important festivals are formed on the basis of social economic life, which is distinguished from astronomical time or physical time in nature. Social time is characterized by discontinuity (Mukerjee 1943) that is reversible and periodic.

The time system for industrial capitalism, which differs from social time, was essentially developed based on lineage time and commercialized time evolved from calculating rationality (Hassard 2009; Marx 2008; Thomson 1967; Thrift 1981). According to Mukerjee (1943), social economic rhythm in an industrial society is dominated by the speed of the machine system rather than life rhythm. The rhythm of production, transactions, and other economic activities for different enterprises and markets, such as the speed of capital circulation and the logistic system, is more compact due to unified time arrangements after which the links are more accordant with economic rationality. It is suggested that time was made into a timing system, the fundamental system of economic production and development, such as the time arrangement of Taylor and hourly wages (Marx 2008). According to Polanyi (2013), this time system would necessarily be replaced by a more rationalized form when encountering the rhythms of social time. However, this is not so. Nyland (1986) argues that a series of arguments and political movements emerges when the rationalization in time arrangements according to economic benefits extends to production, circulation, and exchanges, that is, workers struggle to achieve time for social life (free time) within the economic time system. But indeed, the salary settlement period such as monthly salary and weekly salary is not a time system naturally made by the economic system but a system made by social time, which operates in the economic system.

As a result, we see that Algeria's farmers are dependent on natural time rhythms as Bourdieu (1963) notes, which also indicates that social time still functions by creating a certain mechanism in another system. As Young (2002) argues, time is not only a dimension of social interaction but also an instrument of social interaction. Therefore, when social time occurs as a capital settlement period in a contract relation with no impact on the social economic life of either party, they are able to make remarkable

progress. Thus, this capital settlement period according to social time is defined as social time mechanism. In the following text, the textile industry of Pu Town is taken as an example to clarify how SMEs that cooperate with the capital circulation period in production resort to the social time mechanism in solving the problem of capital shortage.

The case of Pu Town

Located in the north of Zhejiang, the Hangjiahu plain, Pu Town has developed its textile industry since the late 1970s. After 30 years of development, Pu Town has developed into an important textile industry base in the Yangtze River Delta. For example, the lining output in Pu Town in 2009 occupied 2.5 % of the gross national production. In terms of development scale, the industrial scale of Pu Town has increased remarkably, from 100 to 200 looms in the early 1990s to over 35,000 looms in 2014, and from 100 households in three to four villages to more than 2200 households in 11 administrative villages (a total of 14 administrative villages) today. From January to December 2013, the total output of Pu Town's textile industry reached 235 billion yuan. According to economic indicators designed in Pu Town, there were 84 enterprises whose revenue from sales exceeded 20 million yuan in 1 year (14 % of all other enterprises' revenue in the county), while there were 196 enterprises whose revenue was less than 20 million.

Capital shortage has always been a problem in the development of Pu Town's textile industry and addressed by different solutions in different periods. In the early stages of development, there were mainly individual households with small production scale. They overcame the difficulty of capital shortage by acquiring loans from relatives and friends, so there was less debt involved in these transactions. In the middle and later 1990s and especially after 2000, the number and scale of textile enterprises grew rapidly; as a result, they unavoidably exceeded the growth of capital. During this period mutual debts among enterprises helped resolve capital shortages. The following briefly discusses the conditions of the settlement period of social time.

- (1) Country fair trade and social relations: the social relation network of the acquisition type

Despite the development of the textile industry in Pu Town at the end of the 1970s, a small local textile market was not built up until the early 1990s. Before that, most individual households were restricted by capital produced and sold to external domestic markets, respectively. As Fei (1999) argues, there are two forms of rural industry: one is the cottage industry, which developed with the slack season in farming; the other is the workshop industry. The difference between these two kinds of industries is that the former resorts to surplus labor force while the latter makes use of surplus capital. Obviously, after the 1990s, the workshop industry developed in Pu Town.

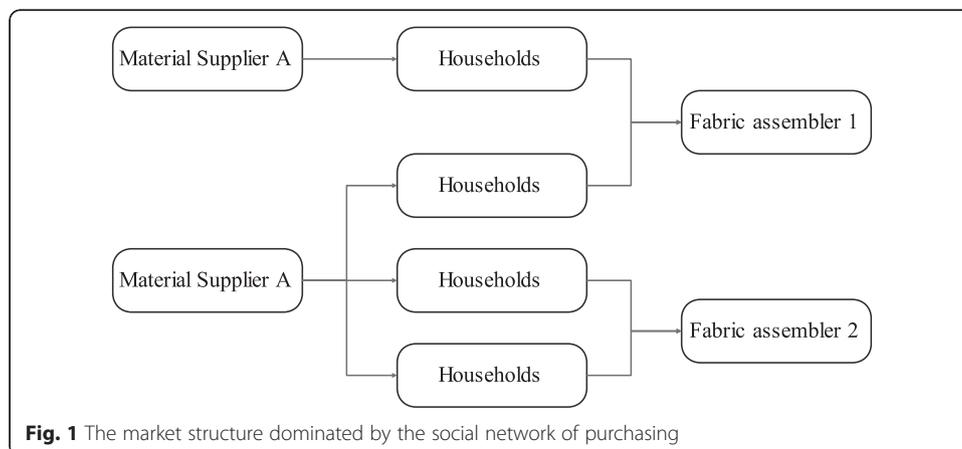
Due to the rise of locative textile market, a large number of foreign fabric assemblers came to Pu Town, gradually breaking the traditional pattern in which production extended at a slow pace in accordance with kin and friend relations in Pu Town. A new pattern of production and sales began to form an interpersonal network in which local agents acting as mediators played a critical role. During this period, social relations were different from that discussed below. Interpersonal

networks were used to acquire information and resources when marketing, while social relations discussed below were used to obtain loans for SMEs or the households in the production chain dependent on the social network. Take case WLC as an example:

Case 1: In 1986, after graduating from junior high school at 16 years old, WLC became a mechanic in a textile mill in town. After working for 2 to 3 years, WLC bought two shuttle looms to start weaving with his father and sisters. They sold their woven cloth on the road. In 1990, WLC became acquainted with mercers from Guangzhou and the northeast of China through his relative's hotel because many foreign mercers stayed there. By age 23, WLC no longer sold cloth by the main road of the town and had instead started a workshop at home to collect cloth for mercers. He began to do business with mercers, selling his own clothes produced by his own shuttle looms and collecting cloth according to these mercers' demands in order to make profits. This pattern lasted until the establishment of the textile market in Pu Town. During this period, WLC rented a store specifically to do business in material, fabrics as well as dyeing, and then went back into the fabric business. He rented machines from the mid-1990s until 2003.

WLC's case demonstrates that foreign assemblers who collected cloth depended on local agents and were obviously making use of WLC's social network. WLC bought cloth from people he knew when purchasing for nonlocal assemblers and from the volunteer households in their villages or neighbor villages. In short, WLC was familiar with these merchants. As business grew, WLC formed a more fixed purchase network. The social network constituted by social relations is typically similar to a circle, from processing the supplied material (Wang 2013; Tian 2014) to laying the foundation for WLC's subcontracting in the mid- and late 1990s (Fig. 1).

In the stage of market transaction, the households take local agents as a connecting hub, forming an industrial chain consisting of material suppliers, the households, and fabric assemblers in Pu Town. The market structure in Pu Town gradually began to be constituted by these different social networks of purchasing. Cash became the main transaction method because trading volume was usually low at this stage and in need of less cash. Thus, loans from relatives and friends became the main solution to capital shortage during this period.



(2) The pattern of subcontracts: the formation of the structure of market power dominated by orders

Since the mid- to late 1990s, a large scale of subcontracts gradually emerged in Pu Town. Distinguished from the pattern of mercers' purchasing, production and management for the pattern of subcontracts was more dependent on orders. During this period, especially after experiencing the transformation of township enterprises from 1998 to 1999, as the domestic market developed and the Go Out Policy was nationally advocated since 2000, some local agents of fabric, in cooperation with the labor force, took a large number of foreign and domestic orders from many local textile markets. Subcontracting occurred at this stage. Take YWL as an example:

Case 2: In 1992, YWL was employed by a locative printing and dyeing mill in an enterprise of Pu Town, taking charge of business services. After the transformation of this mill in 1998, due to his familiarity with the business, he began to conduct textile business in Guangdong. During this period, YWL sold the cloth produced by his father's factory and cloth purchased from Pu Town. He also took orders in Guangdong and went back to Pu Town to find processing factories, which entailed locating households in Pu Town to do the subcontracted work. In 2000, YWL went back to Pu Town, specifically to contract with the households. He took foreign trade orders and became a large subcontractor locally until 2003, when he moved to a printing and dyeing mill.

The textile industry in Pu Town gave rise to more divisions in labor, contributing to a large number of fabric orders and the restriction of time limits for delivery. This is shown in more detail in Fig. 2.

Subcontractors who took orders played a critical role. Driven by subcontractors, a new organizational structure emerged in Pu Town's production chain. First, when subcontracts occurred, the mercenary relationship between the households and material suppliers was replaced by a trading relationship between the subcontractors and material suppliers, while household looms previously took the role of manufacturing. From the particular productive process, subcontractors purchased materials according to the demands of the orders. Organzines and trams that were processed in the previous procedure⁸ were distributed to the households. The households produced white fabric with these organzines and trams and delivered them to subcontractors.

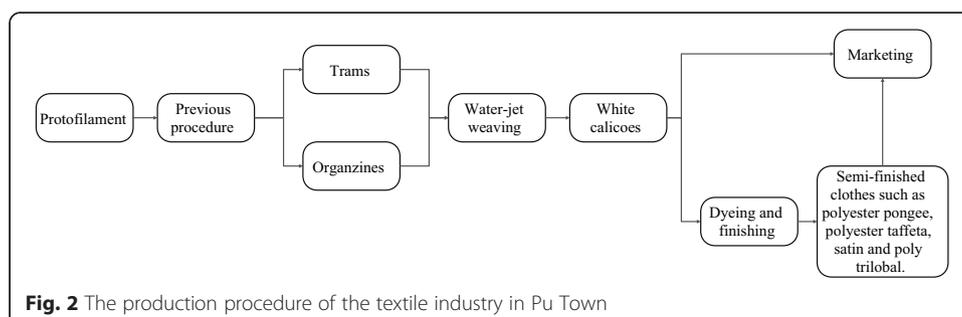


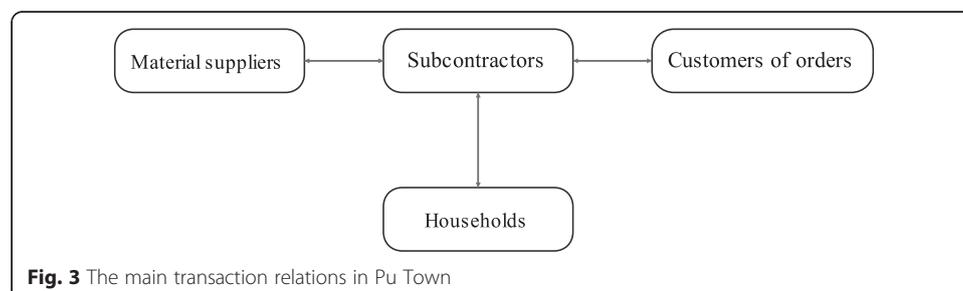
Fig. 2 The production procedure of the textile industry in Pu Town

They would be sold after uniform processing. This is the main transaction relation shown in Fig. 3⁹:

Thus, at the stage of subcontracting, production driven by domestic orders and direct or indirect orders from the international market was greatly changed. For example, local agents responsible for purchasing gradually played the role of operators just as in the material process within the putting-out system (Fu 2014; Tian 2014). The previous social network of purchasing was developed into the social network of processing. In other words, the structure of the order-oriented production chain signified the combination of market power represented by orders and the personalized social network of purchasing. In the process of reorganizing the structure of production and management in Pu Town, those small traders at the previous stage of market sales were replaced, forming a similarly recessive factory system (Xie 1992). It has been suggested that if the households failed to cooperate with the subcontractors, it would have been difficult for them to join in the recessive factory system and survive in the market. The households who made a family living by weaving would be totally on their own in such a case, where they could neither satisfy the production need of orders nor afford a textile mill on their own.¹⁰ Subcontractors at the core position of the production chain would be forced to face the challenge of capital shortage. First, in order to acquire orders, subcontractors have to purchase fabric, exceeding their own capital ability. With market competition strengthening and productivity improving, the profit margin of fabric was decreasing year by year in the mid-1990s. For example, the profit of fabric went down from 2 to 3 yuan per meter at the end of the 1990s to about 3 cents per meter in 2014. The weakening of profit-making ability gave rise to capital shortage. Therefore, faced with the double restrictions, the entrepreneurs of the SMEs who held market power and personalized social networks for purchasing, i.e., subcontractors,¹¹ began to adjust the capital settlement period within upstream contracts in order to tackle the problem of capital shortage.

Two performances of social time mechanism: graduated debt and cost allocation

From the perspective of financing cost, financing the start-up and running of an enterprise through loans from relatives and friends certainly costs the least. However, guaranteed by these so-called strong ties,¹² the amount of financing is seriously limited by the relations because loans from relatives or friends and the expansion of these relations in order to start and run a business are either far from enough to meet the need or costs more with the expansion of relations. What is more, in daily production and



management, constantly borrowing money from relatives and friends due to capital shortage harms trusted relationships because it signifies bad management and loss of money. For the sake of avoiding risk, most relatives and friends are unwilling to lend money. As a result, these loans are very limited and astringent with the social relations expanding gradually and the cost increasing.

Enterprises could put off capital settlement period with the help of market power and the social network of processing. In other words, in solving the problem of capital shortage, enterprises can first be in debt to the upstream and repay after the draining of capital. Distinguished from loaning, this financing channel has its own advantages with no need to pay interest. Therefore, in adjusting the capital settlement period with the upstream, the subcontractors adopt social time accepted by the community as a settlement period, which helps them acquire the largest potential for capital circulation and accumulation.

This practice led to two views in Pu Town: one is “Now every business owns its debts”; the other is “Now you can do business through being in debt as long as you have basic start-up capital.” The former signifies the debts based on social time mechanism; the latter indicates that for a certain operator, the cost of production and management can be allocated by the social time mechanism, which means that the practice of subcontractors is imitated level by level.

(1) Gradual debt and the capital circulation period: how to use capital effectively

I. “Debts are allowed” and “settle together”

Although the view that “now every business owns its debts” fails to directly explain the relationship between debts and the capital circulation period, in Pu Town, a textile mill that subcontracts the work to 700 looms has the view that the “textile business in Pu Town cannot expand without borrowing money, and every mill has its debt.” This confirms the importance of loans for the development of textile production. This view indicates that every businessman in Pu Town can borrow money. Therefore, every lender has to accept the loan relationships. In such case, money or goods can be limitedly transferred. This is a view of reciprocity that prevails in the community. The case of material supplier DZL illustrates this view.

Case 3: DZL is the secretary of the party for the first commune-run enterprise committee. When he retired from work, he rented several stores in the textile market for his son-in-law to run a precursor fiber business. However, his son-in-law did not manage the stores well and they had few customers. After asking the details, DZL realized that his son-in-law demanded that customers pay cash and pay in full. DZL then asked his son-in-law to observe how he sold these precursor fibers. When his son-in-law saw him give some precursor fibers to a customer for free, the young man stopped DZL. DZL still insisted on selling in that way. After a while, another customer came. DZL claimed that he could not accept the transaction until the customer paid in full. After this customer left, DZL's son-in-law asked why the former customer could keep his money while the latter could not. DZL explained to his son-in-law that it was based on his acquaintance with these people. Some were so reliable that you could easily loan the money, while others were not.

II. Graduated debts: the social time mechanism and its practice under market power

In the above discussion, settlement according to social time has appeared. From the perspective of each link of the longitudinal production chain, there was a large scale of structured graduated debts in the whole production and capital chain under the pattern of subcontracting, that is, from the subcontractors to the households and workers of the households, the settlement periods of processing charges and salaries were performed according to social time. The date of settlement usually occurred mainly at the end of the calendar year or important events in daily life including marriages, funerals, enrollment of children in school, or buying a house or car, all of which require a substantial amount of money. The former is fixed, while the latter is more flexible. Regarding the payment for goods, subcontractors normally acquire goods from material suppliers directly, with no need to pay all the processing fees to the households. Only when the upstream has to deal with special events are subcontractors obliged to advance a certain amount of money for the upstream. The remaining payments will still be settled at the end of the calendar year.

Therefore, the rules of loaning can be simply concluded to advance daily spending but save the remaining capital. There is thus a great difference with the air-for-assets in loaning argued by Ai and Zhou (2013). For the whole debt bill, there is still a sum of money that cannot be borrowed because it covers the expenses that maintain basic production and life order upstream. For example, when the large subcontractor YQS mentioned above talked about settlement with clients upstream, he especially emphasized feeding households, that is, maintaining daily life and settling the remaining processing fees at the end of the calendar year. This is also a very important precondition for debts. As a result, the payment list was forced to separate into two parts and each part carried out according to different social time periods. Social time, that is, different settlement periods, was enforced among the households and then introduced to the workers of the households. Household loom worker JSJ presents an example:

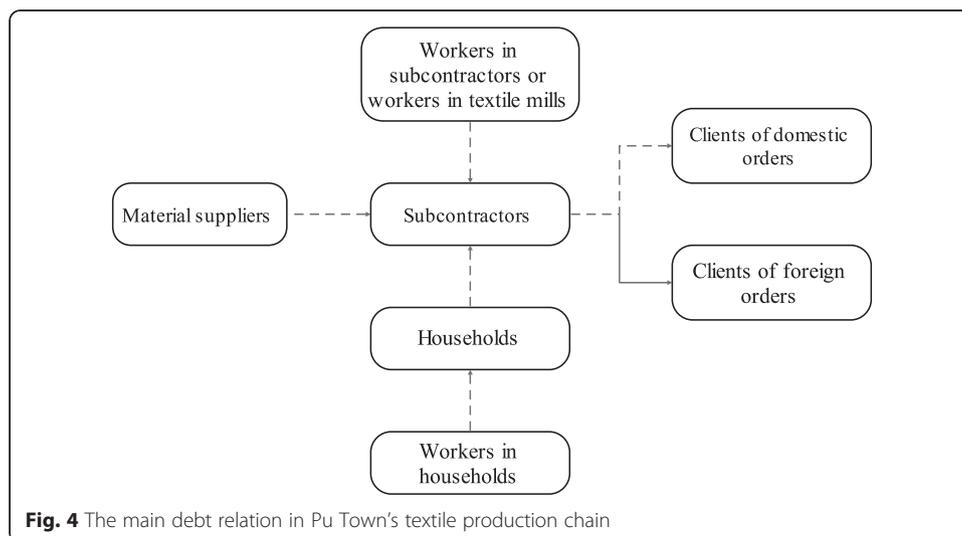
Case 4: JSJ became involved in the domestic weaving industry in the early 1990s and began to do subcontracting work on processing fabric for subcontractors in 1996. According to JSJ, in the 1980s, the bosses purchased cloth in Pu Town with cash. From 1990 to 1995, he also sold his cloth in cash transactions, but beginning in 1996, he only charged a processing fee when cooperating with the locative subcontractors. The processing fee was separated into two parts. The first part was paid in advance every month and then regularly settled on the 25th of each month. However, it was usually put off to the 28th because electricity bills were due on the 25th. Due to the 3-day delay, they had to pay a fine for delaying payment. For example, in 2014, the payment was 1000 yuan each month for the daily basic fee, including the daily expenses of workers in the households. The remaining processing fee was settled at the end of the year, but so far, the processing fee has decreased to 3 cents per meter. In his workshop, JSJ recruited several people from Anqing. Migrant workers usually lived in his house. These workers' salaries were generally settled at the end of the year, but they could receive advance payments under special circumstances such as marriages, funerals, or enrollment of children. At the end of the 1990s (probably from 1996 to 1999) when workers received 5000–6000 a year, they were extremely happy to receive their salary.

JSJ's case suggests that since 1996, with the order-oriented production and management patterns practiced, debts are more immobilized and out of choice. JSJ carried out the capital settlement among workers in the same way because he was unable to pay these workers in full since subcontractors only paid basic fees for each transaction. In Pu Town debts were graduated from the subcontractors to the households and even the workers of the households. Additionally, the subcontractors owed money to the material suppliers upstream and the workers. The specific debt relation is presented in Fig. 4:

The market transaction relations shown in Fig. 3 developed into the capital settlement relations in Fig. 4, in which the dotted line refers to the debt and the arrows point to the debt relations, that is, the arrow points to the debtor. Figure 4 shows that the subcontractors are at the core of all the debt relations. In other words, the graduated debts surround the subcontractors in the production chain. We can also see that debt relations exist between the clients and the subcontractors because of the different clients. We will not discuss this further here because it extends beyond Pu Town. Nevertheless, different clients are directly related to the subcontractors, who adjust different graduated debt relations in order to take effective advantage of their present capital.

III. Utilizing and saving capital more effectively: two different kinds of capital circulation periods

The debt relations are to make use of the social time mechanism to create time differences between the two kinds of capital circulation periods. The first time period is the capital use period, that is, the social time period that maintains the daily social life of the workers of the households (such as the machinists) and the households. The second time period is the capital circulation period in the process of order production and transactions for the subcontractors or enterprises. As for the capital circulation period of enterprises, it is highly restricted by the repayment time point. Therefore, making the period of social time the most efficient capital circulation period for production and management ultimately becomes an important way for the party who holds market advantage to utilize and save capital effectively.



In the period of subcontracting there are two different kinds of capital circulation periods in the production capital chain (Fig. 3 presents more details). The first capital circulation period is between the material suppliers, the subcontractors, and the clients. The second is the circulation period between the subcontractors and the households. The latter adjusts itself according to the period from production to sale, which means adjusting according to the period of orders. Generally speaking, in Pu Town, the period from the material purchase to the production of white fabric and delivery to the clients lasts from 2 to 3 months. In the case of foreign transactions, the time for dyeing and finishing as well as export transportation must be added into the whole period, which amounts to about 45 days. Thus, for subcontractors working on foreign transactions, the capital circulation period of a batch of goods is roughly 4 months, while domestic transactions are about 2 to 3 months. The social time for the second capital circulation period in settling puts off the payment time as much as possible in regard to the speed of capital circulation, which makes the speed of the first capital circulation period go far beyond its circulation speed. It is basically suggested that the first capital circulation period does not need to pay the processing fee in full for the households timely after getting profits in trading. Instead, it saves a large part for daily circulating or capital accumulation.

Let us take a look at the first horizontal capital circulation period. The period for the value realization from material to product lasts about 3 months. Therefore, many textile enterprises (the large subcontractors) do not pay their workers in the first 3 months: the payment for the first month is distributed in the fourth month and so on. The remaining 3-month payments are distributed at the end of the year,¹³ which suggests that the payment for the first batch of goods at the beginning of a year is deferred for 3 months. As a result, the production and management period of orders is just right for the conventions of settlement prevalent in the community, such as settlements according to season. The 3-month payment is deferred by taking advantage of the social time mechanism. The batches of production are lastingly cumulative, as a result of which the draining speed of capital in upstream transactions is still faster than the capital settlement period upstream. The social time mechanism plays a crucial role because the time period is settled according to the cooperation between the upstream and the downstream, that is, settled according to the settlement conventions instead of the consistency of economic production and the transaction period. Depending on these two kinds of capital circulation periods, the subcontractors not only accumulate capital but also effectively utilize their present capital.

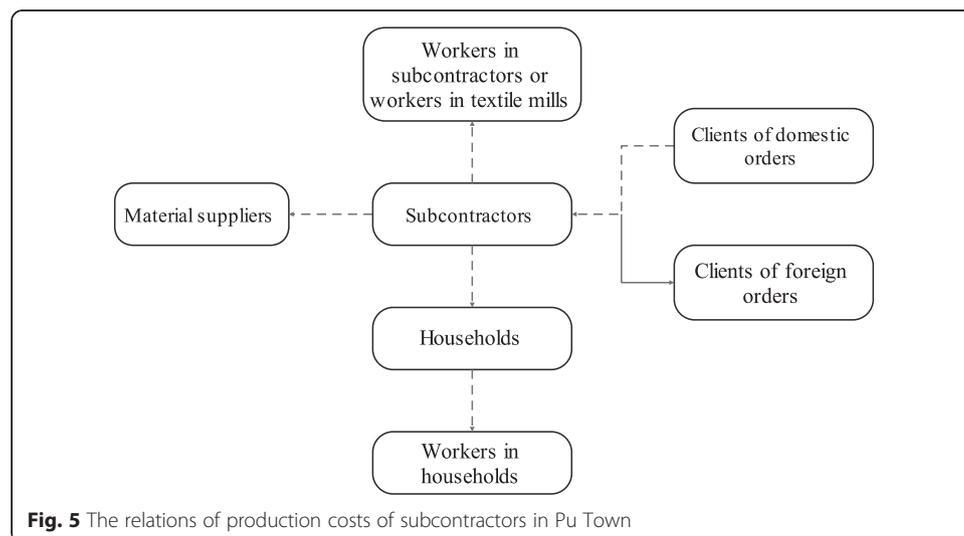
Compared to the first capital circulation period, there are two approaches in settling in the second capital circulation period: monthly and yearly, that is, paying for fundamental charges every month and settling the remaining processing charges at the end of the year. Fundamental charges are paid in advance to maintain the operation of the households and include electricity, tax, sewage charges, and salaries. The debt relation between the subcontractors and the households and then the workers of the households according to the social time mechanism saves much capital for the subcontractors. Therefore, as in the debt relations shown in Fig. 4, the horizontal capital chain mainly presents the relations that are more convenient for subcontractors to effectively make use of cash flow, while the longitudinal capital chain mainly presents the relations that are beneficial for them to save cash flow. Both of these two directions of capital chains that save capital and make use of present circulating funds are dependent on the social time mechanism.

(2) Cost allocation: collective or social cost

In the production chain, the subcontractors improve efficiency of capital use horizontally and longitudinally by the capital settlement period on the basis of the social time mechanism. However, from another point of view, the subcontractors also realize the cost allocation in production and management by the social time mechanism. The cost allocation implies that the subcontractors make the other party in the transaction take on the cost of production and management that originally belongs to them by loans. In other words, depending on the social time mechanism, the subcontractors not only realize graduated debts in the production capital chain but also achieve cost allocation in a sense.¹⁴ This measure is also imitated level by level. As a result, there is no need to pay any interest for the financing in the case where the same cost allocation also occurs in the condition of market power and social network of processing.

Take the subcontractor as an example to illustrate in the following text. Figure 4 shows the debt relations between market subjects. From the perspective of the total amount of debts, that is, after the direction of arrows representing the transaction relations between economic subjects changes, the relations of cost allocation are detailed in Fig. 5.¹⁵ As Fig. 5 shows, when subcontractors take orders, the costs of an order such as the cost of material or the cost of labor are taken on by the material suppliers, the households, the workers of subcontractors, the workers in textile mills, or the workers in the households, indicated by the dotted line. Simply speaking, the subcontractors are able to allocate a large part of the costs of every order to the production and management subjects through loans. Take ZXZ's textile mill as an example:

Case 5: The fabric of ZXZ's textile mill was processed by local households by subcontracting. According to ZXZ, the materials were bought on credit from material suppliers with whom he had cooperative relations for many years. The fabric was assembled on credit from the subcontractors when the production was insufficient or through subcontracting (in 2004, there were about 700 looms). Self-raised capital made up one fifth of the cost of daily production and management; material occupied one third to one fourth, and processing charges took up one fifth.



The capital settlement relations between ZXZ and material suppliers as well as the subcontractors adopted the social time period. Therefore, ZXZ's case shows that the actual cost only composed 20 % of the total cost. In other words, it was possible for ZXZ to utilize less capital to activate the entire enterprise by making use of time differences between the capital settlement periods for production and management of orders and the social time settlement circles caused by the social time mechanism to achieve production and management that could not be reached with the enterprise's own capital. Thus, it is distinguished from the graduated debts that promote the development of textile production in Pu Town through the orders from subcontractors in this situation where the pressure of capital shortage is longitudinally transferred level by level. The cost allocation further illustrates how the costs of production and management for the households and subcontractors in the production chain are allocated horizontally and longitudinally. The allocation mechanism also conveys that the capital requirements for establishing enterprises are reduced, that is, you could do business by borrowing money as long as you have start-up capital.

From the industrial scale, taking the 2011 statistics as an example, the textile industry in Pu Town included 80 persons who subcontracted 100 looms, 25 persons who subcontracted about 300 looms, and 10 persons who subcontracted about 500 looms. These numbers cover all the subcontractors who own looms. The reason why they could support the whole textile industry was that they resorted to the cost allocation mechanism. It also suggests that graduated debts and cost allocation resolved the capital shortage for Pu Town's textile industry, promoting its development. In other words, the development of the textile industry in Pu Town was highly dependent on the collective or social cost on the basis of the social time mechanism.

The countervailing mechanism of social time

Even though more stable graduated debts and cost allocation were built through the social time mechanism, the upstream material suppliers or the households upstream still occasionally encountered capital shortage due to accidents. These financial needs possibly emerged because payment from the downstream subcontractors did not occur before the capital settlement period based on social time or because the daily expenses exceeded the payments advanced by the subcontractors. In order to keep the upstream alive, the downstream subcontractors were obliged to support the upstream, forming a countervailing mechanism between the subcontractors and the households as well as between the subcontractors and material suppliers, that is, resolving the capital shortage by debts or loans.

The dimension of the countervailing mechanism obeying a distinct logic is different from the debts shown in Fig. 4. Specifically, the countervailing mechanism was not intended to repay material suppliers and the upstream households in advance but to build a new mutual debt mechanism between the subcontractors and the households or the subcontractors and the material suppliers on the premise of keeping the original capital settlement period based on social time. It is distinguished from debt relations with subcontractors in which the material suppliers and the households had to pay some costs for their debts. The costs were caused

by the market-dominant position of the subcontractors within the production and management frame. For example, in Pu Town there were some subcontractors lending money to households to purchase looms when these households faced capital shortages due to the expansion of scale or economic hardship and deducting the debts from the processing charges. The reverse debt relations were based on the cooperative relations between the subcontractors and the households. Additionally, capital settlement between them was also based on social time.

For the subcontractors, the risk of debts could be avoided due to the previous debt relations. Likewise, for the households, the money advanced from subcontractors to purchase looms could effectively resolve capital shortage. In fact, when social time became a general rule, the subcontractors who occupy a market-dominant position will take advantage of the graduated debts to realize capital accumulation and make use of the cash flow to achieve counterdebts. Simply speaking, some subcontractors who took advantage of the social time mechanism not only resolved their capital shortage but also accumulated a great deal of cash, which further became the basis for counterloans. A printing and dyeing factory serves as an example.

Case 6: DSH was a dyeing technician in a township enterprise in Pu Town beginning in 1989. After the transformation of the township enterprise in 1998, he first contracted a production line in a privately run printing and dyeing factory and then established an independent printing and dyeing factory in 2001. DSH has maintained cooperative relations with a material supplier of printing and dyeing since 1998. The capital settlement approach between DSH and the supplier was through loans. The settlement period was pushed from 3 months to half a year after years of cooperation. Nevertheless, the factory's needs were quite significant due to the extent of the settlement period. For example, the output was up to 2 million, which led to massive capital pressure for material suppliers. Therefore, DSH made use of the tacit rule—loans—to consult with the material supplier. He put forward the idea that it would be better to borrow from the material supplier and pay some interest rather than borrow from banks or others. The material supplier reached an agreement with him.

The specific operation method for counterloaning, taking March to June 2014 as an example, was as follows: (1) the payment settlement period settled on was every 6 months, that is, the draining period for the capital of suppliers was half a year and the payment for the first month was settled after 6 months, which indicates that the payment for March was not settled until September; (2) the borrowing amount of suppliers could not exceed the total amount that DSH owed. Assuming the March to June period as the calculating unit, the borrowing amount of suppliers in June could not exceed the total amount of 1.04 million in 3 months; and (3) the interest for the debts was 3 cents. If the supplier borrowed 1 billion, taking the amount for 3 months as a borrowing period, the supplier would need to pay 90,000 for each loan. In fact, material suppliers tended to adopt the full borrowing amount to realize the effect of similar cash transactions. From this behavior of borrowing and lending that emerged in this case, we can see first, DSH's borrowing scale was restricted within the total amount of payment he owed to the material supplier, as a result of which he not only did not need to take risks but he could also earn some interest. The worst situation for him was to

conduct transactions in cash. As for the supplier, despite the 90,000 paid for interest, every deal he made was a cash transaction so he relieved the stress of capital shortage due to debts. This was similar to the agreement by both parties. The cost of cash transaction was lower than a loan; thus, the material supplier agreed to DSH's strategy. In 2014, when I learned of this case, the amount of debt was still short of 1-month debt to reach 1 million. Therefore, the material supplier would rather pay interests more than 1 month to DSH in order to borrow 1 million from him to resolve the capital shortage. Therefore, the practice of the countervailing mechanism also made up for the problem of capital shortage.

Obviously, the countervailing debt is different from "chain debts." "Chain debts" are a circulation chain of lending to each other. In the condition of capital shortage, it would lead to the accumulation of debts as a kind of cumulative debt relations. However, the countervailing debts discussed here and loans on the basis of social time mechanism form a kind of mutual debt relation with no cumulative relations as in chain debts. Additionally, the character of mutual debt relations also indicates that it dispels debt relations: first, there is no need to pay interest depending on the social time mechanism; second, countervailing debt dispels or countervails the problem of capital shortage caused by previous debt relations even though it requires some costs, for example, higher interest rates have to be paid because of the fixed cooperation relations or debts. Therefore, with the counterdebt mechanism, there is no large scale of the capital chain collapsing due to capital shortage upstream. It is also a crucial part of maintaining the constant operation of SMEs.

Conclusion

From the perspective of relational contracts, debt is a phenomenon that emerged from the adjustment of the capital settlement period when the upstream and the downstream make use of social relations or market power. However, in fact, it is more complicated than that. For the enterprises in the community, if the time dimension within the contract is overlooked, it would be hard to illustrate clearly why the settlement period presents the character of social time only through social relations and market power. As a result, by introducing the time dimension to explore the production capital chain in Pu Town, in reaching a settlement time on the basis of agreements, a more fundamental social economic life rhythm within the community is obeyed, even though both of the two parties resort to the relational contract to adjust the capital settlement period. It is also suggested that the result of consultation between individuals is a kind of nonindividual and social institution. Thus, occurrence of the social time mechanism indicates that the transaction relations motivate more fundamental social resources or institutions, bringing the contract relation into a deeper social mechanism. More significantly, the cases discussed in the text demonstrate that the social time mechanism further develops the discussion of contract theory.

When New Institution Economics introduces the important analytic concept of transactions, it also breaks the hypotheses of instant transactions within New Classical Economics. The relational contract from the dimension of time presents the process of constant adjustment driven by the incompleteness of contracts in order to deal with the constant emergence of new situations. However, time has not been emphatically analyzed within contract theory. In other words, even though time is introduced into

the contract relation instead of being in the background in the enforcement of contracts, it is still regarded simply as a certain appointed term in contracts, such as the capital settlement period mentioned in the text. After introducing the time dimension of contracts as an analytic concept, it effectively strengthens the explanatory power of the relational contract. In fact, it has been proven in this text.

As emphasized above, the frame of contracts discussed in this text is different from that discussed by Williamson and Hart. In this text it is the social conditions involved in the agreement of contracts and the internal mechanism that are discussed. Some scholars such as Liu Shiding have focused on the relation between social conditions and contracts. Liu (1999) explores the content of the relational contract and discusses the issue of embeddedness. Many of this text's discussions concerning the structure of market transactions in Pu Town are based on this issue. In order to introduce time into the analytic concept, it is necessary to raise it to the same position as "specialties of investments" and "residual ownership," which is to say that the concept of time has analytic significance only when covering the core interest or power relations.

In fact, the concept of time has occupied this status when it involves the issue of capital settlement, for the reason that during market transactions especially under the condition of capital shortage the capital settlement period is directly related to the existence and development of enterprises. When taking the concept of time into consideration in individual cases, we further find that the different time periods have different significance and social time becomes the core of the whole relational contract. Therefore as the relational contract is embedded into social relations, its analytic concept of time naturally becomes social time. More interestingly, there is no similar issue such as the residual rights of control, but it directly develops into a mechanism that motivates the relational contract because social time becomes a kind of social institution. Obviously, the significance of social time in maintaining and controlling is no less than the time that is not discussed in this text. For example, subcontractors control the quality of production produced by the households and the upstream suppliers through deferred payment in order to maintain cooperative relations with the upstream.

What is more, the social time mechanism developing from the social time dimension of contracts effectively explains how SMEs are able to develop rapidly when facing capital shortages. From the perspective of social time, the previously deferred payment developed into the time difference caused by two kinds of capital settlement periods, demonstrating that the production chain based on social relations and market power can provide a financing channel with low costs for the SMEs. In fact, it is through graduated debts and cost allocation on the basis of the social time mechanism that SMEs are able to realize capital accumulation that cannot be reached in unfamiliar market transaction relations.

Finally, the social time mechanism also indicates that the trust relations between two parties have greatly changed. Social time reflects the lowest measure of the repayment period. In other words, when capital settlement relies more on the social mechanism, which is more binding and legitimate than individuals, the fundamental measure of deciding the debt transaction relations to be maintained by the lending party depends on timely repayment within an acceptable period delayed to a great extent and repayment capacity. Obviously a trusting relationship depending on the social institution reflects the difficulty of maintaining trusting relations between individuals in present

economic interactions. When both the transaction parties begin to depend on the institutional trust mechanism of social time, comprehending the possible influences that changes in the trust mechanism bring and other effects of the social time mechanism needs to be further studied.

Endnotes

¹This paper mainly discussed private SMEs in rural industry. From the point of view of the financial system, credit cooperatives set up by the Agricultural Bank of China first provided financing channels. In 1996, since credit cooperatives rescinded the administrative subjection relationship with ABC, original financing services were supported by rural credit cooperatives.

²The internal financing of enterprises, such as the stock system that involves equity and interests, is adopted by private entrepreneurs in a limited way. Its financing capacity is thus restricted.

³This financing approach is distinguished from the financing approach that depends on the production chain even though both channels resort to relationships between upstream and downstream enterprises. As for the production chain, it emphasizes combining the upstream and the downstream enterprises into a whole by resorting to enterprises that have great credit in order to obtain financing from commercial banks. It is still a financial product. Financing through the capital chain discussed in this paper refers to a financing approach that is dependent on debts upstream and downstream, which makes it a loose financing form that does not need to pay interest. The logistics bank and financing warehouse are both similar to financing approaches that depend on the production chain, which are distinguished from financing channels studied in this paper.

⁴When differentiating the concept of power discussed in Hart's contract theory, Zhou (2003) specifically highlights the fact that the term "power" as used by Hart refers to ownership of the remaining capital rather than the concept of power discussed by game theory in the market force sense, which is also the concept of market power discussed here.

⁵What is more, social time has been the legitimate basis for borrowing money and claiming money. Since the two trading parties are in the same interpersonal network, in trading, with the pressure of capital shortage, borrowing money is taken for granted. Meanwhile, as the debtor, even though many debts are settled according to social time, not all debts were settled in time. It is generally acknowledged that debtors take social time like the Spring Festival as a legitimate reason to claim money at the opposite house. If they do not succeed, they have to wait for the next social time period. There is no detailed discussion in this text since it is restricted by the topic.

⁶In rural societies, there are many time points that require money, such as sowing and fertilization, because of the rhythm of agricultural production. However, with the development of rural industrialization and the decline of agricultural production, these time points are losing importance. As a result, there is little need to collect money for agricultural production. In this case, it is not considered.

⁷From the perspective of managing production among economic subjects, these settlement periods occupy the same important position as social time in maintaining the order and policy of social life.

⁸An important effect of subcontractors is to localize the production of the previous procedure in the production chain.

⁹For convenience of discussion, printing and dyeing mills are regarded as subcontractors because most of them have subcontracted the work.

¹⁰It is also one of the reasons why a large number of textile mills emerged in this period; subcontractors have enough stock and capital strength to establish textile mills.

¹¹Here, subcontractors are equal to textile mills. With the change of the market structure, there were many textile mills in Pu Town that were essentially subcontractors. It suggests that there are two kinds of subcontracting: one refers to subcontracting between the households and the subcontractor, while the other refers to subcontracting between textile mills and households. Because many textile mills are developed by subcontractors, all are regarded as chartered looms here. In Pu Town, there are two kinds of textile mills: one is textile mills that produce fabric on their own, although the number of such mills is small; the other mills only subcontract the weaving work to households, which indicates that all of the subcontractors subcontract the weaving work to households but purchase looms for knitting. However, it is hard to promote knitting subcontracting among households because knitting machines are very expensive. One set of knitting machines is worth 1 to 2 million yuan, so only a few of textile mills whose economic strength is strong can afford the technology. As a result, this paper focuses on the weaving textile industry between the households and subcontractors.

¹²The use of the term “strong ties” here is the same as in Granovetter (1973). In contrast, the relation in the social network of processing is a “weak relation.”

¹³With the passage of the new “Labor Contract Law of the People’s Republic of China” at the end of 2007, beginning in 2008, the government required enterprises to pay salaries in full every month, that is, no longer paying only living expenses to workers and deferring the remaining salary until the end of the year. Obviously, the law is not enforced here. Subcontractors and households still continue this practice, as discussed in this paper.

¹⁴In fact, besides the allocation driven by the social time mechanism, for households purchasing looms on their own, it is also a kind of cost allocation of the fixed capital for the subcontractors. This article only studies the cost allocation driven by the cooperation within the production chain from the perspective of the capital chain.

¹⁵As for foreign orders, they are paid on delivery with no existence of debts as in domestic orders. Therefore, it is neither the dotted line nor the allocated part. Lately, chartered looms or textile mills and printing and dyeing factories with capital shortages have attempted to develop foreign trade due to the character of foreign trade. The percentage of foreign trade is usually up to 50 %.

Competing interests

The author declares that he has no competing interests.

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