

무역상무연구
제68권
2015. 12, pp. 197~218.

논문접수일 2015. 11. 30.
심사완료일 2015. 12. 18.
게재확정일 2015. 12. 19.

A Modern Analysis of ‘Guanxi’ of Foreign Investment in China*

Seoung-Taek LEE** · Woo PARK***

-
- I. Introduction
 - II. Literature Review in Guanxi
 - III. Application of Guanxi
 - IV. Cases in performance of Guanxi
 - V. Conclusion
-

I. Introduction

During past decades, China witnessed unprecedented achievement in economic growth as a fast-growing developing country. In particular, China has replaced Japan as the world's second largest economy in 2010. Furthermore, its gross domestic product(GDP) in 2012 reached \$84.3 billion.¹⁾

* This paper was supported by Wonkwang university in 2015(이 논문은 2015학년도 원광대학교의 교비지원에 의해 수행됨).

** First author, Assistant Professor, Division of International Trade, Wonkwang University, E-Mail : agio77@hanmail.net

*** Corresponding author, Assistant Professor, Dept. of Chinese Economics and Trade, Cheju Halla University, E-Mail : parkwootop@naver.com

1) Tashi, G. & Gratton, D. "Compassion in Buddhism and Guanxi: Can There Be a Synergy for Western Companies in China", Chinese Business Review, 12(4), 2013, 4, pp. 287~297.

This great success stimulates the interests of foreign firms who want to benefit from this huge market. In 1980, the capital inflows started to grow and in particular, foreign direct investment(FDI) inflows significantly increased in the early 1990s. Consequently, China became the second largest foreign capital recipient in the world market in 2007, with the US being the first. Almost 5% of the world's total FDI was invested in this country, which was more than \$US 83 billion. Meanwhile, the Western countries' recession arising from the financial crisis in 2008 made them increasingly dependent on this East Asian giant. For example, the United States' trade of goods and services with China increased from around \$US 2.5 billion in 1980 to \$US 208 billion in 2008, which ranked China as the fourth largest trader partner of United States.²⁾

As China's influence grew, so did the awareness of some characteristics of business customs, called guanxi(關係). The unique nature of guanxi plays a vital role in deciding successful business.³⁾ China has a business culture based on guanxi connections underpinned by strong Confucian ethics (Kate and Georqina, 2002). Willingness to embrace the importance of a guanxi-based network can post positive effects on a firm's ability to successfully operate in the Chinese market. In other words, guanxi-based business practices provide certain advantages over existing structural alternatives in terms of transaction cost . For this reason, foreign investors started to learn and accept the concept of guanxi by realizing the distinct impacts it could have on economic efficiency and the well-being of ordinary Chinese citizens.⁴⁾

However, the growing awareness of China's government corruption made people rethink whether guanxi is becoming less significant or even obsolete. Recently, much corrupt behaviour has been reported by the social media. In particular, an anti-corruption campaign such as hunting tigers, which was launched by the new president of China, Xi Jinping, has frightened some top management leaders in stated owned enterprises(SOEs) because government officials involved in corrupt activities are no longer protected as they had been before. For instance, even Zhou Yongkang, the ex-president of the Police Bureau, was caught up in Xi's anti-corruption crusade. Members of his interest group

2) <http://unctadstat.unctad.org/wds/ReportFolders/reportFolders.aspx>

3) Shin, S. Y., Pak, M. S., & Cho, S. W. "Managing Cultural Diversity by Effective Human Resource Management of International Trade: Focus on Asian Perspectives", *The International Commerce and Law Review*, 56, 2012, 12, pp.101-119.

4) Dunfee, T. W. & Warren, D. E. "Is guanxi ethical? A normative analysis of doing business in China", *Journal of Business Ethics*, 32(3), 2001, 8, pp.191-204.

both in business and official circle have been put under investigation.⁵⁾

Chinese guanxi is well known object mainly in marketing and organizational behavior. On the perspective of organizational behavior, the influence of guanxi practice on job satisfaction in China's State-owned Enterprises⁶⁾, guanxi in the relations between organizational support and organizational performance in chinese firms,⁷⁾ studied. Also whether guanxi types differently affect firm performance, and whether each type of guanxi differently affects firm performance when considering firm's life cycle.⁸⁾ In marketing area, few empirical studies have explicitly distinguished between guanxi and relationship marketing, although the role of guanxi in the Chinese business to business (B2B) market as a form of relationship marketing has received increasing attention in recent years. Foreign-invested enterprises(FIEs) may have some difficulty in fully practicing relationship marketing in China without considering the influence of Chinese culture.⁹⁾

However, on the area of international trade and business, it is a key factor to understand consumer patterns, inter-firm relations and extra-firm relations between firm and government to identify the impact of guanxi on the business activities of foreign direct investment firms in China.¹⁰⁾ Nevertheless, there is a little guanxi study to analyze foreign enterprises even though there are relatively many papers to investigate Chinese firms.¹¹⁾

Hence, we will carry out few objectives in this study. Firstly we will review the basic framework of guanxi in order to better understand the guanxi system through the study

5) Beech, H. "China's Ex-Security Czar Ensnared in Corruption Probe", *Time.com*, 2014, p. 1

6) Lee, J. h. "The Moderating Effects of LMX and Guanxi in the Relations between Organizational Support and Organizational Performance in Chinese Firms", *Korean-Chinese Social Science Studies*, 31, 2014, 6, pp. 165~192.

7) Jeon, M, K. "The Moderating Effects of LMX and Guanxi in the Relations between Organizational Support and Organizational Performance in Chinese Firms", *Korea Journal of Business Administration*, 23(5), 2010, 8, pp. 2483~2499.

8) Geng, W. T., Kwon, I. S., & Sul, W.S. "The Effect of Guanxi Types on Firm Performance: Implications for Professional Managers", *The Journal of Professional Managers*, 15(2), 2012, 8, pp. 71~91.

9) Yuan, X. N., Kim, S. Y., & Song, T. H. "When Does Chinese Relationship Culture of Guanxi Work Better Than Relationship Marketing? Case of Foreign-Invested Enterprise in the Chinese Business to Business Market", *GFMC*, 1, 2014, 1, pp. 153~179.

10) Choe, J. Y., & Lee, S. C. "Building Guanxi and Networks of Korean Foreign Direct Investment Firms in China", *Journal of Economic Geographical Society of Korea*, 15(2), 2012, 6, pp. 228~239.

11) Gao, Y., & Bae, J. H. "A Empirical Study on the Ways of Searching for Foreign Buyers and the Performances Improvement of Exporting Companies in China", *The International Commerce and Law Review*, 56, 2012, 12, pp. 29~54.

of Western literature made by Chinese scholars. Secondly identify the advantages and disadvantages of practicing guanxi in business. After that, on the perspective of B2G and B2C guanxi, we will find current cases of foreign enterprises who utilize or don't exercise guanxi network in business. Finally offer insights for Korean managers to compete in this new era of guanxi.

II. Literature Review in Guanxi

1. Background

Guanxi originates from Chinese indigenous structure. Although there are various connotations of guanxi existing in different societies, which also have evolved over time, the fundamental meanings of guanxi can be traced back to ancient Chinese philosophies, mainly Confucianism.¹²⁾ For example, guanxi is in a sense developed from the word 'lun' closely related with Confucian classics.¹³⁾ In ancient China, 'lun' represented a social order that highly stresses the importance of human relationships and moral principles. It was used by rulers to regulate and was obeyed by most people.¹⁴⁾ In modern society, guanxi continuously remains to be an important social force (Tashi and Gratton, 2013). The development of a network of multiple relationships is still necessary in China, especially for businessmen due to the uncertainty of business environments resulting from fragmented sources of authority and constant change of political landscape.¹⁵⁾

However, the reason why guanxi practices are so prevalent in Chinese business

12) Yang, Z. & Wang, C. L. "Guanxi as a governance mechanism in business markets: Its characteristics, relevant theories, and future research directions", *Industrial Marketing Management*, 40(4), 2011, 5, pp. 492~495.; Ranfagni, S. & Guercini, S. "Guanxi and distribution in China: the case of Ferrero Group", *The International Review of Retail, Distribution and Consumer Research*, 24(3), 2014, 11, pp. 294~310.

13) King, A. Y. "Kuan-hsi and network building: A sociological interpretation", *Daedalus*, 120(2), 1991, 3, pp.63-84.; Luo, Y. "Guanxi and performance of foreign-invested enterprises in China: An empirical inquiry", *MIR: Management International Review*, 37(1), 1997, 3, pp. 51~70.

14) Chen, X. & Glen, C. C. "On the Intricacies of the Chinese Guanxi: A Process Model of Guanxi Development", *Asia Pacific Journal of Management*, 21(3), 2004, 9, pp. 305~324.

15) Song, F., Cadsby, C. B. & Bi, Y. "Trust, reciprocity, and guanxi in China: An experimental investigation", *Management and Organization Review*, 8(2), 2012, 7, pp. 397~421.

practices is still not clear. Chen et al (2013) believes that guanxi and guanxi practices are attributed to the weak institutional support.¹⁶⁾ In particular, the lack of legal protection and market mechanism could be reasons for this.¹⁷⁾ Yang(1994) suggested that the breakdown in social order during the Cultural Revolution was the main reason for the growth in guanxi practices.¹⁸⁾ Nevertheless, undoubtedly guanxi is a lubricant for social life. It is an informal connection that plays a vital role in gaining approval for or access to almost every aspect in China.¹⁹⁾

2. Basic characteristics

As a dynamic process of social connections or relationships for different purposes such as economic benefits, guanxi is mainly based on individuals. It features dynamic phenomenon or processes,²⁰⁾ hence new talented entrants can be incorporated into the Chinese business system based on guanxi. Luo and Yeh (2012) also agreed that guanxi is a dynamic process that brings about structural changes, mobilisation, and the balance of different opinion.²¹⁾ Furthermore, it is an informal connection that plays a vital role in gaining approval for or access to almost every aspect in China.²²⁾

The literal meaning of guanxi is 'connection' or 'relationship'.²³⁾ But, it greatly

-
- 16) Chen, C. C., Chen, X. & Huang, S. "Chinese Guanxi: An Integrative Review and New Directions for Future Research. 中國人的關係: 綜合文獻回顧及未來研究方向", *Management and Organization Review*, 9(1), 2013, 3, pp. 167~207.
- 17) Guthrie, D. "Information asymmetries and the problem of perception: The significance of structural position in assessing the importance of guanxi in China", in T. Gold et al. (eds) *Social connections in China: Institutions, culture, and the changing nature of guanxi*, Cambridge, UK; Cambridge University press, 2002, pp. 37~56.
- 18) Yang, M. M., *Gifts, favors, and banquets: The art of social relationships in China*, Cornell University Press. 1994, pp. 145~146.
- 19) Park, S. H. & Luo, Y. "Guanxi and organizational dynamics: Organizational networking in Chinese firms", *Strategic Management Journal*, 22(5), 2001, 7, pp. 455~477.; Wong, Y., Leung, T., Hung, H. & Ngai, E. "A model of guanxi development: Flexibility, commitment and capital exchange", *Total Quality Management & Business Excellence*, 18(8), 2007, 10, pp. 875~887.
- 20) Lovett, S., Simmons, L. C. & Kali, R. "Guanxi versus the market: Ethics and efficiency", *Journal of International Business Studies*, 30(2), 1999, 6, pp. 231~247.
- 21) Luo, J. & Yeh, Y. "Neither collectivism nor individualism: Trust in the Chinese guanxi circle", *Journal of Trust Research*, 2(1), 2012, 3, pp. 53~70.
- 22) Wong, Y., Leung, T., Hung, H. & Ngai, E., *op.cit.*, pp. 875~887.
- 23) Song, F., Cadsby, C. B. & Bi, Y. "Trust, reciprocity, and guanxi in China: An experimental investigation", *Management and Organization Review*, 8(2), 2012, 7, pp. 397~421.

draws on connections or networks to secure mutual favours in persona or business relations. Yang and Bian(1994) refer to guanxi as the relationship and social connection or relationship based on benefits and reciprocal interest. Lovett et al.(1999) argued that as a Chinese system of doing business based on personal relationships, guanxi is the representative way of doing business in the Eastern world.²⁴⁾ The purpose of guanxi, Fan(2002) is the reciprocal exchange of qinqing(親情) which is affection to loved ones, ganqing(感情) which is an emotion to friends, and renqing(人情) which is a human debt to acquaintances between individuals.²⁵⁾²⁶⁾

Trust, reciprocity, transferability, intangibility are the key characteristics of guanxi. To begin with, trust is an essential element to the development and sustainability of guanxi. Trust is helpful for individuals to identify accurate information. In general, individuals or organisations which are called Zijiren (insider) are considered highly trusted.²⁷⁾ Therefore without such trust, it is nearly impossible to do business only through signing legal contracts.

Similar to trust, reciprocity is the glue of guanxi in China. It is of vital importance in dealing with human affairs. It refers to voluntary repayment to a trusting action at a later point time, although it may be defaulted in the short-time.²⁸⁾ Also, it emphasises gift giving, banquets, and the exchange of favours within relationships that are featured by indebtedness and obligation.²⁹⁾ For instance, if a person refuses to return a favour, it means he or she will be viewed as untrustworthy due to their non-adherence to the rules of reciprocity.³⁰⁾³¹⁾

24) Lovett, S., Simmons, L. C. & Kali, R., *op.cit.*, pp. 235~238.

25) Fan, Y. "Questioning guanxi: definition, classification and implications", *International Business Review*, 11(5), 2002, 6, pp. 543~561.

26) The principal of renqing implies that one should return the favour when he or she has received something from other people, following certain social norms and behavioural rules. A flexible and open attitude towards a future that is unknown and unknowable is fundamental to the idea of renqing. In rural areas, renqing is usually used in events like birthdays, marriages and funerals in exchange for gifts. In developed regions, renqing and jiaoqing(交情) which literally means interaction, exchange or business transactions, are used together frequently.

27) Chen, C. C., Chen, X. & Huang, S., *op.cit.*, pp. 171~176.

28) Chen, X. & Glen, C. C., *op.cit.* pp. 310~311.

29) Millington, A., Eberhardt, M. & Wilkinson, B. "Gift giving, guanxi and illicit payments in buyer - supplier relations in China: Analysing the experience of UK companies", *Journal of Business Ethics*, 57(3), 2005, 3, pp. 255~268.

30) Park, S. H. & Luo, Y., *op.cit.*, pp. 461~463.

31) In this situation he or she who showed favour lose face(mianzi), Mianzi, a highly abstract concept, is an individual's public image that can be quantified and measured. The amount of face positively related with the guanxi network, is a source of sustainable competitive advantage

However, reciprocity is not sensitive to social-distance.³²⁾

With regard to transferability, guanxi involves a third party. It means that one can establish guanxi with whom he does not have guanxi through a third person whose influence overlaps the two networks. It is transferable among individuals, parties, or both through a common connection in the middle. If B is a friend of A and C while having guanxi with both, then A or C can build up guanxi with each other through B's introduction.³³⁾³⁴⁾ Apart from these, guanxi is intangible and its long-run viability is dependent on members' commitment to the guanxi and to one another. Individuals or parties with guanxi are committed to unwritten, invisible rules of equity and reciprocity because guanxi does not specify the frequency or range of exchanging favours.³⁵⁾ This is partly due to the long-term orientation nature of guanxi.³⁶⁾

Additionally, it is necessary to know different types of guanxi. There are two ways to classify guanxi. According to Fan(2002), guanxi can be classified into three categories: "family", "helper", and "business guanxi" as is shown.

for a firm to operate business and to negotiate business contracts in China. In particular, giving and losing face are two key terms of mianzi. For instance, unlike western people, causing others to lose face is regarded as an aggressive move, hence even an unintentional action could result in immediate negative guanxi. Therefore, for good performance in guanxi, certain unspoken rules of reciprocity and equity related to mianzi need to be carefully observed.

32) Song, F., Cadsby, C. B. & Bi, Y., *op.cit.*, pp. 408~411.

33) Park, S. H. & Luo, Y., *op.cit.* pp. 462~463.

34) Ranging from individual, organisation, and to government departments, guanxihu is an important target groups for one's specially connected guanxi network. The emergence of guanxihu is partly due to the imperfection of market information due to an unclear or transitional business environment. Guanxihu connections are significantly helpful in getting access to scarce resources whose mobility is severely constrained and administratively controlled by the government. In addition, sales force marketing is heavily dependent on guanxi and can attain benefit from the preferential treatment furnished by guanxihu (partner firms). It is becoming an increasingly popular and effective marketing tool.

35) Luo, Y. "Guanxi and performance of foreign-invested enterprises in China: An empirical inquiry", *MIR: Management International Review*, 37(1), 1997, 3, pp. 51~70.

36) Bedford, O. "Guanxi-building in the workplace: A dynamic process model of working and backdoor guanxi", *Journal of Business Ethics*, vol. 104(1), 2011, 5, pp. 149~158.

<Table 1> a comparison of three guanxi typologies

Type	Family guanxi	Helper guanxi	Business guanxi
Definition	Special relationship, the expressive tie	Process of exchange favours	Process of finding business solutions through personal connections
Nature	Emotional, and instrumental	Instrumental/utilitarian	Purely utilitarian
Cultural/Social Root	Chinese cultural values (Fans, 2000b)	Cultural values and contemporary social-economic factors	Current political and economic structures, eg. Weak legal system
Base	Mostly blood base, some social base	Social base	Mainly through Intermediary
Core Values	Qingqing/affection, obligations, empathy	Renqing, face, trust/credibility	Renqing, face, power/influence
Motivation / Purpose	Mutually dependent, emotion-driven	To get things done' utility-driven	To acquire scarce resources or get special treatment
Function	Ends and means	Means	Means
Exchange	Love/affection.	Favour	'Money + power deal'
Condition	Normative obligation. Reciprocity not necessary, can be altruistic	Reciprocity expected but the weaker party benefits more, incremental calculation	Strictly reciprocal, 'gain and loss' bargaining
Relation	Zijiaren' (member of one's own family) one of us	Shouren' (familiar person), insider or outsider	Shengren' (stranger) outsider, a mixture of private and business relations
Quality/ Closeness	Strong and stable	Medium, normally unstable	Varies (depends on the existence of other bases)
Downside	Nepotism	Burden of renqing (human debts)	Corruption, social loss
Time	Long term or permanent	Varies or one-off	Temporary

Source: Fan, (2002)

The first two are similar to what Hwang(1987) termed 'expressive ties' and instrumental ties. Unlike Fan(2002), Tashi and Gration (2013) categorised guanxi into two groups: blood-based guanxi and social-based guanxi.³⁷⁾ This could be partly explained by Chen and Glen's(2004) ideas about guanxi bases which are divided into common social identities, a common third party and anticipatory bases.³⁸⁾ He stressed that they are not mutually exclusive. Both these two methods state that guanxi is quite complex and has no clear-cut boundary between types in reality.

III. Application of Guanxi

1. Guanxi development

The mechanism of guanxi development can be examined through exploring the entire process of practicing guanxi through its advantages and disadvantages. According to Chen, there are three stages of guanxi development, which are expressed below:

<Table 2> A process of model of guanxi building

Guanxi strages	Guanxi objectives	Interactive activities	Operating principles
Initiating	Setting up bases	Familiarizing	Mutual self-disclosure
Building	Enhancing quality	Expressive & instrumental transactions	Dynamic reciprocity
Using	Getting benefits re-evaluating guanxi quality	Exchanging favors	Long-term equity

Source: Chen (2004)

37) Tashi, G. & Gration, D., *op.cit.* pp. 290~294.

38) Chen, X. & Glen, C. C., *op.cit.* pp. 313~314.

During the stage of initiating guanxi, it is necessary to identify and create bases through familiarisation. Mutual self-disclosure is critical in this stage. The next stage is building guanxi and enhancing the quality of guanxi. Expressive and instrumental interactions are respectively done for affection and affective trust while obligation and cognitive trust are key elements during this stage.³⁹⁾ Dynamic reciprocities such as long-term orientation, great value to the receiver and unequal exchange are the essential rules for creating guanxi. Finally, one can use guanxi to get benefits and adjust the quality of guanxi based on a long-term equity principle. Mutual dependence, adaptation, favour and trust are the four key constructs during the process of guanxi.⁴⁰⁾

2. Guanxi practice of foreign companies

In particular, there are three main differences such as time orientation, pervasiveness, and personal nature of relationships between Chinese guanxi and the non-Eastern style of networking. Although the Chinese market is considered to be too difficult to access because of its bureaucracy, consumer heterogeneity and intense competition, guanxi is regarded consistently as a crucial factor for success in doing business in China.⁴¹⁾

Guanxi is helpful for businesses for many factors. Firstly, efficiency and availability of key sources of information and resources are the fundamental reasons for the establishment of guanxi, because it is hard for businessmen to obtain information and trustworthy figures in China.⁴²⁾ But business partners with guanxi could gain a desirable pool of information because they do not necessarily share information with everyone.⁴³⁾ Therefore, the access and control of strategic resources are favoured by guanxi-based business relations.⁴⁴⁾ Secondly, guanxi plays an important role in the facilitation of collection of payments, development of company's image and reputation, and facilitating a transport arrangement.

39) Chen, X. & Glen, C. C., *op.cit.* pp. 313~314.

40) Buttery, E. A. & Wong, Y. "The development of a guanxi framework", *Marketing Intelligence & Planning*, 17(3), 1999, 6, pp. 147~155.

41) Ranfagni, S. & Guercini, S., *op.cit.* pp. 298~299.

42) Davies, H., Leung, T. K., Luk, S. T. & Wong, Y. "The benefits of "Guanxi": the value of relationships in developing the Chinese market", *Industrial marketing management*, 24(3), 1995, 6, pp. 207~214.

43) Ramasamy, B., Goh, K. & Yeung, M. C. "Is Guanxi(relationship) a bridge to knowledge transfer?", *Journal of Business Research*, 59(1), 2006, 1, pp. 130~139.

44) Ranfagni, S. & Guercini, S., *Ibid.* pp. 301~302.

Thirdly, guanxi can deal with the strict and unpredictable bureaucratic system in place, and make administrative authorisations available.⁴⁵⁾ For example, foreign investors may experience difficulty due to a certain administrative document. Fourthly, guanxi is beneficial for the Chinese economy through the provision of alternatives to the bureaucratic procedures that impede economic and social development.⁴⁶⁾

However, guanxi may bring some negative effects. Firstly, it is not always clear about the boundary between corruption and guanxi.⁴⁷⁾ For example, the unethical use of *zouhoumen*(走后門儿) is one of the corrupt practices in China.⁴⁸⁾ Secondly, guanxi may make society more unfair since some guanxi practices are problematic. Dunfee and Warren (2001) argued that these practices can hurt the interest of the third party or the larger community and can violate principles of justice and fairness.⁴⁹⁾ For instance, favouritism and nepotism existing in Chinese state-owned enterprises are criticized by the public.⁵⁰⁾ Thirdly, the liability of guanxi is easily changed in the short term. Guanxi is a double-entry system where a continuous exchange of favours between two interest groups is involved. In other words, people who get a reward this time could be the one who repaid the favour next time and vice versa.⁵¹⁾ Fourthly, because the principals can vary when different people are in charge, vast amounts of money, time and effort should be invested in the creation and maintenance of social guanxi. Besides, only guanxi with the end user is not enough because problems may occur in the different levels and organisations. Finally, not all guanxi users are rational for proper use of guanxi. They may fail or miscalculate the costs and benefits of guanxi expenditure compared to alternative ways.⁵²⁾ For instance, managers may suffer from a burden arising from the

45) Milliot, E. "The Pivotal Role of Guanxi for Business Intelligence in the People's Republic of China", *XIVth International Euro-Asia Research Conference and IIIrd International Conference on Business and Management Research*. 2008.

46) Warren, D. E., Dunfee, T. W. & Li, N. "Social exchange in China: The double-edged sword of guanxi", *Journal of Business Ethics*, 55(4), 2004, 12, pp. 353~370.

47) Salen, R., *Seeking a harmonious society: How Confucianism could enhance sustainable business practices in the 21st century*, 2008, UNIVERSITY OF HAWAII AT HILO.

48) Chen, X. & Glen, C. C., *op.cit.* pp. 313~314.

49) Dunfee, T. W. & Warren, D. E. "Is guanxi ethical? A normative analysis of doing business in China", *Journal of Business Ethics*, 32(3), 2001, 8, pp. 191~204.

50) Yeung, I. Y. & Tung, R. L., "Achieving business success in Confucian societies: The importance of guanxi(connections)", *Organizational dynamics*, 25(2), 1996, 2, pp. 54~65.

51) Tsang, E. W., "Can guanxi be a source of sustained competitive advantage for doing business in China?", *The Academy of Management Executive*, 12(2), 1998, 5, pp. 64~73.

52) Chen, C. C., Chen, X. & Huang, S., *op.cit.* pp. 178~180.

obligation of guanxi such as receiving lower quality goods, recruitment of unqualified employees, bribery, and smuggling.⁵³⁾

IV. Cases in performance of Guanxi

As it was noted above, it is believed that guanxi is chosen consistently as a significant factor for doing business in China. For instance, Microsoft addressed a lot of problems through building close and strong guanxi with senior government officials.⁵⁴⁾ However, enterprises have witnessed concrete positive outcomes like Kodak over Fuji, Coke over Pepsi, KFC over McDonald and Volkswagen over Toyota through their strong long-term guanxi based on sincerity with the central and local governments.⁵⁵⁾ Therefore in this chapter, several cases will be explained to find the performance of B2C and B2B guanxi.

1. Coca-Cola

Coca-Cola Co.(CCO) successfully found its way into Mainland China through the creation of good guanxi through a joint with venture partner, i.e. Kerry Group(KG). Guanxi with KG not only has minimised transaction costs like building bottling factory to a great extent but also has improved its sales 57 fold. As a result, its market share had been increased to 50%, which was three times greater than its nearest competitor in 2003. In addition, CCO is especially well perceived in China due to it presenting itself as a friend of China due to the trial of development of guanxi with Chinese customers. For example, in the late 1980s when the CCO first entered the Chinese market, it faced a certain degree of hostility from the public because many customers believed that the CCO would disrupt the Chinese soda market. To overcome this obstacle the CCO made an effort to establish relationships with local communities for several years. The CCO constructed 50 primary schools, 100 libraries and donated them to local societies. Due

53) Warren, D. E., Dunfee, T. W. & Li, N., *op.cit.*, pp. 360~361.

54) Buderl, R. & Huang, G. T. *Guanxi (The art of relationships): Microsoft, China, and Bill Gates's plan to win the road ahead*, Simon and Schuster. 2007.

55) Tashi, G. & Gratton, D., *op.cit.* pp. 291~292.

to this corporate social responsibility(CSR), CCO could attain the opportunities for negotiation of good conditions for implantation with government authorities. Moreover, it easily got access to the necessary authorisations for the construction of 23 plants, which led to a 23% of market share in the Chinese soda market in 2008. In contrast to CCO, Pepsi-Cola as a major competitor, invested less money in its guanxi network, which gave Pepsi-Cola difficulties in establishing of its joint ventures. As a consequence, its market share today was only 6% in China in 2008.⁵⁶⁾

2. Carrefour

In general, foreign retailers which have more international experience in Far East countries, such as Tesco and Carrefour, can easily address the guanxi network, which can benefit them for rapid expansion in the Chinese market. In particular, buyer-supplier guanxi is critical for business because control and cooperation interface are interdependent even though both parties want to retain their individuality and identity. For instance, establishment of good guanxi in the mutual governance and cooperation between Wal-Mart and Procter & Gamble improved their performance in turnover.⁵⁷⁾

However, there are some problems in guanxi between the Chinese government and Carrefour. Carrefour was boycotted in China in 2008 due to its bad guanxi with Chinese customers. This typical boycotting event was due to this French retail giant and its major stakeholder's support of the Dalai Lama and pro-Tibetan independence groups. They believed that they had already gained a firm foothold through their business advantages and paid less attention to contain good guanxi with Chinese consumers. In fact, the strong nationalism and taste in contemporary China can affect the guanxi in business and suddenly change the condition of guanxi. Therefore, many internet users called for a boycott of Carrefour in various forms to punish their aggressive behaviour against Chinese nationalism.⁵⁸⁾ Failure to build positive guanxi with Chinese in general, can lead to a devastating consequence for foreign business conducted in China.⁵⁹⁾

56) Milliot, E., *op.cit.* pp. 262~263.

57) Luo, J. & Yeh, Y., *op.cit.* pp. 60~67.

58) Cheng, C. T. "New media and event: A case study on the power of the Internet", *Knowledge, Technology & Policy*, 22(2), 2009, 3, pp. 145~153.

59) Siebers, L. Q. "Foreign retailers in China: the first ten years", *Journal of Business Strategy*,

3. GlaxoSmithKline

Corruption is more common in developing countries such as China. Investors generally require official approval, such as licenses or official permission, which may provide government officials and other related people opportunities to gain personal benefits.⁶⁰⁾ Several studies show that there is an interrelationship between FDI and host country corruption.⁶¹⁾

In June 2013, GlaxoSmithKline of a British drug giant struggled to respond to a scandal in China. Four Chinese executives had been arrested due to accusations of offering almost \$US 500 million in bribes to doctors and officials for sales of the firm's treatments and other reason.⁶²⁾ According to the Glaxo-SmithKline(GSK) scandal in China, GSK may gain investment profitability in the short-term, because it bribed doctors and hospital employees to promote and sell medicine illegally, using a travel agency as an intermediary .⁶³⁾

This corrupt activity brought short-term benefits to GSK. According to the China Economic Review, GSK illicitly obtained almost profitability before this scandal was investigated by Chinese government.⁶⁴⁾ However, in the long-term, GSK will lose out for two reason. Firstly, GSK' president promised to introduce and maintain lower drug prices in China. Secondly, drug sells will be decreased in both foreign and local market because of the corrupt damage to the company's reputation. Moreover, this corruption scandal not only negatively affected GSK's reputation in China as but also affected it in other countries.⁶⁵⁾ Although corruption may increase short-term profit for FDI, it may decrease the profitability of investment in the long-term.⁶⁶⁾

33(1), 2011, 3, pp. 27~38.

60) Duanmu, J.L. "The effect of corruption distance and market orientation on the ownership choice of MNEs: Evidence from China". *Journal of International Management*, 17(2), 2011, 6, pp. 162~174.

61) Singh, P. "Does Poor Quality of Institutions Attract Cross-Border Mergers and Acquisitions?", *South Asian Journal of Macroeconomics and Public Finance*, 1(2), 2012, 12, pp. 191~230.

62) Economist, A reminder of how hard it will be to tackle corruption in China, Jul 20th, 2013

63) Hvistendahl, M. "Corruption and Research Fraud Send Big Chill Through Big Pharma in China" [Online]. *Science (New York, N.Y.)*, 341(6145), 2013, pp. 445~6. Available from <http://www.sciencemag.org.ezproxy.liv.ac.uk/content/341/6145/445.full>(Accessed 22 December 2015)

64) China Economic Review, "China's pharma Crackdown". *China Economic Review*, 24(9), 2013, 9, p. 55.

65) Looney, W. "One Company—One Moment", *Pharmaceutical Executive*, 33(8), 2013, 8, p. 10.

66) Freckleton, M., Wright, A. & Craigwell, R. "Economic growth, foreign direct investment and corruption in developed and developing countries." *Journal of Studies*, 39(6), 2012, 9, pp. 639~652.

What must be remembered through is that, in China, power and resources are usually controlled by people in positions of influence. The best way to be a successful in business is to build good relationships with such people through bribery.⁶⁷⁾ Figure 1 shows that corruption (29.3) and the rule of law (26.8) both have very low score for investors. Floyd and Summan (2008) agree that bribery will become more serious due to lack of law systems for anti-corruption activities.⁶⁸⁾ Take the example of the city of Zhangzhou in China, where in 73 different hospitals, over 90% of all doctors took bribed, in addition to over 1,000 administrators and nurses. Chinese employees are familiar with corruption. Looney claims that manager and employees did not report the bribery to GSK's president because of their familiar attitude to corruption.⁶⁹⁾ In such case, an environment with high level of corruption and a low level rule of law score may have forced GSK to take risks with bribery in order to do business in China.

<Figure 1> Investment institution score

	Investor Protection Score	Rule Of Law Score	Contract Enforceability Score	Corruption Score
Afghanistan	1.2	13.7	29.2	6.3
Bangladesh	33.0	28.5	4.6	25.4
Bhutan	12.7	52.9	99.1	65.6
Cambodia	16.7	14.8	40.4	21.3
China	58.5	26.8	86.4	29.3
Hong Kong	90.5	44.9	84.5	81.8
India	64.2	65.4	11.3	45.3
Indonesia	34.7	37.3	23.3	37.8
Japan	82.5	82.1	75.9	90.0
Laos	1.2	11.1	50.6	6.2
Malaysia	76.9	56.5	43.9	45.8
Maldives	40.1	41.7	57.7	46.4
Nepal	44.5	27.0	35.8	25.7
Pakistan	46.5	15.1	35.7	14.1
Philippines	38.7	48.5	33.9	25.1
Singapore	95.6	72.6	76.7	60.1
South Korea	11.1	77.0	40.3	68.4
Sri Lanka	51.4	52.3	35.3	26.1
Taiwan	64.2	72.4	70.2	72.5
Thailand	63.9	37.7	79.3	38.0
Vietnam	31.9	24.7	66.9	17.4

Source: adopted from Vietnam Business Forecast Reports(2012)

67) Dai, C. "Corruption and anti-corruption in China: challenges and countermeasures". *Journal of International Business Ethics*, 3(2), 2010, 1, pp. 58~70.

68) Floyd, D. & Summan, S. "Understanding the main motives for foreign direct investment, an East-West country contrast: is the host country legislation an important factor?". *Corporate Governance*, 8(5), 2008, 10, pp. 661~668.

69) Looney, W. *op.cit.*, pp. 15~18.

Then, why did the Chinese government target the foreign pharmaceutical company among many multinational enterprises? The pharmaceutical industry has a high value added characteristic owing to monopolistic high price, low production cost, small volume and low transportation cost in spite of high R&D investment.⁷⁰⁾ Therefore the process from R&D development to production is carried out their home countries. As a result, many multinational pharmaceutical companies do not contribute to Chinese society in employment, local tax, and so on, but just concentrate on the illegal marketing activities, such as rebate, luxury trips, and sexual entertainment toward special interested groups, such as doctors and government's health care officials. Hence, they are a deliberate target of corruption investigation.⁷¹⁾ Furthermore, they have ignored the influence of guanxi all over China. Therefore they should have focused on strengthening strong relationships(guanxi) with central or local government's high ranking officers who can influence their firm's business activities.

V. Conclusion

Guanxi which is a transferable social capital is extremely integral in doing business in China. As special relationships that are built into networks, guanxi underpins the way that the Chinese prefer to do business.⁷²⁾ Although it is a new era of science and technology, it does not mean that existing guanxi will lose its importance rapidly.

China is a land of guanxi, everything is connected with guanxi. Thus, if a foreign firm possesses guanxi, it can be a source of competitive advantage for doing business due to lack of law systems for anti-corruption activities in China. Furthermore, although the anti-corruption campaign has decreased the significance of guanxi practice to a certain degree, however it is gaining increasing importance not only in Business to Government(B2G) as it is noticed in the case of GlaxoSmithKline but also in Business

70) Park, H. C. "How to Enhance International Competitiveness of Korean Pharmaceutical Industry with CEPA as a Momentum?", *The International Commerce and Law Review*, 48, 2012, 12, pp. 101~125.

71) Lee, S. T. "Anti-corruption drive, Guanxi and business in China - analysis on the case of GlaxoSmithKline-", *Korea Trade Review*, 39(3), 2014, 6, pp. 125~143.

72) Buttery, E. A. & Wong, Y., *op.cit.*, pp. 150~152.

to Consumers(B2C) relationships as it is referred in the case of the boycott of Carrefour.

In recent time, B2G and B2C guanxi will take a dominant role in deciding a firms' business performances in China. Therefore managers should pay great attention to the proper use of guanxi instead of being involved in corrupt behaviours because now the governments hold a strong attitude against corruption, In particular, establishment of working guanxi through red envelops(basically giving money) or illegal gifts can cause a great problem for both parties, which were naturally accepted among most government officials and businessmen until recently.

References

- Bedford, O. "Guanxi-building in the workplace: A dynamic process model of working and backdoor guanxi", *Journal of Business Ethics*, vol. 104(1), 2011. 5.
- Beech, H. "China's Ex-Security Czar Ensnared in Corruption Probe", *Time.com*, 2014.
- Bian, Y. *Work and inequality in urban China*, SUNY Press, 1994.
- Buderi, R. & Huang, G. T. *Guanxi (The art of relationships): Microsoft, China, and Bill Gates's plan to win the road ahead*, Simon and Schuster. 2007.
- Buttery, E. A. & Wong, Y. "The development of a guanxi framework", *Marketing Intelligence & Planning*, 17(3), 1999, 6.
- Chen, C. C., Chen, X. & Huang, S. "Chinese Guanxi: An Integrative Review and New Directions for Future Research. 中國人的關係: 綜合文獻回顧及未來研究方向", *Management and Organization Review*, 9(1), 2013, 3.
- Chen, X. & Glen, C. C. "On the Intricacies of the Chinese Guanxi: A Process Model of Guanxi Development", *Asia Pacific Journal of Management*, 21(3), 2004, 9
- Cheng, C. T. "New media and event: A case study on the power of the Internet", *Knowledge, Technology & Policy*, 22(2), 2009, 3.
- China Economic Review, "China's pharma Crackdown". *China Economic Review*, 24(9), 2013, 9.
- Choe, J. Y., & Lee, S. C. "Building Guanxi and Networks of Korean Foreign Direct Investment Firms in China", *Journal of Economic Geographical Society of Korea*, 15(2), 2012, 6.
- Dai, C. "Corruption and anti-corruption in China: challenges and counter-measures". *Journal of International Business Ethics*, 3(2), 2010, 1.
- Davies, H., Leung, T. K., Luk, S. T. & Wong, Y. "The benefits of "Guanxi": the value of relationships in developing the Chinese market", *Industrial marketing management*, 24(3), 1995, 6.
- Duanmu, J. L. "The effect of corruption distance and market orientation on the ownership choice of MNEs: Evidence from China". *Journal of International Management*, 17(2), 2011, 6.

- Dunfee, T. W. & Warren, D. E. "Is guanxi ethical? A normative analysis of doing business in China", *Journal of Business Ethics*, 32(3), 2001, 8.
- Economist, A reminder of how hard it will be to tackle corruption in China, Jul 20th 2013 cited at <http://www.economist.com/news/business/21581999-reminder-how-hard-it-will-be-tackle-corruption-china-bitter-pill> in Oct. 7, 2014.
- Floyd, D. & Summan, S. "Understanding the main motives for foreign direct investment, an East-West country contrast: is the host country legislation an important factor?". *Corporate Governance*, 8(5), 2008, 10,
- Freckleton, M., Wright, A. & Craigwell, R. "Economic growth, foreign direct investment and corruption in developed and developing countries." *Journal of Studies*, 39(6), 2012, 9.
- Gao, Y., & Bae, J. H. "A Empirical Study on the Ways of Searching for Foreign Buyers and the Performances Improvement of Exporting Companies in China", *The International Commerce and Law Review*, 56, 2012, pp.29-54.
- Geng, W. T., Kwon, I. S., & Sul, W. S. "The Effect of Guanxi Types on Firm Performance: Implications for Professional Managers", *The Journal of Professional Managers*, 15(2), 2012, 8.
- Guthrie, D. "Information asymmetries and the problem of perception: The significance of structural position in assessing the importance of guanxi in China", in T. Gold et al. (eds) *Social connections in China: Institutions, culture, and the changing nature of guanxi*, Cambridge, UK; Cambridge University press, 2002.
- Hvistendahl, M. "Corruption and Research Fraud Send Big Chill Through Big Pharma in China"[Online]. *Science* (New York, N.Y.), 341(6145), 2013, pp.445-6. Available from <http://www.sciencemag.org.ezproxy.liv.ac.uk/content/341/6145/445.full>(Accessed 22 December 2015)
- Jeon, M, K. "The Moderating Effects of LMX and Guanxi in the Relations between Organizational Support and Organizational Performance in Chinese Firms", *Korea Journal of Business Administration*, 23(5), 2010, 8.
- Jia, F. & Zsidisin, G. A. "Supply Relational Risk: What Role Does Guanxi Play?", *Journal of Business Logistics*, 25(3). 2014, 9.
- King, A. Y. "Kuan-hsi and network building: A sociological interpretation", *Daedalus*, 120(2), 1991, 3.

- Lee, J. h. "The Moderating Effects of LMX and Guanxi in the Relations between Organizational Support and Organizational Performance in Chinese Firms", *Korean-Chinese Social Science Studies*, 31, 2014, 6.
- Lee, S, T. "Anti-corruption drive and Guanxi in China - the case of GlaxoSmithKline-", *Korea Trade Review*, 39(3), 2014, 6.
- Looney, W. "One Company – One Moment". *Pharmaceutical Executive*, 33(8), 2013, 8.
- Lovett, S., Simmons, L. C. & Kali, R. "Guanxi versus the market: Ethics and efficiency", *Journal of International Business Studies*, 30(2), 1999, 6.
- Luo, J. & Yeh, Y. "Neither collectivism nor individualism: Trust in the Chinese guanxi circle", *Journal of Trust Research*, 2(1), 2012, 3.
- Luo, Y. "Guanxi and performance of foreign-invested enterprises in China: An empirical inquiry", *MIR: Management International Review*, 37(1), 1997, 3.
- Millington, A., Eberhardt, M. & Wilkinson, B. "Giftgiving, guanxi and illicit payments in buyer - supplier relations in China: Analysing the experience of UK companies", *Journal of Business Ethics*, 57(3), 2005, 3.
- Milliot, E. "The Pivotal Role of Guanxi for Business Intelligence in the People's Republic of China", *XIVth International Euro-Asia Research Conference and IIIrd International Conference on Business and Management Research*.
- Park, H. C. "How to Enhance International Competitiveness of Korean Pharmaceutical Industry with CEPA as a Momentum?", *The International Commerce and Law Review*, 48, 2012, 12.
- Park, S. H. & Luo, Y. "Guanxi and organizational dynamics: Organizational networking in Chinese firms", *Strategic Management Journal*, 22(5), 2001, 7.
- Ramasamy, B., Goh, K. & Yeung, M. C. "Is Guanxi(relationship) a bridge to knowledge transfer?", *Journal of Business Research*, 59(1), 2006, 1.
- Ranfagni, S. & Guercini, S. "Guanxi and distribution in China: the case of Ferrero Group", *The International Review of Retail, Distribution and Consumer Research*, 24(3), 2014, 11.
- Salen, R. Seeking a harmonious society: How Confucianism could enhance sustainable business practices in the 21st century, University of HAWAII AT HILO, 2008.
- Shin, S. Y., Pak, M. S., & Cho, S. W. "Managing Cultural Diversity by Effective Human Resource Management of International Trade: Focus on Asian Perspectives, *The International Commerce and Law Review*, 56, 2012, 12.

- Siebers, L. Q. "Foreign retailers in China: the first ten years", *Journal of Business Strategy*, 33(1), 2011, 3.
- Singh, P. "Does Poor Quality of Institutions Attract Cross-Border Mergers and Acquisitions?", *South Asian Journal of Macroeconomics and Public Finance*, 1(2), 2012, 12.
- Song, F., Cadsby, C. B. & Bi, Y. "Trust, reciprocity, and guanxi in China: An experimental investigation", *Management and Organization Review*, 8(2), 2012, 7.
- Tashi, G. & Gratton, D. "Compassion in Buddhism and Guanxi: Can There Be a Synergy for Western Companies in China", *Chinese Business Review*, 12(4), 2013, 4.
- Tsang, E. W. "Can guanxi be a source of sustained competitive advantage for doing business in China?", *The Academy of Management Executive*, 12(2), 1998, 5.
- UNCTAD <http://unctadstat.unctad.org/wds/ReportFolders/reportFolders.aspx>
- Warren, D. E., Dunfee, T. W. & Li, N. "Social exchange in China: The double-edged sword of guanxi", *Journal of Business Ethics*, 55(4), 2004, 12.
- Wong, Y., Leung, T., Hung, H. & Ngai, E. "A model of guanxi development: Flexibility, commitment and capital exchange", *Total Quality Management & Business Excellence*, 18(8), 2007, 10.
- Yang, M. M., "Gifts, favors, and banquets: The art of social relationships in China", Cornell University Press. 1994.
- Yang, Z. & Wang, C. L. "Guanxi as a governance mechanism in business markets: Its characteristics, relevant theories, and future research directions", *Industrial Marketing Management*, 40(4), 2011, 5.
- Yeung, I. Y. & Tung, R. L. "Achieving business success in Confucian societies: The importance of guanxi(connections)", *Organizational dynamics*, 25(2), 1996, 2.
- Yuan, X. N., Kim, S. Y., & Song, T. H. "When Does Chinese Relationship Culture of Guanxi Work Better Than Relationship Marketing? Case of Foreign-Invested Enterprise in the Chinese Business to Business Market", *GFMC*, 1, 2014, 1.

ABSTRACT

A Modern Analysis of ‘Guanxi’ of Foreign Investment in China

Seoung-Taek LEE · Woo PARK

China is a land of guanxi, everything is connected with guanxi. China has a business culture based on guanxi connections underpinned by strong Confucian ethics. However, there are some reasons why it is difficult for western companies to run businesses in China. Firstly, foreign firms lack the understanding and experiences necessary for doing business in China. They don't know the absence of alternatives is one of reasons that guanxi is so powerful in Chinese society. Secondly, there are many misconceptions about guanxi. It is easier for many foreign scholars or businessmen to equate guanxi with corruption due to the ambiguity of guanxi.

Thus, if a foreign enterprise possesses guanxi, it can be a source of competitive advantage for doing business due to lack of law systems for anti-corruption activities in China. Furthermore, it is gaining increasing importance not only in Business to Government(B2G) but also in Business to Consumers(B2C) relationships.

Therefore, managers should pay great attention to the proper use of guanxi instead of being involved in corrupt behaviours because now the governments hold a strong attitude against corruption. In particular, establishment of working guanxi through red envelopes(basically giving money) or illegal gifts can cause a great problem for both parties, which were naturally accepted among most government officials and businessmen until recently.

Keywords : China, Gaunxi, Foreign Invested Enterprises(FIE)