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### GUANXI'S CONSEQUENCES: PERSONAL GAINS AT SOCIAL COST

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### **ABSTRACT**

Is guanxi ethical? This question is largely ignored in the existing literature. As guanxi has an impact on the wider public other than the guanxi parties, it must be studied in the context of all stakeholders. This paper examines the ethical dimension of guanxi by focusing on the consequences of guanxi in business, from ethically misgiving behaviour to outright corruption. Guanxi may bring benefits to individuals as well as the organisations they represent but these benefits are obtained at the expense of other individuals or firms and is thus detrimental to society. It can be argued that guanxi is an inevitable evil under the current political and socio-economic systems in China. Its role and importance in business life will be diminished as the country moves towards an open market system.

**KEY WORDS:** Guanxi, relationship, business ethics, corruption, China

## GUANXI'S CONSEQUENCES: PERSONAL GAINS AT SOCIAL COST

### INTRODUCTION

Guanxi, a Chinese term referring to interpersonal connections, has been receiving growing research interests in the western management field. In the existing literature, guanxi has been identified as one of the most important success factors in doing business in China (Yeung and Tung, 1996; Abramson and Ai, 1999); regarded as a source of sustainable competitive advantage (Tsang, 1998; Fock and Woo, 1998); linked with some western concepts such as relationship marketing (Ambler, 1994; Simmons and Munch, 1996), and extolled as the future direction for the western business practices in the new century (Lovett, et al 1999).

Despite the growing number of publications on guanxi and the benefits guanxi is alleged to bring to business organisations in terms of cost reduction and enhanced performance, there is still considerable confusion around the concept as well as its function in business. Whether guanxi is ethical is a particular issue largely ignored in the previous studies. This paper aims to examine the ethical dimension of guanxi, with a focus on the consequences of guanxi. It starts with a discussion of the guanxi concept and different types of guanxi, followed by a detailed analysis of the role that guanxi plays in business and its consequences to the society.

## DEFINING THE CONCEPT

The term *guanxi* in the Chinese language has multiple meanings. It could refer to one of three things: (a) the existence of a relationship between people who share a group status or are related to a common person, (b) actual connections with and frequent contact between people, and (c) a contact person with little direct interaction (Bian, 1994). *Guanxi* is commonly defined as special relationships two persons have with each other (Alston, 1989). Osland (1990) adds on: "...a special relationship between a person who needs something and a person who has the ability to give something." In this paper, *guanxi* is defined as the *process* of social interactions that initially involve two individuals A and B. A may or may not have special relationships with B. A asks B for assistance (favour) in finding a solution to a problem. B may have the solution at hand, or more often, has to seek further assistance from other connections, i.e. starts another process.

This definition presents a significant departure from the literature. Firstly, it emphasises that *guanxi* is a dynamic process which begins with the two persons but may involve more parties at later stages. Secondly, in a *guanxi* relationship, one person (B), in most cases, may not have the solution even though s/he is eager to grant a favour. B has to search for further connections in order to find the solution. This is exactly what *guanxi* means. Here B's role is a facilitator or matchmaker, rather than a solution-provider. Thirdly, relationships, strong or weak, exist all the time; but *guanxi* can only happen when there is a need for something to be done. This need triggers the *guanxi* process. Fourthly, *guanxi* involves a series of activities mostly pre-planned and carried out between the two or more parties in the *guanxi* network. Such activities can include anything from having a meal together, to gift-giving or doing a favour. Finally, contrary to the conventional definitions, *guanxi* can occur between two

persons without any shared attributes (guanxi base). If A and B have special relationships between them, i.e. they share a guanxi base, a) the guanxi process would start more easily or quicker; b) they had guanxi before, the start of a new guanxi process is just to renew it. If A does not have any special relationship with B, A could still try to start the process though this would be more difficult. Alternatively, A may decide to use a go-between C. There are several sub-processes in this case. The process will not stop until either a solution is finally found or the task is abandoned.

## CLASSIFICATIONS

Guanxi is a complex social construct with many variations. In most existing studies, guanxi is discussed in general terms; complexity and differences between different types of guanxi are largely ignored. There are mainly three types of guanxi: family guanxi, helper guanxi and business guanxi. Family guanxi and helper guanxi are similar to what Hwang (1987) termed 'expressive ties' and 'instrumental ties' respectively. Business guanxi refers to the process of finding a solution to a business rather than personal problem by using 'personal' connections. From the comparisons in Table 1, it is clear that the three types of guanxi are quite different in almost all aspects: nature, purpose, function and what is exchanged. Family guanxi is rooted in Confucian values; emotionally driven, *qingqing* (affection) is exchanged, in which reciprocity is not always necessary. On the other hand, business guanxi is the product of current political and socio-economic systems; utility-driven, a deal of money and power. In terms of quality, family guanxi is stronger, more stable and requires long-term commitment. Business guanxi, on the other hand, is characterised as tactical, opportunistic and unstable. There is little trust and commitment in the business guanxi

relationship (Fock and Woo, 1998). The only thing that matters to the parties is their own business interests and the utility of other party.

To an individual who has three types of guanxi with different persons, these guanxis are treated differently in terms of importance, frequency and intensity, and all these may change over time. It is worth noting that guanxi in reality is far more complicated as all the three types of guanxi could be intertwined making it difficult to distinguish between them. It is also possible that guanxi between two parties may evolve from one type to another over a period of time, or members of a guanxi network share more than one relationship between them.

#### CLARIFICATION

To have a better understanding of how guanxi is related to business and how guanxi distinguishes itself from western concepts, the following clarification must be made. In the literature, guanxi is frequently referred as the Chinese version of relationship marketing or business networking (Amber, 1994; Simmons and Munch, 1996; Lovett, et al, 1999). This is a misunderstanding of the concept. Guanxi, by its definition, is a kind of personal property: an asset owned by an individual and working only at personal level. Whether an organisation can use the guanxi assets of its employees is entirely up to the individual himself. He may use his guanxi (in his private capacity) to bring benefits to his employer but this guanxi remains as his personal property and will not become an organisational asset (Tsang, 1998). When the employee leaves the firm, he takes his guanxi with him. Another fundamental difference between guanxi in China and a marketing relationship or business network in the west lies in that the two individuals engaged in guanxi exchanges are often neither buyer/seller nor business

partners; the relationship is more likely between a businessman and a government official or someone who has connections with the official. Customers and business partners may not even be counted in such a guanxi network. In short, guanxi is a network of private contacts characterised by personal, informal and clandestine deals.

## GUANXI AND BUSINESS

Business guanxi is a unique Chinese phenomenon and a product of China's contemporary political and socio-economic systems. Much has been written on the importance of and benefits brought by guanxi, but how guanxi is related to business and what kind of role guanxi plays in business operations remain largely unknown, partly because that all three different types of guanxi are tangled in reality, so it is hard to separate them. For example, should business guanxi be viewed as a) the practice of general guanxi ("family" and "helper") in the business sector; or b) a special type of guanxi that distinguishes itself from the other two types; or c) the mixture of personal and business relationships? How can business guanxi be defined, and what characteristics does it have? How is guanxi practised by managers to achieve their personal as well as organisational objectives? Answers to these questions are hard to find and beyond the scope of this paper. It is notoriously difficult to get an insight into a guanxi relationship or transaction as both are shrouded in secrecy and are not shared with an outsider. The remaining part of the paper will discuss the impact of guanxi on business, with a special focus on its links with corruption and consequences to society.

In the existing literature, the role and benefits of guanxi have been grossly exaggerated and cannot be substantiated. There is no convincing evidence to show

how and to what extent guanxi is beneficial to business performance. One of the major benefits that guanxi is believed to offer is obtaining information on government policies, market trends and business opportunities (Davies, et al, 1995). The following case shows how such a benefit was actually achieved. The chairman of an Australian company seeking investment opportunities in China had a good relationship with the local executive of a large state-owned enterprise, who was a close friend of a key government official in Shenzhen.

*Throughout the entire negotiation process, the executive continuously fed the chairman with prompt information on how the government had viewed the project itself. The chairman was able to make an appropriate presentation based on this input, which led to a successful negotiation outcome (Yau, et al, 2000).*

The paper, citing this as a good example of using guanxi, gave no details on what favours were returned to the Chinese official and the local executive. The behaviour of the Chinese official and executive had clearly broken rules, if not laws. On the other hand, the way that the Australian firm used to obtain information is morally questionable.

Another benefit widely cited is that the guanxi network improves efficiency by reducing the transaction costs (Davies, et al 1995 and Lovett, et al 1999). However, recent empirical studies show the contrary: developing and maintaining guanxi relationship is a time-consuming and expensive endeavour and perceived as a major disadvantage (Fock and Woo, 1998; Lovett, et al, 1999; Yi and Ellis, 2000). Guanxi is also said to help credit collection, but the fact is that most companies in China find themselves in the predicament of bad debts and triangular debts (*Far East Economic Review*, 6/7/2000). Under the current market environment in China, guanxi may be the effective option, sometimes even the only way to make things work, but it is by no



means efficient or even the cheaper option in the long term. A survey conducted by the Hong Kong Independent Commission Against Corruption estimated that guanxi accounted for up to 5% of total costs in doing business in China (ICAC, 1993).

An important character of guanxi that is often overlooked in the literature is that the intended benefit of guanxi transaction cannot be delivered immediately after the 'payment'; in some cases, the delivery may never arrive. By definition, guanxi exchange takes place as informal and complicated multiple processes that often involve more than two parties. It is largely a future transaction with unspecified delivery time; and there is no guarantee in terms of the value or quality of the benefit. This is the paradox of guanxi: does it reduce uncertainty or does it increase uncertainty? When a firm has a heavy reliance on guanxi to the point that cultivation and maintenance of guanxi networks consume much of the financial and managerial resources, the expenses and risks may outweigh any potential benefits such guanxi could generate. This explains why some companies deliberately try to weaken or terminate their guanxi relationships, the so called "guanxi evasion" (Chen, 1995).

#### THE ETHICS OF GUANXI

The ethics of guanxi has so far received little attention in the literature. In contrast with the extravagant claims on the benefits of guanxi, the dark side of guanxi is never fully understood. Is guanxi ethically acceptable? It depends on the type of guanxi and the context in which guanxi occurs. While family and helper guanxi are generally perceived in China as *good guanxi* that is totally moral or even desirable; business guanxi is widely regarded as *bad guanxi*, a grey area even if it is not implicated with corruption. To the Chinese, business guanxi is inevitably associated with favouritism, nepotism, unfair competition and fraud. There are countless examples. In 1998

pyramid selling was banned in China after millions of people lost their lifetime savings in the bogus selling schemes (McDonald, 1998). In the majority of cases swindlers deliberately chose people whom they had close guanxi relationships with (relatives, friends or classmates) as unsuspecting easy targets. Trust was betrayed for profits. Ironically, when the victims realised the fraud most of them tried to recruit newer victims in the same fashion in order to recoup their losses. Such scandals exposed the pernicious side of guanxi.

Guanxi may bring personal gains to individuals, vital resources and cost savings to organisations. But these benefits are often achieved at the expense of other individuals or firms, as business guanxi dealings create significant disadvantages to the parties outside the network, thus stifling competition and being detrimental to the whole society. In this way, social goods are sacrificed for personal gains. A simple acid test to judge whether a guanxi transaction is ethical is to find whether there are victims as a result of such a deal. These victims may be known as the competitor of the firm, or the customer, or even unknown in some cases. But the truth remains that such guanxi transaction produces gains for individuals or firms but social loss to the whole society. A guanxi action is right from the ethics point of view only if there is no third party either known or unknown that is adversely affected as a result of this guanxi action. Unfortunately, the vast majority of guanxi cases would fail this test.

The proponents of guanxi defend these practices on ethical relativism by arguing that *guanxi is based on eastern principles, and can be as ethical as any western system* (Lovett, et al 1999). They looked only at one side of the coin. Confucius did set up principles which govern the interpersonal relations in the Chinese society but he also

placed greater emphasis on virtue by establishing principles of moral behaviour. He felt that a person who lived by his rules would develop the habit of ethical behaviour. Eventually this behaviour would become deeply ingrained in one's personality. Those who followed his principles would thus achieve virtue. According to Confucius, one should always put moral concerns before the pursuit of business interests. Differences in business norms and legal systems exist between western developed countries and a developing economy like China, and ethical norms might generally be higher in the former (Vogel, 1992). However, it is debatable whether the latter would attach less importance to ethics and would be more prone to corruption. If certain *guanxi* practices deemed unethical in the west are currently 'accepted' in China, this still does not justify its existence as morally acceptable, but simply shows that it is the *necessary evil* under the current political and socio-economic environment. There is no country in the world where corruption, in whatever forms it may take, is either legally or morally acceptable. China is no exception. If anyone obtains personal gains through *guanxi* activities at the expenses of others (competitors or general public, the society), this *guanxi* should be deemed as unethical even if they did not break the law. As a matter of fact, the majority of business *guanxi* practices are totally unacceptable even by the current Chinese ethical standard. That is why business *guanxi* has a terribly bad reputation inside China.

## GUANXI AND CORRUPTION

As stated afore, business *guanxi* is a network of connections between business people and bureaucrats. In a society with a long tradition of rule by man instead of rule by law, having good *guanxi* with officials has always been vital. This special *guanxi* relationship between businessmen and officials is aptly termed in Chinese as *venal*

guanxi or “qianquan jiaoyi” - the exchange or deal between money and power.

Guanxi is the matchmaker who ties up the two parties in the following diagram:

**Money ← *Guanxi* → Power → Corruption**

Corrupted guanxi and guanxi-based corruption are like Siamese twins that cannot be separated. It is safe to say that there is no business guanxi network that is not tinted by corruption and no corruption without using guanxi. Inside China, guanxi is the synonym for corruption and other malpractices such as nepotism, bribery and fraud (Yang, 1994). It is not surprising that in the latest survey carried out by Transparency International among 19 major exporters in the world, China was ranked the worst in the Bribery Index (Transparency.com). During the economic reform and opening up of the past twenty years corruption in China has become so prevalent that it becomes the cancer of the society. In the middle of the 70s, guanxi meant to obtain scarce consumer goods or to find a better job for one’s children through the ‘back door’. Today, guanxi is implicated in all big corruption cases and organised crimes. One particular feature is that corruption has evolved from individual wrongdoings into institutional corruption that often involve a complicated guanxi network between high-ranking officials, businessmen, army/police and mafia. The recent case in Shenyang led to prosecution of both the mayor and his deputy along with a dozen of officials. They were accused of accepting bribes of millions of US dollars and having mafia links. Corruption can be found in any country or economic system, but it is guanxi that provides a fertile soil in China for corruption to flourish. The central government has waged and lost every anticorruption campaign as new ‘worst’ cases are constantly emerging. In the past two years, China executed more than 20 high-ranking officials, including a vice-chairman of the People’s Congress (the national

parliament) and a few ministers, the first in the 50 years history of the People's Republic. Other big cases currently under investigation include a smuggling ring in Fujian Province, and a custom fraud in Guangdong Province, with estimated value of \$80 billion and \$20billion respectively.

On the other side, it is not uncommon for companies to be forced or even blackmailed into the guanxi-related corruption. Jakobson (1999) offered a vivid account of business guanxi in reality. A manager in a private company had to spend tens of thousands of Renminbi each year improving his guanxi with local officials. If he didn't, he would not be granted export licence, would not get a bank loan, and would not even have the electricity and water supply to run the factory. Clearly in this case, the firm was forced to maintain its guanxi; thus the guanxi became a powerful tool wielded by corrupt officials to blackmail business for their personal gains. Despite the persistent campaign by the government, corruption has continued unabated in China because the political-economic systems and guanxi culture – the very soil in which corruption flourishes – have remained unchanged.

#### GUANXI'S CONSEQUENCES

Studies on guanxi has so far been mainly at the personal level, i.e. those who are the members of a guanxi network, though some discussions also relate to the organisations these individuals represent. This is inadequate. As a guanxi transaction influences a far wider public than the guanxi parties concerned, the consequences of guanxi must be examined in the context of all stakeholders and at three levels: personal, organisational and societal. Firstly, guanxi, by its very nature, discriminates against people outside the guanxi network. This is against the Principle of Fairness. People have the right to be treated fairly, impartially and equitably. If a person

(outsider) is treated unfairly because of the special treatment granted by a guanxi deal, the ethics of such guanxi deal is called into question. Secondly, guanxi is all about exchanging favours, especially about obtaining 'special treatment' from those who are in power. In this case, guanxi is inherently corruptive as such a special treatment may be just legal, but is very much questionable in moral and ethics terms. 'Special' means to bend or break rules, to act against one's moral consciousness or act illegally. Individuals and organisations that stick to ethic standard will suffer as the result of unscrupulous guanxi practice. Where some individuals gain via guanxi, the society in general loses. In short such a guanxi transaction does harm to the social goods.

Moreover, business guanxi violates the so-called 'arm's length principle' which states no personal or family relationship should play any role in economic decision-making (Tanzi, 1994). All the benefits that guanxi is alleged to have in the literature can be summarised into two categories: acquiring rare resources and obtaining protections. Firstly, guanxi gives its members the opportunity to acquire rare resources which are otherwise unobtainable or too expensive. To name some obvious examples:

- business /import /export license,
- land, property, shares, personnel, key supplies,
- cheap bank loans or foreign exchange,
- inside /confidential information,
- secure a market or distribution channel,
- official endorsement for a poor product, etc.

In an open market economy, no individual or firm should be allowed to have such a privilege as the advantages enjoyed by guanxi members bring competitive disadvantages to other firms and amount to unfair competition. Eventually not only those firms suffer but consumers and the society in all will have to pay the price.

The second benefit is protecting guanxi members when they face threats and troubles, for example, pollution fines, taxes increase, consumer compensation, court disputes, bankruptcy, etc. Such protection offers guanxi members immunity from the law. Guanxi-related corruption, no matter if it is grand or petty, is in fact to bribe the bureaucrat where the interest of general public is victimised. In a democratic society no one should be allowed to be above the law. Those who break the law should be punished in order to protect the public interest. Ethically speaking, there is good guanxi and bad guanxi. The consequences of guanxi can range from benign, neutral, to questionable and corruptive. While family and helper guanxi are generally good or neutral, business guanxi at best has misgivings and at worst is corruptive. Although there are unlikely to be any simple rules that can be used to judge what guanxi is ethically acceptable and what is not, a rule of thumb is that a guanxi practice is ethical only if it causes no harm to a third party or to the society.

Corruption exists in every economic system but guanxi-related corruption has unique Chinese characteristics. The weakness in the market structure and an inadequate legal system, combined with a lack of transparency due to the absence of political opposition and media scrutiny, has allowed guanxi to contribute greatly in making China top of the league table of the most corrupted countries. Corruption is not only present in isolating cases but also institutional and structural, from the top elite bureaucrats to bottom, involving almost every part and level of the society. Some people ruthlessly use guanxi in their pursuit of personal gains, causing egregious or invisible long-term permanent damage to the society. China has passed hundreds of laws and legislations each year, but the problem lies in the interpretation and enforcement. In a society with the tradition of rule of man and the party above the

law, it is not uncommon that the standard of stringency and enforcement vary from case to case. Each year 70 percent of economic cases remain unsettled after the court verdict (*China Youth News*, Aug. 2000). In some cases, the judicial system itself is also plagued by guanxi and corruption.

## CONCLUSION

It is rather strange to see that something detested and condemned in China has found its popularity in the western business literature. While China is attempting to move away from the guanxi-based system to a rule-based system (*the Economist*, 8/4/2000), advocates of guanxi in the west appeared to have found a new business model with a utopian enthusiasm (Amber, 1994; Lovett, et al, 1999, etc.). If China wants to modernise herself and join the global economic system, it has to abandon unethical guanxi practices. In fact the need of relying upon guanxi in doing business in China is no longer as compelling as in the past. As discussed above, business guanxi is a product of China's political and socio-economic environment: imperfect legal system, transient market structure and underdeveloped infrastructure as well as traditional cultural values. Under the shortage economy of the 70s and early 80s, one had to use guanxi to buy a bicycle or train ticket, but there is no need to do so today. The development of the market in the last 20 years has made all these uses of guanxi redundant. It can be argued that with further progress in the market economy and the emerging democratic civil society, the importance of business guanxi (in its current form), will be gradually reduced rather than increased.

For international companies doing business in China, guanxi may still have a role to play, particularly at the initial entry stage: introduction, negotiation and set-up of



operation. As soon as the business is up and running, other factors will take over the importance of guanxi even though the relationship established at the early stage needs to be re-assessed to decide whether to maintain it over time. This is because the guanxi stock and the role it plays will be diminished or changed while foreign firms move down the learning curve in the Chinese market. This is supported by the author's recent survey of 28 international joint ventures in Eastern China. Respondents named branding, quality and distribution channels rather than guanxi as the most important factors in achieving marketing goals. Ultimately it is not guanxi, but superior marketing strategy and better customer values that make a business successful in the Chinese market, just as it is true anywhere else.

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Table 1 A Comparison of Three Types of Guanxi

Guanxi Type	<b>Family</b> Guanxi	<b>Helper</b> Guanxi	<b>Business</b> 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	Cultural values and contemporary socio-economic factors	Current political /economic structures, eg. weak legal system
Base	Mostly blood base, some social base	Social base	Social base, or through intermediary
Core Values	Qinqing / affection, obligations, empathy	Renqing, face, trust? Credibility	Renqing, face, power/ Influence
Motivation / Purpose	Mutually dependent, emotion-driven	'To get things done' utility-driven	To overcome bureaucratic obstacles, to get special treatment /protection
Function	Ends and means	Means	Means
Exchange	Love / affection, Support	Favour	'Money and power deal'
Condition	Reciprocal not necessary, can be altruistic	Reciprocal expected, but the weaker party benefits more	Strictly reciprocal, 'gain and loss' bargaining
Relation	'Own people/ zijiaren', member of a big family	'Shouren- familiar person', outsider (but not 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	Temporary, one-off	Temporary