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## **Paper Submission**

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## **ABSTRACT**

This paper extends the discussion of guanxi beyond instrumental evaluations and advances a normative assessment of guanxi. Our discussion departs from previous analyses by not merely asking, “Does guanxi work?” but rather “Should corporations use guanxi?” The analysis begins with a review of traditional guanxi definitions and the changing economic and legal environment in China, both necessary precursors to understanding the role of guanxi in the Chinese business transactions. This review leads us to suggest that there are distinct types of, and uses for guanxi. We identify the potentially problematic aspects of certain forms of guanxi from a normative perspective, noting among other things, the close association of particular types of guanxi with corruption and bribery. We conclude that there are many different forms of guanxi that may have distinct impacts on economic efficiency and the well-being of ordinary Chinese citizens. Consistent with Donaldson and Dunfee (1999), we advocate a particularistic analysis of the different forms of guanxi.

Keywords: Guanxi, China, Normative, Bribery, Corruption, Hypernorms

A critical dimension of international business ethics deals with cross-cultural issues (Donaldson, 1996) and how managers “can successfully maneuver the disturbing trends that lie at the intersections of different cultures.” (Donaldson and Dunfee, 1999, p. 46). Whenever a strongly ingrained, culturally derived practice confronts a dynamically changing business environment, cross-cultural ethical dilemmas arise. Such predicaments occur more often today because growth in international capital markets often involves the imposition of international business practices onto formerly isolated economies.

China is enjoying rapidly increasing foreign investment while at the same time it must cope with local changes influenced by Western legal forms and concepts. The role of *guanxi* in Chinese business culture provides one of the most dramatic examples of an entrenched cultural norm under pressure from international business trends. To date, the popular and academic literature has focused on descriptive and instrumental dimensions of *guanxi* (Xin and Pearce, 1996; Yeung and Tung, 1996; Leung et al., 1996; Tsui and Farh, 1997) to the virtual exclusion of normative aspects. The few who do recognize the ethical issues regarding *guanxi* consider mainly efficiency arguments (Lovett et al., 1999)<sup>3</sup>. This paper extends previous analyses by going beyond merely asking “Does *guanxi* work?” to focus on the critical normative question “Is the practice of *guanxi* ethical?”

Our analysis begins with a review of traditional *guanxi* definitions. Next, we discuss the changing economic and legal environment in China, a necessary precursor to understanding the role of *guanxi* in the Chinese business transactions. This section is followed by a discussion of the current status of *guanxi* in China and the economic or instrumental impact of its practice. The analysis leads to the conclusion that there are quite distinct types of, and uses for *guanxi*. Finally, we then identify the

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<sup>3</sup> Lovett et al., 1999, conclude that an ethical case against *guanxi* can be sustained only under a universalistic-analytic perspective and then dismiss it by noting “this interpretation simply does not hold under the particularistic-

potentially problematic aspects of certain forms of guanxi from a normative perspective, noting among other things, the close association of particular types of guanxi with corruption and bribery. The article closes by discussing the implications of the changing economic environment in China for a normative evaluation of guanxi.

## **I. GUANXI DEFINED**

The first step in determining the merits of guanxi as a business practice requires that we define it. Guanxi is not a precise term of art. Instead, it refers to a cultural phenomenon and, as such, has been described differently by various scholars. Scholarly descriptions of guanxi include “tight, close-knit networks” (Yeung and Tung, 1996, p. 54), “interpersonal connections” (Xin and Pearce, 1996, p. 1641; Leung et al., 1996, p. 749), and a “gate or pass” (Yeung and Tung, 1996, p. 54). Tsui and Farh (1997, p. 59) remark “the literature (both Chinese and English) shows no consensus in the translation or definition of the term guanxi. According to Bain (1994), guanxi 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.”

The core idea of guanxi involves relationships between or among individuals creating obligations for the continued exchange of favors. Akin phenomena are found in most societies, characterized by familiar terms such as blat, bakshish and relationship marketing.<sup>4</sup> Imperfect Western analogues include networking, reciprocity and nepotism. Western antonyms would be impartiality and objective merit. In

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integrative assumptions of the east.” (p.236)

China, guanxi begins with a “guanxi base” (Tsang, 1998, p. 65) entailing either a blood relationship or some social interconnection. The latter may involve having gone to the same school, lived in the same neighborhood, belonged to the same organization and so on. The former is reflected in the tendency of Chinese in many countries to organize around family firms. Connections based on blood or kinship represent “ascribed” or inherited guanxi while other connections must be cultivated or “achieved” (Yeung and Tung, 1996).

However, a guanxi base alone is insufficient to establish strong guanxi. The individuals must interact, exchange some favors, build trust and credibility, and work over time to establish and maintain the relationship. Actions supporting the development of strong guanxi may include invitations to visit one’s home or place of business, entertainment, gifts, use of supportive intermediaries and such things as hiring the offspring of the subject party (Tung, 1998). True guanxi can not be established merely through the one time payment of a coarse bribe.

Guanxi plays an important role in Chinese society. It may serve as means of signaling trust and integrity in a system that lacks strong background institutions (Lovett, et al., 1999). It may also constitute an informal network allowing individuals to bypass the inefficiencies inherent in a communist bureaucracy (Xin and Pearce, 1996). Some regard guanxi as the glue that holds the Chinese society together (Lovett, et al., 1999).

For organizations, guanxi serves as a strategic tool, especially for those without strong government ties. Recent business publications applaud multinational corporations who skillfully use guanxi while entering the Chinese market (Tanzer, 1993; Pitta, 1994; Engardio, 1996;

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<sup>4</sup> Lovett et al., 1999, claim that there is a growing recognition that “relational exchange systems are the way that much of the world does business.” (p. 232)

Vanhonacker, 1997). Some regard guanxi so highly that they advise organizations to consider guanxi a strategic resource and recommend guanxi audits (Wall, 1990; Yadong, 1997; Tsang, 1998).

Recent research suggests that privately owned organizations use guanxi as a substitute for formal institutional support. Xin and Pearce (1996) found that executives in privately-owned organizations placed more value on business connections, relied more heavily on guanxi for protection and gave more unreciprocated gifts than executives in state-owned or collective hybrid companies. Thus, guanxi may be used as a substitute for the direct contacts with state and party personnel that may be available to the other organizational forms.

At the individual level, managers may establish and use guanxi to carry out business in a number of ways<sup>5</sup>. Guanxi can be used to gain access to new customers, keep existing clients, facilitate daily business operations, or even to avoid government investigations. For example, a manager may befriend a government official as means to avoiding a time-consuming approval process on a new product. Thus, this friendship allows the manager to bypass a government system and bring his product to market more quickly. Other managers may utilize guanxi by relying on old classmates for job opportunities or depend on relatives to purchase goods that cannot otherwise be sold. Guanxi may even be a tool for screening job candidates –some organizations require potential new hires to exhibit a strong web of business relationships in order to be considered for certain managerial positions (Fan and Ambler, 1998).

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<sup>5</sup> Ambler (1994:69) describes how guanxi systematically unfolds in the Chinese business setting. “The first part of the word, guan, is transferable. If A has guan with B and B with C, then B can introduce A to C, or vice versa. Otherwise contact is impossible. For this reason, faxes are unlikely to receive a reply until direct personal contact has been established. In the meantime, A has to fax B who will in turn, if the guan is satisfactory, relay it to C. The xi part of the word implies formalisation and structure. Favours are banked, to be repaid when the time is right, if ever. There is no urge to use up the guanxi stored; like insurance, one hopes not need it but its existence is reassuring.”

Guanxi is an intricate, illusive concept. In the next section, we review the changing economic and legal environment in China as a precursor to normatively evaluating guanxi.

## **II. THE CHANGING ENVIRONMENT IN CHINA**

During the past two decades, China has made great economic progress, becoming a major player in world trade and attracting substantial foreign investment. Concurrent with China's cautious integration into the world economic system, significant changes have taken place in the domestic business environment. These changes include, among other things, increased privatization of business firms, a movement toward more emphasis on the rule of law, changes in forms of business operation and corporate governance, increasing competition among business firms and increased foreign investment. Each of these is briefly discussed in turn.

### **Rule of Law**

Although still in a primeval stage, background regulatory organizations are being formed and commentators such as Eakeley (1997, p. A23) claim that "China is showing an interest in the rule of law" by virtually transforming its legal system. There are now 100,000 lawyers licensed to practice in China, which is remarkable in view of the fact that the profession was outlawed as recently as 1979 (Eakeley, 1997). Even so, problems of federalism, administration and corruption plague the nascent legal system and enforcement of judgments or even national statutes remain chancy (Nikkel, 1995). When legal remedies are not available or effective, then "shareholders, whether Chinese or foreign,

usually must rely on mediation and arbitration, or the more common route of guanxi (personal connections, to resolve disputes.” (Nikkel, 1995, p. 515).

There is considerable debate concerning how fast China is moving toward a Westernized emphasis on the rule of law. Some believe that global business forces will speed the transition as China’s need for capital creates a demand for certainty and impartiality. Guthrie (1998) believes shifts in the economy have led China to redesign the legal system in such a way that it favors efficiency and produces disincentives for guanxi-based transactions. Specifically, Guthrie (1998) explains how increases in the monitoring of industrial organizations decreases the degree of reliance on guanxi. Others, such as Garten (1998, p. 173-4), disagree, “(f)or decades to come, the structure of China’s government will be far less important to businesses than the officials who are in charge. More than any other large country, it will be a system not of laws and institutions but of people and relationships.” Some even argue that guanxi will gain importance in international transactions because it provides a more effective means of conveying trust than formal legal contracts (Lovett et al., 1999).

### **Corporate Governance**

In April 1994, the National People’s Congress in China approved a new Company Law that provides a legal framework for the organization and operation of private stock companies (Fang, 1995). Formal implementation of a corporate legal system reflects various motivations on the part of the state. For example the changes in the legal system should pressure the underperforming, state-controlled companies to become more efficient. This is a serious concern because as of 1994, 41% were

estimated to be losing money (Nikkel, 1995). The changes are also designed to attract new sources of capital by tapping into the significant personal holdings (“mattress capital”) of ordinary Chinese citizens.

The new law sends mixed messages concerning corporate objectives and governance. Article 102 provides that shareholders “shall be the organ of authority of the company.” That seemingly liberalizing standard must be viewed in the context of majority state ownership for most companies. In addition, the law itself sends countervailing signals. Article 14 provides that “companies must...strengthen the establishment of a socialist spiritual civilization, and accept the supervision of the government and the public.” (Nikkel, 1995, p. 523). Although Article 15 reads in the nature of a preamble it also serves as a clear reminder that China is a communist country.<sup>6</sup> Overall, the rights of shareholders in joint stock companies are in theory similar to those in Western companies, including the rights to limited liability, elect a board of directors, receive dividends, exercise a residual claim against corporate assets and vote by proxy. The board of directors, in turn, has the responsibility to appoint, and if necessary, remove senior management. Article 123 requires that “the directors and manager shall...faithfully perform their duties and protect the interests of the company” (Nikkel, 1995, p. 526). The law goes on to specify these duties some of which appear to be similar to fiduciary duties of loyalty and due care found in U.S. corporate law. For example, specific provisions “disqualify government officials from serving concurrently as directors or general managers, prohibit directors and managers from taking bribes or accepting illegal income and preclude directors and managers from entering contracts with the company except in limited circumstances” (Nikkel, 1995, p. 527).

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<sup>6</sup> There are conceptual similarities between the language of Article 14 and the so-called corporate constituency statutes found in some U.S. States.

## **Privatization**

Even though the majority of enterprises within China remain owned by the state, privately owned firms continue to emerge, along with hybrid forms in which a governmental entity owns the majority of the shares<sup>7</sup> and private investors own an interest. By 1999, the Shanghai Stock Exchange listed 457 companies (Xinhua News Agency , 1999). The Chinese government encourages privatization as a means of increasing efficient decision-making (as for example, in the banking sector where certain banks have become notorious for making bad loans and also tapping the flexibility of global capital markets. For example, in 1998, over 100 Chinese companies were interested in issuing convertible bonds (Lucas, 1998). Although privatization encountered difficulties in the late 1990s, it is expected to accelerate particularly when China is finally admitted to the World Trade Organization.

## **Foreign Direct Investment**

Many of the trends described in this section are interrelated. This is particularly true of the increase in levels of foreign investment during the 1990s. China, in an attempt to sustain economic growth, offers increasingly more attractive opportunities for foreign investment. These opportunities coincide with major changes in the legal and political environment such as the legalization of wholly foreign-owned enterprises. Such ownership opportunities continue to attract foreign investors who do not want the hassle of partnering with local businesses. Tung and Worm's (1997) research on European firms conducting business in China confirm the assertion that foreign investors desire a controlling position (majority or sole ownership) in their Chinese business. Tung and Worm (1997, p.

3) explain how such managerial preferences stem from “their need to exercise control and their attempt to minimize the influence of the large cultural distance between Europe and China.” In 1996, the number of wholly foreign-owned enterprises surpassed the number of new joint ventures for the first time (Smith, 1997).

While any type of foreign investment poses a threat to the Chinese business culture, the growth of wholly-owned foreign enterprises threatens to disrupt traditional Chinese practices the most. Owners who wholly own a Chinese company are not bound by the demands of a Chinese business partner and therefore do not need to conform to as many Chinese practices as foreign partners in Chinese joint ventures. This freedom may also lead to the importation of non-Chinese cultural norms. Most importantly, these foreign-owned organizations may present competitive forces that conflict with guanxi traditions and thereby impact the effectiveness of an organization that relies heavily on guanxi.

## **Competition**

According to Guthrie (1998, p. 264), the Chinese government continues to shift more financial responsibilities to business firms who must then find ways to remain competitive under stricter economic conditions. Guthrie (1998) believes that such trends will result in the abandonment, at least in part, of guanxi-type business transactions because relation-based contracting will be outperformed by more market-driven, economic variables such as price and quality. Essentially, as China opens its doors to competitive markets, organizations will be more conscious of their competitive advantage. This awareness will lead organizations to value economic transactions over social obligations because the

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<sup>7</sup> “In China, a business enterprise is generally controlled by either a local government (hence the term ‘local enterprise’), or by the ministry of the central government that has responsibility for the company’s primary line of

former is more efficient for the organization. The claims for efficiency lie in the certainty of monetary debt over the ambiguity of a future social obligation imposed by guanxi. This logic suggests that as competition rises in China, businesses will find it easier to pay one's debt with money rather than favors.

### **Other Influences**

Other changes in China may also have an effect on the practice of guanxi. Job mobility, once greatly restricted, is now a significant phenomenon. One estimate indicated that 15% of Shanghai's workforce changed jobs in 1993, almost 10 times the prior rate (Tsang, 1998). As people are more mobile, the types of ties that lead to strong guanxi are presumably harder to maintain. The increase of information flows through the internet and telecommunications also may weigh against the traditional forms of relationships as people have more direct sources of information and influence.

In addition, forces outside of China may have an impact internally. The most significant of these for the purposes of this article is the rapidly escalating worldwide condemnation of bribery and corruption. Transparency International, an international NGO based in Berlin, has been a major influence behind the emerging global view condemning bribery and corruption. The organization promotes an annual Corruption Perception Index based upon surveys of those doing business globally and the index has become an influential measure of perceptions of corruption in individual countries. In 1997, China ranked as the 12<sup>th</sup> most corrupt country out of 52 countries, falling between Argentina (11) and the Philippines (13). China's rank shifted in 1998 to 33<sup>rd</sup> most corrupt country out of 85 countries

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business (hence the characterization as a 'central enterprise'). (Eu, 1996, note 124).

but it is difficult to tell if the shift in rank reflects true progress or an increase in the number of countries indexed (Kaltenheuser, 1998).

In December 1997, the 29 OECD countries (plus five others including Argentina, Brazil and Chile) formally signed a non-self-executing convention to combat public sector bribery. In general terms, the signatories are committed to implement domestic legislation compatible with the Convention's terms, which bear a generic relationship to the U.S. Foreign Corrupt Practices Act. In March 1997, the Inter-American Convention Against Corruption entered into force. It has far-reaching provisions, encompasses the receiving of bribes and even provides for extradition under certain circumstances. These government-based actions were complemented by the promulgation of anti-bribery rules by the International Chamber of Commerce in 1996 and the World Bank's condemnation of bribery and corrupt practices in its guidelines.

#### **IV. THE CURRENT ENVIRONMENT FOR GUANXI**

Before engaging in a normative evaluation of the practice of guanxi it is necessary to briefly discuss certain aspects of the current environment for guanxi that help to identify likely changes in the phenomenon while also highlighting certain dimensions of current practice that have, or will have in the future, normative significance.

##### **Changing Perceptions of Guanxi**

As a foundation for a normative analysis of guanxi, particularly one based on social contract norms, it is useful to know how current Chinese view guanxi, particularly practicing business managers.

Are for example, the views of guanxi changing as a result of the trends and changes detailed in the prior sections? In a recent survey of Chinese managers, Guthrie (1998) found that some view the practice of guanxi as increasing in importance while others believe that it is of less or even no importance in the emerging Chinese legal framework. Guthrie summarized the views by stating that guanxi, while still an important institutional system, is diminishing in importance due to both increasing competition and legalism. Managerial perceptions of guanxi's importance varied according to the firm's "position in the industrial hierarchy of the former command economy" (Guthrie, 1998, p. 275). Specifically, Guthrie (1998) found that managers in the higher institutions of the Chinese industrial hierarchy perceive guanxi as less important than managers in institutions that hold lower positions in the industrial hierarchy. Guthrie interprets the difference as a reflection of the manager's ability to access high-level officials. Those managers in higher institutions already have access to the bureaucrats who facilitate business transactions and therefore do not need to rely on guanxi as much as those managers in lower institutions.

### **Who owns guanxi?**

Another important question for a normative analysis is whether guanxi may be associated with an organization rather than just an individual. That is, when an obligation is created as a result of guanxi, is it always attributed to a particular individual or does the organization, as an independent entity, possess the association? Tung and Worm (1997) in a survey of European firms doing business in China found that 63% of the respondents considered guanxi to be a personal asset while 20% considered that it belonged to the employer. Tsang (1998) provides a possible explanation for this dual perception by claiming that guanxi may be "elevated from an individual to an organizational level." Presumably the test

of such a case would be whether those obligated see the organization as the object of reciprocation rather than an individual. Thus, if managers work to establish guanxi with another individual on behalf of their organization and that individual continues to recognize an obligation to their organization, even after the managers leave, then the organization could be said to have guanxi. If this is true, then it should be the case that guanxi may exist between organizations. The idea that organizations may themselves possess guanxi is reflected in popular press headlines such as “Chinese Shares Show ‘Guanxi’ Appeal” (WSJ, 9/29/97, p. C1.) In this article, Webb reports how guanxi rooted in political connections provided crucial attraction for the investors of two large stock issues in China.

### **How ingrained is guanxi?**

A normative analysis will also be affected by the extent to which guanxi is embedded in the underlying culture. Among other things, this should influence the ease and rapidity by which guanxi may change within a society. Many argue that guanxi is deeply tied to the Confucian heritage of the Chinese people and entrenched in the Chinese way of life (Yeung and Tung, 1996; Lovett et al., 1999). If guanxi is deeply rooted in traditional Chinese culture as many maintain, then economic forces, standing alone should not be sufficient to bring about major changes in the practice. Instead, one would expect the guanxi to adapt to the economic forces while also changing them in turn. If instead, guanxi is more artificial, representing a particular response to a given set of institutions or events (e.g. the aftermath of the cultural revolution) then it may be expected to change rapidly in the face of evolving background institutions.

A final issue is whether guanxi is in fact a conglomerate of very diverse practices which can be rationally broken out into sub-groups. Many academic writers have attempted to do this.

Some researchers suggests that managers conducting business in China differentiate between the many uses of guanxi, treating each type as an individual strategy for developing and maintaining business. Tung and Worm (1997) asked managers of European companies working in China to rank the importance of four types of guanxi used when trying to establish connections with a target institution. The behaviors included (1) inviting executives on a trip, and offering to pay for all expenses, (2) entertaining executives by throwing extravagant parties, (3) giving modest gifts, and; (4) using an intermediary to establish contacts. Not only did the managers distinguish between different types of guanxi, they showed strong preferences for different types (e.g., the first type was recommended by most as a strategy for establishing contacts).

Other researchers focused on the recipient of the guanxi as a way of categorizing types of guanxi. Xin and Pearce (1996) asked Chinese executives the primary reason for a person's usefulness and then coded responses based upon whether connection provided contacts in government, key companies, elsewhere in the same company, or if the connection controlled financial resources, access to customers, technical or professional knowledge. As stated earlier, executives in private companies relied more heavily on guanxi than those in state-owned or collective hybrid companies.

We believe that the uses of guanxi vary in significant ways and that this helps to provide a basis for a comprehensive normative analysis of the practice.

## V. ECONOMIC IMPACT

The impact of guanxi on economic performance is not known with precision. On the positive side, there are certain macro considerations in support of the claim that the impact of guanxi may be positive. For example, it may serve as a means for signaling trust and credibility in a society in which such characteristics are not transparent and are not supported by incentives embedded in strong background institutions (Lovett, et al., 1999). It may also constitute an informal network allowing the bypassing of the inefficiencies inherent in a communist bureaucracy. In this sense, guanxi may be seen as a substitute for the rule of law. Interestingly, Xin and Pearce (1996) report that private managers were more likely to rely on guanxi, but they saw it as a necessity – a defensive measure. As Yeung and Tung (1996, p. 56) point out, “Emphasis on personal power promotes the practice of guanxi, since an individual (rather than institutional authority) defines what is permissible in a given context at a particular time. According to Lee Kuan Yew, founding father of the Republic of Singapore, the Chinese use guanxi ‘to make up for the lack of the rule of law and transparency in rules and regulations’.”

The overseas Chinese experience remarkable economic success in China and some attribute it to guanxi. As recently noted by the American Chamber of Commerce in Hong Kong (1997), overseas Chinese receive better returns on their investments in China because they rely on family members and friends who already possess guanxi to assist in the establishment of businesses. Such in-country contacts aid in the transfer of funds, negotiations with governmental officials and the establishment of contracts in a country with weak institutional support. Thus, relying on a guanxi-based approach has provided overseas Chinese with some advantages vis a vis Western investors.

On the other hand, micro considerations suggest that guanxi is inefficient. By definition, it is inconsistent with the idea of performance merit. Many people get hired for jobs, not on the basis of their individual merit, but instead on the basis of their lineage or connections (Sensenbrenner and Sensenbrenner, 1994; Yadong, 1997). Further, when the credits and debits due to guanxi are subtracted from an analysis of a transaction, what is left may appear to be a very bad deal. A respondent to a survey conducted by Tung and Worm (1997, p. 11) survey stated that “In the 1980s, if you had good guanxi you can sell a piece of bad equipment at a high price.” This quote implies that extra-market considerations may dominate business purchasing leading to inefficient allocation of resources. Another respondent to the Tung survey stated that the best guanxi is “where I’ve got something on you”. This would seem to be a negative rather than a positive dimension of guanxi. Its power is not a positive relationship that involves some form of mutual exchange over time. Instead, in a manner similar to extortion, the power comes from an implicit threat. “If you don’t do as I say, then I will reveal something harmful about you”. It is easy to understand how a misallocation of resources would incur when negative forms of guanxi are employed. As Ambler (1994) notes “(t)he obligations of guanxi are very real: in the wrong place, at an inappropriate time, with unsuitable people, the obligations can become a trap which is hard to escape.” While many business communities condone the practice of gift-giving and providing entertainment for business, their use in certain types of guanxi appears to be different. In these, the gifts and entertainment are provided with the intention of securing guanxi and creating the existence of a quid pro quo relationship. This may create “an offer that one cannot refuse”. In some instances, businesses must actively refuse gifts for fear of future obligations. Vanhonacker (1997) warns that some foreign companies have found that their Chinese partners’ guanxi has taken

them in directions that were difficult to control. Lovett, et. al. (1999:234) note that “the skillful practitioner of guanxi will as often as not consciously try to avoid relating him or herself too intimately with certain others so as to avoid being weighed down with obligations.”

A problem receiving recurring mention during the liberalization of company ownership in China involved an institutional form of guanxi that appeared to interfere with the efficient operation of capital markets. Firms would issue stock that would produce an influx of cash to the firm. Then, instead of investing in the firm’s own production processes, the managers of the firm would act as bankers and would invest in other firms in the area, sometimes at the behest of local government officials who wanted to see employment maintained in their locality. The firms receiving the loans were often inefficient and subsequently defaulted on the loans. This produced a double negative effect. The money was lost to productive investment in the issuing firm and market forces acting against a highly inefficient enterprise were thwarted.

The importance of guanxi in business dealings is accepted as virtually a truism in certain areas of Asia. Many have argued that understanding and practicing guanxi is essential for successful market entry and sustained success in China (Wall, 1990; Leung et al., 1996; Tung and Worm 1997; Tsang, 1998). A resource-based analysis of guanxi indicates that in many cases it may be difficult to sustain a comparative advantage based on guanxi (Tsang, 1998). Perhaps guanxi is more in the nature of a barrier to entry, with a lack of guanxi constituting a comparative disadvantage. This may be reflected in findings that managers of private firms in China may be more likely to use guanxi than managers of other state-owned, or partially state owned firms, particularly as a defensive measure (Xin & Pearce, 1996).

Guanxi may be used as a substitute for the direct contacts with state and party personnel available to the other organizational forms.

## **V. NORMATIVE ANALYSIS OF GUANXI**

Controversy surrounds the ethical status of Guanxi. Although there has been virtually no normative analysis of the practice in the academic literature, it has been both condemned and defended in the popular media. To some “guanxi” is a Chinese word synonymous with corruption. Seen as one of the forms of “Asian values” contributing to the abuses of crony capitalism, guanxi is both righteously condemned and reluctantly accepted as an unfortunate, though necessary, evil for those wishing to succeed in business in China. Others defend the morality of guanxi claiming that it is “no more equivalent to corruption than social drinking is to drunkenness” (Tsang, 1998, p. 66).

As we have described it, guanxi encompasses a set of practices that may be used to achieve a variety of objectives in widely varying contexts. One of the important recent developments in business ethics is the growing emphasis on the context of actions (Donaldson and Dunfee, 1999). Under this approach, a specific act of guanxi may or may not be ethically problematic depending on the intentions surrounding its use and its particular impact.

### **A. Uses for Guanxi**

As we have described, guanxi may be used to facilitate efficient exchange. One analogue to guanxi that is viewed positively in the West is relationship marketing. (Dwyer et al., 1987; Morgan and Hunt, 1994.) Relationship marketing is based on trust and involves taking steps, over time, to create

tightly linked connections between business parties. These connections are seen to produce a more enduring, yet also flexible, foundation for a long-term business relationship. The ability to develop these is seen as a comparative advantage for firms.

Gift-giving and entertainment used as a foundation for future business relationships are common in many cultures. This is certainly true in the United States where a large industry supports business entertaining. Upscale restaurants and major sports stadia owe their existence to such practices. These practices are so common they are the subject of norms and rules established by firms and other interested parties. They are based on the idea that humans are social creatures and that social relationships underpin many other types of interactions. To the extent that guanxi is used in a manner consistent with these concepts of networking and relationships, it must be evaluated by the same criteria applied to Western business entertaining.

Although guanxi may be used in a private context to facilitate exchange it may also be used to produce an outcome whereby a firm's lower quality good or service is substituted for superior alternatives. When one gets a discount because of friendship, or one's child is employed due to a social relationship, or one obtains a loan from a bank operated by a relative, then efficiency suffers. The better qualified candidate is not hired, capital, already in short supply is not put to its most efficient use, a product is "sold" below the market price.

A very different use of guanxi is to apply it to overriding government rules and regulations. It may be the equivalent to coarse public sector bribery where payments are made to avoid environmental or safety regulations. Or it may be used to obtain licenses or capital controlled by self-interested government bureaucrats. Because of the significant role that government plays in the Chinese economy

there are many approvals required and the opportunities for extortion are great. The sums that are paid to government officials are estimated to reach staggering proportions. It was estimated that \$14.18 Billion of Chinese government funds went “astray” during the first half of 1999. (Li, 1999). One way to avoid extortion or to cope with required permissions is to build up guanxi with the relevant officials who will give special treatment to certain firms.

## **B. Problematic Guanxi**

Understanding the different context and uses of guanxi it is now possible to turn to a normative analysis of the practice. In the sections that follow, we present an analysis of the potentially problematic dimensions of guanxi.

### **1. As a social practice, guanxi may reduce societal wealth.**

Richard DeGeorge (1993) has offered illustrative rules for proper behavior of U.S. multinationals doing business with less developed countries. These are relevant in a broader sense in that they help to characterize the validity of practices, even those within host developing countries. A key rule among the set offered by DeGeorge is #2 Produce more good than harm for the host country. Using the idea in a somewhat different sense, we ask whether or not, taken as a societal practice, guanxi produces more good than harm. We described earlier the current debate concerning the overall effect of gaunxi on a national economy. If the answer is that on net guanxi reduces societal wealth, or that certain forms of gaunxi reduce societal wealth, then guanxi may be problematic. An efficiency-oriented analysis of guanxi constitutes a form of consequentialism. Such analysis either requires an evaluation of

each particular practice of guanxi to determine its effect, or an overall netting of outcomes from the practice as a whole. Certain specific acts of guanxi may not have a negative effect on efficiency. Thus, an ad hoc consequential approach requires that each specific instance of guanxi be judged on its own merits. On the other hand, it seems plausible to argue that the overall impact of the practice is to distort and disrupt the operation of capital markets. Guanxi as a generic practice may therefore be found wanting under rule consequentialism.

## **2. As a social practice, guanxi benefits a few at the expense of the many.**

It appears that large numbers of people in modern China have limited guanxi when it comes to business relationships. To the extent that is true, and to the extent that the possession of guanxi is an important determinant of the allocation of resources, it may be that guanxi works to the disadvantage of ordinary Chinese people. The claim that business-related guanxi is pervasive and widely accepted as a cultural practice in China may not be true. If there are large communities of Chinese rejecting or opposing these forms of guanxi, perhaps those disadvantaged by the practice because they lack opportunities to benefit from its use, then the practice of certain types of business-related guanxi may be problematic.

## **3. Guanxi may result in the violation of important fiduciary duties.**

Guanxi is ethically problematic if one of the parties engaged in its practice directly violates a significant fiduciary duty defined in local social norms (Donaldson and Dunfee, 1999). If two people exchange personal favors associated with guanxi (X baby-sits for the Y's child, later Y takes X's

mother to the doctor) no duties are violated. In a business context, however, important duties to third parties may be implicated. Consider the case of a bureaucrat who awards a license to do business in response to an obligation based in guanxi. The bureaucrat is a public official who has certain defined obligations to act in the public interest. If the bureaucrat receives personal benefits in return for his/her official action, then the exchange may be viewed as one of public assets for personal benefit. This is problematic if the public official may be considered to have a duty to not personally benefit from official action. The boundaries of any such duty would be determined by local law and custom. It may be for example, that the public official is expected, as one of the perks of the job, to use the power of his or her position for self benefit.

The appearance of private firms in China creates another variation of this problem. Some firms now have shareholders. The shareholders have some form of claim against the profits and assets of the firm. Now, instead of a public bureaucrat, the focus is on a manager who exchanges organizational assets for personal benefits. For example, a purchasing manager may decide to buy overpriced supplies from a personal acquaintance who has helped to get the manager's son into a prestigious school. The firm spends more than it should for the supplies and therefore makes less profit that it would otherwise. This may be viewed as an exchange of the shareholder's property for the personal benefit of the manager.

In order to conclude that either or both of these two types of exchanges are unethical, a specific fiduciary duty must be identified. An immediate question is whether or not the guanxi works to the benefit of the public agency or the organization, or instead, is fully personal to the individual. If the guanxi benefits the agency or organization then, even though certain officials or managers receive some

personal benefit, it may nevertheless be consistent with their duty. Or even though guanxi may only benefit the manager personally, this may not be problematic if, and this is a big if, the shareholders of the firm see the benefit to the manager as an efficient way of compensating the manager for his or her work. These issues suggest that it may be necessary to analyze each particular incident of the use of guanxi in order to determine whether it is problematic. Earlier we reported the high percentage of managers who characterize guanxi as a personal asset which lends support to suspicions that fiduciary duties may be breached when managers who work for publicly held firms practice traditional forms of guanxi.

#### **4. Certain uses of guanxi may violate hypernorms.**

Hypernorms are manifest universal ethical norms defined as principles so fundamental to human existence that we would expect them to be reflected in a convergence of religious, philosophical and cultural beliefs (Donaldson and Dunfee, 1999). As expressed by Michael Walzer (1992), they would be a thin “set of standards to which all societies can be held- negative injunctions, most likely, rules against murder, deceit, torture, oppression and tyranny.” The use of guanxi to override government regulations designed to protect public safety and health or to facilitate actions that restrict human rights is clearly problematic. Similarly, guanxi that results in or leads to extortion whereby the quid pro quo involves threats to one’s life or physical well being violates a hypernorm. Allen Cheng (article “Just Say No”) warns against the dangers of this type of guanxi “it’s also becoming increasingly clear that if you don’t have guanxi, or if yours aren’t good enough, doing business in China can be hazardous to your health.”

Return now to an earlier example of guanxi whereby a government official allows a manager to bypass a governmental approval process. The product approval process probably exists for a reason,

one that should not be compromised (e.g., regulates prescription drugs). But guanxi places an obligation on business people in such a way that the government official may feel it is necessary to compromise the safety of others in order to uphold his ties to the manager. In such a case, the use of guanxi may violate hypernorms.

Coarse public sector bribery involving the selling of public assets for private gain is widely condemned and may be characterized as violating a hypernorm. (Dunfee, Smith & Ross, 1999.) Bribery is explicitly condemned in many religions and has been denounced by writers holding radically different political and economic beliefs, e.g. Ayn Rand, Adam Smith and Mao Tse-tung. We described earlier the growing global consensus that bribery is harmful and should be constrained. All of these factors support the condemnation of guanxi when it is intended to or does in fact result in the exchange of significant public assets for private gain.

##### **5. Guanxi may corrupt background institutions.**

Another of DeGeorge's illustrative rules is #7, Cooperate with local governments in developing and enforcing just background institutions. An impartial, efficient and fair legal system is an essential foundation for a just society. The phrase "the rule of law" implies the existence of a disclosed set of rules that are applied fairly to everyone. The type of guanxi that results in special favors from government officials is directly inconsistent with the existence of a just legal system.

## VI. CONCLUSION

Popular business publications and academic literature praise guanxi as a facilitator of business transactions in China. Recent business publications applaud multinational corporations who skillfully use guanxi while entering the Chinese market (Tanzer, 1993; Pitta, 1994; Engardio, 1996; Vanhonacker, 1997). Some regard guanxi so highly, they advise organizations to consider guanxi a strategic resource and recommend guanxi audits (Wall, 1990; Yadong, 1997; Tsang, 1998). However, most of these recommendations rely upon purely instrumental evaluations of guanxi and provide little consideration for ethical concerns. This paper extends the discussion of guanxi beyond instrumental evaluations and advances a normative assessment of guanxi. The paper departs from previous analyses by not merely asking, “Does guanxi work?” but rather “Should corporations use guanxi?”

We conclude that there are many different forms of guanxi that may have distinct impacts on economic efficiency and the well-being of ordinary Chinese citizens. It is difficult to just the overall impact of the practice. Instead, consistent with Donaldson and Dunfee (1999) we advocate a particularistic analysis of the different forms of guanxi. Firms should be wary of those forms which violate emerging Chinese business norms. They should also eschew those which threatened human well-being or which significantly disadvantage ordinary Chinese. No longer can outside investors just simply uncritically accept guanxi as a Chinese cultural practice.

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