



# BUSINESS AND INTERPERSONAL RELATIONSHIPS

*The Importance of Guanxi When Doing Business in China*

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Master's Thesis

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## PREFACE

This research is a result of my final Master's Thesis conducted in the spring semester 2017 as a part of my Master's program, Development and International Relations – Chinese Area Studies, at Aalborg University, in supervision with Professor Ane Bislev.

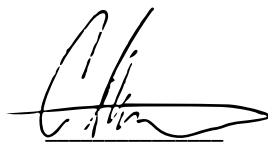
The background for the chosen topic comes from my interest in business and China. Guanxi is an important concept to understand when doing business with and in China, which is why I saw it as perfect fit for my Master's Thesis.

The purpose of this thesis is to see why guanxi is problematic to a lot of Western organizations and businesspeople and how three different business manuals prepare businesspeople for these challenges. In order to investigate this topic, a qualitative research strategy has been applied, as I have used a combination of interview and already written literature on the concept of guanxi. The thesis also describes the applied theories in connection with the analysis, which presents a thorough analysis of whether guanxi is unique in terms of interpersonal relationships and a discussion on the connection between guanxi and corruption.

I wish to express my gratitude to my supervisor, Ane Bislev, for her constructive and useful feedback during the entire writing process and her inputs on how to construct my thesis. In addition, I wish to thank my friends and family for supporting me in the entire period. Lastly, a special thank you to my wonderful girlfriend who has helped me through the difficult periods of this process and pushed me when needed.

May 2017

Christoffer Madsen

A handwritten signature in black ink, appearing to read 'Christoffer Madsen', with a long horizontal stroke extending to the right.

## I. Abstract

In China, guanxi is a very important phenomenon for Westerners to be aware when doing business as it can be the difference between a successful and unsuccessful partnership. This research explores why guanxi is a recurring challenge to Westerners doing business in China. In order to carry out this research, a qualitative research strategy has been used by using an interview and various written data on the concept of guanxi. The data hereof is analyzed by Western theories on interpersonal relationships, including social exchange theory and social capital. Through the analysis, it becomes clear that there are both cultural and institutional explanations for why guanxi is a recurring challenge. Guanxi is culturally embedded in most Chinese, which is why it occurs as second nature to them, while Westerners must be aware and use a lot of resources in order to learn these skills. Furthermore, guanxi can be seen as an addition to contract law as both terms are very important when closing a deal in China.

Keywords: Guanxi, social capital, social exchange theory, bridging and bonding, business, challenge, qualitative research, cultural explanation, institutional explanation

## II. List of Figures and Tables

### Figures:

Figure 1 – Project Design.....	8
Figure 2 – Structure of analysis, discussion, and conclusion.....	11
Figure 3 – Guanxi Classifications .....	17
Figure 4 – Bonding, Bridging and Guanxi Classifications.....	31

### Tables:

Table 1 – Overview of Business Manuals .....	20
Table 2 – The Three Components of Social Capital.....	25
Table 3 – Guanxi according to the three components .....	30



## Table of Content

<b>PREFACE</b>	<b>1</b>
<b>I. Abstract</b>	<b>2</b>
<b>II. List of Figures and Tables</b>	<b>3</b>
<b>1. Introduction</b>	<b>5</b>
1.1 Problem Area and Research Question	7
1.2 Project design	8
<b>2. Methodology</b>	<b>10</b>
2.1 Theoretical Considerations	10
2.2 Analysis Plan	11
2.3 Method	12
<b>3. Concept of Guanxi</b>	<b>16</b>
3.1 Classification and Mechanisms of Guanxi	16
3.2 Business guanxi	19
3.3 The three business manuals	20
<b>4. Theoretical Framework</b>	<b>22</b>
4.1 Social Exchange Theory	22
4.2 Social Capital	23
<b>5. Why is Guanxi a Recurring Challenge?</b>	<b>27</b>
5.1 Is Guanxi Unique in Terms of Interpersonal Relationships?	27
5.2 How is the concept of guanxi presented by the three selected business manuals?	32
5.3 Does Practice of Guanxi Lead to Corruption?	34
<b>6. Conclusion</b>	<b>37</b>
<b>7. Bibliography</b>	<b>39</b>
<b>8. Appendix</b>	<b>41</b>
8.1 Summary of Interview with Søren Niebuhr	41

## 1. Introduction

Guanxi is a Chinese term used to describe interpersonal connections with a broad social and cultural construct that the Confucian tradition the country has. In business context, guanxi refers to the process of finding solutions and getting resources through your personal connections. It is believed that a good guanxi network is necessary for doing business successfully in China because of the opportunities to secure scarce resources, bypass or short-cutting the bureaucratic maze, or obtain information and privileges. (Fan 2002) Because guanxi is so critical for doing business in China, many researchers, including anthropologists, have started to focus a lot on this special Chinese concept.

Cultural anthropologists have in recent years applied their theories, findings, and methods to a wide range of professional areas, including education, urban administration, and the various health services. However, people working with international business remain skeptical to the relevance of cultural anthropology. Cultural anthropology, which is also known as the comparative study of cultures, search for similarities and differences among contemporary people of the world and is considered as the most useful type of anthropology when looking at international business. In short, it is a comparative study of cultural differences and similarities found throughout the world. (Ferraro 2002, 1-4)

No matter what areas companies are dealing with, whether it is marketing, managing, or negotiating, the success and failure depends on how effectively its employees can exercise their skills in new locations. This is not only a question of their job-related expertise but also their individual sensitivity and responsiveness to new cultural environments, which could mean that a person with success in the home environment is not necessarily equally successful in other cultures. Research shows that failures in overseas business settings most frequently is a result from an inability to understand and adapt to foreign ways of thinking and acting rather from a technical or professional incompetence. (Ferraro 2002, 7) This is exactly why cultural understanding is essential for doing international business. But what is culture exactly? In everyday use, culture refers to finer things in life, including fine arts, literature, and philosophy. According to Gary P. Ferraro, Professor Emeritus of Anthropology at the University of North Carolina, it is *"everything that people have, think, and do as members of their society"*. These particular verbs, have, think, and do, can help us identify the three major structural components of the concept of culture; when people *have* something, some material objects must be present; when people *think*, ideas, values, attitudes, and beliefs are present; and when people *do*, they behave in certain socially prescribed ways. Thus, culture is made up of (1) material objects, (2) ideas, values, and attitudes, and (3) normative, or expected, patterns of behavior. However, to be considered as a culture, these three components must be shared by at least two people, or typically a larger group of people, otherwise it must be considered as a thought or action that is personal and not cultural. Even though we have mastered our own culture through the process of learning, it is possible, albeit more difficult, to learn to function in other cultures as

well. (Ferraro 2002) One of the more difficult cultures to learn to function in, at least to Westerners, is the Chinese. A Chinese word you will often hear when doing business in China is *guanxi*. Although *guanxi* is inconsistently translated into English, it roughly means interpersonal relationship. Although being a concept often discussed, it is one of the most misunderstood concepts in doing business in China. (Goh & Sullivan 2011) Below, an example of the use of *guanxi* is provided:

*"In the early nineties, McDonald's had a 20 year land-use agreement for a huge restaurant in Beijing. However, within two years it had to vacate the location for a businessman from Honk Kong, Li Ka-Shing. He had the required guanxi with the local government. McDonald's lost the trial and had to find somewhere else for their restaurant. The reason for Li Ka-Shing's outstanding guanxi was that he had financed Chinese schools, universities, hospitals, etc. from his profits in China." (Ambler, Witzel & Xi 2009)*

Fundamentally, *guanxi* is about building a network of mutually beneficial relationship that can be used for personal and business purposes. The concept of *guanxi* has been deeply embedded in the Chinese culture for thousands of years and has become one of the most important building blocks in constructing the social structure in Chinese society. (Zhou, Wu & Luo 2007) However, the term '*guanxi*' is relatively new entering the vocabulary in the twentieth century, but the practice goes back to antiquity and is rooted in Confucianism where family and social context defines the individual. (Ambler, Witzel & Xi 2009) There are almost as many definitions of *guanxi* as there are people who have observed and written about it. The term is, however, commonly explained as a special relationship and/or connection between two persons where exchange of favors is a key element. As *guanxi* is such a complex concept, no definition can be considered better than another, and the mechanisms of how it works and who gets involved and influenced remains unclear, which is why many authors often use Ying Fan's process concept to define *guanxi*:

*"Guanxi is the process of social interactions that initially involve two individuals (A and B). A may or may have special relationships with B. A asks B for assistance (favor) 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" (Fan 2002)*

Based on Fan's and other theorists' description, *guanxi* can be perceived as a kind of bank account where both parties deposit and withdraw favors. However, according to Ambler, Witzel, and Xi, this metaphor is very crude as they "*see it more as a description of affect, or feelings, in which a very small favor may mean a lot and very large favor mean very little*". (Ambler, Witzel & Xi 2009)

### *1.1 Problem Area and Research Question*

In the introduction, it was presented that guanxi can be considered as an interpersonal relationship between two individuals. It can be extremely difficult for Western businesspeople to navigate in as it outwardly seems like a very complex and complicated system. To investigate the difficulties of the problem, the following research question has been propounded:

*"Why is guanxi a recurring challenge to Westerners doing business in China?"*

In order to answer this research question, I have asked the following sub-questions: *"How does guanxi differ from Western theories on interpersonal relationships?"* and *"How is the concept of guanxi presented by three selected business manuals?"* These two sub-questions will allow me to better answer the research question by analyzing whether guanxi is unique compared to Western theories on interpersonal relationships and what areas the selected business manuals point out as challenging and difficult.

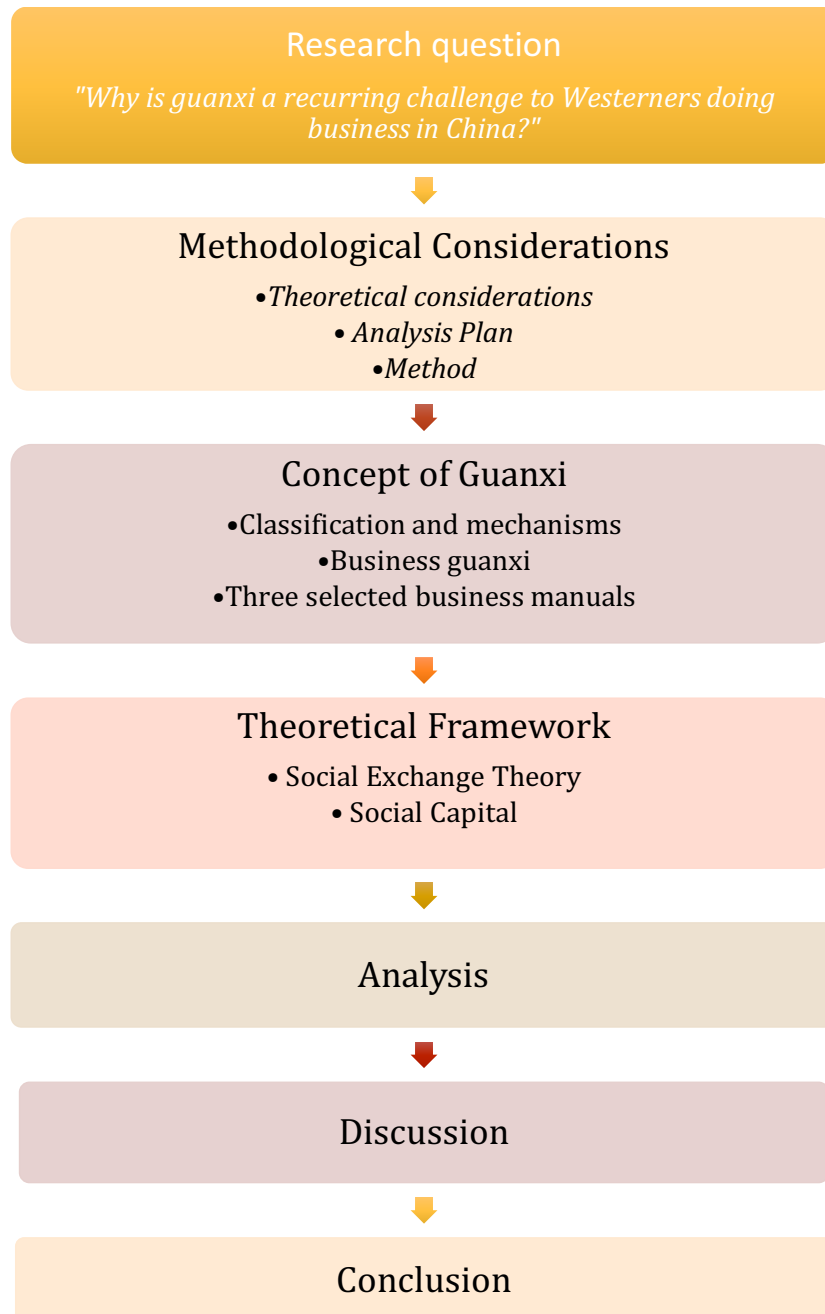
The purpose of this thesis is to see why guanxi is problematic to a lot of Western organizations and how three different business manuals prepare businesspeople for the challenges. This will be done by applying the two Western theories on interpersonal relationships, social exchange theory and social capital. Social exchange theory is about the exchange of resources in society, either among individuals or organizations. Social capital regards the civil society and includes all our social networks. Dr. David Halpern argues that social capital is composed of three different components that make it possible to analyze any kind of community or network. In relation to social capital is Robert Putnam's theory on bridging and bonding, which refers to the connections among individuals. The considerations for choosing these specific theories will be further elaborated in the methodological considerations.

As mentioned in the introduction, guanxi can be a difficult cultural concept to deal with for a Western businessman. It can be the difference between a successful and unsuccessful business partnership, which is why it is so important to master, or at least be aware of. Therefore, it is solely relevant to conduct a research about the recurring challenges of guanxi to Western businesspeople. Furthermore, this topic is also relevant to my master's program 'Development and International Relations – Chinese Area Studies' due to the fact that Westerners are working in China and therefore might be affected by the challenges. From the search process, I have noticed that the material that I have found does not provide a general overview on why guanxi is a recurring challenge to Westerners doing business in China.

## 1.2 Project design

The following project design is to display the outline of this thesis, which focuses on the challenges of guanxi in intercultural business.

*Figure 1 – Project Design*



*Source: Own design*

As the figure shows, the research question is the background of this thesis. In order to answer the research question in the best possible way, the data on guanxi has been collected from interview, various books, and scientific articles, in order to get the most nuanced picture of guanxi.

The thesis will be structured by first presenting the methodological considerations. This chapter includes the theoretical considerations, the analysis plan, and method. Next, I will briefly provide some basic knowledge about the concept of guanxi, including the classification and mechanisms of guanxi, business guanxi, and how the three selected business manuals present the concept. Hereafter, the theoretical framework of this thesis will be presented; social exchange theory and social capital, which can be perceived as Western theories on interpersonal relationships. The ensuing section will analyze the concept of guanxi in relation to the social exchange theory and social capital, and see how the three selected business manuals prepare Western businesspeople for the challenges of guanxi. Afterwards, I will discuss why the use of guanxi is often connected to corruption. Lastly, I will conclude upon my research question and answer why guanxi is a recurring challenge to Westerners doing business in China.

## 2. Methodology

*The following chapter will present the methodological considerations made throughout the entire thesis. The methodological considerations will form the basis of the research in this thesis and serve as a guideline for how it is structured. It will include different methodological considerations including theoretical considerations, analysis plan, data collection, and limitations.*

### 2.1 Theoretical Considerations

In the selection of theories, social capital and social exchange are the most suitable to explain why guanxi is a recurring challenge to Westerners doing business in China. A combination of the two theories is chosen as these two supplement each other quite well. Based on my understanding of the two theories, it can be argued that social capital is a part of the resources that can be exchanged in social exchange theory.

Although social exchange theory has produced a great deal of research, it does have its disbelievers and has received some serious criticism. One critique point it has received is its testability. The theory is not testable and capable of being proven false because of the difficulty with the concepts of costs and rewards, which are not clearly defined. Another problem is concerning its conceptualizing of human beings. In social exchange theory, humans are seen as rational calculators coming up with numerical equations that represent their relational life. People object this understanding and ask whether people rationally calculate the costs and rewards when engaging in a behavior or pursuing a relationship. (West & Turner 2017)

There are many definitions of social capital provided by various scholars in various fields. Although there are differences in what they emphasize, most of them define social capital as resources composed of or derived from trust, and/or norms, and/or network. However, the most basic question about social capital concerns its legitimacy of the concept and whether capital is an appropriate terminology to use. Generally, capital stands for stock of produced or natural factors of production that can be expected to yield productive services for some time, which critics are finding difficult to perceive in social capital. The ethnographic approach has yielded several critiques of social capital. Their criticism on Putnam includes the points; that his definition of social capital fails to capture important dimensions of local community life, that subgroups within the same neighborhood may experience social capital differently depending on their race, age, and gender, and that social capital is determined by complex historical and economic factors. (Inaba 2013)

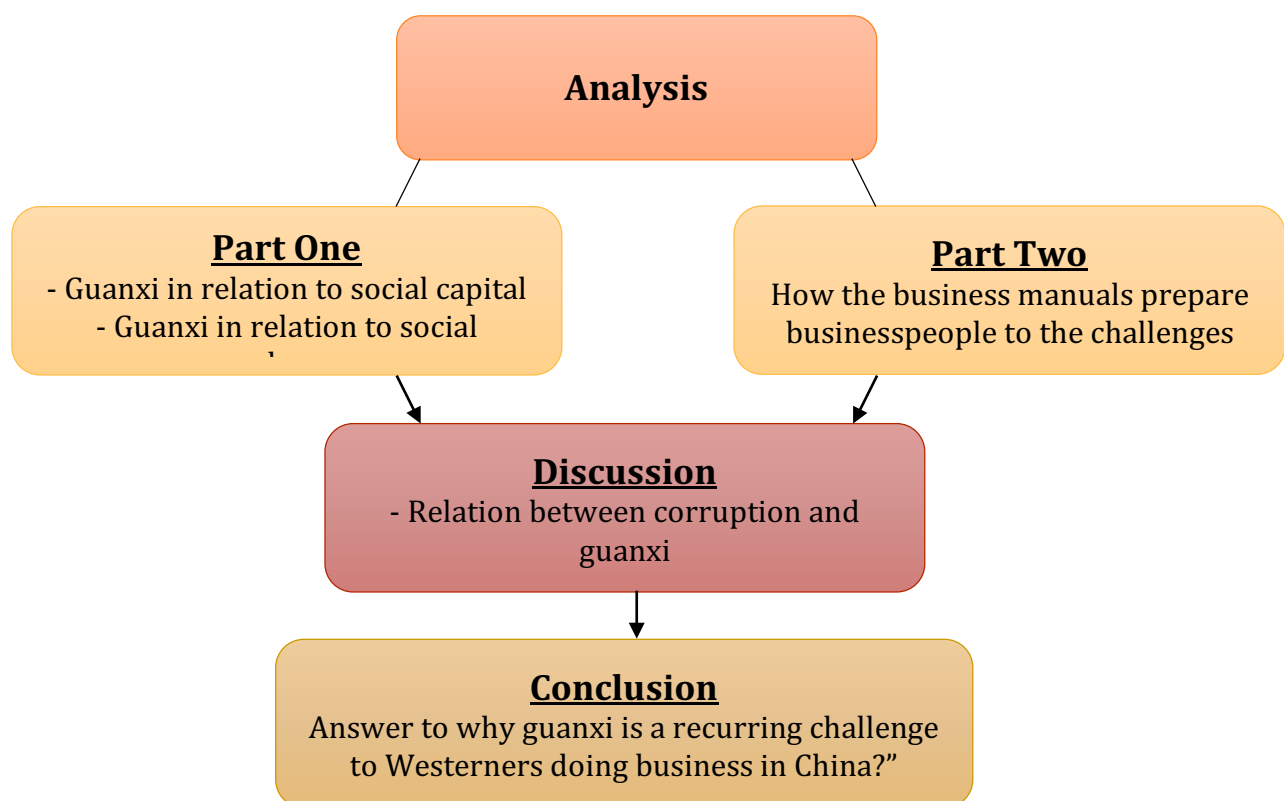
A limitation for both theories is their Western approach to social life. The theories are mainly written by researchers with Western beliefs and thoughts. This can make it difficult to apply the theories to a Chinese social phenomenon like guanxi. However, the purpose of using the two theories is to compare guanxi to Western theories on interpersonal relationships in order to point out the challenges of the concept. This will be further elaborated in the following section.

## 2.2 Analysis Plan

The idea of social capital and social exchange in the Chinese context captures the local social phenomenon called guanxi. The concept of guanxi and the origin of social capital and social exchange theory do have several similarities and overlaps. Moreover, some researchers have gone to the extreme to mention that guanxi is a form of social capital or social exchange and that guanxi is the Chinese version hereof. (Cheng & Tang 2012)

The analysis will be two-folded. The first part will analyze and compare guanxi to the two theories, social exchange theory and social capital, to provide a thorough understanding of the concept of guanxi by comparing it to Western theories on interpersonal relationships and whether guanxi is unique in comparison to relationships in the Western world. The second part will analyze how three business manuals, which will be presented later in this thesis, prepare Western businesspeople to the challenges of guanxi. This will lead to the discussion on why guanxi is often related to claims of corruption. Lastly, the discussion and analysis will lead to the final result and a conclusion on the research question on why guanxi is a recurring challenge to Westerners doing business in China. This gives the following structure of the analysis, discussion, and conclusion:

*Figure 2 – Structure of analysis, discussion, and conclusion*



*Source: Own design*



### 2.3 Method

The data of this project is solely based on the qualitative research strategy. Contrary to the quantitative research strategy, which focuses on numbers and statistics, qualitative research strategy focuses on written data including articles and reports. (Bryman 2012, 36-37) The data of this thesis includes scientific articles, reports, and newspaper articles, but also knowledge obtained from Chinese culture classes, personal experiences in relation to my internship with Bach Composite Industry A/S, and the answers I got from the interview with Siren Niebuhr, owner of Business Connect A/S and associate partner in Mictory Management Ltd. All this data will be used to shed a light on why guanxi is a recurring problem to Westerners doing business in China. Below, I will provide the reflections I have had on the selection of the written data I have acquired.

After identifying the topic of the thesis, 'guanxi and its challenges', I have used a various amount of words and sentences as key words when looking for relevant literature in the following three search engines:

1. **The Aalborg University Online Library** (AUB) was used to find books and articles on guanxi, literature on the chosen theories, and the three business manuals.
2. **Google Scholar** provides relevant literature across the world of scholarly research. I have used both Danish and English key words to search for relevant literature.
3. **The Aalborg University Digital Project Library** was primarily used to get inspiration in the beginning phases of the thesis period, but also to look for further sources other projects have used.

All the search results from these databases show that the relevant literature has one of the following features; (1) Focus on one specific case. An example could be "*Utilization of Guanxi (ties) in Immigrant Groups - A Case Study of Pingjiang Village in Shenzhen*" published by CNKI in 2001, which focused on guanxi in a specific group in a small village in Shenzhen. (2) Studied a specific area or sector. In '*How Business Guanxi Affects a Firm's Performance: A Study on Chinese Small and Medium Sized Construction Companies*', Qian Cheng and Wayne Tang discuss what areas business guanxi affect and how it is affected. (3) Researched on a local level rather than a national level. An example hereof could, again, be the article released by CNKI, but also the book written by Andrew B. Kipnis: "Producing Guanxi – Sentiment, Self, and Subculture in a North China Village", published in 1997 and focuses on how guanxi works in an everyday life in a small North China village.

As earlier mentioned, previously written material on guanxi does not provide a general overview on why it is a recurring challenge to Westerners doing business in China. However, the different articles and reports did inspire and help me to narrow down the data selection. Based on my academic background in international relations, I planned to do this thesis on an international rather than local level. As a result, I have chosen to focus on the challenges

Westerners experience in relations to guanxi when doing business in China, in order to make the topic internationally related.

### *The Data*

Guanxi in a business context can be very sensitive subject to Western organizations and businesspeople because of the corruption issue. The line between nursing your relationships and figure in corruption is very difficult to define, which is why a lot of Westerners do not wish to speak of this topic. Contrary, Chinese businesspeople might not be aware of their practice because it appears natural to them. Because of these two issues, I have not been able to collect any primary data besides the interview with Søren Niebuhr, despite several attempts with various organizations and businesspeople, both Danish and Chinese.

This thesis uses three different business manuals in order to detect the challenges of guanxi. The issues they point out could be considered as some of the difficulties of guanxi. All this is done with a view to the analysis and discussion on how Western businesspeople can be prepared for these challenges and difficulties. The first business manual is written by Tim Ambler, Morgen Witzel, and Chao Xi and called "*Doing Business in China*". I am using the third edition of the book, which was published in 2009 by RoutledgeCurzon. The book focuses on a lot of different topics that have relation to doing business in China, including the cultural differences. This includes an entire chapter describing the importance of relationships in both the personal life as well as in the business world. The second business manual, "*Doing Business with China*", is written by Jonathan Reuvid and Li Yong. The fifth edition, which is the one I am using, was published in 2005 by GMB Publishing Limited. Where the first business manual was more culturally focused, this book has its focus on the commercial part of doing business in China as it includes topics as economy, trade, entering the Chinese market, and of course the relevance of guanxi. The third and last business manual that is used in this thesis is "*Doing Business Successfully in China*" and is written by Mona Chung. This first edition was published by Chandos Publishing in 2011. This book focuses a lot on the cultural differences there exist when doing business in China. The reason for choosing these specific manuals for my thesis is because of their different approaches to the concept of guanxi. The mix of the three book forms the basis of an analysis on how they prepare Western businesspeople to guanxi. A further, and more thorough, elaboration of the three business manuals will be made later in this thesis.

As part of my data collection I have interviewed Søren Niebuhr who is a professional advisor in Business Connect A/S, which is a part of Mictory Management A/S, with extensive experience from both the corporate and the SME world as co-owner of Niebuhr Gears A/S, and previous employment in global, class leading companies such as KPMG and Nokia. He has specific experience from doing business with China for 17 years, of which he lived four in Beijing setting up and running a manufacturing company supplying the wind power industry. (Niebuhr 2017) Niebuhr's answers are coming from a Western businessperson who has experienced the complications and challenges of guanxi. As mentioned before, he has huge knowledge and

experience in working for Western organizations in China and can hereby tell what challenges other Western organizations might face in relation to *guanxi* when doing business in China.

Interview research like this, happens through human relations where the knowledge obtained is decided by the interaction between the interviewer and the interviewee. In addition, the planning of the interaction also matters. An interview can either be relatively structured with few prepared questions or it can be strictly structured with many leading questions by the interviewer. (Brinkmann & Tanggaard 2010) For my interview with Søren Niebuhr, I have used a semi-structured interview as I prepared an interview guide, which is a directive document consisting of questions and themes I wanted to illuminate during the interview. This was made to create the framework of the interview. In order to get a more fluent interview, I chose to push the pre-fabricated questions aside and reorganized the structure in accordance to the responses he gave. However, the risk of doing the interview this way would be if I, as the interviewer, lost track as this type of interview requires a creative and, to some extent, skilled interviewer.

### *Limitations*

Because of historical and political reasons, certain parts of China, including Hong Kong, Macau, and Taiwan, as well as other overseas Chinese communities, have had a different historical trajectory. Therefore, social relationships and social behavior in terms of social exchange and social capital, might be different from the ones in Mainland China. As this thesis focuses on Mainland China, it might not be applicable. Hence the generalization of this thesis, it might not be applicable when analyzing the particularity of these specific areas of China. However, even in Mainland China there are cultural differences. Western China is mostly rural and not as developed as Eastern China, where the bigger cities may be closer to Western business standards.

Furthermore, it is a limitation that the thesis does not use a specific country in the comparative analysis. Due to historical background as well as the formation of the countries, not all Western countries are alike. However, it can be argued, that in relation to doing business, most organizations and business in the West do it in similar ways, at least to some extent. The fact that this thesis focuses on the West in general and not a specific country, might fall short to cover all different circumstances or any culturally particular situation. Therefore, some inconsistencies of certain social behavior and rule, social relationship pattern, or cultural values may occur in this study.

Another limitation of the project is regarding the number of business manuals chosen as data for the analysis. The three selected business manuals can be considered as representative to all business manuals because of their different approaches to the concept of *guanxi*. However, it still must be considered as a limitation as other business manuals might have other approaches.

The last limitation of the thesis is regarding the complexity of the study field. Social and cultural study is very complex so it is very difficult to cover all situations and cases within this field, even though I have tried to select the most representative cases in my sampling process. In other words, the external validity of this study may seem a bit weaker than its internal one. To prevent this limitation, I have tried to narrow down the scale, but further relevant studies will be needed in order to expand the generalization.

### 3. Concept of Guanxi

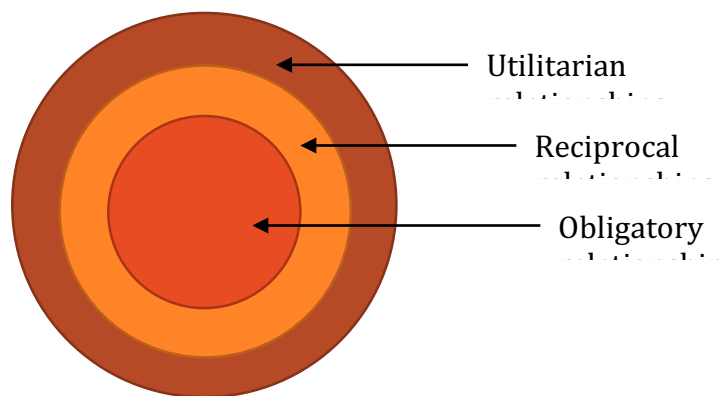
*This chapter will give a more thorough understanding of the concept of guanxi. Firstly, I will provide a short presentation of the classification and mechanisms of guanxi, including ganqing, renqing, and xinren. Secondly, the difficulties of guanxi to businesspeople and Western organizations will be described. Lastly, three Western business manuals will be examined with a view to the analysis on how they prepare Westerners to some of the challenges of guanxi.*

#### 3.1 Classification and Mechanisms of Guanxi

For Western businesspeople coming to work and do business in China, an understanding of guanxi is critical. It can be very difficult to understand for someone coming from a highly individualistic society, which includes most Western countries. Academic research states that many Western businesspeople are bad at building and maintaining relationships, which means that in China, these people can find it very difficult to do business. Researchers have tried to help these matters by classifying guanxi into various types. Classifying guanxi is like classifying the type of air you breathe, but it does make it seem more tangible. (Ambler, Witzel & Xi 2009)

Not all guanxi relationships are equal and two people having a guanxi relationship does not necessarily imply an absolute bond between them. They may both have stronger guanxi relationships with others. The Chinese scholars Zhang Yi and Zhang Zhigang describe guanxi as existing in concentric circles around each person. The inner ring, which they describe as *obligatory relationships*, or relationships by blood, consists of members of one's family and kin-group. Kinship means obligation, which is why the guanxi relationship to this group is considered as the strongest form of guanxi as you, in theory, must perform any favor asked of you. The middle circle, which they term *reciprocal relationships*, also called relationships by nature, includes lasting and long-term relationships with old friends, classmates, close colleagues, and peers. In these kind of guanxi relationships, members exchange favors as a matter of course, but there is always a sense of balance; you must not ask too much of someone, or at least, not unless you are prepared to return the favor at an equal or greater amount. The outer ring, which Zhang and Zhang term *utilitarian relationships*, or relationships acquired, are with people one knows through association but perhaps not well. At the same time, they are not exactly strangers, but if one party asks the other for a favor it might or might not be granted, as there is no necessity for the second party to do so. Nor will the second party want the favor returned, though the first party should be prepared for the request in any case. (Ambler, Witzel & Xi 2009) (Zhang & Zhang 2006) In figure 3 below, I have illustrated the three rings in order to show Zhang and Zang's classification of guanxi.

*Figure 3 – Guanxi Classifications*



*Source: Own design*

Another thing there is to determine the strength of a guanxi relationship is its mechanisms. In order to reflect on that, some researchers indicate ganqing, renqing, and xinren as basic factors that influence the quality of the guanxi. However, as these terms are abstracted from people's social life, it is difficult to measure guanxi in terms of a real quantity but an understanding of these three is necessary to understand and being able to evaluate the guanxi relationship. (Wang 2007)

### ***Ganqing (affection)***

Written as 感情 in Chinese, the first character signifies feeling as a verb and the second character refers to affection, emotion, and sentiment. Ganqing reflects the human feelings and refers to the emotional side and feeling (affect) of a social exchange between two people. It reflects the mood of the social relationship as well as the level of emotional attachment that is among the two parties of the network. (Cremer & Nguyen 2016) Chen and Chen (2004) defines it as:

*"Ganqing refers to the degree of emotional understanding, connections and the sharing of feelings of happiness and fears alike. Additionally, it refers to a sense of loyalty and solidarity, the willingness to take care of each other under all circumstances." (Chen & Chen 2004, 314)*

In Chinese context, the phrase ganqing is usually used to describe the quality of the relationship between the two parties of the network. It describes the degree of emotional understanding, connections, and the sharing of feelings, including happiness or fears. Communication and the sharing of experience during social interactions develops ganqing and thereby the emotional bonds. Thus, when people have the opportunity to understand each other better, ganqing is developed and perpetuated. Ganqing is strongly associated with the quality of the guanxi between the two parties and it is often an indicator of guanxi. Hence, a deep or good ganqing can somehow reflect a good quality of guanxi. (Cremer & Nguyen 2016) (Cheng & Tang 2012)

### **Renqing (favor)**

Written as 人情 in Chinese, the first character refers to human being and the second character means feeling, affection, and sentiment, which the same as the second character in ganqing. Renqing refers to the informal obligation to exchange favors with the other party such as gift or favor. (Kipnis 1997) Translated to English, it has similar meaning as owing a favor, and according to Wong and Leung renqing is defined as:

*“The special treatment of an individual, the allocation of resources to another party as a ‘gift’ in the process of a market transaction, to tighten up the bonds between parties” (Wong & Leung 2001)*

Renqing emphasizes the obligation to nurture the social exchange relationship in order to develop a guanxi network and use this network for one's advantages. It can both be given or received and the person who gives renqing is expecting the receiver to pay back in the future once circumstances permit. This means that renqing is usually reciprocal for both parties, in order to secure a healthy guanxi, and obligation of reciprocation is highly valued by the Chinese people. In case a person is not willing to pay back renqing, he/she will lose mianzi (face), which will also inflict his/her guanxi with other people in the network. This can, eventually, result in a more difficult life for him/her as less people are willing to help or cooperate. Renqing is reciprocity and empathy and it is practiced through the exchange of favors. The greater this exchange is, the closer the two parties are, which is why renqing partly could reflect the quality of the guanxi. (Chen & Chen 2004) (Cheng & Tang 2012) (Fan 2002) (Cremer & Nguyen 2016) (Ambler, Witzel & Xi 2009)

### **Xinren (trust)**

Written as 信任 in Chinese, the first character acts as a verb meaning to trust and believe in, and the second character represents the heavy responsibilities that a person can carry. It refers to the trust between individuals and implicates the degree of commitment and confidence that one party is willing to put into the other party within the guanxi network. Chen and Chen describes xinren, or trust, as:

*“To the extent that guanxi building represents efforts by individuals to deal with an environment lacking general trust, interpersonal trust is essential in building a quality guanxi. In other words, trust under- lies the differentiated order of one's guanxi net: the higher the level of trust between two individuals, the better the guanxi quality will be.” (Chen & Chen 2004, 313)*

Throughout a long-term interaction between the two networking parties, they gradually create what is called xinyong (信用), which can be translated to credibility. The higher xinyong one has, the higher degree of commitment the counterparty will have. According to some scholars nobody is willing to do business with you, if he/she does not trust you, which is why xinren in the process of social interaction between the two parties is very important. The higher degree



of Xinren, the stronger are the ties between the two parties, thus the better guanxi they may have. (Chen & Chen 2004) (Cheng & Tang 2012) (Fan 2002) (Cremer & Nguyen 2016) (Ambler, Witzel & Xi 2009)

### *3.2 Business guanxi*

A lot of literature on business guanxi divides it into two categories in terms of the different parties involved. The first one, business to government (hereafter referred to as B2G), involves a business person as the first party and a government official as the other. The second category, business to business (hereafter referred to as B2B), implies that both parties are business persons. (Fan 2002) (Cheng & Tang 2012) (Ambler, Witzel & Xi 2009)

The Chinese government sees the free market as a means to its own ends, not as an ideological principle. They will change the rules whenever they feel a need to do so. With this in mind, the Chinese government acts in a Confucian way; laissez-faire capitalism is used to generate wealth, but it is the responsibility of the state to ensure that the resulting wealth is used for the most appropriate. Local government in China has considerable powers, it can for example deny approval for a proposed projects or withdraw licenses from existing ones. It follows that if you have a good relationship with the relevant branches of government, you are more likely to get what you need, no matter whether it is permission to build, develop, sell goods, set up a factory, etcetera. Good relations to the authorities can make the wheels of bureaucracy turn faster, maybe even allowing you to 'jump the queue' and get your proposal approved more quickly. (Ambler, Witzel & Xi 2009)

According to Fan, B2G appears to be the predominant form of business guanxi in China, which is why the majority of the guanxi literature seems to focus on this category. However, it is identified that B2B guanxi is also an important factor when it comes to doing business in China. It can be an important source of business information and can also help SMEs to get financial support through temporary partnership. In the Chinese business community, one can often hear people say, 'This is our old client, we should give them special terms' and 'We are old guanxi, therefore we can get better deals'. As a supplier, this means that you can stay on the value chain of a manufacturer as long as you do not break the codes of guanxi, even with competition from other suppliers. As a buyer, old clients can get better terms of payment or take delivery of goods on credit, which would not be possible without a well-established guanxi. (Reuvid & Yong 2005)

Furthermore, by having a well-established guanxi relationship with your Chinese partner, you can potentially avoid problems in case of unexpected circumstances in the process. Foreigners tend to be contented with the signed contract for sincere commitment, while the Chinese look beyond the contract and more towards a good personal relationship. This, however, does not mean that the Chinese will not abide by the signed contract without a good personal relationship, because when a deal is closed, you can expect the Chinese to perform their part of it. In general, you can say that a well-established business guanxi is built on the basis of mutual



trust, giving face to one another, a good track record of exchanges of favors, obligation or gratitude from past help, etcetera. It cannot be overused and all favors will have to be reciprocated in one way or another. (Reuvid & Yong 2005) Ambler, Witzel, and Xi argues that guanxi is the property of individuals, not organizations. Businesses do not have guanxi, it is the people within that do. The point is that unless the people within the business are prepared to use their guanxi on behalf of the business, nothing will happen. (Ambler, Witzel & Xi 2009)

### 3.3 The three business manuals

As mentioned in the methodological considerations, three selected business manuals will be used to analyze how Western businesspeople can be prepared to the challenges of guanxi. Below, I have worked out a table that shows the three manuals' approach to three important topics within guanxi.

**Table 1 – Overview of Business Manuals**

<i>Topic</i>	<i>Name of the book</i>	<b>Doing Business with China (Reuvid &amp; Yong 2005)</b>	<b>Doing Business in China (Ambler, Witzel, &amp; Xi 2009)</b>	<b>Doing Business Successfully in China (Chung 2011)</b>
<i>Cultural sources</i>		- Has its roots in Confucianism and is closely connected to different cultural phenomena including face, hierarchy, and power distance.	- Is closely connected to the thoughts of Confucianism - family and social life defines the individual.	- Guanxi is a relationship built on a practiced form of respect and obligation that adheres to Confucian hierarchical values.
<i>Institutional sources</i>		- Foreigners tend to be contended with the signed contract, while the Chinese look beyond the contract for sincere commitment.	- Guanxi with government remains of primary importance for any businessperson. - Business practices in China are backed up by guanxi contrary to contract law in the West.	- For the Chinese, the relationship governs the terms of the contract and its implementation.
<i>Corruption</i>		- Guanxi has nothing to do with corruption, only when the exchange or transaction involves corrupt activities such as bribery.	- Legal processes carried to excess are as corrupt guanxi carried to excess, but the corruption lies in the excess, not in the product itself.	- This book does not deal with corruption in relation to guanxi.

Generally speaking, the three business manuals agree where the guanxi is rooted. The Confucian values are deeply embedded in the Chinese people, also when it comes to business and interpersonal relationships. Ideas including face, reciprocity, and obligation are, according to the three manuals, core concepts when speaking of guanxi in the business world. Despite agreeing on the cultural sources of guanxi, the depth of the elaboration differs from book to book. Both 'Doing Business in China' and 'Doing Business with China' elaborate on many different cultural sources, while 'Doing business Successfully with China' primarily focuses on face and the roots of guanxi. When it comes to the institutional sources of guanxi, all three business manuals seems to approve that guanxi is a substitute for what we know as contract law in the West. They all say that contract law still exists but often Chinese people look beyond the contract and value the relationship they have to the counterpart. Lastly, only two of the business manuals deal with the relation between guanxi and corruption. While 'Doing Business in China' and 'Doing Business with China' seem to agree that guanxi can only be considered corrupt if the actions herein are corrupt, 'Doing Business Successfully in China' does not mention anything about corruption in its guanxi chapter.

In general, the three books agree on most of the mechanisms and concepts of guanxi in relation to both cultural and institutional sources. However, there is an obvious difference in how exhaustive the three books are. Especially 'Doing Business in China' and 'Doing Business with China' are very thorough in their exposition of guanxi, while 'Doing Business Successfully in China' is more superficial and concise.

When it comes to guanxi, Western businesspeople have to remind themselves that these relationships are reciprocal, as favors received are credits against future favors expected. It is important that when doing business in China, you should keep all relationships harmonious and long-term by having the three concepts renqing, ganqing, and xinren in mind. You never know when a guanxi relationship will come in handy, even the seemingly useless relationships. To the Chinese, cultivating and using relationships is second nature, a natural part of the society and doing business. To deal with this, Westerners need a plan and track such networks consciously and with great care, and build these networks carefully and patiently. Western companies should always have a long-term commitment in the Chinese market in order to succeed. Understanding the way things are done in China can be difficult for foreigners but can be rewarding if dealt with properly.

## 4. Theoretical Framework

In the following chapter, the applied theories will be described. The chapter will give a presentation of social exchange theory, social capital by Pierre Bourdieu and Dr. David Halpern, and bridging and bonding by Robert D. Putnam. As mentioned in the methodological considerations, these theories have been chosen as they are found most suitable for analyzing the empirical data about guanxi.

### 4.1 Social Exchange Theory

Social Exchange Theory may be traced to 'one of the oldest theories of social behavior' - any interaction between individuals is an exchange of resources. The exchanged resources may not only be tangible, such as money or goods, but also intangible, including social amenities or friendship. The basic assumption of social exchange theory is that all parties enter and maintain relationships with the expectation that doing so will be rewarding. Discourse on social exchange has been traced as far back as Aristotle's *Nichomachean Ethics* in which social exchange is distinguished from economic change. (Lambe, Wittmann & Spekman 2001)

Social exchange theory deals with types of asymmetrical power relationships by examining the nature of trades in relation to the equity. If both parties have similar attitude toward equitable exchange, which is (1) the same beliefs about relative profit and (2) the same beliefs about equitable exchange, then inequitable social exchange will not continue in the long term because one party might feel annoyed and the other guilty. In terms of social relationships, exchange theory has been extended to power dependency. Here, organizations are thought to exchange resources for mutual gain, including money, influence, information, etc. The more powerful organizations are the less dependent they are on the exchange than their partners. If an organization has several sources of information on its clientele they would be less dependent on individual sources than an organization that only has one source of information. (Dowding 2011)

Theorists within the perspective of political science have two assumptions in common; firstly, the motivation to create relations with the players (organizations and individuals) is strongly dependent on interests and incentives/sanctions, and secondly, almost every social interaction features exchange of values. (Cook & Whitmeyer 1992) In this context, values should be understood broad and include *"the provision of information, affection or approval, advice, or more tangible things like goods and direct services"* (Cook, et al. 1983) The explanation on why relations between actors are created and remained is because of the norm of reciprocity where individuals or organizations will interact with the expectation of positive contributions will be returned by others and negative contributions will be returned negatively. (Gouldner 1960)

## 4.2 Social Capital

*Social capital* has become a buzzword among political and academic elites, despite remaining relatively unfamiliar to the public. Even among the people who regularly use it, there is often confusion about the term really is and how to measure it. A look at how the term is used tells us that it has something to do with 'community', 'civil society', and the 'social fabric' – it is about how people are related with one another. The birth of the mainstream academic interest can be dated back to the 1980s, where especially Pierre Bourdieu, French sociologist, anthropologist, and philosopher, played an important role in mapping the concept. He argued that the economic orthodoxy was artificially limiting itself to the study of a narrow band of practices that were socially recognized as 'economic'. By doing so, they were missing the fact that 'capital presents itself under four fundamental species, each with its own subtypes; (1) *Economic capital* is immediately and directly convertible into money and may be institutionalized in the form of property rights, and is the only capital characterized as physical and material. (2) *Cultural capital* is convertible, on certain conditions, into economic capital and may be institutionalized in the form of educational qualifications. (3) *Social capital* is made up of social obligations, 'connections', which is convertible, in certain conditions, into economic capital and may be institutionalized in the form of a title of nobility. (Bourdieu & Wacquant, 1992; Bourdieu, 1986) In his book of 1986, *The Forms of Capital*, Bourdieu describes social capital as:

*"Social capital is the aggregate of the actual or potential resources which are linked to possession of durable network of more or less institutionalized relationships of mutual acquaintance and recognition – or in other words to membership in a group – which provides each of its members with the backing of the collectivity-owned capital, a 'credential' which entitles them to credit, in various senses of the word."* (Bourdieu, 1986, 51)

(4) *Symbolic capital* is made up of prestige, reputation, and honor. The extensive amount the first three capitals may have a positive outcome in a form of symbolic capital. For example, a person that has a large amount of economic capital might be considered a very important person whose opinion is highly valued in society. (Rosenmeier 2007) According to Bourdieu, symbolic capital is both the instrument and the stakes of collective strategies seeking to conserve or increase it. Furthermore, it can be seen as individual strategies seeking to acquire or conserve it by joining groups which possesses it. (Bourdieu, 1986)

Social capital includes all our everyday networks. Everything from our colleagues at work and people we socialize with in our leisure time to our family and friends in the local neighborhood. An example of 'social capital' could be the one James Coleman gives in his seminal paper of the New York wholesale diamond market (Coleman 1988). Here, he describes how merchants frequently hand over bags of diamonds, often worth thousands of dollars, to other merchants to examine at their leisure. All this is done without insurance or formal agreement, only because the information inside this network of traders flows freely and exchanges can be made without the need for elaborate and expensive contracts or insurance. The reason this market can work

this way is because of the closeness, high degree of trust, and trustworthiness among the community members. Yet this type of network cannot be described as financial, psychical, or even human capital, even though it pays handsome returns to those with access to it. Instead, this network can best be described as a form of 'social' capital. (Halpern, 2005, 2-3)

Despite various discussions and disagreements on what should be counted as social capital and what should be excluded, the essence of the concept is simple enough. People are connected with one another through intermediate social structures – webs of association and shared understandings of how to behave. This social fabric greatly affects with whom, and how, we interact and co-operate. It is this everyday fabric of connection and tacit co-operation that the concept of social capital is intended to capture. (Halpern, 2005, 1-10)

According to Dr. Halpern, social capital is composed of three components; a *network*, a cluster of *norms, values, and expectations*, and *sanctions* – punishments and rewards that help to maintain the norms and network. The first component, the social network, can for example be seen among neighbors. These relationships may vary from simple recognition by sight to deep friendship involving frequent visits. The social network can further be characterized by its density (the proportion of people who know each other) and closure (the preponderance of intra- versus inter-community links). The second component, the social norms, are the rules, values, and expectancies that characterize the community or network members. Being a part of a network, you will have to follow certain rules, which in most cases are unwritten. If taking a neighborhood as example, these norms could include helping other neighbors, avoid making noise at night, and sweeping leaves and snow. Some norms may be unique from network to network, while other may be found in most networks. The third and last component in social capital, sanctions, are both formal and informal rewards and punishments for breaking or following the social norms in a community. The sanctions may be through someone being told directly, an angry exchange of words, or even the threat of action. More commonly, however, the sanction is indirect and subtle, for example through gossip in a neighborhood. Sanctions can also be positive, such as praise for a helpful act. The three components can be used to analyze any kind of community or network. (Halpern 2005, 10-11) To show this, Dr. Halpern has produced the following table:

*Table 2 – The Three Components of Social Capital*

<b>Component</b>	<b>Network - Network members</b>	<b>Norms - Rules and understandings</b>	<b>Sanctions - Rewards (+) and punishments (÷) for complying with / breaking network norms</b>
<b>Example</b>			
<i>Traditional communities</i>	Neighbors (lending, caring, and protection – and sometimes rivalry and dislike)	Reciprocity, due care of property, challenging strangers	+ Recognition and honouring  ÷ Gossip, social exclusion
<i>New York diamond wholesale market</i>	Other dealers (providing access to diamonds and deals)	Trustworthy exchange, without payment, of uncut diamonds for examination	+ Approval  ÷ Disapproval and exclusion

*Source: (Halpern 2005)*

Robert Putnam, American political scientist and professor at Harvard University, stands out as the most widely recognized proponent of the social capital today. (Field 2008, 32) In his book “Bowling Alone” (2000), he argues that social capital refers to “*connections among individuals – social network and the norms of reciprocity and trustworthiness that arise from them*” (Putnam 2000). He distinguishes social capital; *bonding* and *bridging*. Bonding refers to closed social networks between homogenous groups. This type of social capital can be valuable for oppressed and marginalized members of the society to gather in groups and networks to support their collective needs. It provides some sort of social nets to individuals because of the shared social norms and cooperative spirit. However, it can have negative consequences as in the case of criminal gangs and factions based on ethnic or political lines. Francis Fukuyama, American political scientist, economist, and author, warns that in-group bonding can strengthen vertical patronage system where social capital can be used to cultivate nepotism in the interests of family or a group, thus depriving members outside the group from equal opportunity in accessing these goods and services. This is exactly where his Putnam’s concept of bridging comes in handy. Robert Putnam refers to bridging in social capital as social networks between socially heterogeneous groups and it allows the different groups to share and exchange information, ideas, and innovations. Furthermore, it builds consensus among the groups representing diverse interests. (Panth 2010) Outwardly, it builds on weaker social bonds and includes individuals with different backgrounds from various social strata. (Socialkapital.dk 2017)

The two types of social capital refer to specific types of social relations. One of many ways to divide connections between people is by distinguishing between strong and weak social band. The strong bands are the ones that bond the individuals in a close relationship, which includes spouses, siblings, or close friends. Weak social bands, on the other hand, characterize more peripheral friendships and relations, for example colleagues, fellow students, etcetera. The theory about bonding and bridging has often enhanced the importance of bonding social capital. However, it is important not to disparage the bridging capital's potential. The bonding capital is necessary to create a cohesiveness and solidarity internally in a group, while the bridging capital is decisive for the group and its members to develop and innovate themselves. Each of the two forms of social capital therefore serve their own function and the optimal conditions are both/and rather than either/or. (Socialkapital.dk 2017)



## 5. Why is Guanxi a Recurring Challenge?

In this chapter I will conduct an analysis in relation to my research question, which focuses on the challenges of guanxi when Westerners are doing business in China. Initially, I will be analyzing how guanxi differs from Western theories on interpersonal relationships, including social capital and social exchange, in order to tell whether guanxi is unique in terms of interpersonal relationships. Following this, the presentation of guanxi by three selected business manuals will be analyzed with the purpose of finding the challenges proposed by these manuals. Lastly, I will discuss why corruption is often mentioned with guanxi.

### 5.1 Is Guanxi Unique in Terms of Interpersonal Relationships?

In the following section, the concept of guanxi will be analyzed in relation to Western theories on interpersonal relationships, social exchange, and social capital. This analytical framework will give an understanding of the differences between the use of interpersonal relationships in the West and in China and investigate whether guanxi is unique compared to interpersonal relationships in the West.

As mentioned in the theoretical framework on social exchange, any interaction between individuals can be considered as an exchange of resources. Resources that can be both tangible - money and goods, or intangible - social amenities and friendship. The assumption of social exchange theory is that all parties enter and maintain the relationship with the expectation that it will be rewarding. In order for a relationship to remain strong and continue for a long term, both parties must share the same beliefs about relative profit and equitable exchange.

*"When internalized in both parties, the norm of reciprocity obliges the one who has first received a benefit to repay it at a later time. Consequently, there may be less hesitancy in being the first and a greater facility with which the exchange and the social relationship can get underway. For most Chinese, a transaction or exchange will only take place when there is mutual benefit for both parties involved." (Reuvid & Yong 2005, 172)*

The quote by Reuvid and Yong shows how important reciprocity is in relation to guanxi. Just as in the Western social exchange theory where both parties enter the relationship with certain expectations. This is the exact same situation when it comes to guanxi. When an exchange of resources, in this case favors, is taking place, both parties in the guanxi relationship expect mutual benefit, maybe not immediately, but at least when the favor will be repaid in the future. The difficulty here is the relative profit of the favors received and deposited. In case that the favor is either not returned or of less emotional value, the renqing of the relationship will be damaged, which can cause the loss of face of at least one party. This mistrust will also affect the xinren and lower the parties' desire to commit further to this specific interpersonal relationship, which, in the end, will lead to a decline in the quality of the guanxi, the ganqing. With all this in mind, it is important to underline that you should not go head over heels returning a favor, but



instead respond and repay proportionally. Let us say someone is taking you out for dinner one evening on their dime, you can, eventually invite them out for dinner or a show. There is a risk that one party will receive a more 'valuable' favor than he is repaying. This can cause the loss of face as one party might feel annoyed and the other guilty. In this case, the two parties do not share the same beliefs about relative profit and equitable exchange and it will be difficult to retain a long-term guanxi relationship. All in all, the obligation to return the favor really depends on the quality of the guanxi. Another major element is how the interpersonal relationship is classified. If it is a relationship belonging to the obligatory relationships, family or kin, the favor *must* be returned at some point, a reciprocal where the favor *should* be returned in order to maintain the guanxi relationship, or a utilitarian relationship where it is not required to return the favor, depending on the value of the first favor and the interest in continuing the relationship. If you are having a good and strong guanxi relationship with another person, he will be more willing to take risks. Ambler, Witzel, and Xi describes it:

*"Guanxi is a mechanism for dealing with risk. The Chinese may be gamblers but, without guanxi, they prefer to miss the opportunity for gaining £1 million. On the other hand, they may prefer to risk losing £100 in order to build guanxi for the future. We should not risk what we cannot afford. This is why the Chinese build trust progressively by introducing more and more risk and seeing how it works out. They are looking backwards, not forwards." (Ambler, Witzel & Xi 2009, 99)*

This should be seen in a competitive environment in which it acts on two levels: a strong relationship gains entry to the consideration set and then the relative guanxi affects the probability of doing business, which means that the bigger the risk is, the stronger the guanxi will need to be. An example could be tendering for large contracts, which is rarely the free-market auction Westerners expect. Here, the supplier will often be determined by who has the strongest guanxi with the decision makers and it is only the terms of the business that are to be determined by the tenders.

During my interview with Søren Niebuhr (summary in appendix 8.1), he mentioned that when he first started working in China and were told that it was impossible to get anywhere without guanxi. By being aware of this fact, he was committed to getting relationships established from the beginning, especially with the local government. To the opening of the new factory, he invited the local politicians along with several prominent Danish politicians. It can be argued that this was an exchange of resources as the local government earlier had allowed him to build the factory and him repaying them by inviting them to the opening. By doing this, the local politicians receive symbolic capital in form of reputation and honor, which is one of the capitals Pierre Bourdieu mentions in his book 'Forms of Capital'. This use of reciprocity in the form of symbolic capital may have secured Niebuhr and his organization a stronger guanxi relationship to the local government, which could, in the end, have a mutual benefit. Niebuhr will have the possibility to 'win' tenders on large contracts because of his strong relationship to the decision

makers that in return will receive either social capital in the form of nobility title or symbolic capital in the form of honor and reputation. Bourdieu argues that social capital is *“made up of social obligations, connections, which is convertible, in certain conditions, into economic capital”*, which he defines as *“convertible into money and may be institutionalized in the form of property rights, and it is the only capital characterized as physical and material”*. With all this in mind, including the abovementioned circumstance with symbolic capital, it can be argued that these different capitals are the resources exchanged in the social exchange theory.

According to Dr. David Halpern, social capital is composed of three components; network, norms, and sanctions. These three components are applicable to the concept of guanxi, both with personal guanxi and business guanxi. The network members of a personal guanxi, are the people belonging to all three guanxi classifications, obligatory, reciprocal, and utilitarian. The norms of this network are that any favor received must be repaid in one way or another. However, as earlier mentioned, you are more obliged to return the favor in an obligatory and reciprocal relationship than you are in a utilitarian relationship. The rewards for following these norms will be a strengthening of the already existing guanxi, which will mean they will run a bigger risk for you in the future. On the other hand, the punishments for not following the social norms will be the loss of face and hereby your credibility.

When it comes to business guanxi, both B2B and B2G, these three components are present. In a B2B guanxi, the members of the network are the two parties representing the organizations. Again, the norms of this network are that every favor received must be returned in any way. By complying with this, both parties will have access to information and resources, and it might give them a better possibility for better terms in the future. However, if the norms are not followed, the punishments could be loss of credibility, which in the future could make business interactions harder to accomplish. The network members of a B2G relationship are a businessperson as one party and a government official as the other party. Just like with the personal and B2B guanxi, the norms and expectations of this network would be that every favor will be returned. The rewards of following these norms within this network will be the possibility to get stuff done much faster, evade bureaucracy, and maybe get a heads-up about future large contract tendering. The punishments, however, can be fatal to an organization trying to do business in China. The local government official can easily put sanctions or refuse to give organizations certain permissions in order to displace the organization because of the failed guanxi relationship. Furthermore, they are often the ones that are the decision makers for large contracts, which will make it nearly impossible for an organization to win if the guanxi relationship has failed. The following table illustrates these findings:

*Table 3 – Guanxi according to the three components*

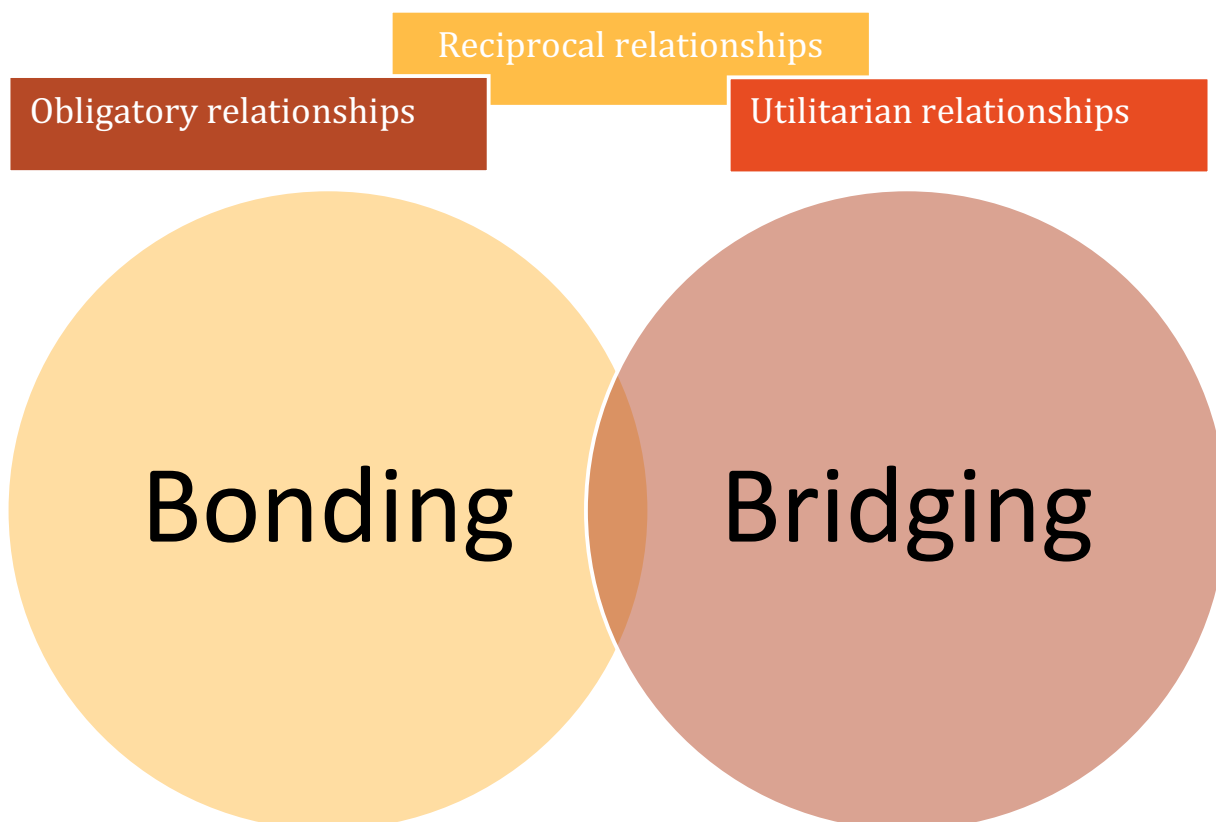
<b>Component</b>	<b>Network - Network members</b>	<b>Norms - Rules and understandings</b>	<b>Sanctions - Rewards (+) and punishments (÷) for complying with / breaking network norms</b>
<b>Example</b>			
<i>Everyday guanxi</i>	The people within your guanxi network – both obligatory-, reciprocal-, and utilitarian relationships	Any favor received must be repaid in one way or another	+ Stronger guanxi relationship with the counterpart  ÷ Loose face and credibility
<i>B2B guanxi</i>	Both parties are representing a business	Any favor received must be repaid in one way or another	+ Access to information and resources. Possibility for better terms  ÷ Loss of credibility
<i>B2G guanxi</i>	Business person as one party and a government official as the other party	Any favor received must be repaid in one way or another	+ Get stuff done faster, evade bureaucracy, and get a heads-up about future tenderings for large contracts  ÷ Difficulties with getting permissions and contracts

*Source: Own design*

According to Robert Putnam, social capital refers to “connections among individuals – social network and the norms of reciprocity and trustworthiness that arise from them”. As for the concept of guanxi, reciprocity is the alpha and omega in order to have a long-term relationship, which is why guanxi can, to some extent, be seen as a form of social capital. Furthermore, Putnam distinguishes social capital with bonding, closed social networks between homogenous groups, and bridging, social networks between heterogeneous groups. It can be argued that bonding and obligatory relationships could have similarities. This type of social capital is characterized by being valuable for oppressed and marginalized members of the society, which in the case of guanxi could refer to people living in rural areas with less opportunities, or people owning small or medium-sized enterprises (hereafter referred to as SMEs). These people can gather in social homogenous groups to support their collective needs because of their shared social norms and cooperative spirits. However, this can be dangerous as it can deprive members outside the group from the opportunity in accessing the goods and services of the group, which can prevent an SMEs from growing and rural areas from developing. Instead, they should consider using a mix of bonding and bridging, which allows the different groups to share and exchange information, ideas, and innovations.

Bonding, bridging, and the classifications of guanxi do have some parallels. Typically, the people you are bonding are the ones you have a close relationship to, which in the case of guanxi is the obligatory relationships. In terms of business guanxi, it could also be close friends you are now doing business with and therefore have a closed social network with these reciprocal relationships. The people you know but not well are the potential network members that you could reach by using bridging. In this case, you could use your utilitarian relationships to gain information, ideas, or innovations. To show how all this is related, I have designed figure 4, which shows where the different classifications could belong.

*Figure 4 – Bonding, Bridging and Guanxi Classifications*



Some researchers claim that the concept of guanxi is equal to both social capital and social exchange theory. Based on the previously written analysis, this can, at least to some extent, be confirmed as they do have similarities. In both Western and Chinese interpersonal relationships, both parties have some sort of reciprocity. However, in the case of guanxi, it seems like a more binding obligation as a guanxi relationship cannot continue unless both parties enter the reciprocity. This does, of course, depend on the classification of the relationship as obligatory relationships are more obliged to return a favor than reciprocal and utilitarian are. In this exchange, it can be argued that some of Bourdieu's forms of capital are the ones getting exchanged. These resources can be both tangible in form of money or goods, or intangible in form of social amenities or friendship. The more exchange and stronger guanxi relationship you have with the counterpart; the higher risks are he/she willing to take in a

competitive environment. Besides having some similarities with Bourdieu's forms of capital, guanxi is applicable to Halpern's three components of social capital, network, norms, and sanctions, which he argues every network is composed of. Both everyday guanxi and business guanxi have norms to follow and there will be rewards in case these are followed or punishments in case they are broken. It is obvious that Chinese guanxi relationships and 'typical Western relationships' do have things in common. Saying that, you need to have in mind that guanxi is much more than just reciprocity and resources exchanged. It can be concluded that if you want to succeed in building a strong guanxi relationship, you need patience and time as it is a difficult and demanding project.

## 5.2 How is the concept of guanxi presented by the three selected business manuals?

In this section, I will analyze how the three selected business manuals prepare for the challenges of guanxi. This analytical framework will make it possible to point out what challenges the business manuals see as the being difficult for Westerners to deal with.

It seems that all three business manuals agree on the cultural source of guanxi. All three books mention that it is closely related to other Confucian thoughts and phenomena like face, family, and obligations. Since all books are indicating this there must be something true about it. It can be argued that by implying that guanxi has its roots in Confucianism they tell the reader that guanxi is something every Chinese inherit through their culture. The conclusion given in 'Doing Business in China' by Ambler, Witzel, and Xi emphasizes this fact:

*"To the Chinese, cultivating and using relationships is second nature, a natural part of the environment and doing business. Westerners, however, need to plan and track such networks consciously and with great care. We need to build our networks carefully and patiently." (Ambler, Witzel & Xi 2009, 113)*

As the above written quote states, the Chinese are cultivating and using relationship as a natural thing, both in their private life and when doing business. Furthermore, they argue that if Westerners want to utilize relationships in China, they need to do it carefully by planning and tracking the networks, which implies that it is not a natural thing to them. This fact can indicate that it is very difficult for Westerners to succeed with the use of guanxi in China as it is something naturally learned through their childhood by society. The following quote from 'Doing Business with China' confirms this statement:

*"To succeed in the Chinese market, foreign firms are advised to use mentors (contact people) to start up a business relationship. Understanding the way things are done in China can be difficult for foreigners, but will be rewarding as well." (Reuvid & Yong 2005, 175-76)*

According to Reuvid and Yong, foreign firms should use mentors when starting up business relationships. In other words, they must find someone to who it is natural to make use of guanxi relationships, a Chinese contact person. This confirms all three business manuals' statement that parts of the guanxi is culturally rooted and is very difficult to learn for a Westerner.

Another thing the three business manuals seems to agree on is the institutional sources of guanxi. While Westerners tend to be backed up by a signed contract and contract law, they agree that Chinese businesspeople look beyond this and value the relationship to the counterpart for sincere commitment. Both 'Doing Business with China' and 'Doing Business in China' describes the importance of having guanxi relationships with both other businesses as well as the local government. Both business manuals point out the difficulties and challenges of starting and retaining these guanxi relationships, but at the same time emphasize the opportunities the potential relationship can have.

While the two other business manuals see both the challenges and opportunities of guanxi, 'Doing Business Successfully with China' is much more critical and negative about the use of guanxi in China. The book uses terms such as them and us and indicates that the game of guanxi is a game you cannot win unless you are Chinese, which the following quote from the book clearly emphasizes:

*"The importance of guanxi is linked to the concepts of insider and outsider. Chinese gravitate towards each other especially when there are outgroup members. They will trust their fellow Chinese first if they are faced with insiders and outsiders. Certain things may be said to other Chinese that will never be said to Western outsiders." (Chung 2011, 138-39)*

The fact that this manual pictures the game of guanxi as nearly impossible for a Westerner to succeed in might be an explanation on the very sporadic exposition of the concept in this book. To the reader, it literally seems like the author see the concept of guanxi as redundant to succeed in China.

When it comes to the question of corruption, 'Doing Business with China' and 'Doing Business in China' agree, guanxi is not directly linked to corruption. They both mention that guanxi can only be perceived as corruptive if the exchange or transaction involves corrupt activities such as bribery. Just as with the institutional sources, the two books point out the challenges and difficulties regarding corruption, but still tell the reader that it is possible to avoid the corruption claims. The linkage between guanxi and corruption will be further discussed in section 5.3.

There is a considerable difference in how the three business manuals handle the concept of guanxi and its challenges to Westerners. 'Doing Business with China' and 'Doing Business in China' do, however, agree on most topics and are, by far, the most thorough business manuals of the three. The fact that they are very thorough in describing both challenges, possible solutions, and the opportunities of successful guanxi make it seem possible to succeed with building guanxi relationships in China. On the other hand, 'Doing Business Successfully with China' is very thin in content as it barely describes the challenges and opportunities of guanxi. Instead, it quickly concludes that Chinese businesspeople favor other Chinese over Westerner,



which in my personal experience is not very true as many Chinese prefer to do business with people born outside of China.

### 5.3 Does Practice of Guanxi Lead to Corruption?

In the following section, it will be discussed whether guanxi and corruption goes hand in hand, or if it is possible to use guanxi without being accused of consenting with corrupt practices. This discussion will give an understanding it is so difficult for Western organizations and businesspeople to draw the line between corruption and nursing your guanxi relationship.

It is often said that conducting business ethically in China while making profit is impossible due to the business climate. It is allegedly so riddled with corruption that companies that are trying to follow the FCPA<sup>1</sup> and other restrictive regulations are unable to compete effectively. In order to get ahead of these challenges, organizations are advised to develop guanxi relationships with key national and local Chinese Communist Party and government officials in China. You can compare the trust it accrues through mutual guanxi to the good old-fashioned gentlemen trust and relationship trust that have molded Western society for centuries. Deals are done based on some sort of verbal contract, or “my word is my bond”. Today, Western businesspeople are more focused on getting a contract signed as his rights then are backed up by the contract law, while the Chinese tend to look beyond the contract for sincere commitment. Therefore, Western organizations must consider investing in their guanxi relationships as investing resources solely based on Western norm-based practices, such as contractual obligations, is not sufficient given the realities of Chinese society. Instead, using your guanxi network and its mechanisms are generally superior in order to determine outcomes.

*“The cultivation of guanxi involves more than the negotiation of a deal and the usage of customary forms to disguise what might otherwise be recognized as a corrupt or illegal exchange. Instead, the exchanges are used to cultivate and strengthen relationships that are expected to continue. In the process, not only advantages and obligations are achieved, but also some degree of trust” (Smart 1993)*

As Alan Smart argues in the quote above, the cultivation of guanxi involves more than the negotiation of the deal, it is also about the exchanges within this guanxi relationship, which is exactly where guanxi is often related to corruption. The line between nursing the relationship in terms of gift giving and returning favors is very difficult to define. To Westerners, sending *hongbaos*, which is small red envelopes with money given during holidays, will be seen as bribery and corruption, but to a Chinese person it is just a polite and common practice. However, contrary to many Westerners' beliefs, guanxi cannot be purchased, so sending hongbaos may or may not be corrupt, but it is not guanxi. It can be perceived as corruption, but in context it is gift-giving, which is a long and honorable tradition in most parts of the world.

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<sup>1</sup> Foreign Corrupt Practices Act – Legal act amended in the United States concerning bribery of foreign officials.

The difficult question in this case here, is that the resources exchanged is economic capital, in form of money, does that fact change it from gift-giving to bribery? This is where the cultural differences come into action, because to a Chinese person, receiving these hongbaos will never be perceived as bribery, while a Western person right away would think he is trying to get bribed.

In today's China, corruption is a major issue. Since the economic reform, it has become one of the biggest problems facing the Chinese economy. It played no small part in the protests of 1989, it has led to a growing number of officials receiving death sentence, and Xi Jinping's anti-corruption campaign where more than 100,000 people have been indicted for corruption. The Chinese are fearful of it for the same reason that Germans fear inflation: they remember the damage it has done. This has resulted in less corporative corruption as people simply are afraid of what will happen to them, their family, and their business if they get caught in corruptive businesses.

Corporatizing a guanxi network capability via a systematic, institutional, and comprehensive program, which some organizations call *multilateral relationship development and management* (hereafter referred to as MRDM), can be a critical first step for any multinational companies in order to control their outcomes in China and to suppress the risks of corruption. Many of these multinational companies that are active in China have not taken a hands-on approach to developing and managing their own guanxi relationships, either because they do not try to manage their guanxi systematically or because they outsource it to either an in-house employee or to an external agent. Creating and maintaining these guanxi relationships via MRDM requires a significant and on-going commitment by the entire company and an outsourcing to a third party in order to develop and manage the network should not be considered as the easy and best way. Once the organization start using their own corporate MRDM-developed guanxi mechanisms, they can lever them to transform the competition with Chinese counterparts from practices affiliated to zero-sum warfare, where the winner takes it all, into win-win outcomes, where all interested parties achieve the mutual understood and acknowledged objectives. Experts say that if organizations have a well-developed set of focus areas to develop key MRDM in China, they are well on the way. On the other hand, if they are not identified yet, there is a long way to go. However, according to Søren Niebuhr, it is possible for Western organizations to be successful in the bigger Chinese cities by following the book and its Western rules. China has become more internationalized, which has made them more open towards the Western way of doing business. From his personal experience, many Chinese people living in the bigger cities accept that Western organizations must follow certain CSR politics and they cannot run the business with the use of corruption. Often, they accept this, either because they have done business with Westerners before or they just accept that is how it is. However, the Western organization is still the strange one and the one breaking the norms.



It can be concluded that the line between corrupt and harmless practices is very difficult to draw. The FCPA specifically excludes 'grease payments' and tipping, including money given to encourage officials to do what they should do anyway. Corruption, on the other hand, including bribery, involves paying someone to do what he should not do. Therefore, guanxi and corruption are not necessarily linked. You can argue that guanxi and corruption are not the same thing, any more than drink is the same to drunkenness. You can still enjoy the one and still avoid the other. When used for legal purposes, which do not infringe on public interests, guanxi can be an extremely useful way to take care of their legitimate personal or business affairs. Guanxi only becomes corrupt when the exchange or transaction taking place involves corrupt activities or one of the parties operate outside of the law. When corporatizing guanxi relationships, Western organizations must be aware that it is a time- and resource demanding to develop and maintain their guanxi networks. When doing business with Chinese organizations located in the larger Chinese cities, it is possible to do without the use of corruption, as these are used to deal with Western organizations. However, it is important to emphasize that there is still a need to develop and maintain guanxi, it is just the corruptive part that is avoidable.

## 6. Conclusion

The purpose of this thesis has been to explore why guanxi is a recurring challenge to Westerners doing business in China. In order to conduct this research, empirical data has been gathered through an interview with Søren Niebuhr and reading various literature on the concept of guanxi. This empirical data has been addressed in the analysis by applying Western theories on interpersonal relationships, including social exchange theory and social capital. Hence, an attempt will be made to answer the research question, which is:

*"Why is guanxi a recurring challenge to Westerners doing business in China"*

Here, the cultural and institutional sources was considered as some of the reasons for the challenges. To answer this, I have chosen to analyze data on guanxi with social exchange theory and social capital. Furthermore, for deeply understanding why these challenges exist, the following sub-questions have been researched; *"How does guanxi differ from Western theories on interpersonal relationships?"* and *"How is the concept of guanxi presented by three selected business manuals?"*

On the basis of the research in this Master's Thesis, it can be concluded that both cultural and institutional sources are some of the reasons for the challenges of guanxi. According to both social exchange theory and social capital, there are several similarities between guanxi relationships and interpersonal relationships in the West. These three concepts do possess some of the same characteristics, including reciprocity, social norms and rules, and rewards or punishments in case these rules are complied with or not followed. However, the concept of guanxi appears much more complex than Western interpersonal relationships. The reason for this could be that guanxi is a practice that goes back to antiquity and is something that is second nature to the Chinese people, whereas Westerners are usually very bad at building and maintaining relationships and therefore must learn and use more resources to function in a guanxi network. This cultural difference is also one of the challenges the three selected business manuals all point out, as they all focus on the deeply rooted Confucian culture with the Chinese, which is closely connected to the use of guanxi relationships.

Besides the cultural sources, it can be concluded that there are some institutional reasons for the challenges as well. As stated by all business manuals, and also in my analysis, guanxi relationships is, along with contract law, the two determining factors when doing business in China, while it usually only is the contract law in the West. The Chinese look beyond the signed contract for sincere commitment, which is where a strong guanxi relationship comes in handy. This is the occasion in both B2B and B2G guanxi as both types yield great opportunities in case it is done right. However, this is also where the question on corruption often occurs, as the line between nursing a relationship and being corrupt is very difficult to draw. However, the research shows that the use of guanxi can only be perceived as corruptive if the exchange or transaction taking place involves corrupt activities or one of the parties operate outside the law.

Western organizations must however be aware of the issues the use of guanxi may have and at the same time be attentive to the time and resources it will take to create a useful and strong guanxi within the line of the Western laws. Nevertheless, China is a country developing and getting more and more internationalized, which also affects their approach to corruption and Western business styles. Together with historical happenings and this is mind, the larger Chinese cities are more used to Western organizations, which is why they accept if a Western organization wants to do business without the use of corruption. It is important, though, that the Westerners are the strange one and the one breaking the local norms.

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## 8. Appendix

### 8.1 Summary of Interview with Søren Niebuhr

#### **How will you describe the concept of guanxi?**

It is, in our understanding, an extended version of relationship and network, but something you build on the basis of long termed perspectives. A favor is either done of kindness or because the counterpart has something interesting.

Businesslike it is about meeting some over others, either economically or in terms of powerful positions. What we work with in Mictory is to avoid these drivers. He mentioned a case with a steel company whose production in China runs through four different agents because of various restriction, lack of capacity, or quality. At least that is the excuse coming from the purchasing agent as this puts him in a more powerful position and there might also be an economical profit for him, also in his private life. When Mictory contacted the production site whether they could handle the tasks themselves, the answer was clear---cut yes. This situation has only occurred because someone is trying to improve their own position of power and personal benefits. This is the negative side of guanxi, the positive is to know the right people.

The mentality is very Darwinist, it is about surviving. No one is pushing you, instead you have to make sure that you progress in life. Everyone is trying to have the right networks.

#### **Comparison of Danish and Chinese network**

Danes are now very good at using their network and often it is a very systematic network we are speaking of. It is often divided into boxes with direct lines between these boxed, where, on the other hand, Chinese guanxi is much more complex and the relations can be much more different than the relations we know in Denmark.

Social guanxi is close to what we know with family and friends, but business guanxi is much more manipulating and more strategic and long termed oriented.

#### **Is it the positive or negative guanxi that is mentioned in the business manuals?**

When he started working in China he was told that it was impossible to get anywhere without guanxi. He was aware of getting these relationships established from the beginning for example by inviting the local political elite to the opening of their factory in China among other prominent names from both China and Denmark.

You can without any problems nurse your Chinese relations as we do it in Denmark. This can be done by sending gifts to customers or business partners during festive seasons.

The books are driven by China's historical aspect. They have not been used to how we are doing business in the West where it is much more transparent and where the contract is the one that decides how it all should be and is not just the basis for the negotiations, which it is in China.

Today, you can be successful in the bigger Chinese cities by going strictly by the book and follow the rules, which you could not earlier.

That China has become more internationalized has made them more open towards the Western world's way of doing business. At the same time, the many Chinese students that study abroad brings different approaches that affect the business life in the country.

Guanxi in the business world often leads to corruption, at least in a Danish context

Søren told, that he has often told the Chinese counterpart that he is from Denmark where you run your business without the use of corruption. At the same time he has to follow a CSR politic and if he does not, he will get in trouble. Often, they accepted this, either because they have done business with Danes before or they accept that is just how it is. However, he is still the strange one and the one that breaks the norms.