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Guanxi and networking: The hidden business matrix of the Chinese economy

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**MARKUS TAUBE
SVEN HORAK**

Guanxi and Networking.
The Hidden Business Matrix
of the Chinese Economy

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MARKUS TAUBE / SVEN HORAK

***Guanxi* and Networking**

The Hidden Business Matrix of the Chinese Economy

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Abstract

China's economic structures, business dynamics and individual management decisions are not determined by the country's formal institutional arrangements alone. China's society, its politics and business are rather governed by powerful informal mechanisms that complement and sometimes overrule the ordering principles outlined in the formal sector. Network structures and *guanxi*, in particular, create hidden microcosms that exist beyond, or rather parallel to, markets and hierarchies and have a profound impact on the structures and dynamics of China's economy and its business sector. This phenomenon exists since the early days of China's civilisation and continues to shape the China of today (Bian, 2018; Fei, 1992; Yang, 1994). This contribution endeavours the following: (i) to outline the mechanics of *guanxi* relations and networks in Chinese society; (ii) to highlight the impact of *guanxi* relations and networks on Chinese business and management; and (iii) to discuss China's *guanxi* relations and networks in international comparison. In order to do so, this contribution integrates different streams of literature (economic and sociological network literature, management and organization studies, Chinese and East Asian area studies) into a comprehensive analysis shedding light on the various forms and dimensions in which *guanxi* relations and networks shape the way business is conducted in China.

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1 THE MECHANICS OF *GUANXI* RELATIONS AND NETWORKS IN CHINESE SOCIETY

In Chinese society, there exists a broad variety of relational networks. *Renmai* (人脉), for example, relates to ego-centred networks based on personal trust, while relationships characterised as *yuan* (缘) or *yuanfen* (缘分) are based on the notion of a shared destiny or fateful bond (Horak, Taube, Yang & Restel, 2019; Luo, 2006). The most common and most formative type of relational network in and for Chinese society, however, are *guanxi* (关系). The essence of *guanxi* networks and their operating principles continue to be the object of intensive debate, having given rise to different schools of understanding. This debate will not be replicated here (for excellent overviews, see Bian, 2018; Nolan, 2015). Instead, the key characteristics, structural elements and functionality of *guanxi* relationships will be outlined in their relevance for Chinese business and management.

At the core of *guanxi* relationships lie ties between individuals. While social ties, as such, may be differentiated between ties rooted in family bonds, ties based on familiarity, or ties between strangers (Hwang, 1987), *guanxi* ties may be understood to evolve among individuals that perceive familiarity amongst each other (Li, Zhou, Zhou & Yang, 2019). Ties between strangers may be characterised as being purely instrumental and are usually of an on-off nature. As such, they do not qualify for dense social networks. However, the present authors also do not count family bonds as *guanxi*, as the former are 'born-into' relationships usually based on strong sentimentality and 'blind trust', which are not dependent on reciprocal exchanges.¹ *Guanxi* ties, in contrast, must be actively developed and follow a strong logic of reciprocity. The

basis for *guanxi* relations is usually joint experiences based on regions, universities, business environments, joint leisure-time activities and the like (Kiong & Kee, 1998; Luo & Ye, 2007; Luo, 2000). These shared experiences create a first sense of familiarity and shared general beliefs, which convinces individuals to advance trust to others to engage in experimental exchanges not covered by formal, third-party enforcement mechanisms. This trust advancement must then be honoured by faithfully complying with jointly agreed upon exchange parameters to establish *guanxi*. Stable trust, reputation and sentimental affection are attained in the course of multiple exchanges and the steadfast renouncement of opportunistic behaviour (Li, 2007a, 2007b; Luo, 2011). Multiplexity, understood as relations covering different spheres of life (e.g. business relations, party membership, community involvement, leisure time and private activities, among others), can greatly strengthen *guanxi* relations by cementing bilateral bonds and dovetailing belief systems. As a matter of fact, one could argue that business-unrelated social events, the (in) famous 'winning and dining', constitute an important element in the creation of bilateral trust and establishing 'familiarity' (Yang, 1994).

Guanxi transactions are not on-the-spot market transactions where goods and services are exchanged at a specified time, location and price. They are rather based on the exchange of 'favours', the respective value of which neither the time nor the conditions of repayment are being specified ex ante. What is fixed, however, is the unwavering obligation of the receiving party to return this favour at a later point in time. *Guanxi* transactions are always reciprocal, although there may exist asymmetries in the 'objective' value of favours exchanged (Li et al., 2019). *Guanxi* transactions are strictly informal; claimants cannot go to court and sue partners for

¹ Nevertheless, this does not preclude family ties to be integrated and instrumentalised in specific *guanxi* relationships and transactions.

fulfilment of their *guanxi* obligations. However, *guanxi* relations can also prepare and lead to the conclusion of large, highly complex contractual relations that partners choose to have governed by formal contracts in the state's juridical system (Nee & Oppen, 2012).

The frequency of such reciprocal exchanges determines the strength of such ties (Granovetter, 1985). The more often individuals exchange favours, and thereby see their goal attainment supported by reliable partners and their faculties, the stronger their bilateral trust (i.e. the notion of shared beliefs and eventually the evolution of sentimental affection). A high frequency of *guanxi* interaction is not only a sign of a highly functional relationship with strong instrumental value but also the key to a strong bilateral tie.

Transforming these concepts of dyadic *guanxi* relations to the dimension of *guanxi* networks, constituted by three or more individuals,² the Confucian notion of hierarchy as a ubiquitous feature of Chinese society becomes crucial (Hwang, 2000). *Guanxi* networks evolve out of the bilateral relations of an 'elite'-ego that commands extra-ordinary resources, material and immaterial.³ In the first stage, a starburst pattern develops that becomes transformed in a multipolar network, once the core-ego starts to mediate transactions between its dyadic partners and facilitates horizontal interaction patterns (Li et al., 2019).⁴ While no longer being part of every single transaction in the *guanxi* network,

the core-ego actually strengthens its standing by leveraging the resources of its dyadic partners to the benefit of all network members.

Over time, a layered network structure may evolve, in which an inner circle of individuals with strong resource endowments constitutes the basis for a system of concentric rings of *guanxi* members (Luo, 2011, 2016). While in the center, the level of bilateral trust, the range of shared beliefs and the manifestation of sentimentality or affection are the most pronounced and become weaker towards the periphery. The further out from the core, the more important the instrumental value of membership becomes to individuals (Burt & Burzynska, 2017). As such, a slope can be postulated where the strength of ties decreases with the distance of a *guanxi* network member from its core. Once established as a multipolar network, *guanxi* relations no longer rely on trust alone. Network closure based on tie strength and intra-network communication becomes an important parameter (Coleman, 1988; Granovetter, 1985). In such a network, opportunistic behaviour entails high opportunity costs, insofar as rules breaking behaviour in one transaction is immediately communicated as a trust-betraying act to all network members. All the positive reputation underlying the individual's participation in the network members' social relations is destroyed. Automatic expulsion from the group is the result. Any further interaction with members of this network becomes impossible (Granovetter, 1985; Nee & Oppen, 2012). As a consequence, rule breakers are punished with the exclusion from the network resources and access to its low transaction cost operations system.⁵

2 *Guanxi* networks may constitute dozens and hundreds of individuals.

3 Alternatively, the nucleus of the 'elite'-ego may also be taken up by a small group of 'elite'-egos that already have a history of interaction, multilateral trust and affection.

4 The larger the *guanxi* network, the greater the probability that especially peripheral members do not know all other members of the network personally. However, these unacquainted members can be reached via intermediates, whose assessment of their trustworthiness is acknowledged.

5 In comparison to a market system that relies on a set of specific formal institutions for coordinating, monitoring and adjudicating transactions between strangers. The variable costs of transacting in a network are low as they are embedded in the network discipline. The fixed costs of creating the network and upholding its social relationships, however, may be substantial.

Guanxi networks are open networks (Horak & Taube, 2016; Luo & Yeh, 2012) that facilitate the integration of new members, as well as a 'bridging' to other networks. New members (and their resources) may be integrated into an established network at any time. New members may be recruited from the ego-centric sub-networks of non-core members of the focal network⁶, or be introduced from a pool of strangers to whom some sense of familiarity has been established in the course of non-*guanxi* interactions. As newly introduced members, these individuals start off in the network periphery, but may travel towards its center.⁷ To do so, they must prove themselves in repeated interaction and acquire the trust of other net-

work members. 'Bridges' to other networks are important to access new categories of knowledge and resources that require some translation and adaptation to become usable (i.e. valuable to the focal network).⁸ According to the traditional network theory, brokering between networks usually relies on members with weak ties (Granovetter, 1973, 1983) that are loosely embedded in a given network in structural terms (e.g. transaction frequency). *Guanxi* networks are not different. However, they may be in a position to – better than other networks – reinforce the trust-basis of weak ties by means of relational experiences (Burt & Burzynska, 2017) and, therefore, even better utilise exogenous resources.⁹

2 THE IMPACT OF GUANXI RELATIONS AND NETWORKS ON CHINESE BUSINESS AND MANAGEMENT

Guanxi networks permeate Chinese society and do have a substantial impact on the organisation, structure and output of business and management in China. The concrete manifestation of this impact, however, depends on the way in which these informal networks are embedded in and interact with the existing formal institutional framework. In principle, *guanxi* networks have the capacity to provide self-contained, comprehensive coordination structures for decentralised economic interaction independent from all super-structures. Nevertheless, they can also exist as sub-ordinated ordering systems catering to specific functional needs or niche interests. In the following, these phenomena will be explored in greater detail.

In all these cases, it must be understood that *guanxi* networks are providing microcosms of high transactional security in otherwise perilous socio-political and business environments. Their basic functional logic is straightforward. Given the high frequency of contacts and business transactions amongst network members, information about any malfeasance (e.g. substandard goods delivery in terms of quantity, quality, timeliness, or any default on financial obligations) is disseminated quickly amongst the network members (Nee & Oppen, 2012). Network

6 In practice, almost every Chinese individual can be assumed to be core to the individual – mostly small – focal *guanxi* or *renmai* network, while at the same time belonging to a larger *guanxi* network centred on some other individual featuring an exceptional resource endowment.

7 On the dynamic nature of *guanxi* relations see, e.g. Chen and Peng (2008).

8 One may think about *guanxi* networks focusing on different industries but employing similar technologies. Entrepreneurs may explore substantial synergies by linking these industries. Other examples may address *guanxi* networks with core functions in different spheres of society like party affairs, government, business, etc.

9 This is not a small point. As Aral and Van Alstyne (2011) have been able to show, weak ties are restricted in terms of frequency and band-width. This results in low quality information being transferred at a slow rate. That means, while weak ties may be important to establish a bridge in the beginning, it is strong ties that are needed in order to make full use of the new resources.

members cannot hide in anonymity but face high transparency with regard to all their activities. Also, just as contact abiding behaviour strengthens their reputation in the network, malfeasance is punished by a withdrawal of trust. Punishment can go so far as to expel individuals from a *guanxi* network, stripping them of the possibility to conduct (low transaction cost) business with the respective business circle. Multiplex relationships dramatically expand the reach of such punishment into other spheres of life and may result in ostracising individuals from their social peer group. As such, *guanxi* networks exert strong inherent incentives for norms abiding conduct and a refraining from opportunistic behaviour.

2.1 GUANXI AS A SUBSTITUTE: FACILITATING BUSINESS AND STRENGTHENING FIRM COMPETITIVENESS IN ADVERSE ENVIRONMENTS

Guanxi networks can provide a level of information exchange and transactional security that allows intensive economic interaction to unfold irrespective of the existence of a functional framework of formal institutions. As such, it can be surmised that *guanxi* networks play an especially pronounced role in Chinese society and business whenever the formal institutional framework is incomplete, dysfunctional or in a state of flux. As a matter of fact, during the last 150 years, such a characterisation describes the reality of Chinese society and business as well as their interaction with government quite well. Only in recent years the formal institutional framework appears to have gained in strength and factual ordering capacity.

Focusing on the reform period beginning in 1978, it becomes apparent that Chinese businessmen have many years been required to manoeuvre in a hybrid system, in which elements of a centrally planned economy and a market economic system coexisted. Adding to the difficulty of operating in such an environ-

ment, the relative importance and manifestation of these two institutional realms kept shifting permanently. As a result, all business in China – but especially the private and semi-private sector – have been subjected to substantial procedural insecurity. *Guanxi* networks have been instrumental to overcome these difficulties (Xin & Pearce, 1996) in two fundamental manifestations: (i) *guanxi* linking business and politics and (ii) *guanxi* linking individual businesses.

Ad (i): *Guanxi* networks connecting decision makers in the business with such in the political sphere have been of outstanding importance for the bottom-up evolution of the Chinese reform and marketisation process (Boisot & Child, 1996; Hendrischke, 2007; Nee & Oppen, 2012). In the early days of China's reform process, business success was less determined by the quality of underlying business ideas and entrepreneurial savvy but rather by the access to licenses, land use rights, electricity, raw material, among other things, the allocation of which was controlled by cadres in various government and party organisations. Entrepreneurs with strong *guanxi* to decision makers in the political sphere were invested with substantial advantages over their competitors (Wank, 1999).

It comes as no surprise that the first generation of entrepreneurs in China consisted to a large degree of cadres of the Communist Party (who often did not relinquish their party position right away) and former managers of state-owned enterprises (Taube, 2009). *Guanxi* with decision makers in the political sphere was the most important (social) capital a company could have. This is a feature that foreign enterprises conducting business and investing in China have become aware of early on in their business activities. Having no 'natural' *guanxi* ties to Chinese Communist Party and government officials, many firms decided to hire individuals for no other qualification, except their *guanxi* to decision makers in the political realm (Handelsblatt,

2019; Nolan, 2011),¹⁰ or tried to profit from the *guanxi* networks of their joint venture partners.

Over the years, the relative importance of cadres in Chinese politics and bureaucracy has been slowly reduced as markets have become increasingly functional and the old planning system has been dismantled. Access to the political sphere, however, remains an important asset for business leaders all over China. The Chinese economy remains characterised by a strong state-business-nexus, in which many market transactions are not only controlled but influenced and directed by political actors (Taube & in der Heiden, 2015; Xu, 2011). Private entrepreneurs are not yet guaranteed to receive impartial court rulings (Zhang & Li, 2017) or be protected from predatory local governments (Zhou, 2013). In this environment, strong informal contacts to government and Communist Party cadres continue to constitute a valuable asset and source of competitive advantage. Lu and Yao (2018) reports several cases where *guanxi* relations trump regular bidding processes and result in the preferential awarding of land use rights and project contracts controlled by local governments. In the 2000s, local Chinese People's Political Consultative Conferences, membership of which do not require membership in the Chinese Communist Party, have become important market fora where private business entrepreneurs can establish *guanxi* with political leaders and engage in intensive state-business interaction (Heberer & Schubert, 2019; Li, Meng & Zhang, 2006).

Ad (ii): *Guanxi* have also provided the basis for establishing fruitful partnership amongst individual firms designed to overcome discriminatory practices of the state-controlled economy and the vagaries of a very dynamic but, at the same

time, highly volatile and risk-laden business environment (Luo, Huang & Wang, 2011).

A prime example for a constellation where governmental discrimination drives entrepreneurs to pool resources and support each other by means of *guanxi* networks constitutes the discrimination of (semi) private firms with regard to access to financing services from the formal financing sector and its primarily state-owned commercial banks. In order to expand their financial means beyond the highly restricted sphere of self-accumulated funds, Chinese entrepreneurs have reverted to a broad range of network-based 'shadow' financial institutions (Tsai, 2002). These include – inter alia – the traditional private-ordering institution of *rotating savings and credit associations* (ROSCA) (Feng, 2006). ROSCA may be understood as special 'closed' financing clubs established under the umbrella of *guanxi* networks and led by a highly reputed 'elite'-ego who organise the pooling and allocation of financial resources among participants.¹¹ With sometimes very substantial amounts of money being swapped between ROSCA members, the temptation for opportunistic behaviour is high. The sanctioning threats that constitute an inalienable part of *guanxi* networks, however, have proven their capacity to discourage any wrongdoing.

Guanxi networks have also been conducive to the dynamic development of individual businesses in the highly volatile market environment of China's reform period. The specific mix

10 From the perspective of Western market economies, such individuals might be categorised as 'lobbyists'. This term, however, does not capture the full dimension of Chinese *guanxi* relations, which go far beyond Western lobbying practices and spin-doctoring.

11 In a ROSCA, members meet at regular conventions, during which they each contribute a fixed amount of money to a 'common pot'. This 'common pot' is then either auctioned-off or allocated according to an ex ante determined fixed sequence to one member, who then in all following meetings has to pay an 'interest fee' in addition to his or her regular fixed contribution. A specific ROSCA comes to an end once all members have received the 'common pot' once. The chronological order in which a member receives the 'common pot' determines the character of the ROSCA for any participant as a net-lending or net-savings scheme.

of strong and weak ties constituting *guanxi* networks allow for a comparatively high degree of openness. This allows – on the basis of a stable business portfolio – the continuous enrichment of a given network's social capital and access to new resources. As such, entrepreneurial innovativeness striving for ever new applications of existing technologies and business models as well as creative innovations in new business fields is promoted. Entrepreneurs are not caged in immutable business structures but are free to explore new business opportunities. As documented by Nee and Oppen (2012), such *guanxi* networks are also providing a basis for higher forms of economic interaction than regular supplier and customer relations.

The authors show that Chinese private entrepreneurs rely on the governance regimes of their *guanxi* networks to engage in joint R&D projects, which are too risk-laden and resource-intensive for any single actor. In so far, as *guanxi* networks offer a means to overcome the constraints that prohibit individual agency and provide a platform for joint activities, they contribute to dynamic innovation of individual businesses as well as the advancement of innovation-driven productivity in the economy as a whole. The relevance of strong trust and the existence of shared beliefs in a given *guanxi* network becomes obvious when considering that such joint R&D activities are not only characterised by high degrees of non-ergodic risk but also of considerable ambiguity in the attribution of individual contributions and gains.

2.2 GUANXI AS A COMPLEMENT: SUPPORTING MANAGEMENT OF DAY-TO-DAY BUSINESS OPERATIONS

Guanxi play a crucial role for start-up entrepreneurship and business development in contemporary China. Founding a firm is a process characterised by high risks caused by fundamental insecurity about market constellations (i.e. consumers, competitors and regulators), tech-

nical feasibility of production, operational management capacity (i.e. financing, marketing and supplier management), among other things. All these challenges can be mastered much more easily with the support of people controlling required resources and willing to extend trust to the focal entrepreneur. Family support and embeddedness in a resourceful *guanxi* network comprising a sound mix of strong and weak ties have proven an invaluable asset for start-ups in contemporary China (Luo, 2016). However, *guanxi* networks have also proven to be important in later stages of business development.

The exceptional dynamics and structural shifts to be observed in the last four decades of economic development in China have forced all firms to re-invent themselves (i.e. their product range, business model and organisational set-up) every few years. In these periods of re-organisation managers have been forced to venture into new business areas and explore new markets. In these environments, once again, membership in *guanxi* networks integrating a broad range of technical and management expertise, market experience and access to political capital has been of foremost importance to successfully manage these transitions (Boisot & Child, 1996; Gu, Hung & Tse, 2008; Burt & Oppen, 2017).

In recent years, the role of *guanxi* networks in the context of Chinese firms' international expansion has become a topic of rising interest. It appears that *guanxi* networks can actually play an important role in the internationalisation of business activities in two different ways. Firstly, *guanxi* to cadres in the political realm – as well as to top managers in the financial sector – can provide information about and access to state-promoted international projects; for example, in the context of the Belt and Road Initiative. These projects are usually not tendered publicly but are rather designed and awarded in an arms-length manner, discriminating against players not having access to the 'right' people; that is, the 'right' *guanxi* (European Chamber of Commerce in China [EUCCC], 2020). Secondly,

well established business-to-business *guanxi* networks can greatly support successful business operations in foreign economies. In these alien environments, firms must cope with ever new challenges to adapt and adjust their product specifications, manufacturing processes, operating structures and the like to new requirements and standards. A strong *guanxi* network in the home market can greatly support these activities by providing required resources, supporting process innovations and allowing for flexible operations planning (Du & Zhou, 2019). *Guanxi* relations established in the course of former business activities with foreign firms (which are usually weak) are, in contrast, shown to have no substantial impact on the internationalisation drive of Chinese firms (Lin, Wang & Si, 2018).

One of the most investigated areas pertaining to the role of *guanxi* in business is recruitment and the workplace, in general (Nolan, 2015). Chinese job seekers regularly employ *guanxi* to get access to human resource (HR) managers,¹² and the latter continue to take *guanxi* as a signalling device for valuable social capital an applicant may possess (Ko & Liu, 2017). However, especially in recent years, the value of *guanxi* to job seekers has diminished. With rising competitive pressure and the need to create profits, especially private firms cannot afford to hire people irrespective of their qualifications simply on the basis of their *guanxi*. Merit-based screening of applicants becomes more common (Bian, 2018). Still, *guanxi* remain valuable for job seekers and HR managers alike (e.g. when there is a large number of applicants with similar skills and qualifications for a specific job). Then, being 'introduced' by the right person may provide the necessary additional quality to outcompete other contenders (Huang, 2008). Nonetheless, there exist other mechanisms that prevent *guanxi*-based applications from being completely detached from basic qualification levels.

The usage of *guanxi* for job searches remains especially productive where soft skills are required that are hard to ascertain objectively. Here, HR managers may have a tendency to favour candidates that are being introduced (Huang, 2008). By actively introducing (and promoting, which can come in various degrees) somebody, people implicitly guarantee a certain minimum qualification of the applicant. Promoting a person that proves to be unfit for the job and creates a burden to the employer will automatically weaken the bonds between the introducer and the employers and reduce the social capital of the former. Pulling one's *guanxi* to get introduced to a specific company also comes to the job seeker with a cost. It establishes a liability that, according to *guanxi* logic, must be returned at a later point in time. As such, individual job seekers may undergo a self-selection process and mobilise their *guanxi* capital only for job openings for which they feel sufficiently qualified and see a sufficiently high probability of being actually hired. Here as well, *guanxi* are not completely detached from true qualifications. That is, *guanxi* may help but cannot take away the need for meeting certain minimum requirements.

2.3 THE DARK SIDE OF GUANXI: COSTS OF NETWORKING ON THE MACRO AND MICRO LEVEL

As shown above, *guanxi* relations and networks do create 'value' to their members. These gains, however, are not Pareto-optimal. The very functionality of *guanxi* networks that feature on the individual (micro) level usually does create negative results in terms of productivity and welfare creation on the macro level, which eventually negatively impact the utility of all members of society and economy – including the erstwhile profiteers. Such adverse effects manifest themselves in various forms like fragmented markets, regulatory capture, rising corruption hazards, as well as product, service and technology development inertia. The most important negative impact, however, can probably be observed in the realm of competition-based market de-

12 Similar behaviour can be observed in Western societies, where job-seekers try to leverage their 'contacts'.

velopment. *Guanxi*-based business transactions often lead to an impairment of the competitive process, where not the best contender is awarded a contract but rather a – decently performing – network member. Therefore, the power of competition-based markets to select and promote performance and scarcity-reducing entrepreneurship is significantly weakened.

The dynamics of transaction costs reducing, innovation driving market development are being slowed down (Lee, 2007). *Guanxi* relations can and should not be equated to corruption (Taube, 2013). However, the borderline between rule-abiding behaviours in a network, which require the return of favours and services received, may easily transgress the rules of the larger, formal marketplace, which requires impartial treatment of all market contenders. What is correct behaviour in one realm, becomes criminal behaviour (corruption) in the other (Taube & Schramm, 2004). Furthermore, *guanxi* networks are known to become easily encroached upon and instrumentalised for corrupt business schemes (Chen & Kung, 2019; Guo, Sun & Dai, 2018; Li, 2018).

Firms may also suffer, if their political *guanxi* become ensnarled in faction wars, ideological disputes and so forth. Strong relations to office-holders in a political party or government may backfire, if these people are demoted or purged and all their contacts and former activities are being scrutinised (Pan & Tian, 2017; Wang, 2016). Studies on the impact of the arrest of Bo Xilai, a former politician and politburo member, in 2012 indicate a substantial drop in asset prices, investment expenditure and overall performance

of firms, which had been nurturing *guanxi* relations to Bo Xilai and his circle (Liu, Shu & Wei, 2017).

In addition to these negative macro-effects, individual actors are being documented to complain about negative effects caused by them being compelled to uphold network discipline and being blocked from engaging in network-external business transactions (e.g. sourcing, hiring and the like) (Warren, Dunfee & Li, 2004). Such negative effects on business have become more substantial as formal market institutions in China have become more refined and better equipped to facilitate the efficient allocation of resources and coordination of business interaction. Formal market institutions are encroaching on socio-economic spheres that, until then, had been governed by informal network structures.

Another potentially damaging characteristic of *guanxi* lies in the fact that *guanxi* relations are always personal and never relate to a company or business unit as a whole. This implies that individuals with strong, useful *guanxi* can greatly support their firm; however, at the same time, these very individuals constitute a danger to their companies. Overdependence on the *guanxi* of these individuals can create lock-in effects to the detriment of the firm, which may be exploited by these people by means of blackmailing or result in a breakdown of business dynamics once these individuals are leaving the company for competitors (Tsang 1998). The same negative effects may also arise from these persons simply falling ill or passing away without a well-established successor (Lu & Pan, 2016).

3 CHINA'S *GUANXI* RELATIONS AND NETWORKS IN INTERNATIONAL COMPARISON

While essential for doing business in China, influential informal ties and networks are not solely a phenomenon of China alone. Though *guanxi* research can look back on a decades-long re-

search and publication history, other informal networks are researched in parallel. The most widely debated are: (a) *wasta*, which is to be found in the middle east (Abosag & Lee, 2013;

Hutchings & Weir, 2006); (b) *yongo* in South Korea (Horak, 2014, 2016; Horak & Klein, 2015; Lew, 2013; Yee, 2000); and (c) *jeitinho* in Brazil (Amado & Brasil, 1991; Duarte, 2006). Especially, the increasing importance of emerging markets can explain the recent surge in research about informal networking in a business and management context (Ang & Michailova, 2007). Not only do Western countries see increased competition from firms in emerging markets, but also investing and operating in overseas markets means that foreign firms are operating under a different and unknown institutional framework (Peng, 2010; Peng, Pinkham, Sun & Chen, 2009).

While from a practitioner point of view, managers may think that informal practices exist in every country and can be managed in a similar way. Michailova and Worm (2003: 509) argue that:

personal networking in former socialist societies differs from the West in terms of how extensively it is rooted and activated in social and business life and how business success is influenced by the quality and cultivation of personal relationships. This implies that personal networks need to be managed differently in different countries (...).

It is unclear whether international firms are prepared to train and develop their managers so that they are enabled to successfully navigate informal ties and networks for the benefit of their firm. Empirical studies on Western expatriates in Korea show that foreign managers have difficulties to become a part of local networks and use them for business purposes. Also, they have ethical concerns as local networking follows different values and norms of behaviour that are unknown to them and leave them in doubts of whether to engage deeper in informal networking without being able to understand the long-term consequences of expectations and reciprocity (Horak & Yang, 2016).

Interestingly, while informal networking is becoming increasingly popular in the emerging market literature, informal networks can also

be strong and pervasive in advanced and industrialised countries, such as in Korea. Pursuing a comparative approach to understand the similarities and differences of informal networks, to work towards a theory on informal networks, is a promising approach to generate new knowledge. While past studies have been conducted that compare *blat* (Soviet Union) and *guanxi* (e.g. Ledeneva, 2008; Michailova & Worm, 2003), recent research has focused on comparing *guanxi* and *yongo* (Korea) (Horak & Taube, 2016). This comparison is interesting, as it compares a transitional economy (i.e. China) and an already industrialised economy (i.e. Korea), where informal networks are still strong. Since research tends to assume that informal networks are merely an emerging market phenomenon that will disappear with economic development and the strengthening of formal institutions future (Brennan & Wilson, 2010; Guthrie, 1998; Hutchings & Weir, 2006; Peng, Denis, Wang & Jiang, 2008), this comparison helps to understand how informal networks differ and why they seem to persist.

Amongst the most remarkable differences between *guanxi* and *yongo*, as suggested by Horak and Taube (2016), is that *yongo* is much more homogenic and exclusive compared to *guanxi*. *Yongo* networks are defined narrowly by family ties, education-based ties and regional-based ties, as those ties make up original *yongo* ties. Hence, due to the members' background they tend to be 'highly homogenous' (Park & Shin, 2005), compared to *guanxi* that can be established on larger and more diverse tie-bases, and those ties are in principle transferable, which is not the case with *yongo* ties. Whereas, the cultivation and maintenance as well as the strengths of *guanxi* requires and is determined by reciprocity and commitment; thus, in principle, it can be established among strangers (including business expatriates), so that *guanxi* networks can grow and are somewhat open (Luo & Yeh, 2012).

Yongo networks, on the contrary, can only grow internally as the membership base is preset (i.e.

they can intensify by enlarging linkages to others from the same hometown, high school or university). It usually does not happen that someone from University A has *yongo* with someone from University B. Certainly, both can have a trustful and close relationship but, by definition, not *yongo*. Similarly, foreigners who possess no original Korean tie-base can hardly have *yongo* ties. In comparison to *guanxi*, *yongo* is exclusive. Further, *yongo* treats outsiders in an egalitarian way, similar to the case of *guanxi*, but it is a stronger egalitarianism. Within segregated *yongo* networks, there is 'flexibility, tolerance, mutual understanding as well as trust. Outside the boundary, on the contrary, people are treated as 'non-persons' and there can be discrimination and even hostility' (Kim, 2000: 179).

Given these differences of network characteristics, it reveals that we still know comparably little about informal networks in East Asia, not to mention the differences between *guanxi* and the way people network in the West (Burt & Batjargal, 2019). Recent studies explore this subject deeper and show that some notions of 'trust and achievement in China has the same network correlations associated with trust and achievement in the West' (Burt & Burzynska, 2017: 222). Burt and Burzynska (2017) believe that Chinese informal social networks (i.e. *guanxi*) are still 'fundamentally different from networks in the West' (p. 222). Overall, comparative studies are a promising approach to understand the nature of informal networks better and to guide future research.

4 CONCLUDING REMARKS

Guanxi networks are characterised by a set of specific features that shape Chinese business and management. These characteristics allow managers to explore freedoms unavailable in other environments, but they also restrict their agency in other fields. Specifically, the business framework set up by *guanxi* networks comprises the following parameters:

- The business environment is divided in network-internal transactions and a network-external market. This implies that managers must actually operate in two distinct business environments characterized by different price structures and risk dimensions. Balancing the respective functions of these two realms for a given business model as well as management of the interface between them requires specific skills that cannot be learnt at university but can ripen only in the context of day to day operations.
- Individuals and their command of resources, not abstract firms, are the elementary forces of the network and all *guanxi*-based business.

This proposition stands in stark contrast to standard business administration and organization studies, which highlight the aggregate resources and organizational strengths of firms as decisive parameters. Individuals in these organizations are understood to be exchangeable. In the context of *guanxi* networks individual decision makers at the very top as well as crucial nodes of firm operations are deemed to be of crucial importance and not easily substitutable.

- Business and management relations are integrated in multiplex interaction patterns, moving beyond purely functional business links. I.e. managers are modelled as human beings featuring social lives that overlap with their business interests. As such business is understood to feature a strong social dimension that cannot be explained by standard business rationality (*homo oeconomicus*).
- Business relations are designed for long-term cooperation. This implies that once established business relations feature strong structural

inertia, which makes them crisis resistant, but also increases the danger of becoming locked-in to sub-optimal interaction patterns.

- Informal communication structures allow for fast responses to positive and negative exogenous shocks. Exactly those structural patterns that lead to high structural inertia on the other hand allow for fast coordination to challenges suddenly arising in the business environment.
- Network size limits the access to resources and scope of individual business activities. As networks, by definition, never encompass the whole market and restrict their club-like membership advantages to a limited group of actors, certain resources must be sourced from the outside. “Inter-systemic” management of transactions at the interface to the outside world therefore constitute a crucial complement to all network internal business activities.
- Investments in monitoring and sanctioning mechanisms for network-internal transactions can be reduced to minimal levels. Due to the high fixed cost of network membership and low variable cost of network internal transactions, opportunistic behaviour is discouraged. Network norms violating behaviour is sanctioned prohibitively inside the network community. As such resources can be diverted to other value creating activities thereby enlarging the (potential) scope of entrepreneurial agency.
- Trust and reputation invested in network members trump displayed capability of outsiders. Given the specific mix of fixed and variable costs of *guanxi* business, a bias exists for

conducting business with network partners, even though outsiders may feature a better functional fit. As a result inefficiencies may arise that – if not alleviated – may endanger competitiveness vis-à-vis contenders operating out of integrated market systems.

- Reciprocity constitutes a primacy but may result in inefficient lock-in constellations. Just like in the case of trust accumulated in network members, this phenomenon may lead to a creeping loss of competitiveness. Management is required to strategically plan beyond existing network patterns.
- Risk-assessments in the context of *guanxi*-based transactions must (also) consider other parameters than market-based transactions. Management in *guanxi* networks must consider a different mix of risks as some risks arising in market environments are absorbed by the network, while new network-internal risks arise.

These features have been instrumental in navigating the difficult hybrid markets of China's reform economy since the last 40 years. Today *guanxi* relations continue to persist in their relevance for Chinese business and management. While losing functionality in some areas, they attain new usage in other fields. As Bian and Shua (2019) illustrate, *guanxi* networks are increasingly employed in a flexible manner that allow the best characteristics of these particularistic networks, on the one hand, and the performance, merit-based principles of capitalist markets, on the other hand, to structure business transactions in the contemporary Chinese economy.

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