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***Can Western interorganizational governance mechanisms be applied to a  
guanxi-based market?***

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# CAN WESTERN INTERORGANIZATIONAL GOVERNANCE MECHANISMS BE APPLIED TO A GUANXI-BASED MARKET?

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## **Abstract**

**Purpose** — The emergence of “interorganizational marketing” as a hot topic leads to one key question: can interorganizational governance mechanisms (socialization, incentives, and monitoring) offered by marketing theory be applied to China, an emerging economy characterized by the Chinese guanxi relationship? This paper finds that the answer is “yes” and develops a theoretical model to show such interactions.

**Design/methodology/approach** — The paper applies interorganizational strategies to interpersonal relationships. Guanxi was categorized into three categories – family members, helpers and business partners – which meet each of the three governance mechanisms (in addition to favoring exchange as a special and typical Chinese governance mechanism) in the model.

**Findings** — Through ex-post role activation, the paper argues that guanxi is a dynamic balance and the ways in which various governance mechanisms can set roles will lead to the roles either changing (reinforcement or dilution) or switching (helper to business partner, and vice versa). It seems futile to implement external governance mechanisms on family ties (the main category of guanxi) that have been firmly rooted in Chinese culture. On the other hand, applying the four mentioned governance mechanisms could reinforce, maintain, or dilute helper and business partner roles, or even make it possible to switch from one to another.

**Originality/value** — The paper proposes a new concept regarding relationship marketing, namely the application of governance mechanisms to interpersonal relationships, which provides people doing business in China with a new perspective for reference.

**Keywords:** Guanxi, Roles, Interorganizational Governance Mechanisms, China

**Paper type:** Conceptual Paper

“Zhi ren zhong yu zhi wu” (Who you know is more important than what you know) – Chinese proverb

## **Introduction**

In China, traditional Confucianism attaches great importance to social connections and emphasizes that individual happiness and social harmony can only be achieved when everyone plays their proper roles within different social networks (Chen, 2005). The Confucian world, which includes China, Japan, Korea and some Southeast Asian countries, is strongly influenced by Chinese culture and acknowledges the significance of social connections in social and economic life. Along with the development of Asian economies since the 1950s, this particular phenomenon aroused great interest in Western scholars, which led to people’s social connections becoming a hot intercultural research topic. “Guanxi” (Chinese), “kankei” (Japanese), and “kwankye” (Korean) have all been universal English vocabularies already (Chen, 2005). Davies et al. (1995) explained Chinese guanxi as a conflict/harmony dichotomy or dilemma because of institutional weakness and an efficient network mechanism on account of the poor development of property rights and contract law. However, these are only a few aspects of the phenomenon and are judged from a narrow perspective. Guanxi is one of the ramifications of the Chinese culture that has a long history. It is very difficult for individuals to make even slight changes to the cultural environment, but they can learn to adapt and accept them.

In recent times, more and more scholars have become interested in relationship marketing theory (e.g., Grayson, 2007; Gu *et al.*, 2008). Heide and Wathne (2006) argued that, at the organizational level, there are two prototypical relationship roles: (1) a “friend” who uses a “logic of appropriateness” and follows established rules, and (2) a “businessperson” whose decisions are guided by utility-maximizing considerations under a “logic of consequences.” In addition to these two roles, however, the Chinese guanxi also maintains a dyadic personal cooperation equilibrium. In guanxi-based business practices, people not only pursue temporary cooperation and utility-maximization, but also future expectations. This raises the question of whether Western interorganizational governance mechanisms (socialization, incentives, and monitoring) can be applied to China, which is an emerging economy characterized by the Chinese guanxi-based market.

This paper seeks to answer this question by introducing the importance of guanxi roles and by illustrating how to apply proper governance mechanisms to roles activation in Chinese business practice. The paper proposes a new concept regarding relationship marketing;

through ex-post role activation, the paper argues that guanxi is a dynamic balance and that the ways of setting roles with varying kinds of governance mechanisms will either lead to roles changing (reinforcement or dilution) or switching (helper to business partner and vice versa). While it seems futile to implement external governance mechanisms on family ties (the main category of guanxi), which are firmly rooted in Chinese culture, applying governance mechanisms could make it possible to reinforce, maintain, dilute, or even switch between helper and business partner roles. This paper contributes to relationship marketing theories and provides a new frame of reference for people doing business in China.

The rest of the paper is structured as follows. The next section will provide a brief review of the relevant literature. This is followed by the conceptual model, and the last two sections offer further discussion and point out an orientation for further research.

## **Theoretical Background**

### **Interorganizational Governance Mechanism**

Before presenting the concept of interorganizational governance mechanisms, it is necessary to elaborate on what governance actually is. Early studies on the subject treated governance quite broadly, as a “mode of organizing transactions” (Williamson and Ouchi, 1980), while others defined the subject in a narrow sense as “a shorthand expression for the institutional framework in which contracts are initiated, negotiated, monitored, adapted, and terminated” Palay (1984, p.265). A more popular definition appears to be that of Heide (1994, p.72): “Governance is a multidimensional phenomenon, encompassing the initiation, termination and ongoing relationship maintenance between a set of parties.” Since Heide, an increasing number of scholars have favored the concept of governance as “a set of mechanisms” (Denis and McConnell, 2003). Based on those mechanisms, it is possible to maintain organizational operation and meet organizational targets by establishing a series of institutional arrangements, coordinating organizational stakeholders in terms of their relationships and benefits, making scientific decisions, and implementing proper incentives and monitoring to stakeholders (Williamson, 1975).

There are two types of governance mechanisms. Denis and McConnell (2003, p.2) argued that, “The governance mechanisms that have been most extensively studied in the U.S. can be broadly characterized as being either internal or external to the firm.” As far as internal governance mechanism is concerned, Jensen (1993, p.51), for instance, claimed that such a mechanism is “the top-level control structure, consisting of the decision rights possessed by

the board of directors and the CEO, the procedures for changing them, the size and membership of the board, and the compensation and equity holdings of managers and the board.” The other mechanism is the external one, also referred to as the interorganizational governance mechanism (e.g., Heide, 1994; Wathne and Heide, 2000). Heide and Wathne (2006, p.94) divided such governance mechanisms into two categories: parties’ identification (implemented through selection and socialization) and managerial system design (based on incentives and monitoring). These categories are the main focus of the following discussion. Among the four approaches, socialization, incentives, and monitoring are applied to the conceptual framework of the study. Selection is excluded, as the focus is on interpersonal guanxi without any other relationship selection.

From an interorganizational governance perspective, Heide (1994) developed three forms of governance (relationship initiation, relationship maintenance, and relationship termination), in which he discussed how several types of governance mechanism – such as role specification, planning, adjustment, monitoring, incentives, and enforcement – can be applied at the organizational level. Thus, the governance mechanism at the organizational level is to balance organizational relationship among organizational stakeholders. Specifically, Wathne and Heide (2004) drew on the interorganizational governance perspective in order to explain external stakeholders. They contended that “the ability to show flexibility toward a (downstream) customer under uncertain market conditions depends on the governance mechanisms that have been deployed in an (upstream) supplier relationship” (ibid, p.73). Moreover, Wathne and Heide (2000) have previously linked governance strategies to different forms of opportunism, through which they highlighted the fact that several interorganizational governance mechanisms, such as monitoring efforts and incentive structures, are, in principle, capable of solving opportunism problems.

Finally, governance mechanisms (both internal and external) in emerging countries have different characteristics than those in developed countries. A vivid example can be seen in Selekler and Öktem’s (2009, p.209) study of Turkish family business, which noted that “business systems of emerging economies are built on principles quite different from the principles of corporate governance introduced by OECD.” On the other hand, by examining over 1200 firms across eight emerging markets, Gibson (2003) pictured governance mechanisms in emerging countries and reached a conclusion that seems somewhat surprising but is actually quite accurate: that governance mechanisms in emerging marketing are efficient. All these conclusions provide theoretical support for the following discussion of Chinese guanxi.

## **Guanxi**

As an academic term, guanxi has been defined in many ways over the last three decades. Bell (2000, p.133) said, “guanxi is a mechanism by which individuals are able to achieve personal, family, or business objectives.” This definition indicates that dynamicity and the pursuit of interests of guanxi, the establishment of guanxi, and objective interests are produced simultaneously. Yeung and Tung (1996) emphasized the achievement of benefits and “two-party” transactions on the basis of establishing guanxi, which means that both parties must derive benefits from the transaction in order to ensure the continuation of such a relationship. Accordingly, they defined (ibid, p.55) guanxi as “the establishment of a connection between two independent individuals to enable a bilateral flow of personal or social transactions.” Similarly, Fan (2002b) defined guanxi as a process of social interactions that initially involves two individuals (A and B). Yang (1994) concentrated on the essential mechanism behind guanxi, arguing that once guanxi is established between two people, each can ask a favor of the other with the expectation that the debt incurred will be repaid sometime in the future. Yang claimed that favor exchange is a necessary part of establishing guanxi, but that it cannot be measured quantitatively, as it mostly involves emotions, affection, feelings, considerations of “face”, and so on. Davies et al. (1995, p.208) defined guanxi as “the social interactions within the network place and its members in the equivalent of an infinitely repeated game with a set of people they know.” Guanxi, therefore, shifts from being a two-person game to a larger network establishment, which brings more of a guanxi base. Furthermore, Xin and Pearce (1996) had a macro view that guanxi is the lifeblood of personal relationships in Chinese society, arguing that managers who run business in China should realize the importance of establishing wide interpersonal connections for their business needs.

Guanxi is tightly tied to the China’s traditional culture. In the fact of internationalization and globalization, there is no suggestion that Confucianism will lose its impact on modern Chinese society (Vanhonacker, 2004). Confucianism teaches that individuals are relational beings and that people should fulfill proper roles in relationships (Michailova and Worm, 2003). Under Confucianism, “helping friends through connections is a moral and social obligation” (ibid, p.515). Guanxi is a basic tool with which the Chinese can fulfill their roles. For instance, many Chinese learn from a young age how to maintain harmony with others by exchanging favors or “saving face” (that is, not humiliating others) (Yang, 1994).

Three characteristics of guanxi, which provide the foundation of our analysis, are summarized here. Firstly, guanxi is an interpersonal relationship. To some extent, however, some scholars have misunderstood guanxi as interorganizational relationships. For example,

“a firm could enhance its performance by benefiting from the guanxi network it has established” (Luo and Chen, 1997, p.4) and “Guanxi is a cultural characteristic that has strong implications for interpersonal and interorganizational dynamics in Chinese society” (Park and Luo, 2001, p.455). In fact, the definitions provided above show that guanxi only refers to interpersonal connections that could be developed between family members, friends, classmates, schoolmates, people from the same town, business partners, etc. Secondly, the guanxi base is the main premise for developing guanxi. Guanxi could not be developed between two total strangers who had no shared guanxi base. “Strangers have to share indirect guanxi base in order to develop guanxi, that is to say, no guanxi base, no guanxi happening. Guanxi can only be produced when guanxi base plays roles for specific purposes at a particular time” (Fan, 2002b, p.547). Thirdly, guanxi is dynamic. Natural relationships could develop a guanxi base, but if people who hold the guanxi base do not take advantage of shared attributes or apply the guanxi base to reality, dynamic guanxi will never occur. A non-natural relationship is produced on the basis of a natural one and is tightly related to action. Action is likely to begin with a favor exchange; otherwise, guanxi simply remains natural and may only be considered as guanxi base.

### **Connecting Interorganizational Governance Mechanisms with Guanxi**

According to marketing theory on interorganizational relationships, the governance mechanisms mentioned above are usually adopted at the firm level. The major theories that Heide (1994) used for his pioneering article, which synthesized interorganizational governance mechanisms, are all designed to analyze relationships among firms. These include marketing channels literature (Stern and Reve, 1980), resource dependence theory (Pfeffer and Salancik, 1978), transaction cost theory (Williamson, 1975), and relational contracting theory (Macaulay, 1963).

On the other hand, many works have shown that applying marketing theories at a personal level is feasible. Firstly, theoretically speaking, normal business theories still consider that individuals have more or less influence on firms’ performance (e.g., Andrews, 1960, p.60; Cyert and March, 1963, p.9). Individual ties can be partially attributed to interorganizational characteristics (Breiger, 1974), while “Interunit ties are often a function of interpersonal ties ... the simultaneous mapping of units as well as individuals can contribute to a better understanding of both interpersonal and interunit networks” (Brass *et al.*, 2004, p.801). Secondly, there is a paradigm that primarily illustrates marketing issues from sociological perspective. Some research has addressed how individuals’ endogenous factors, such as

power, personality, and status, help create interorganizational relationships (Kilduff and Tsai, 2003). Some sociologists believe that a person's personal relationships generate social capital for the group to which the person is attributed (Burt, 1992; Coleman, 1988). Moreover, many scholars have sought to identify the "correct" matches between various roles and governance mechanisms. For example, Price and Arnould (1999) classified four personal friendship roles, with which they quantitatively modeled the commercial friendship and explained how such friendships form. Grayson (2007) went a step further with a survey of 685 agents, based on which he proposed that personal friendship can influence business both positively and negatively, depending on different circumstances.

One significant characteristic of guanxi is that the guanxi-based market is built on personal relationships. As soon as the relationship between organizations becomes formal and contractual, such as strategic alliances, joint ventures, and mergers, guanxi ceases to exist (Fan, 2002b). In other words, formal interorganizational relationships are not equivalent to guanxi. It is only when business transactions need to be reached by resorting to personal relationships that interorganizational relationships have a "guanxi face."

This leads to the question of when and how such governance mechanisms can be applied at a personal level. In fact, the Chinese have a special method that deconstructs business from the firm level to the personal level (Peng and Heath, 1996). This process is explained by Gu et al. (2008, p.15): "If person A approaches person B, with whom he or she has interpersonal ties, for a favor in a business exchange, person B is obliged to treat the exchange the same way he or she would treat person A. Otherwise, Person A may feel disrespect or loss of 'face.' This process bundles interpersonal guanxi with corporate guanxi. This process also operates in the opposite direction. Person A can pay off his or her personal obligation to Person B by giving favoritism to a business exchange Person B is involved in ... by doing so, corporate exchange (and favoritism) is personalized."

Furthermore, guanxi can replace interorganizational relationships in some situations because it is a personally private asset. Guanxi positively benefits a firm's performance. It helps firms access scarce resources caused by China's unsophisticated marketing institutions that create inconvenience and barriers for business in certain cases, especially in a planned economy (Xin and Pearce, 1996). Guanxi also reduces transaction costs by cultivating trust among firms, which particularly benefits small firms (Ramasamy *et al.*, 2006). The dark side of guanxi is that, unlike Western business models, which are based on formal contracts, firms in guanxi-based models may be "kidnapped" by those who have strong guanxi (Tsang, 1998). In this situation, if such persons quit or leave their jobs, all relevant businesses might collapse.



All in all, the above statements show that individuals are a force that determines business activities. However, because they regard interpersonal force as an outlawed “trade,” many Western business theories don’t emphasize the importance of such force. For example, Burt (2002, p.343) noted that “there is almost no research on the stability of interpersonal relationships.” In guanxi, however, the Chinese not only mix interpersonal relationships with normal business relationships, but also they have a special rule and philosophy that guides people to adapt to guanxi. This, in turn, makes it feasible to apply Western governance mechanisms in Chinese guanxi (Guthrie, 1998; Wank, 1996). The next section articulates this governance mechanisms-guanxi combination by presenting a conceptual model.

## **Roles and Governance Decision Making in Chinese Guanxi: A Theoretical Framework**

This section develops a theoretical framework that matches a variety of guanxi roles with various types of governance mechanisms. Based on guanxi theory, initial roles in guanxi are classified into two types, nature and non-nature, from which three kinds of guanxi relations appear: family members, helpers, and business partners (Su and Littlefield, 2001; Wong, 2007). After a certain guanxi relation is built, three governance mechanisms are combined with such guanxi relations, followed by a detailed analysis of different combinations. The paper emphasizes that one of the biggest differences between guanxi and relationship marketing is that guanxi can be activated by one particular governance mechanism, favor exchange, which is a typical Chinese vehicle. The paper briefly presents all of the interorganizational governance mechanisms, followed by the conceptual framework, which notes how and why guanxi relations are classified into three roles. The governance mechanisms are then matched with each of the three abovementioned roles.

## **Concrete Interorganizational Governance Mechanisms**

Numerous special issues and edited volumes in marketing research have clearly shown how it is possible to effectively manage interorganizational relations (Heide, 1994; Heide *et al.*, 2007). Four basic governance mechanisms – selection, socialization, incentives, and monitoring (Bergen *et al.*, 1992) – are widely accepted by marketing scholars. Because guanxi is formed in natural and non-natural ways (Farh *et al.*, 1998; Hammond and Glenn, 2004), as opposed to direct and indirect ways (Wathne and Heide, 2000), the mechanism of “selection” is overlooked in favor of the mechanism of “favor exchange.” Heide and Wathne (2006, pp. 94-95) have already provided detailed synthesis of four such Western-style

governance approaches; the current paper simply covers these, while also introducing the Chinese type of mechanism, favor exchange.

*Socialization.* As part of classic business theories, relationship marketing theory assumes that when facing business uncertainty, humans have bounded rationality and opportunism. Apparently, socialization in agency theory is a method that helps agents learn skills and special communicating “languages,” and adapt to the idiosyncratic values required by principals. A significant real-life example is that one side in a transaction (e.g., an employer and principal) offers a training program to the other side (e.g., employee and agent) for the latter to receive enough knowledge and experience before they start work (Bergen *et al.*, 1992, p.7).

*Incentives.* Socialization differs from incentive as a governance vehicle in that it is typed into a “hide action model” in which principals constrain agents’ behaviors by either monitoring or by incentives (Heide and Wathne, 2006). Incentive as a governance method emphasizes offering sufficient benefit to agents, employees, or other business partners that they will reduce their opportunistic behavior. For instance, John (John *et al.*, 1987; John and Weitz, 1989) conducted studies about using fluctuating salaries to test and stimulate employees’ working efficiency.

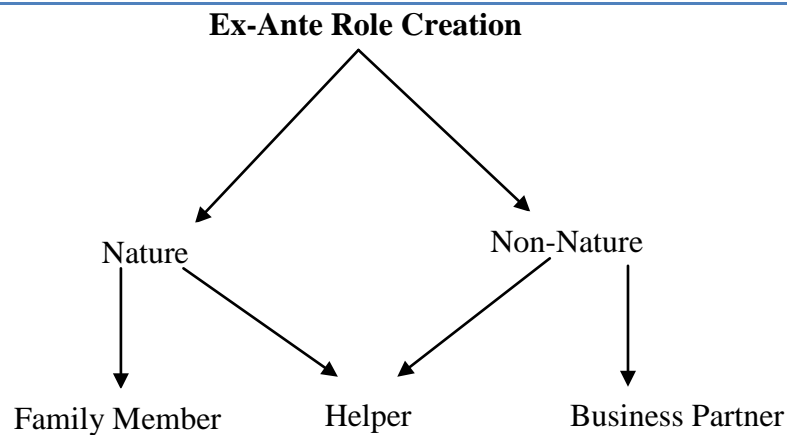
*Monitoring.* “It connotes measuring output performance, apportioning rewards, observing the input behavior of inputs as means of detecting or estimating their marginal productivity and giving as assignments or instruction in what to do and how to do” (Alchian and Demsetz, 1972, p.782). For instance, Eisenhardt (1985) conducted an empirical study of 95 stores to identify the most effective business-context-based control. Anderson and Oliver (1987) and Carvens *et al.*(1993) conducted similar studies.

*Favor exchange.* Favor exchange occurs when one business side does another side a favor, which means that an “unpaid obligation” is naturally borne by the side who receives the favor (Shelanski and Klein, 1995; Standifird and Marshall, 2000). Favor exchange differs from trust, which is “an expectation of goodwill and begin intent and is based on interaction partner’s personal traits and intentions” (Yamagishi and Yamagishi, 1994, p.132). Confusion philosophy submits beneficiaries who receive helps from outside to repay favors to those who issue the favors. In accordance with this philosophy, favor exchange is a governance mechanism, like an invisible hand that causes two sides in a transaction to follow certain rules. Favor exchange is a tacit knowledge, as well as a custom, in which there is no precise model to indicate the most economical behavior in normal business. For instance, in terms of time, Hammond and Glenn (2004, p.26) assert that “favors are always remembered and returned,

but not always quickly.” Furthermore, no one knows what form the favors will take and to what extent.

The following figure shows the current paper’s conceptual framework.

## Conceptual Framework



<b>Ex-Post Role Activation</b>	Socialization	1. Resource waste	5. Role reinforcement	9. Role switching to Helper ←
	Incentives	2. Resource waste	6. Role reinforcement, benefit gains, but high cost;	10. Role reinforcement; or Role switching to Helper ←
	Monitoring	3. Role dilution, and less trust	7. Role dilution; or role switching to Business Partner →	11. Role maintenance; or Role dilution
	Favor Exchange	4. Resource waste	8. Role switching to Business Partner →	12. Role maintenance: more resource can be used; more human debt should be taken

### Ex-Ante Role Creation

Heide and Wathne discussed the two prototypical relationship roles that represent interorganizational relationships: “friend” and “businessperson” (Heide and Wathne, 2006). These are referred to in the present paper as “organizational friend” and “organizational businessperson” because they are commercially based on corporate-to-corporate relationships. The subject of this paper is “interpersonal relationships.” This refers mainly to “real-life businesspeople,” who are similar, but not identical, to “organizational businesspeople.” While an “organizational businessperson” is guided by rational thinking (that is, utility maximization), a “real-life businessperson” is more concerned about humanized obligation. This means that interorganizational relations, including both “organizational friends” and

“organizational businesspeople,” are solely commercial, while interpersonal relations are more social, more complicated, and involve favor exchanges (Luo and Chen, 1997).

Unlike Western sociology, which tends to measure a relationship through the two dimensions of frequency and stability (Brass, 1995), Chinese *guanxi* is measured by psychological distance (Chen and Chen, 2004). *Guanxi* is usually formed either naturally or non-naturally. Some relationships, such as blood relationships (for example, that between a parent and a child) just exist and cannot be created based on individuals’ preferences. Other relationships, particular business relationships, need to be built through some designed means (such as business strategies). Therefore, following Confucianism, the Chinese *guanxi* can be divided into three categories: “family member,” “helper,” and “business partner” (Fan, 2002b).

*Family member.* As far as Chinese *guanxi* is concerned, the most crucial category is “family member.” *Guanxi* operates in concentric circles, with close family members at the core and other acquaintances arranged on the periphery (Yang, 1994). Family ties are typically given priority over those outside the family (Chua *et al.*, 2009). Furthermore, extended family networks also play an important role in establishing interpersonal relationships. The other two roles are inferior to family member role in terms of both durability and stability.

*Helper.* Because of the complexity of Chinese *guanxi*, the term “friend” is expanded here into the wider term of “helper.” This category depends primarily on shared identification (Xin and Pearce, 1996) and can include colleagues, classmates, schoolmates, neighbors, people from the same hometown, club members, etc. People can utilize a “helper” network directly and indirectly (involving a third party or even more people). Chinese managers cultivate ties toward those who directly hold the necessary expertise or resources, and also toward those who are connected to those individuals (Chua *et al.*, 2009).

*Business partner.* While transactions in China often follow successful *guanxi*, relationships in the West usually follow successful transactions (Park and Luo, 2001). Business *guanxi* is the least stable personal relationship among the three categories as it is always established based on certain occasions, such as at a business conference, meeting or trade fair, which may or may not help to further cooperation. Therefore, business *guanxi* is defined as “the process of finding business (rather than personal) solutions through personal connections” (Fan, 2002b, p.551). It is helpful for business *guanxi* to be switched to the “helper” level by enlarging *guanxi*-based networks; for example, by developing humanized obligation.

## **Ex-Post Role Activation**

Based on this paper's conceptual framework, the next step is to analyze the differences of matching variable governance mechanisms with various guanxi roles. The study focuses firstly on family member roles, and consequently on helpers, and then on business partners.

*Role of family members.* The core issue is that the role of family members in Chinese guanxi is bonded by blood/kin relations that cannot easily be removed, from the cultural level and from the personal, emotional level. "China's guanxi is developed based on people's familiarity, similarity and friendship. Friendly ties become the center for Guanxi development. Guanxi's building up, maintaining and enhancing is based on how well people know each other, and how friendly they are to each other" (Hackley and Dong, 2001, p.19). Cells 1 to 4 in the figure are all based on this attribute. Cells 1, 2, and 4 are characterized as "resource waste" because, as noted by Yau et al. (2000), the kinships or family ties are very special:

*"Chinese society is built around clan-like networks, with close family members and kinship at the core. The general rule of exchange for individual having close kinship ties is role obligation that implies unconditional protection. Loyalty and trust for family members is an obligation and is rendered without anticipation of reciprocity. Disregarding this obligation can seriously damage one's social reputation and lead to loss of prestige or face. Thus, family members and relatives are those one can depend on and trust the most."* (Yau et al., 2000, p.19)

Cell 1: The role of family members is matched with the governance mechanism of "socialization." This combination is a typical "resource waste" strategy. Family members are normally quite familiar with and loyal to each other (Fan, 2002a), which means that further socialization behaviors are unnecessary and create very limited effects. Yau et al. (2000, p.17) said, "Family businesses are the most common form of corporation among the Chinese. Family members are considered to have the tightest bonds and thus are the most trustworthy." Cell 2 also reflects the same result. A critical reason is that this kind of family relationship in Chinese guanxi is already the closest relation between persons, and although more incentive mechanisms could be imposed on such relations, it cannot improve and cannot be reinforced. Cell 4 is family guanxi connected with favor exchange. Under such circumstances, Fan (2002b, p.551) pointed out that "family guanxi is shaped by Confucian values, emotional driven ... reciprocity is not necessary."

Cell 3 in this column is somewhat special in that the monitoring is the governance mechanism. Because guanxi is based on trust, any behaviors that are opposite to trust would be likely to present a hazard to guanxi. When monitoring is used at the individual level rather than at the firm level, any monitoring action might be regarded as untrusting behavior toward the monitored person, which will make the monitored person uncomfortable. Specifically, in a family member situation, such a monitoring mechanism would not lead to role switch, but it would definitely cause role dilution as two sides within one guanxi would not be willing to cooperate with the other.

*Role of helper.* Cells 5 to 8 are the combinations of helper role and governance mechanisms. Cell 5 is the scenario of helper role with socialization. Such a socialization process is understood here as one side in the business allows their business partner to be more familiar with himself or herself, even if they do not have direct involvement in the matter on hand, as guanxi networks may require meeting obligations to the above individuals (Davies *et al.*, 1995, p.213). Such behavior will entrench the existing roles because helper roles are bilateral and both parties are each other's helpers. For example, managers in China always have an incentive to maintain good guanxi with their employees, employees understand the managers' concerns and managers try to satisfy employees' requirements. This kind of guanxi helps maintain employees' loyalty. Furthermore, Chinese employees would like to become allied with those managers who consider the employees to be their friends (Yau *et al.*, 2000).

Helper relations also involve the two reversed mechanisms laid out in Cells 6 and 7. More incentives should have a positive effect on helper relations. In Cell 6, incentive as a marketing approach simultaneously strengthens helper role and increasing commercial benefit. For example, Arias (1998) presented an example in the consumer product market. Chinese consumers are quite brand loyal and reluctant to try new brands, which makes it very difficult for newcomers to enter certain markets. The personal relations of a company's internal staff could be utilized to promote new products, such as offering several bottles of new brand shampoo to a friend as gift (indirect advertisement fee), which could also help reinforce friendship. By the time some of the friend's neighbors notice this brand and decide to try the new product, the brand name has spread rapidly by word of mouth in the shampoo market. As mentioned above, however, such relations cannot generally switch to family relations, no matter how great an incentive is paid from one side to the other. As well, such a mechanism might increase unnecessary transaction costs. Cell 7, in contrast, illustrates a situation that would cause negative effect on helper role, either resulting in role dilution or in role switching to a business partner. Trust is the foundation of Chinese guanxi. Therefore, any behavior that

violates trust will threaten the guanxi. Consider the example of a principal who sets a series of rules to monitor an agent. If the rules are aimed at a group of people, that should be acceptable. But if they are imposed on a person-to-person relation, the monitored side (in a helper relation) could become unhappy. The monitored party will then either reduce their cooperation or simply consider the cooperation as a purely business relationship.

With regard to Cell 8, Yang (1994) indicated that the helper role with a favor exchange goal cannot last for an extended period. After the first several transactions built on favor exchange, both parties in the business will automatically adjust their roles from a helper relation to a purely business relation. By way of example, Yang (1994, p.169) offered the following story: “A business manager admits that he might give an old friend or classmate low price in recognition of their special relationship. But, this is only on the first transaction. After that he would treat them like normal business partner.” In this case, the non-normal low price could be treated as a kind of favor exchange in which the manager starts a business with his friend and, at the same time, his friend will also bear a human debt in such a transaction.<sup>1</sup>

*Role of business partner.* Of the three roles, business partner roles in China might have the fewest differences from those of the West. Cell 9 shows that the business partner role encounters socialization governance mechanism. The premise of this combination is that, unlike Westerners, who used to rely on law and litigation, “the Chinese use personal contacts and negotiations to resolve disputes” (Pearce and Robinson, 2000, p.35). Guanxi enhances competitive advantage by providing access to the resources of other members, and are particularly important in terms of market entry, where their strategic role has been well-documented (Davies *et al.*, 1995, p.209). In this scenario, socialization becomes a more informal communication among business participators. In addition, such communication helps to switch business partner roles to helper roles by gradually cultivating and finding interpersonal common points. Chua *et al.* (2009, p.493) added to this, saying, “after several times family events like dinners and birthday parties, such business role becomes personalized.” In the labor market, the employer-employee relation also reveals that “managers who take time to interact and socialize with employees they gain their respect and trust, and find that Chinese employees are extremely loyal once guanxi has been established” (Pearce and Robinson, 2000, p.33).

For Cell 10, incentive (developing and expanding guanxi) could be applied to business partners as a form of investment in social capital (Burt, 1997) that enriches the executive’s

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<sup>1</sup> Some scholars, such as Fan (2002b), do not agree with Yang, arguing that guanxi is a long-term relationship and that favor exchange is necessary and indispensable.

current resources and future potential. It might also be similar to Heide and Wathne (2006)'s explanation in which such relationships should be enhanced when the role is originally set up as business orientation, and then by using an "appropriate" governance mechanism. Nevertheless, Heide and Wathne (2006) did not refer to a personal level dimension. In essence, "firms will always be held hostage by staff with strong guanxi" (Gu *et al.*, 2008, p.13), and some changes (such as the retirement or transfer of a CEO) would cause a problem or an improvement to the existing relation because guanxi is a personal asset (Bjorkman and Kock, 1995; Yeung and Tung, 1996). Accordingly, the present paper submits that incentives as a mechanism used at the firm level could result in a role switch from business partner to helper. Consider the following situation in a principal-agent relationship. A principal decides to improve the economic performance of one of its agents by offering a financial stimulus package, which is executed by a seller representative named A in the principal. The agent receives such financial support and the agent's CEO, called B, builds a good personal relation with A. Some day A moves to another firm. At this time, it is extremely likely that B will offer strong support to A as he knows "well begun is half done" for A, particularly if A and B cooperated successfully in previous transactions. The role between A and B then changes from business partner to helper.

Cell 11 is akin to what Heide and Wathne (2006) described: this is the "correct" match between role and governance. This is true even at a personal level. In addition, such monitoring governance may also dilute the role, especially if one side in a business is tightly constrained. The principle is the same as that explained in Cell 7. Moreover, in real life, Pearce and Robinson (2000) and Yau *et al.* (2000), among others, found that many Western managers find it difficult to trace and monitor the behavior of Chinese employees. The Chinese employees may continue working there for certain reasons (such as salary), but they may consider the manager to be an outsider with whom they barely have any employment relationship.

The last cell is the combination of business role and the favor exchange approach. Such a relationship is helpful to business participants. An old Chinese saying captures the essence of favor exchange: "If someone pays you an honor of a linear foot, you should reciprocate by honoring the giver with 10 linear feet." Yau *et al.* (2000) has a story that enhances this point.

*"A raw material supplier in China was facing a financial crisis. He asked one of his manufacturers, who had been his customer for years, to lend him \$10 million to tide him over the difficulty. The manufacturer considered their relationship a good one and, empathizing*



*with the supplier's situation, he lent him the amount without collateral. A few years later, when the manufacturer was desperately short of some raw materials, the supplier reciprocated the favor by giving the manufacturer first priority to obtain all the raw material he needed to fulfill customer orders in time to maintain his market reputation” (Yau et al., 2000, p.20).*

Meanwhile, the present paper also recognizes that such favor exchange needs business participants to cultivate it. Favor exchange is a double-edged sword. The above story shows that the supplier received a financial “bailout” from the manufacturer, but the supplier also bore around \$10 million of “human debt,” which he had to pay back (and later did).

## **Discussion**

There have been many attempts to extend the existing knowledge of the Chinese market. These attempts can be divided into three categories. The first way discusses whether guanxi in marketing relation is consistent with Western ethical standards. Papers of this type are normally published in business ethics journals (e.g., Dunfee and Warren, 2001; Lovett *et al.*, 1999). The second way concerns how guanxi can be used to do business in China. Scholars from Hong Kong, Taiwan, and Singapore created a body of empirical studies on such issues (Wong, 2007; Wong and Chan, 1999; Yao, 2002; Yeung and Tung, 1996). The third way is directly applying Western business theories (e.g., marketing theories like TCE, agency theory, networking theories like Burt's structural hole (Burt, 1992) and Coleman's closure (Coleman, 1988), and the resource-dependence view, etc) to the Chinese market, like Xiao and Tsui (2007) did.

In accordance with Heide and Wathne (2006)'s study, the present paper contends that there actually is a method that makes it possible to combine the mainstream Western interorganizational governance mechanisms with the Chinese guanxi role that differs from the Western business role (Biddle, 1986). This method goes beyond most of the existing guanxi literature, in which guanxi is dealt with as a “static” balance; for instance, good guanxi increases mutual trust that increases working efficiency and profitability (Lu *et al.*, 2008). Guanxi is a dynamic balance in which the ways to activate roles by governance mechanisms will either lead to the role changing (reinforcement or dilution) or switching (helper to business partner, and vice versa).

Because Heide and Wathne's (2006) work has already built up a benchmark model of roles and governance mechanisms, it is important to highlight the differences between our work and that of Heide and Wathne (2006).

1. Contrary to Heide and Wathne (2006), there is no so-called "correct match" and "incorrect match" between the guanxi roles and governance mechanisms. Heide and Wathne's created the friend role and business role artificially: selection,<sup>2</sup> socialization, incentive, and monitoring are accompanying with roles from beginning to end. In the Chinese guanxi, however, such a causal relation is not evident.

2. Furthermore, the present paper views the helper role and business partner role as relative concepts in guanxi because they could vary according to variable governances adopted by two individuals in one guanxi. To a large extent, this is because guanxi is a "psychological net space" (Chen and Chen, 2004), and trivial and informal behaviors, communications and attitudes directly affect individuals' feelings towards one another. In addition, such guanxi relations change quickly and easily with little transaction cost, because most psychological feeling could not be measured and written down clearly in formal contracts.

3. Recently, new institutional economics (such as transaction cost theory and agency theory) have prevailed in business research and are more and more inclined to become a standard tool for conducting interorganizational marketing research. However, this paper argues that institutions, like culture, politics, religion, and customs, are as important as business strategy and management/control methods for firms. From this point of view, our work contributes to and expands Heide and Wathne (2006)'s theory. More concretely, such theory is applied to China's business context and given a "Chinese countenance."

## **Further Research**

Based on the paper's theoretical framework, further studies could be conducted from several perspectives.

1. *Premise*. A basic but not simple question that remains to be asked is referred to here as the "crash of premise." While many scholars have been familiar with the fact that people, as well as firms, are not 100 percent self-interested and profit-oriented (Uzzi, 1996), opportunism is still treated as a critical premise on individuals' behavior. So, when such premises are mixed with the Chinese guanxi, business benefit is important but is not as important as what new institutional economists declared. The extent to which opportunism as

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<sup>2</sup> Selection only exists in the first phrase of role creating (Heide and Wathne, 2006).

a premise could be applied to guanxi (e.g., family member guanxi) still leaves room for future research.

2. The framework in this paper makes it clear that there are switches between helper role and business partner role. As far as knowledge is concerned, however, there is a scarcity of articles that explain such dynamic process, either from a conceptual or empirical perspective; for instance, the extent to which a governance mechanism will quantitatively cause role switches.

As an emerging economy, China has attracted growing attention from business scholars. However, China also has its own special rules and business cultures that distinguish it from other markets. Many researchers have argued that, although the materialization of its economic development will popularize advanced Western management methods in China, guanxi as a cultural heritage will not disappear (Luo, 2007). As Vanhonacker (2004, p.53) noted, "We only have to look at Hong Kong or Taiwan to see guanxi survive in modern, rule-of-law societies ... guanxi relationships, with their unique code of ethics, will always be an ingredient of doing business in China." Because of the variety of roles in the Chinese guanxi and the need to test them empirically with various governance mechanisms means that there is still a long way for business scholars to go.

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