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**Guanxi networks as business and  
investment advantage of Overseas Chinese  
in Mainland China**

**by**

**Tobias Rottwinkel**

**2012**

A dissertation presented in part consideration for the degree of MSc International Business

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# Abstract

Guanxi has been a fundamental element of the Chinese culture for centuries and its significance in modern day China should not be underestimated. Guanxi is considered to be an essential means for business and corporate success in China. It can inter alia facilitate the access to top-level decision-makers, reduce information and transaction costs, and improve the overall competitive positioning of a firm.

The dissertation aims to analyse guanxi in the context of ethnical Chinese investment in China. It is analysed whether guanxi constitutes a unique investment advantage that ethnical Chinese possess over Western companies. A case study analysis of Robert Kuok's business operations provides practical insight into the benefits of guanxi and its implications for Western companies using the example of Coca Cola in China.

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**Key words:** Guanxi, Overseas Chinese, investment, China

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## 1. Introduction

Fast globalisation requires companies to learn and understand a lot more about foreign markets. The generally accepted values, norms and ethnics can strongly vary from culture to culture and between geographic regions. The understanding and thoughtful interpretation of foreign cultures, their customs and norms can be essential for business success.

The ethnic group of the Chinese represents the largest ethnic group of the world. Literally one fifth of the world's population is Chinese or of Chinese descendant. The People's Republic of China and countries with strong Chinese minorities in Southeast Asia have shown some of the highest economic growth rates in recent decades and play an increasingly important role in international business and global politics. The recent phenomenon of Chinese businesses and ethnical Chinese businesses going international made the research on these topics more popular. The fast growth of these companies and the increasing competitive environment that resulted from this development means that the understanding of the ethnic Chinese businesses has become crucial (Redding, 1996). This paper aims to analyse the increasing economic power of ethnical Chinese in the region and examines their business advantages in Mainland China that derive from their cultural and social ties with China.

For the further analyses we refer to the Chinese minorities or ethnic Chinese in East Asia namely Taiwan, Hong Kong, and in Southeast Asia, namely Singapore, Malaysia, Indonesia, Thailand, and the Philippines as Overseas Chinese (OC).

The focus of the analysis is on a particular Chinese networking style known as *guanxi*. There is unfortunately no exact translation of the term *guanxi* but it is most typically translated as personal connections. The literature review provides us with an in-depth overview about the characteristics and implications of *guanxi* and how *guanxi* emerged and developed in the



Chinese society. It is argued that a century-old concept such as guanxi with its roots in the Confucian tradition of China still plays a significant role in the social, political, and economic lives of the Chinese.

The literature review provides us with a closer look at the phenomenon guanxi and at the prevailing conditions that underlie its establishment and cultivation. An important part of this chapter is the examination of the impact of guanxi networks on business performance. Many authors consider guanxi to be a key factor for business success in China and in Chinese societies (Luo, 2007, Seligman, 1999, Wilson and Brennan, 2010, Yeung and Tung, 1996). We analyse the benefits and disadvantages that arise from the use of guanxi and how guanxi can be used to leverage business performance? The findings from this part are used for the further analysis of the OC business practices in Asia. Several authors such as Rauch and Trindade (2002), Gu et al (2008), Steidlmeier (1999) have warned of the negative and harmful sides of guanxi. A closer look at these warnings provides us with an overview of the negative aspects of guanxi and their impact on business performance. An analysis of the future of guanxi and a summary conclude the chapter.

The discussion chapter analyses guanxi's influence on the business practices and deals of Southeast Asian OC. Most OC that live in Southeast Asia left from the coastal provinces of Fujian, Guangdong or Hainan in the 19<sup>th</sup> and early 20<sup>th</sup> century after the collapse of the Qing dynasty which brought political and economic uncertainty to China. These unrests were followed by famines and social structural disintegration (Chen, 2004, Haley et al, 2009). The need for labourers and better living conditions in the former British colony of Malaya, in the Dutch colony of Indonesia, in Thailand, or in the Philippines attracted many Chinese emigrants (Wah, 2001). These emigrants understood themselves predominantly as Chinese and only in a second instance as citizen of their host countries. They brought their customs,

values, and practices to their new home countries, maintained their traditional way of life and interacted mainly with the existing Chinese population of these countries (Chen, 2004).

The increasing importance and success of these entrepreneurs make it essential to have a closer look at the business practices of OC (Luo, 1997). We analyse if the familiarity of the OC with the Chinese culture and their use of *guanxi* with Chinese businessmen and the Chinese government resulted in significant business and investment advantages over Western companies in China? To support the findings of this research we analyse where appropriate the business operations of Robert Kuok in East and Southeast Asia and his use of *guanxi* to obtain investment and business advantages in China. The final section of the discussion part analyses the implications of these findings for Western companies and how their operations in China can benefit from collaborations with OC businesses. An analysis of Coca Cola's business operations in China and its collaboration with Robert Kuok's Kerry Group provides an insight in the benefits of this cooperation.

Before we start the analysis we have a closer look at some common definitions of networks. Laumann et al define a network "as a set of nodes (e.g. persons, organizations) linked by a set of social relationships [...] of a specific type" (Laumann et al, 1978 cited in Nohria, 1992, p.4). Luo (2007, p.83) regards networking as "an individual's attempt to mobilise personal contacts in order to profit from entrepreneurial opportunities, or a firm's effort to cooperate with others in order to obtain and sustain a competitive advantage". Liebeskind et al (1996) emphasise trustworthy behaviour as a foundation for networks. Networks can be furthermore a group of individuals who aim to maintain a mutual and steady exchange with one another (Rauch, 2001). We can therefore summarise that a network involves mutual exchanges based on trust between two or more individuals over an extensive time period with the objective to generate mutual benefits and to gain a competitive advantage.

Business networks are however not a unique Chinese phenomena (Kienzle and Shadur, 1997). The Old Boy Network is prevalent in many Western countries, Koreans know personal networks as Kwankye, Japanese as Kankei, while the Russians refer to connections and relationships as blat and Arabs as wasta (Michailova and Worm, 2003, Hutchings and Weir, 2006, Wilson and Brennan, 2010). The analysis of guanxi attracted however considerably more attention than any other culturally embedded networks because of the implication that guanxi has on the daily life of literally hundreds of millions of people and because of the importance that is given to guanxi in daily social life and business activities by these people (Michailova and Worm, 2003).

## **2. Literature review of guanxi**

The literature review of this paper aims to provide an overview of the nature of guanxi. Guanxi has been analysed mainly from cultural and business perspectives but rather rarely in international economic literature. The findings of this literature review are essential for the further in-depth analysis of guanxi and its implications for OC business in the discussion chapter.

### **2.1. Definition of guanxi**

#### **2.1.1. The term guanxi**

Tsui and Farh (1997) observe that there is no homogenous translation or definition of the term guanxi neither in Chinese nor in English literature. Guanxi is usually translated as relationship or connection and defined as interpersonal network. Western scholars however sometimes interpret and define guanxi with a rather negative notion and equate guanxi with nepotism, corruption or bribery (Hutchings and Weir, 2006, Yeung and Tung, 1996). The cultural lens through which many scholars analyse a phenomenon limits their analytical capabilities and can lead to severe misinterpretations. The Chinese themselves interpret guanxi as social networking and translate the term guanxi most often as relationship or connection without negative connotations (Yeung and Tung, 1996).

Most scholars agree that guanxi connections are long-term oriented, mutually beneficial relationships that are based on trust, mutual obligations, affection, and issues of face. Guanxi can exist between two or more individuals and enables a two-sided flow of transaction that can be of either personal or social nature. A prerequisite for the existence and continuation of the guanxi relationship is the generation of mutual benefits from these transactions (Dunfee and Warren, 2001, Luo, 2007, Michailova and Worm, 2003, Vanhonacker, 2004, Yeung and

Tung, 1996). The adding of reciprocal obligations lets guanxi differ from friendship and other interpersonal relationships (Michailova and Worm, 2003).

Chen and Chen (2004) write that guanxi is a highly informal connection that binds two or more individuals by a psychological contract. The guanxi partners can use their relationship to secure specific favours in personal relations that comprehend the social life of the guanxi partner but may also extend to business affairs (Luo, 1997). Both parties are however compelled to follow the social norms of guanxi, such as mutual commitment, loyalty and continued exchange, as well as reciprocal obligations. Yeung and Tung (1996) argue that the long-term orientation of guanxi and the generation of mutual benefits eventually create interdependence between the parties to the guanxi contract.

Chen and Chen (2004) observe that there are different kind of guanxi, such as business-, family-, political-, and friendship-guanxi that operate in different life spheres of a person. Business guanxi for example represents the ties of a manager to his suppliers, buyers, distributors etc. whereas political guanxi represents ties with the government and regulatory officials (Chung, 2011).

A group and a dyadic perspective on guanxi exist (Chen and Chen, 2004). Former suggests that guanxi is used to maintain social order within the society and that guanxi can be used as a substitute for deficiencies in the legal system. The later perspective emphasises the personal relationship between two or more individuals.

## **2.1.2. Characteristics of guanxi**

### **2.1.2.1. Renqing (Obligations)**

Renqing can be translated as obligations and can be understood as the accumulated unpaid debts or favours that accrue from using guanxi over the lifetime of the relationship (Chen, 2001, Luo, 1997, Luo, 2007).

Reciprocity of obligations and the exchange of favours is a fundamental pillar of social intercourse and one of the most pervasive rules that underlie social and economic transactions in the Chinese society (Chen and Chen, 2004, Steidlmeier, 1999). The general idea of friendship teaches that people should always reciprocate help. The principle of renqing means also that a strong expectation of reciprocity follows each granted favour or offered assistance (Chen and Chen, 2004, Luo, 1997, Tsui and Farh, 1997). Renqing induces feelings of gratitude and indebtedness in the other party and is an important means to continue and develop the relationship (Chen and Chen, 2004, Seligman, 1999). The reciprocating party often tries to repay the granted favour with a little more effort and exchanges are thus more often than not of an unequal nature. This unequal exchange is prove of the continued interest in the friendship and shows that the well-being of the guanxi partner is more important than the own personal gain. To avoid over-indebtedness to a guanxi partner, most Chinese try to keep the economy of favours in a rough balance.

Michailova and Worm (2003) note that the interest in a long-term continuation of the relationship is an important condition for guanxi. It is however not expected to repay a favour immediately and the reciprocation of favours usually takes place relatively late. This is due to the fact that guanxi is weakened when the counterpart judges the debt to be repaid (Seligman, 1999). Chen (2001) argues that guanxi's non-time specific nature makes it so binding and

pervasive. The extension for the repayment symbolises trust and closeness (Michailova and Worm, 2003). The importance of the repayment of renqing obligations should never be underestimated. A non-repaying results in a loss of mianzi or face, an aspect of the Chinese culture that is explained in the further analysis (Luo, 2007, Michailova and Worm, 2003, Chen, 2001).

#### **2.1.2.2. Xinyong (Trust)**

Xinyong literally means the use or usefulness of truth. At the same time it also describes the reputation or character of another person and his or her integrity, credibility, and trustworthiness (Hutchings and Weir, 2006, Kiong and Kee, 1998). China is a relationship based society with a high degree of particularistic trust. This means that the trust among family members is high and low among larger collectives (Chen and Chen, 2004, Yeung and Tung, 1996). Mutual trust is always a fundamental condition for guanxi.

Interpersonal and reciprocal relationships are usually valued over relationships that are of a contractual or transactional nature (Lasserre and Schuette, 2006, Michailova and Worm, 2003). Kiong and Kee (1998) note that Chinese deal with people who have xinyong and tend to avoid people without or with little xinyong. Trust builds the foundation for financial arrangements and all kinds of transactions within the network, minimises fraud, ensures certainty and order, and helps to settle disputes informally, be it in business or in the family (Buckley et al, 2006, Chen and Chen, 2004, Kienzle and Shadur, 1997, Kiong and Kee, 1998, Wong and Ellis, 2002, Yeung and Tung, 1996). Good work performance, commitment, and perseverance in honouring his word help a businessman to maintain his xinyong (Kiong and Kee, 1998, Yeung and Tung, 1996). Decision making that is based on competition instead of guanxi may even be considered unwise and disloyal (Xin and Pearce, 1996).

### **2.1.2.3. Ganqing (Affection/ Feeling)**

Ganqing can be translated as affection or feelings towards another person. It is closely tied to renqing and guanxi (Hutchings and Weir, 2006). Ganqing describes an emotional connection with another person and implies deep mutual understanding. Experience of sharing and interaction through living, working or studying together is a prerequisite to build up ganqing (Tsang, 1998). Strong ganqing brings along loyalty, trust and solidarity. Guanxi partners with high ganqing are more willingly ready to take care of each other independent of the situation and the circumstances (Chen and Chen, 2004). The development of ganqing results in a closer, more dependable and valuable guanxi which increases the chances to secure favours (Kiong and Kee, 1998).

### **2.1.2.4. Mianzi (Face)**

Mianzi is one of the most important cultural aspects in the Chinese society and closely interwoven with guanxi. Buckley et al (2006) interpret mianzi or face as the recognition of an individual's social standing and position. Luo (1997) describes mianzi as an intangible form of social currency which helps to define a person's status in the society. People with an extensive guanxi network possess more mianzi and it is easier for them to establish and extend their guanxi network (Michailova and Worm, 2003).

Maintaining and saving face is an important part of any guanxi relationship (Luo, 2007). It is essential to follow the unspoken rules of guanxi, such as reciprocity and xinyong, to prevent a loss of face. Losing face can result in a serious damage of reputation (Luo, 1997, Park and Luo, 2001). A loss of mianzi and therefore of guanxi also occurs when a person breaks his given word or demonstrates opportunistic behaviour towards other people (Hutchings and Weir, 2006, Luo, 2007). The larger the size of a person's network, the bigger is however the



insurance that a partner will not act opportunistically because opportunistic behaviour would harm the guanxi network as a whole and make the person less trustworthy (Luo, 2007).

## **2.2. Reasons for the existence of guanxi**

There are two main explanations for the existence of guanxi in the Chinese society. Some scholars such as Park and Luo (2001), and Tsui and Farh (1997) agree with a cultural and historical explanation that emphasises the importance of Confucianism for the development of guanxi. Guthrie (1998) and Xin and Pearce (1996) support an economic and political explanation and say that guanxi developed because of inadequately developed legal systems and lack of resources. Lasserre and Schuette (2006) and Kao (1993) combine these explanations. They argue that guanxi developed because of cultural reasons such as the impact of Confucianism and kept its importance because of political and economic developments, such as a poor legal infrastructure, lack of resources, and an environment that was hostile to business operations.

### **2.2.1. Cultural and historical explanation**

Buttery and Wang (1999) argue that culture is the platform on which relationships are built and maintained. Western and Eastern culture differ in many aspects hence the way relationships are developed can differ fundamentally. This applies to the relative importance of the values that characterise relationships too.

Guanxi is embedded in the Confucian philosophy which has preserved a very strong influence on the Chinese society and its moral code (Gao, 2006). Confucianism teaches that a person is fundamentally a social or relational being. An individual can enter into predetermined and voluntary relationships which build the basis for each guanxi network and have to be maintained with great care (Chen and Chen, 2004, Hutchings and Weir, 2006, Tsui

and Farh, 1997, Park and Luo, 2001). Five cardinal relationships (wu lun) define the relationships between ruler-subject, father-son, husband-wife, elder brother-younger brother, and among friends (Chen and Chen, 2004).

Michailova and Worm (2003) note that Confucianism teaches that personal relationships are more important than any man-made rules. The strong influence of the Confucian teachings and the wu lun relationships weaken the impact of the legal system in Chinese societies considerably while guanxi remains strong and all pervasive (Gao, 2006). Chen and Chen (2004) state that modern families in Mainland China and the OC remain to a very strong degree family oriented and are strongly influenced by the cardinal relationships of wu lun.

### **2.2.2. Economic and political explanation**

Most authors define guanxi as a legacy of the Confucian teachings. Guthrie (1998) however argues that guanxi is an institutional defined system which, especially in China, changed with the institutional changes of the reform era. The insecurities that came along with the close to subsistence living conditions in China and a lack of trust in institutional forces contributed to the development of strong networks that could bridge these inefficiencies (Hutchings and Weir, 2006). Further factors that encouraged the development of guanxi are the lack of clear bureaucratic norms, sound legal principles and practice, institutional trust, and developed factor markets (Hutchings and Weir, 2006, Luo, 1997, Seligman, 1999, Wilson and Brennan, 2010). Xin and Pearce (1996) see guanxi as a substitute for weak or non-existent institutions. Lee Kuan Yew, the founding father of Singapore, said that “the Chinese can use their guanxi to make up for the rule of law and transparency in rules and obligations” (Dunfee and Warren, 2001, p.197).

Hoskisson et al (2000) write that the role of institutions is to reduce information and transaction costs. This is achieved through the reduction of uncertainty in the economic and political environment, and through the establishment of stable structures that facilitate interactions. If the government cannot guarantee this reduction of transaction costs, network based strategies may be used to overcome these deficiencies and to reduce uncertainty. The reduction of transaction and information costs is also a major factor that makes guanxi so important for business deals when institutions fail. However, developing and maintaining guanxi is a time-consuming and expensive endeavour. According to a survey by the HK Independent Commission Against Corruption guanxi can account for up to 5% of total cost of doing business in China (Fan, 2002).

The activation of personal relationships can help circumvent rules and overcome institutional barriers and instabilities that companies face in view of frequent regulatory changes (Gu et al, 2008, Luo 1997, Luo, 2007). Luo (1997) notes that the institutional uncertainties in Mainland China and Southeast Asia are fairly high. Networks are hence used to facilitate economic exchanges. Since factor mobility is often severely constrained and government intervention strong, guanxi can provide flexibility of resource allocations (Luo, 1997). Early established relationships provide further advantages such as preferential access to licenses which are often limited by governments (Hoskisson et al, 2000). Guanxi allows thus to bypass the inefficiencies of communist bureaucracy in China where officials still have considerable power to approve projects and allocate resources (Gao, 2006, Zou and Gao, 2007). All this requires however the cultivation of some guanxi with officials.

## **2.3. Establishing and cultivating guanxi**

### **2.3.1. Guanxi base**

A common guanxi base is the basic requirement for the creation of guanxi. A guanxi base can be understood as a commonality of shared identification between two or more individuals, such as familiarity or great intimacy (Dunfee and Warren, 2001, Hutchings and Weir, 2006, Jacobs, 1979, Kiong and Kee, 1998, Luo, 2007).

The sheer complexity of guanxi is often underestimated and thus discussed in very general terms that cannot sufficiently explain the depth of these connections (Fa, 2002). A division of guanxi was carried out by Jacobs in 1979. His study provides an extensive analysis and description of guanxi bases in a Taiwanese township. He admits that the generalisation of his findings is limited. His research has however been widely accepted and his findings are cited by many authors such as Tsui and Farh (1997), Kiong and Kee (1998), Fan (2002), and Chen and Chen (2004).

Jacobs (1979) writes that three major categories of interpersonal relationships exist in China. These categories can be divided into blood and social bases (Tsang, 1998). Jia-ren is the only blood based and most intimate guanxi base. It involves only family members and is characterised by relatively permanent, stable, and expressive relationships. Persons connected through a Jia-ren relationship show a great deal of loyalty, focus on the welfare and well-being of other family members and render obligations without an anticipation of reciprocity (Tsui and Farh, 1997). The second base, Shou-ren, includes familiar persons, such as relatives outside the immediate family, neighbours, people from the same village, friends, colleagues, or classmates. These relationships can range from superficial to extremely intimate (Fan, 2002, Jacobs, 1979, Tsui and Farh, 1997). The final, Sheng-ren, comprehends mere

acquaintances and strangers. These are people outside the family that do not share any meaningful experiences based on past transactions. Contacts to people in this category tend to be superficial and dominated by utilitarian concerns (Fan, 2002, Tsui and Farh, 1997).

There are however differences in the categorisation of the Shou-ren and Sheng-ren bases. Lou (2007) categorises e.g. classmates, friends, and fellow employees as Shou-ren, whereas Tsui and Farh (1997) categorise them as Sheng-ren. Kiong and Kee (1998) identify six main guanxi bases: locality, fictive kinship (common surnames), kinship, work place, trade associations or social clubs, and friendship. We follow Jacobs' categorisation of guanxi bases.

Interpersonal relationships are multidimensional and show different levels of intensity in China. Guanxi is built upon various one-on-one relationships that are derived from Confucianism (Chen and Chen, 2004, Steidlmeier, 1999). Some guanxi exists already from the date of birth, Other guanxi has to be established and cultivated (Yeung and Tung, 1996, Tsui and Farh, 1997). Chen (2001) notes the importance of common birthplace or ancestry. New acquaintances with common birthplace and ancestry are immediately placed in the innermost circle of relationships.

The strongest guanxi exists however between immediate family members and other kinsmen. Jia-ren guanxi involves always a very high degree of trust (Luo, 2007, Yeung and Tung, 1996). Hence Chinese are more biased to hire a relative than a stranger for their business. This shows in the ownership structure and control of the pre-dominantly family controlled businesses (Seligman, 1999). The relative relevance and importance of any guanxi base depends on the situational context. A similar dialect can have impact on inter-firm relations but has no effect on the control and ownership structure of a firm (Kiong and Kee, 1998).

### **2.3.2. Building and cultivating guanxi**

Many scholars have written about the importance of establishing and maintaining guanxi, such as Vanhonacker (2004), Chen (2001), Chen and Chen (2004), Luo (1997 and 2007), and Wilson and Brennan (2010). Their analysis of building and cultivating guanxi is however rather one-sided and focuses merely on the Western perspective of guanxi building. The way Chinese establish and maintain their guanxi is unfortunately less documented.

#### **2.3.2.1. Building guanxi**

According to Chen and Chen (2004), guanxi can be established in three sequential stages: Initiating, building, and using guanxi. Developing, cultivating, and expanding guanxi is a process that involves strong dedication and is seen by most Chinese as a form of social investment (Hutchings and Weir, 2006, Luo, 1997, Luo, 2007, Wilson and Brennan, 2010). Chinese tend to construct networks with multiple guanxi partners from various backgrounds at the same time. This is necessary because of the changing political landscape, fragmented sources of authority, and the requirement to have access to insiders at all levels of the society in politics and business (Vanhonacker, 2004, Chen, 2001). Vanhonacker (2004) emphasises that the status and reputation of the people one has a relationship to, help to define the status of the individual. Lovett et al (1999) write that the more connections a person has, the greater are the opportunities to connect to others.

The nature of a guanxi base can be rather flexible and can be continuously expanded and reinvented according to personal circumstances and experiences. The birthplace for example can be extended from one city or village to an entire province. This increases the chances of finding a Shou-ren base with another person considerably (Chen and Chen, 2004, Jacobs, 1979, Tsui and Farh, 1997). The existence of a guanxi base does however not imply that a

relationship develops. It merely helps to initiate the development of a guanxi relationship (Dunfee and Warren, 2001, Luo, 2007, Kiong and Kee, 1998). The building of guanxi is time intensive and long-term process which requires both sides to interact and exchange renqing continuously, and to build xinyong and credibility over time (Dunfee and Warren, 2001).

A person is not limited to his guanxi network but may rely on intermediaries who possess a common guanxi base with both sides and who are willing to transfer their guanxi. This is done by a formal introduction of both sides through the intermediary who advocates the credibility and trustworthiness of both sides. This allows a considerable expansion of the own network and to tap into networks that were earlier out of range (Chen and Chen, 2004, Hutchings and Weir, 2006, Kiong and Kee, 1998, Luo, 2007). Intermediaries become increasingly more important in today's international business environment. They are often used to establish contacts between non-Chinese businessmen and Chinese businessmen that do not share a common guanxi base (Yeung and Tung, 1996).

Scholars such as Vanhonacker (2004) and Yeung and Tung (1996) write unfortunately only about the importance of establishing guanxi with Chinese partners. They however do not explain how a person can create a sustainable guanxi base that would put the foreign manager in a trusted position within the guanxi network.

#### **2.3.2.2. Cultivating guanxi**

The cultivation of guanxi requires a lot of energy. People must interact over a long time to maintain a solid guanxi relationship (Gao, 2006). This is important because Chinese businessmen prefer to deal with people they know. They invest a lot of time and efforts to establish guanxi with people they find respectable and worthy of having a relationship with (Chen, 2001).

Feelings and affection can change over time as can the value of guanxi. Guanxi between two people is not static and is subject to changes over time. This requires both parties to pay social visits from time to time or to invite each other to dinner. Gift giving is another popular way to maintain the contact with one's guanxi counterpart (Chen, 2001, Steidlmeier, 1999)

We have already seen that Chinese prefer that reciprocal obligations are not entirely in balance. This guarantees the continuation and intensification of the relationship. An even exchange of obligations and favours could even mean the end of the guanxi relationship (Yeung and Tung, 1996). The reciprocating with bigger and more valuable favours or gifts tends to continue the relationship (Lovett et al, 1999). Lovett et al (1999) note that the most skilful guanxi practitioners let obligations lie for some time. This provides more potential opportunities to ask for assistance or support and helps to continue the relationship. Kiong and Kee (1998) even argue that a certain amount of mutual dependability is necessary to maintain guanxi. If guanxi is however not cultivated properly it can be lost (Kiong and Kee, 1998).

#### **2.4. Guanxi and business performance**

Many scholars agree that good guanxi is crucial for long-term business success and essential to build a profitable organisation in China (Dunfee and Warren, 2001, Luo, 2007, Yeung and Tung, 1996). Relationships are considered to be one of the most important company assets and are often internalised as a company's core competence (Chen, 2001, Gu et al, 2008). Seligman (1999) argues that the key to getting anything done in China lies in one's guanxi network and in knowing how the people in one's network view their obligations to you. A fairly diversified guanxi network provides faster access to information, enhances flexibility of the management, and increases the competitive positioning of the firm (Luo, 2007).



Firms and managers develop and maintain guanxi as a strategic mechanism which can be used to create a significant advantage for a firm. An active participation in the multiple levels of social networks can help a business to overcome market and institutional failure and can be beneficial for achieving rapid growth (Liu, 2001). Guanxi thus helps to reduce operation and investment uncertainty in unstable or fast changing markets. Gao (2006) and Zou and Gao (2007) write that guanxi is not only beneficial for the market expansion of a business, it is also considered to be a great means to start new business ventures. Wong and Ellis (2002) found that in their search for potential joint venture partner, all 35 investors that were interviewed in the study, relied on information that were retrieved from social networks because guanxi is seen as a valuable resource to reduce search costs. Wong and Ellis (2002) found in the same study that a close guanxi base, e.g. the same village, was however only a first step to establishing trust and thus guanxi.

Guanxi may help an organisation or a manager to receive preferential treatment from partners and enhances the responsive and strategic capabilities of a firm. Preferential treatment includes but is not limited to faster access to limited resources or controlled information, as well as the granting of credit and the protection from external competitors (Gu et al, 2008, Park and Luo, 2001, Zou and Gao, 2007).

The usage of guanxi and the steady cooperation and exchange of favours with competitive forces or government forces can result in considerably smoother business operations and an overall increase of business performance (Gu et al, 2008, Kiong and Kee, 1998, Park and Luo, 2001). Transactions are made more flexible and the postponing of deadlines can be easier because of the inherent element of trust that is part of all guanxi relationships (Kiong and Kee, 1998, Luo, 2007). Guanxi can furthermore facilitate the daily business operations,

increase the external legitimacy of the firm or even avoid government investigation (Dunfee and Warren, 2001, Luo, 1997).

Park and Luo (2001) and Gu et al (2009) conclude that guanxi benefits market expansion, sales growth, and the competitive positioning of the firm. They note however that guanxi does not necessarily enhance the internal operations of a firm or the growth of profit margins.

Political guanxi with government officials is one of the most important relationships in China. Michailova and Worm (2003) suggest that the dynamism of market transactions can be facilitated if political guanxi exists. Gu et al (2008) observe that government guanxi enables companies to achieve an advantageous position against their competitors. Government guanxi is beneficial in obtaining land, licenses, or access to otherwise limited distribution channels. A further advantage is the access to extensive information in regard to industry or trade reforms that may influence business operations (Gu et al, 2008). In their interview of 32 executives from state-owned, private, and collective-hybrid companies, Xin and Pearce (1996) found out that the executives in private firm rely more heavily on guanxi than managers in state-owned or collective-hybrid companies. They conclude that interpersonal connections with officials are regarded as compensation for the lack of institutional support.

Hutchings and Weir (2006) write that large organisations possess guanxi by the virtue of their size. Hence it is less essential for them to build guanxi than it is for small companies. Government guanxi with local authorities is especially important for small and medium sized projects. Projects with a value of less than US\$30million do not require direct approval from Beijing and guanxi with local officials is hence considerably more important than guanxi

with officials on the central level (Haley et al, 2009). Guanxi itself is always only a necessary means of business success in China but never sufficient for long-term success (Fan, 2002,).

Table 1 provides an overview of the various business benefits that can arise from guanxi.

Table 1: Business benefits of guanxi

<b>Enhances</b>	<b>Reduces</b>	<b>Assists</b>
Business performance	Market uncertainty	Expansion of network
Responsive and strategic capabilities	Operation uncertainty	Granting of credits
Flexibility of management	Search costs	Access to top level decision-makers
Access to limited or controlled information	Transaction costs	Market expansion
External legitimacy	Competitive threats	Sales growth
Market transactions		

Guanxi is not limited to a single person. It is transferable. People with extensive guanxi relations can act as intermediaries. They introduce two otherwise unrelated parties and thereby establish a common guanxi base. The success of these guanxi transfers depends however greatly on the relationship between the intermediary's guanxi with the two parties that are interested in establishing contact (Luo, 1997, Seligman, 1999). Luo (1997) warns that the real decision-maker can be the guanxi network as a whole. This makes it often necessary to engage more than one connection to achieve personal or organisational goals.

The personal and mobile characteristics of guanxi make it a double-edged sword. A company can leverage the good guanxi contacts of its employees but is at the same time to some extent dependent on this person. An organisation would lose guanxi should an employee with good guanxi decide to leave the company (Gu et al, 2008, Hutchings and Weir, 2006, Lasserre and Schuette, 2006, Luo, 1997, Luo, 2007, Wilson and Brennan, 2010).

## 2.5. Negative aspects of guanxi

The use of guanxi may sometimes have a negative impact. Accepting a favour from another person puts an individual in debt. We have seen earlier that favours have to be reciprocated. The requested favour may however turn out to be inconvenient and unethical for the reciprocating party or even illegal. This puts the reciprocator in a dilemma (Wilson and Brennan, 2010). A non-reciprocated favour or a violated agreement results in the blacklisting of a person in the entire community and ultimately in a loss of mianzi and xinyong (Rauch and Trindade, 2002).

Gu et al (2008) write that not only a person but even a firm may lose mianzi and xinyong when the organisation does not reciprocate granted favours. A strong guanxi network can therefore be a burden if it is not managed properly and when the renqing obligations are not kept in balance. An acute reliance or dependence on favours and reciprocal exchange of information etc. in business can even harm the innovativeness and flexibility of an organisation or person. This can occur if the reliance is so strong that the firm is not able to gather reliable information without guanxi (Gu et al, 2008, Fan, 2002).

Many people are hired for their guanxi with the company head or a manager because of their Jia-ren base and not on the basis of their skills. This may result in a lower overall performance of the organisation if a person with more suitable skills could have been employed (Dunfee and Warren, 2001). Kiong and Kee (1998) note that some economic and business decisions are not solely based on market considerations but rather in the context of larger social relations and institutional forces. They refer to Wong who found in his study of spinners in Hong Kong in 1988 that over 50% of the respondents felt obligated to hire relatives of the Jia-ren category against their better judgement.

Steidlmeier (1999) focuses his research on gift giving and bribery and the ethical management of relationships in China. He says that the lines between gifts and bribes are often blurred and that it is very hard to know about all the implications that come along with giving or receiving a gift. Both sides need to know what kind of gift would be appropriate in which situation and they need to be aware of the social obligations that come with a gift. This is especially important with regard to anti-corruption campaigns in China. Yang (1994 cited in Fan, 2002) writes that guanxi is put on a level with corruption inside China, and closely connected to nepotism, bribery, and fraud. Fan (2002) argues that the reasons that are responsible for the importance of guanxi today (e.g. weak market structure, inadequate legal system, lack of transparency) have allowed guanxi to make China one of the most corrupted countries in the world.

## **2.6. Future of guanxi**

Opinions about the future of guanxi are divided. Luo (1997 and 2007), Gu et al (2008), Michailova and Worm (2003), Dunfee and Warren (2001), and Yeung and Tang (1996) opine that the importance of guanxi will not diminish in a near future. Luo (2007) argues that the establishment of institutional law in other Confucian societies, like Japan, South Korea, Taiwan, Hong Kong, or Singapore has not been able to reduce the reliance on personal connections. Michailova and Worm (2003) write that the importance of guanxi does not seem to have diminished during China's period of reforms. They note that guanxi has even become more widespread after the era of socialism and that the access of China to the World Trade Organisation in 2001 created even greater competition between the local and central government in attracting foreign investment from OC and Western multinationals.

Gu et al (2008) refer to the deep rooted cultural legacy of guanxi and conclude that guanxi despite the fast changing environment in China, remains salient and pervasive. Dunfee and Warren (2001) agree with the cultural explanation and say that economic and political forces will not be able to reduce the relevance of guanxi since it is so deeply rooted in the society. Chen (2004) summarises that guanxi will continue to play an important and active role in the life of the Chinese, be it in a political, economic, social, or cultural way.

Guthrie (1998), Hutchings and Weir (2006), Kiong and Kee (1998), Kao (1993), and Wilson and Brennan (2010) disagree with these statements. They are convinced that the importance of guanxi will diminish in future. Hutchings and Weir (2006) argue that guanxi is adapting to internationalisation. Networks and connections will lose their importance as transitional economies become more competitive and implement international standards, such as international accounting laws, property rights, and advanced management practices. Attempts to fight corruption and unethical conduct of business, as well as the exposure to Western management practices will eventually lead to a decline of guanxi (Wilson and Brennan, 2010). Guthrie (1998) emphasises this argument and says that modern Chinese managers pay less attention to the practise of guanxi because of anti-corruption movements and new regulations and approaches that condemn the practice of guanxi. Kao (1993) identifies the development of the Chinese organisation to high-tech companies as the reason for the diminishing importance of guanxi. He says that the management of these highly complex companies and their products requires managers from outside the company with specific industry experience and expertise. The entrance and promotion of managers without Jia-ren or Shou-ren guanxi bases with the owner or founder of the company will further weaken the importance of guanxi. This comes along with a new generation of Chinese entrepreneurs who

were educated and worked in Western countries and who pay less attention to the establishment and cultivation of guanxi.

There are however differing opinions and predictions. Lovett et al (1999) argue that throughout the next century, Western management and business practices will move in the direction of guanxi style networks. The growing interest in relationship marketing and virtual integration, they say, is evidence of this development. Chen (2003) writes that the Chinese businessmen will have to find a way to gradually adapt guanxi to the increasing pressures of market rationality.

## **2.7. Conclusion and summary of literature review**

We have seen that guanxi is an essential part of the Chinese culture that has still a fundamental impact on China's modern society. It is essential for both local and foreign managers to know about guanxi to successfully conduct business in China.

Establishing and maintaining guanxi requires a lot of time and energy (Gao, 2006). The value of guanxi is not static. Both guanxi partners are hence required to exchange favours, conduct social visits, and to give gifts on a regular basis. This shows their sincerity about the guanxi relationship (Kiong and Kee, 1998). But this investment of time and energy may pay back manifold through e.g. preferential treatments in business deals and in private life. While guanxi may facilitate business operations and the gathering of information etc. there is also the omnipresent duty to reciprocate favours. These favours may unfortunately prove be unethical or even illegal (Kiong and Kee, 1998, Wilson and Brennan, 2010).

It is difficult for Western managers and investors to gain access to the guanxi networks of China. Networks are built on guanxi bases that are partly predetermined from the time of birth and built on long-term relationships that develop over the life-time of the guanxi

partners (Gao, 2006, Jacobs, 1979). Most foreign expatriate managers spend only a limited time in China. Thus they do not have the chance to understand guanxi completely and to establish and maintain in-depth guanxi because guanxi is fundamentally long-term oriented. They leave their assignments behind before they have a chance to benefit from their contacts.

Kiong and Kee (1998) report however that the notion of xinyong which is an essential element of guanxi is changing among the younger generations of businessmen in China. They argue that the younger generations prefer to rely on written contracts and institutional law (Kiong and Kee, 1998). Young Chinese entrepreneurs increasingly align their operations to Western business models. They aim to become more professional and to achieve higher levels of organisational capability to win the confidence of Western companies (Kiong and Kee, 1998).

Because of their limited understanding of the nature of guanxi Western scholars and companies often tend to interpret guanxi as bribery or corruption (Steidlmeier, 1999). This kind of networking and cooperation is so fundamentally Chinese that the concept and implication of guanxi are not sufficiently known in countries outside the Chinese culture area and often misinterpreted.

Most scholars focus their research on the basic theories of guanxi. They analyse how individuals can maintain and use their guanxi in business deals and focus on the importance of guanxi for expatriate managers in China. The importance of guanxi outside China is however not properly researched. The discussion chapter of this dissertation aims to provide a deeper insight into the guanxi networks of OC and aims to analyse the implications of guanxi on OC investment and business in China.



### **3. Methodology**

This chapter focuses on the research methodology that was applied in this dissertation. It aims to justify that the selection of the applied research methods was appropriate in order to answer the research question.

#### **3.1. Research question and purpose**

The literature review provides us with an overview and analysis of guanxi in the context of the Chinese society and guanxi's implications for business. So far we were able to conclude that guanxi is a fundamental element of the Chinese culture and society that may constitute a significant business advantage in China.

Recently scholars have increasingly focused on the emergence of the OC in the countries of Southeast Asia and their growing political and economic influence in East Asia. Several authors, such as Gomez et al (2001), Haley (1996), Haley et al (2009), and Yeung (2006) believe that the importance and scale of OC's business operations will considerably increase in future and that further research in this area is important.

This dissertation aims to expand these researches and to analyse the growing influence and dominance of OC businesses in Asia. Admittedly, several studies about the OC businesses in East and Southeast Asia already exist. However the business and investment advantages of OC in China that arise from ethical and social ties have not been researched in-depth yet. The focus of former works is on the economic implications of OC investments and analyses the reasons for the growth or decline of OC foreign direct investment (FDI) in China. The discussion part of this dissertation aims to analyse if the OC of East and Southeast Asia enjoy a business and investment advantage over Western companies in China and how these advantages manifest.

After providing an overview of OC businesses in East and Southeast Asia, this dissertation analyses the distinct business and investment advantages of this ethnic group in China. First, it is argued that OC investors have a strong affinity with the Chinese culture of which *guanxi* is a fundamental element, due to historical and social ties. The possession of these cultural and social ties gives OC a competitive edge over their Western competitors because the establishment and maintenance of *guanxi* is essentially based on *guanxi* bases that Western managers or investors do not possess. Second, it is argued that OC enjoy access to superior information and enjoy lower transaction costs because of their *guanxi* relationships with private businessmen and officials in China. An examination of Robert Kuok's *guanxi* networking provides us with evidence for these findings. In conclusion we analyse the implications of these findings for Western companies. A close examination of Coca-Cola's business strategy in China in the 1990s provides us with information on how Western companies can make use of OC *guanxi* relationships.

### **3.2. Data collection**

Research can be conducted in accordance with qualitative or quantitative research methods. While quantitative research focuses generally speaking on the measurement and analysis of causal relationships between variables, qualitative research aims to analyse the correlation between variables and inherent processes (Denzin and Lincoln, 2005, Silverman, 2007). Qualitative researchers generally focus on the analysis and interpretation of natural occurring settings and the meaning people bring to them. A variety of empirical materials, amongst others case studies, interviews, or personal experience are used to describe these routines or specific moments (Denzin and Lincoln, 2011).

The research of this dissertation is of a qualitative nature. Silverman (2011) writes that qualitative research aims to analyse and study phenomena in their specific context. The aim of this dissertation is to analyse and interpret the correlation between guanxi and business advantages of OC in China. This is done by evaluating and analysing different sets of data that are mainly based on secondary sources, such as books, academic journals, and newspaper articles. Silverman (2007) writes that examples or case studies are further sources of information that are regularly used in qualitative studies to support the findings of any research. We follow this qualitative research approach by using a case study that focuses on the business operations of Malaysian Chinese businessman Robert Kuok. This case study provides information that supports the findings from the secondary sources. This multi-method approach is typical for qualitative research papers and aims to add depth, richness, breadth, and complexity to the inquiry (Denzin and Lincoln, 2005).

### **3.2.1. Secondary data analysis**

Secondary sources are used because of the difficulties of obtaining primary data from OC businesses. This is due to two reasons: In the first place, Southeast Asia is far away and a trip to the relevant countries of this research is not possible due to financial and time constraints. A further reason is the limited access to OC businessmen and the limited access to information about the operations which are normally kept highly secretive (Yeung and Tung, 1996). The central character of the case study Mr Robert Kuok for example gave so far only one interview to China Central Television 2 (CCTV 2) in 2011 which is unfortunately only available in Chinese. This dissertation therefore relies on previous researches and newspaper articles that were conducted by scholars or journalists. The library facilities of the University of Nottingham Business School provide adequate access to an extensive number of up-to-date leading business journals, such The Journal of International Business Studies, The China

Quarterly, The Harvard Business Review, Journal of Business Strategy, Strategic Management Journal, Academy of Management Journal, and Management Decision to name a few. Further information can be obtained from online sources, such as newspaper websites. The strong reliance on secondary sources and the insufficient access to primary sources is however no major setback. Silverman (2007) argues that secondary data-analysis is the foundation of any academic research work and the diligent analysis, not the source of the data, ultimately matters for the outcome of the work.

### **3.2.2. Case study approach**

A case study is “an intensive analysis of an individual unit (as a person or community) stressing developmental factors in relation to environment” (Flyvbjerg, 2011, p.301). The purpose and aim of a case study is to provide a deeper insight into one single relationship across a larger number of cases (Gerring, 2007). Yin (2003 cited in Baxter and Jack, 2008) argues that a case study should be considered when (1) how and why questions build the focus of the study, (2) the interviewer cannot manipulate the behaviour of the interviewees, (3) the contextual conditions are relevant to the studied phenomena, or (4) the boundaries between the phenomena and the context are unclear. Point one and three are the main reasons for using a case study in this dissertation.

Stake (2000 cited in Silverman, 2005) identified three types of case studies. The intrinsic case study is an attempt to generalise beyond a single case or even to build theories. Silverman (2005) argues that this case study method is not very popular and rarely used. The instrumental case study aims to provide insight into an issue or to revise a generalisation. This is the case study type used in this dissertation because it provides a deep insight into the topic but the main focus of the dissertation is on something else. The final type of case study

is the collective case study which aims to study a number of case studies simultaneously to investigate some general phenomenon.

The multi-perspective analysis of a case study allows the researcher to consider the voice and perspective of the central character and of third-party actors. It furthermore allows interpreting the interactions between two parties (Tellis, 1997). According to Yin (1994) a single case study can be used to test a theory or to determine alternative explanations.

The advantages of a case study approach are the high degree of depth in the analysis of a single individual or phenomena and the high conceptual validity. A case study allows an easier understanding of contexts and processes and helps to understand the causes of a phenomenon by bringing causes and outcomes together. These characteristics of the case study help to create new hypothesis and new research questions (Flyvbjerg, 2011).

### **3.3. Evaluation of research approach**

#### **3.3.1. Evaluation of secondary data collection approach**

This dissertation relies mainly on secondary sources. Silverman (2011) argues that qualitative researchers often rely on printed and internet material to study the context of phenomena. The use of these sources is however relatively limited because of the high dependency on English-language journals and books. The interpretation of *guanxi* and of the OC business environment is therefore biased towards a Western interpretation of the phenomenon *guanxi* and its implications for business success in Asia. A diligent analysis of Chinese-language journals or any other language of the region could have provided information from a very different perspective. The evaluation and interpretation of local journals could have resulted in a more accurate analysis of the research topic.

### 3.3.2. Evaluation of case study approach

Flyvbjerg (2011) observes that it is difficult to generalise by means of an individual case study. If we would however try to develop a larger set of relevant case studies, the total sample size of these cases would be too large. This would weaken the usually preferred depth of qualitative researches. A single case study provides a concrete and context-dependent knowledge that allows a better understanding of the developments and processes that are inherent in the analysed situation or phenomenon (Flyvbjerg, 2011). Since the case study is used as an instrumental case which aims to provide a deeper insight into the role of guanxi in the business environment of Asia, a single case is sufficient.

Mason (1996 cited in Silverman, 2005) notes that there is however an inherent danger to select a case that is most likely to support the argument. The case study of Robert Kuok was selected based on the following reasoning: Robert Kuok is considered to be the most successful businessman of Southeast Asia. He is furthermore a typical representative of the OC business community which is characterised by its strong work ethos, close relationships, and social structures (Redding, 1993). Dominic Ziegler of the Economist magazine (1997) identified Robert Kuok as the largest individual investor in China. An analysis of his business operations should help to create a deeper understanding of the social, political, and economic developments of this region. The high degree of secrecy that is characteristic for the OC constrained unfortunately the finding and analysis of reliable information about the Kuok business empire and its operations in Asia (Yeung and Tung, 1996).

Weaknesses of case studies are the above named selection bias of the author, the weak understanding and classification of the case in the context of the overall environment, and the ignorance of the statistical significance of the case study (Flyvbjerg, 2011, Gerring, 2007).

### **3.4. Case study overview: Robert Kuok**

Robert Kuok Hock Nien was born October 06<sup>th</sup> 1923 in Johore Bahru, Malaysia. He is considered to be one of the most successful businessmen of Southeast Asia. Kuok's father was a commodity trader who had emigrated from Fujian Province to then British Malaya in the early 20<sup>th</sup> century (Gambe, 1999). Robert Kuok received a Western education at the English College in Johore Bahru and at Raffles College in Singapore where he got in contact with two future prime ministers of Malaysia (Tun Hussein Onn and Datuk Seri Dr. Mahathir Mohamad) and Singapore (Lee Kuan Yew) (Heng, 1997, Gambe, 1999, Tanzer, 1997). These contacts proved to be very helpful to establish and expand his operations in Southeast Asia which are however not analysed in this dissertation. Kuok furthermore received instructions in Mandarin and Confucian classics from private tutors (Heng, 1997).

After the death of his father, Robert Kuok and his brother Philip founded the company Kuok Brothers in Johore Bahru in 1949. They started trading rice, flour, sugar and other commodities. The decolonialisation of former British Malaya in the 1950s and the independence of Malaysia in 1957 offered Kuok the opportunity to expand his business interests into sugar plantations and sugar refining. The rising sugar prices in the 1960s and 1970s and his quasi-monopoly on sugar trading and refining in Malaysia earned Kuok the title "Sugar King" (Heng, 1997, Tanzer, 1997).

The New Economic Policy (NEP) restricted the further diversification of Kuok's business in Malaysia in the 1970s. He started to put more emphasis on his offshore operations (Heng, 1997). In 1971, Kuok expanded his operations to Singapore where he diversified into real estate and opened his first Shangri-La Hotel under the management of Western International Hotels (Shangri-La, 2012). The company headquarters was moved to Hong Kong in 1974

because of significantly lower tax rates (Hong Kong 16%, Kuala Lumpur, 50%, Singapore 40%) and Kuok himself moved permanently to Hong Kong in the late 1970s (Morf, 1994, Tanzer, 1997). Kuok's long-term residence in Hong Kong has given him an insider status in the society of Hong Kong which was helpful in establishing and cultivating contacts within circles that represented the interests of Chinese officials (Heng, 1997).

Kuok's employees say that he built his empire through vision tenacity, risk-taking and guanxi (Kandell, 1997). Kuok is particularly famous for his networking skills (Lasserre and Seng, 1995). He is close to the political and economic leadership in China, Malaysia, Indonesia, and the Philippines. Heng (1997) adds that Kuok possesses impressive cross-cultural skills that he used successfully to build political capital for his operations, especially in China (Heng, 1997). In 1993, Kuok was appointed as an advisor to China on Hong Kong, and is the second largest stakeholder with a stake of 12.5% in China International Trust and Investment Corporation Pacific (CITIC Pacific), Beijing's premier investment corporation based in Hong Kong (Gambe, 1999, Lasserre and Seng, 1995). These appointments attest his political influence and connections to Beijing.

Kuok's interest in China started well before the gradual liberalisation of China's economy after 1979. Kuok started to sell sugar to China in a great scale when China faced a supply shortfall in sugar in the 1970s and gained the trust and gratitude of the leaders in Beijing (Heng, 1997). In 1984, he opened his first Shangri-La Hotel in Hangzhou. His Hong Kong based Kerry Group started the construction of the China World Trade Center in Beijing in the same year. He holds a great stake in this very prestigious project of the Chinese government (Lasserre and Seng, 1995, Shangri-La, 2012, Tanzer, 1997). China is the major market for his Shangri-La Hotels today. Kuok regards his well-planned and optimally located luxury hotels



as timeless investment that grow with their communities and as superb hedges against inflation (Tanzer, 1997).

In 1993, he became the joint venture partner of Coca Cola in China. Coca Cola's President John Farrell said that they chose Robert Kuok as partner because of his excellent connections with the Chinese government and this ability to use these contacts in a highly profitable way (Tanzer, 1997).

Today, Kuok's business operations embrace commodity trading, financial services, hotel ownership and management, property development, plantations and vegetable oil refining, shipping, manufacturing, retail sales, beverage bottling, mass media, and entertainment (Heng, 1997).

## **4. The Overseas Chinese and guanxi**

### **4.1. Introduction**

China started to gradually liberalise and open its economy for FDI after 1979. In 2010, FDI inflows in China peaked at more than US\$ 185 billion, making China the second largest destination of FDI after the USA (World Bank, 2012). The World Bank (2012) defines FDI as “the net inflows of investment to acquire a lasting management interest (10 percent or more of voting stock) in an enterprise operating in an economy other than that of the investor”.

In the initial phase of liberalisation, the by far largest share of FDI inflows came from other Asian countries. The cumulative investment of Hong Kong, Taiwan, Macao, and the five largest member states of the Association of Southeast Asian Nations (ASEAN: Indonesia, Malaysia, Philippines, Singapore, and Thailand) accounted for more than 80% of total investments in China from 1979 to 1997 (Gao, 2005, Heng, 1997, Morf, 1994). The high inflow is partly achieved through subcontracting synergies in East Asia. Geographic proximity allows the pairing of Taiwanese or Hongkongese capital with cheap labour in China’s Guangdong or Fujian Province (Crawford, 2000). The relative share of FDI contribution declined however to about 50% in 2008 because of larger investments from Western companies (Davies, 2010).

When interpreting these numbers we have to act with great caution. A great number of investments from companies in ASEAN are channelled through companies in Hong Kong or other offshore centres, like the British Virgin Island or the Cayman Islands (Samphantharak, 2011).

There are several factors that made China a prime location for FDI. One of the reasons is the close geographic proximity of China with capital rich economies in Hong Kong, Macao and Taiwan. Further important factors than explain the high FDI flow from neighbouring countries are historical ties, cultural affinities, and networks with cash-rich OC in Hong Kong, Taiwan, Macao, and ASEAN (Crawford, 2000, Lu, 2012). China offers foreign investors furthermore a huge domestic market, cheap labour, liberalised investment policies, political stability, and improved infrastructure (Buckley et al, 2007, Gao, 2005).

This chapter aims to examine the significance of guanxi networks for cross-border investments from OC businesses in Mainland China. We analyse if guanxi networks can be understood as a business and investment advantage of OC in China. After analysing the nature of OC business in East and Southeast Asia and their cultural roots with China, we proceed to examine the various aspects of guanxi networking in the context of business in China. Whenever possible we refer to the case study of Robert Kuok. This approach provides us with a deeper understanding of the implications of guanxi in China.

Since most of the extensive guanxi literature is related to Mainland China, we use the Mainland Chinese interpretation of guanxi and transfer the findings to the OC business networks. The characterisation of the OC in the next section shows the eligibility of this approach.

#### **4.2. Characteristics of the Overseas Chinese**

The Mainland Chinese and the OC developed to some extent differently over time and had varying experiences (Hutchings and Weir, 2006). Gambe (1999) argues however that a big share of the OC never left China psychologically and that they are still deeply rooted in the cultural norms and values of China. Other scholars add that the OC eagerly nourish and

maintain their cultural heritage and often merely adopt the citizenship of their host countries (Haley, 1996, Redding, 1990, Yeung, 2007). Redding (1990 cited in Heng, 1997, p.155) refers to the OC as “creatures of Chinese tradition because of these psychological and emotional notions”. The cultural heritage of China in everyday life is especially strong in a country like Malaysia with a large Chinese minority of 24.6% (Chen, 2004, Department of Statistics Malaysia, 2012). Admittedly many of the ethnic Chinese born in Southeast Asia today regard themselves as Southeast Asians rather than Chinese even though they acknowledge their cultural and historical heritage (Yeung, 2006).

The OC emigrants to Southeast Asia experienced various kinds of hardship in their life, such as economic turmoil, famines in China in the late 19<sup>th</sup> and early 20<sup>th</sup> century, and political disasters, like the Cultural Revolution (Kao, 1993). Kao (1993) finds in his research with more than 150 participants that many OC consider the environment in which they operate as unsafe. Hence they accumulate capital and maintain *guanxi* to hedge against these insecurities in their environment (Gambe et al, 1998, Kao, 1993, Yeung and Tung, 1996). These experiences combined with the influential Confucian teachings that were imported from China characterise the way of OC business operations and their organisational principles greatly (Limlingan, 1986 cited in Yeung, 1999). This applies also to the concept of *guanxi* which has a significant impact on the organisational structure of Chinese and OC businesses and which greatly influences business operations (Hutchings and Weir, 2006). We can see the dominant role of *guanxi* inasmuch as these businesses are characterised by an ownership structure that is based on *Jia-ren guanxi* bases (Luo, 20076, Yeung, 2006). Most OC businesses are family businesses due to the strong influence of *guanxi* bases and the inherent trust that is so important for the Chinese society.

The leadership style in OC businesses is paternalistic with a highly centralised decision-making process. This allows rapid decision-making and high flexibility. OC put a strong emphasis on collectivism and group behaviour. A network of personal contacts provides access to and control of information (Gambe, 1999, Haley et al, 2009, Heng, 1997, Lasserre and Seng, 1995, Redding, 1996, Wah, 2001, Yeung, 1999). Many OC still have strong connections with family members, friends, former colleagues or class mates in China. This provides them with the opportunity to leverage their guanxi networks and to cooperate in a much wider geographic sphere which goes well beyond their own home markets. Kao (1993) refers to this cross-border guanxi network of Chinese businessmen as “Chinese Commonwealth”.

The above described paternalistic management style is also dominant in the business operations of Robert Kuok. He has been the head of operations since 1949. The highly centralised management style provides his operations with a great deal of flexibility that allows him to react timely on changes in the political and business environment (Kao, 1993, Redding, 1990). His eight children manage different operations of his extensive business. While his oldest son Beau oversees hotels and other real estate from Hong Kong, his second son Ean is based in Singapore and Malaysia and manages the edible oil business. His daughter Ruth is manager of the group’s charitable foundation. Other important positions are held by two nephews and a nephew-in-law (Tanzer, 1997).

Most OC tend to diversify their operations due to state policies, growing competition, or the desire to venture in a field with good profit prospects (Gomez and Hsin-Huang, 2001, Haley, 1996). Trading and real estate are the initial focus of many OC businesses. They later diversify into other industries and countries to hedge against risks in these sectors and to avoid expropriation and ethnic discrimination in their host countries. The diversification into

new business ventures is often enabled through *guanxi* that provides insider information about business opportunities (Yeung, 1999). These diversification decisions are often not based on strategic necessity but determined by social relationships which can result in disastrous investments and deals (Yeung, 1999). The diversification of Robert Kuok's business interests follows the above described course. Kuok Brothers was essentially a trading business before the company diversified in plantations and vegetable oil refining, shipping, real estate, and hotel ownership and management (Heng, 1997).

After the Asian Financial Crisis in 1997/98 OC businessmen started to restructure their operations and focused on specific lines of industries to gain competitiveness in a more globalised market environment (Lasserre and Schuette, 2006, Gomez and Hsin-Huang, 2001).

A successful internationalisation requires OC to reduce their dependency on paternalistic management structures, as well as personalism and their tendency to business fragmentation (Yeung, 2006). The above mentioned characteristics have thus been changing and there exists a tendency to hybridisation. This shows in the combination of traditional elements of OC management styles with Western technology and management techniques (Heng, 1997). Yeung (2006) argues that the new emerging style of management is neither Chinese nor Western.

### **4.3. Overseas Chinese investment in China**

There are two main reasons for companies to invest in foreign countries. Firms venture abroad in search of new markets (market-seeking) or to realise a higher overall efficiency of their operations through e.g. the relocation of labour intensive work to countries with lower labour costs (efficiency-seeking) (Samphantharak, 2011). The most important factors that attract investments in China are the huge size of the market, availability of cheap labour,

liberalised FDI policy, political stability, and improved infrastructure (Buckley et al, 2007, Gao, 2005).

In the introduction of this chapter we identified the OC as the traditionally largest investors in China. The large share of OC investments can be explained by the existence of strong cultural ties and geographic proximity. Johansen and Vahlne (1977) research the internationalisation processes of Swedish firms. They find that the psychic distance between two countries (i.e. differences in language, education, business practices, culture, and industrial development) is an important factor that influences the order of investment decisions. The smaller the psychic distance between two countries, the earlier and the easier is the entry in these markets. The OC have a low degree of psychic distance with the Chinese Mainland and were hence the earliest and largest investors in China. Another important reason which is related to the small psychic distance is the existence of *guanxi* with government officials, private businesses, and families (Buckley et al, 2007, Gao, 2005).

The economic rise of China and the gradual liberalisation of its economy after 1979 offered the OC great opportunities to expand their operations. This was a welcome development to these businesses that faced saturated markets and growing competition in Southeast Asia that limited growth (Yeung, 2006, Yeung, 2007). Ethnic Chinese had always maintained close links with the local political elites of Southeast Asian states and enjoyed their patronage for many years. An arrangement described as *Ersatz-capitalism* by Yoshinara in 1988. Political movements in Indonesia and Malaysia in the 1970s and 1990s were however signs of continued hostility and discrimination towards ethnic Chinese. The political developments attacked these long-lasting and beneficial ties between the ruling elites and Chinese businessmen and called for the demolition of privileges and monopolies previously held by OC (Yeung, 2006, Yeung, 2007). China's economic opening provided the OC with the

opportunity to secure their investments against political interventions in their home markets and to diversify into businesses that were restricted in their home countries because of state regulations. These developments reduced the risk to compete with up-and-coming and highly protected businesses in these markets (Jesudason, 1997, Yeung, 2000).

Yeung (2007) notes that the economic and political developments in East and Southeast Asia in the last three decades have threatened the export business models of many OC in Southeast Asia. The strong export-orientation of the Chinese economy and the implications of the Asian Financial Crisis forced the OC to restructure their business operations. As quasi monopolies were abolished in the aftermath of the Financial Crisis, OC further internationalised their business interests to maintain their competitive position in Asia and export markets of North America and Europe (Yeung, 2006). Guanxi with families, government officials etc. in China are often used to gain a foothold in China that offers a new market, cheap production location and helps OC to respond to the above described problems in their host market economies (Ampalavanar-Brown, 1998).

#### **4.4. Guanxi as investment and business advantage of Overseas Chinese in China**

Smart and Hsu (2004) identify several business and investment advantages of OC in China, among them a high degree of flexibility, tolerance for uncertainty, political knowledge, and social connections. The analysis in this paper focuses however on social connections which have been identified by several scholars as a competitive advantage for corporate and investment success in China (Chen, 2004, Fan, 2002, Gao, 2006, Michailova and Worm, 2003, Wilson and Brennan, 2010, Yeung and Tung, 1996).

Heng (1997) writes that guanxi is as essential as labour or capital for running a business in China. However in order to be considered as a competitive advantage, guanxi has to be rare,



valuable, and imperfectly imitable: Rare means that guanxi is only possessed by a small number of people in the same industry; Valuable implies that guanxi leads to higher sales and/or lower costs; And imperfectly imitable presumes that it is difficult to obtain for others (Tsang, 1998). Guanxi can however be established by non-OC too and people who have guanxi with government officials etc. can be hired by Western MNEs. Fan (2002) thus argues that guanxi should rather be understood as a tactical or temporary advantage than a strategic competitive advantage. Guthrie (1998) and Tsang (1998) add that guanxi is not a source of advantage because it is difficult to sustain and insufficient for the long term success of a business because it is not restricted to a limited number of people. We examine guanxi as investment and business advantage because the building and maintaining of guanxi requires a great deal of energy and time. Guanxi can thus not easily be imitated by competitors from close to scratch. It is however not a competitive advantage because it is imitable, and possessed by many OC and non-OC businessmen.

The existence of high transaction costs is one of the major barriers for large-scale capital flows between two countries (Fan, 1997). Guanxi is an essential means to reduce transaction costs through the establishment and regular interaction with private businesses as well as local and central government authorities. Guanxi is useful to hire workers, obtain goods and raw materials, gain access to public utilities, or to set up a business venture. Guanxi helps to reduce costs that arise from business partner search, to reach price agreements, and to ensure the compliance of contract terms (Fan, 1997).

The existence of a dual-track system in China until 1994 which managed the allocation of some rare resources made guanxi even more essential to obtain access to key materials, equipment, and markets (Fan, 1997, Lin et al, 1998). Guanxi is however not a substitute for

managerial and technological know-how which is required to stay competitive in high-technology sectors and value added manufacturing (Smart and Hsu, 2004).

Haley et al (2009) write that businessmen must possess three different kinds of guanxi to be really successful in China: business guanxi, guanxi with the government, and guanxi within the family. Looking for suitable guanxi is therefore one of the first things a Chinese does when venturing abroad (Seligman, 1999).

For the further analysis of guanxi as a unique advantage of OC we contemplate the importance of familiarity with Chinese culture and the importance that guanxi plays in the daily life and business operations of millions of Chinese businessmen. This is followed by the examination of guanxi as a source of superior information and means to reduce transaction costs.

#### **4.4.1. Guanxi as source of trust and foundation for long-term business success in China**

Guanxi is a fundamental element of the Chinese culture and a necessary requirement for establishing business contacts, carry on negotiations, or to make deals in China. A disregard of guanxi and its implications for business success could result in a considerable disadvantage. Familiarity with the Chinese culture is a prerequisite for establishing and using guanxi successfully. An in-depth understanding and comprehension of the Chinese culture and of the implications of personal networking in the Asian economic region is a necessary must. The OC knowledge of Chinese culture and business ethnics provides them with a unique advantage that helps them to master cultural aspects such as xinyong and commitment that enjoy a level of significance in Asia.

#### **4.4.1.1. Familiarity with Chinese culture as basis for business success in China**

Guanxi is one of the most fundamental elements of Chinese culture and an important means of business. The familiarity of most OC with Chinese culture and therefore also with the concept of guanxi helps them to gain an investment and business advantage over their rivals (Lu, 2012, Tong, 2005). These advantages show among other things in their superior match-making skills, the faster and easier establishing of business contacts, or simplified deal-making (Lu, 2012, Rauch, 2001).

Most cooperative relationships in China and in the business environment of the OC are embedded in business networks unlike in Western countries where cooperative relationships are fundamentally based on firm-specific strategies (Yeung et al, 2000). This different approach to business gives OC an advantage when it comes to the establishment and the maintenance of guanxi. They know this business approach from operations in their host countries in East and Southeast Asia which are based on very similar cultural foundations imported from China and are thus well aware of guanxi's business implications. They are less reserved about building networks and using their contacts for personal gains.

Foreign non-OC investors are however highly disadvantaged when it comes to creating networks with Chinese or OC businessmen. They have to learn about guanxi and how to make use of it. They consequently need to invest a large amount of time and efforts in order to develop meaningful relationships with business partners and government officials. Foreigners face regular set-backs in their creation and cultivation of guanxi because of their unfamiliarity with the Chinese culture, language, and underemphasised guanxi (Wu, 2008).

The deep understanding of the Chinese culture which is a basic requirement for guanxi networking equips OC businessmen with the ability to establish contacts and conduct

business with a large number of indigenous businessmen and government officials (Lasserre and Schuette, 2006). Business partners possess a thorough knowledge of each other because of the long-term orientation of the guanxi networks which are based on the regular exchange of favours. The regular exchange provides them with the necessary knowledge to match their business interests and to refer each other to outside business opportunities (Rauch, 2001). The access to these opportunities and knowledge is however extremely limited to foreign managers who have less experience with the Chinese culture and who spent insufficient time in the region to establish a strong network of contacts.

Lu (2012) found in his research of the ethnic dimensions of Chinese and non-Chinese FDI in China that 79.1% of the OC and 73.7% of the non-OC firms interviewed agreed or highly agreed with the statement that the cultural and linguistic affinities of OC provide advantages in building up networks and exploiting guanxi relations in China. Lu's findings agree with Steidlmeier's research (1999) who says that firms and their managers need to have an in-depth understanding of the acceptable behaviour patterns in a foreign culture because knowing why and how people act in a certain way eliminates cultural misunderstandings and increases the chances of business success.

We can see the implications of these ethnic dimensions for business in China through an analysis of Robert Kuok's cultural and linguistic affinities. He received not only instructions in the language Mandarin but was also taught the values of Confucianism and Chinese business ethics. As a long-term resident of Hong Kong he is familiar with the local culture. This knowledge and awareness provide him with a concrete understanding of acceptable business behaviour patterns in Mainland China and Hong Kong (Heng, 1997). This cultural and local knowledge gives him a competitive edge over OC that are less familiar with the Chinese culture and over his foreign competitors.

#### **4.4.1.2. Xinyong (Trust)**

It is rather difficult for non-Chinese managers to understand the unique values and beliefs of China because they are so fundamentally different from Western norms (Wu, 2008). Gambe et al (1998) write that Chinese conduct business preferably within the same ethnic group on the bases of xinyong and guanxi. We have already seen that this is due to the fact that the Chinese culture is very much people-oriented and has a strong emphasis and reliance on trust-based relationships. Chinese enterprises emphasise relationships and deals with people that have xinyong. The establishment of meaningful and often very personal relationships between managers and investors is thus essential before Chinese are willing to conduct business. More importantly this trust has to exist before the deal is struck unlike in Western cultures where relationships grow out of deals (Vanhonacker, 2004, Wu, 2008).

Bhardwaj et al (2007) research the influence of country cultural variables, such as trust and uncertainty avoidance, on FDI decisions. They argue that foreign companies prefer to invest in countries with lower level of uncertainty avoidance. They furthermore found that there exists an interaction effect between uncertainty avoidance and trust. The lower the level of uncertainty avoidance, they write, the higher the reliance on trust. The level of uncertainty in China is, as we have already seen, rather high. The level of uncertainty for OC is considerably lower because of their historical, cultural, and social ties with Mainland China. OC can furthermore fall back on Jia-ren or Shou-ren guanxi bases that provide a basis for trust and security (Liu, 1998).

Xinyong lies at the heart of every single interaction in China and involves not only business partners but government officials and employees of the firm. Trust between two parties secures the constant support of all involved parties (Buckley et al, 2006, Tan and Yeung,

2000). The long-term operations of OC businessmen in the region helped them to create deep and trustful relationships with numerous people. Guanxi networks are used to introduce potential business partners that share guanxi or a basis of mutual trust with an intermediary (Chen and Chen, 2004).

The substantially differing business ethics urge Western managers to make decisions based on hard facts and in compliance with company policies and not based on mutual trust or gut feelings. Managers of Western MNEs are additionally rather limited in their ability to fall back on guanxi bases and to build trust-based relationships because of the different orientation and organisational culture of Chinese and Western businesses. Western enterprises focus principally on contractual agreements and often disregard or underestimate the importance of personal trust for business deals. This limits their ability to reduce the level of investment uncertainty considerably (Buckley et al, 2006).

Smart and Hsu (2004) argue that the success of OC investors derives from their reliance on gentleman's agreements rather than carefully negotiated contracts. This enables them to circumvent the inefficiencies of bureaucracy in China and to set up operations more rapidly and at significantly lower transaction and negotiation costs. Mianzi or face makes the gentleman's agreement possible. A non-compliance with the rules of guanxi would result in a loss of mianzi which has to be avoided by all means. Guanxi promotes and ensures FDI in China through community enforcement and sanctions (Tong, 2005).

#### **4.4.1.3. Commitment**

Gao (2006) notes that commitment is a very important way to maintain guanxi with the government or business partners. Wong et al (2007) even write that it is expected to build guanxi on commitment. Gao (2006) defines commitment as a desire to establish a long-term

and stable relationship that is characterised by the willingness to make short-term sacrifices to maintain the relationship. Wong et al (2007) write that the questioning of one's commitment worthiness and integrity results in a loss of face. An increased level of commitment between two or more parties leads to a greater continuity of the relationship and thus in a better business performance (Wong et al, 2007). We have to differentiate two kinds of commitment:

The first type of commitment is attitudinal. Attitudinal commitment implies for example visiting of officials, inviting them to banquets or company celebrations, or the invitation of government officials and their families to visit companies abroad (Gao, 2006). It is very important to emphasise and intensify existing friendships because commitment has to be built on regular social interaction and helps to strengthen the personal friendship between two managers (Wong et al, 2007). Attitudinal commitment from government representatives means that officials interview business leaders about their opinions about government policies or visit company premises from time to time to emphasise the good relationship of the government with a specific company (Gao, 2006). We can see at this point that attitudinal commitment is strongly related to the reciprocal element of *guanxi*.

The second type is behavioural commitment. This means for businesses that they have to show a long-term interest in their business interests at all times. The Tiananmen Square incident of 1989 had a negative impact on the overall FDI commitments from Western but also Eastern companies in China (Dees, 1998). Robert Kuok had started the construction of the Beijing World Trade Center in 1985. He held on his plans to complete the building even when the Chinese government faced severe challenges at that time. Adrian Fou, the Chairman of Hong Kong's Furama Hotel Enterprises Ltd said about Robert Kuok's commitment to China that "it is important that you can prove to the leaders that you do not abandon them

when they are in trouble. Kuok has done that” (Tanzer, 1997, p.6). The continuation of the construction did not only strengthen guanxi and xinyong between Robert Kuok and the officials in Beijing but also saved mianzi for both sides.

A further prove of Robert Kuok’s commitment to China was the move of his main operations from Southeast Asia to Hong Kong which has strengthened his relationship with political leaders in Hong Kong and China (Gambe, 1998). This enables him to leverage behavioural commitments from the Chinese government which often include the provision of useful information or favourable policies on land, taxes, licenses, and so forth (Gao, 2006). Kandell (1997) writes that it is therefore not surprising that Robert Kuok’s companies, like the Shangri-La Hotel and Resort Chain, get the best locations for their buildings in China.

Crawford (2000) argues that long-term commitments based on kinship and personal relationships ensure better market information and reduce uncertainties in business transactions which can result in a first mover advantage. Internal company protocols and ethnical codes that would define the above described services as bribery or corruption restrict however the actions and decision-making capabilities of Western companies.

#### **4.4.2. Guanxi as source of superior information and means to reduce transaction costs**

Buckley et al (2007) and Lu (2012) write that a shared ethnicity as well as family and ethnic guanxi networks constitute a firm specific advantage for Chinese and OC MNEs. Chinese and OC managers can fall back on their guanxi contacts to obtain crucial information about the present business and market environment as well as coming changes (Haley et al, 2009). This reduces business risks and transaction costs associated with the identification of business opportunities. Especially guanxi with government officials and private business partners



provides OC decision-makers with the capability to navigate their operations in an uncertain business environment and serves as a resource of superior information at often lower cost.

Until China's accession to the World Trade Organisation in 2001, business in China was characterised by high investment risks because of uncertain property rights and political risks (Smart and Hsu, 2004). Good guanxi with business associates and government officials was especially important in the early stages of China's gradual liberalisation to make informed investment decisions and to navigate in China's uncertain business environment. Smart and Hsu (2004) argue that the reliance on guanxi declined after the accession of China to the WTO and consequently increased the competitive position of Western MNEs in China considerably.

#### **4.4.2.1. Family ties and guanxi bases**

This section provides us with a description of the OC businesses in Southeast Asia and their connection to Mainland China. We have seen that the OC are fundamentally rooted in the traditions of Confucianism and that their guanxi networks are characterised by informality, personality, and based upon family ties that have no or just little institutional foundation (Liu, 2001).

According to Rauch (2001) ethnic networks are communities, individuals, or businesses that share a demographic attribute such as ethnicity or religion. Many of the first and second generation OC in East and Southeast Asia still feel a strong connection to their ancestral homeland. They thus feel a strong affinity to people whose forefathers are from the same village, town, or even province. As we have seen before, locality is believed to be one of the strongest guanxi bases in the Chinese society and places new acquaintances instantly in the innermost circle of relationships (Chen, 2001, Yeung and Tung, 1996). These guanxi bases

facilitate contact between local groups and OC investors and thus promote investment flows to China. Dieleman (2007) argues that many OC started their investments in their regions of origin, most often Fujian Province. Robert Kuok has been a prominent investor in Fujian himself not least because of his connections with OC kinship groups and voluntary associations (Hsiao, 2003, So, 2012).

Kinship groups and voluntary associations play an important role in representing the interests of various OC ethnic communities in China and are a unique source of advantage for OC. These associations actively connect OC communities with their ancestral homes in China and serve as business networking platforms (Gao, 2003, Heng, 1997, Liu, 1998). Tan and Yeung (2000) in their analysis of Singaporean Hainanese investment in Hainan found that business societies focus on introducing and establishing business contacts among Singaporean Hainanese as well as linkages to China (Tan and Yeung, 2000). These cultural affinities help to direct substantial amounts of money in the form of investment and charitable money to China (Liu, 1998).

The associations help to create or deepen relationships and to identify Shou-ren guanxi bases between Mainland Chinese and OC investors. The mutual guanxi base furthermore implies a higher degree of mutual trust and helps to identify a common basis for business, provides information, access to markets, easy access to capital, credential checks on potential business partners, and help to resolve disputes through arbitration through e.g. the enforcement of sanctions that deter opportunistic behaviour (Chen, 2004, Luo, 1997, Luo, 2007, Rauch and Trindade, 2002, Tan and Yeung, 2000). Robert Kuok took advantage of the above described benefits that were provided by the OC associations. He is a member of the executive committee of the International Association of Fuzhou (Fuzhou is the capital of Fujian Province) (Dieleman, 2007).

Heng (1997) suggests that because of the existence of ancestral ties to China, ethnical Chinese have dominated investments in the Special Economic Zones in Guangdong and Fujian. Family ties in Mainland China provide these OC investors with direct access to political and economic regulatory bodies of local governments. These direct connections, based upon Jia-ren and Shou-ren guanxi bases, with the local governments in these regions help OC to overcome informal barriers to international trade and investment (Gao, 2003). Rauch and Trindade (2002) find that ethnic networks have an important impact on bilateral trade. This is not only because of the mechanisms of market information but through matching and referral services that bring OC investors and local businesses or government officials together. The guanxi of family members, friends, or intermediaries greatly supports the creating or refreshing of guanxi.

Lu (2011) in his study of OC and non-Chinese firms' investment in Southern China finds that the closeness of the ancestor's hometown was a significant determinant for the location choice of 18.6% of the OC participants. 30.2% answered that their possession of guanxi in the city or the experience of friends who manage successful businesses in the region, was an important determinant for the location choice. These determinants were however not or less essential for non-Chinese investors. Dunfee and Warren (2001) conclude that in-country contacts aid in the transfer of capital and provide superior match-making skills. These advantages result in better returns on investment for OC investors.

So far we have seen that guanxi contacts in Mainland China can have considerably positive implication on investment and business success. Today, many OC are actively reconstructing their Chinese identities because they deem it a necessary for long-term success in the Chinese market. It is however a strategic deployment of the shared Chinese identity that is used to promote business and economic interests rather than a cultural revival of the Chinese culture

(Yeung, 2006). It is interesting to note that most initiatives for Chinese community businesses are implemented by relatives or business associates in China that hope to promote investments in their region and not by OC looking for new markets (Luo, 2007).

#### **4.4.2.2. Government guanxi and business success**

The economy and politics are highly interwoven in China. The government has a strong impact on the economic development and this makes government or political guanxi highly important (Redding, 1996). Guanxi with government officials on the local, provincial, and central level provides information on prospective government policies, market trends, and business opportunities. It further helps to gain access to distribution channels or to obtain licenses (Fan, 2002, Gut et al, 2008). OC mobilise their local networks and webs of associates in order to gather information, pursue business opportunities with the government, and to lobby for or against the promulgation of laws and regulations. The access to various decision-makers and influential people in China provides them with a significant advantage over their rivals (Haley et al, 2009, Lasserre and Schuette, 2006).

We have seen in the literature review that a lack of trust in the institutional environment and a limited information exchange through official channels can significantly increase the investment barriers for foreign investors (Gao, 2003). Family guanxi and associations can help to facilitate the sharing of information, and help to match buyers and sellers in the markets. Formal and informal contacts with government officials have similar implications. Local governments can provide information and other services that are relevant for conducting business and that improve the overall investment environment (Dees, 1998, Gao, 2003). This includes information on labour and material costs, general market knowledge, or information and access to suppliers and distributors.

Complicated and time-consuming administrative procedures are one of the biggest challenges for foreign investors in China. A close and long-established *guanxi* relationship helps to improve the administrative efficiencies and to escape the costly and complicated bureaucracy (Fan, 1997). Hsing (1996) documents cases when local Chinese officials interpreted laws and regulations with a great deal of flexibility to accommodate the needs of Taiwanese investors.

Robert Kuok is renowned for his close ties with the authorities in China (Gomez, 2006). We have seen earlier that he invested substantial amounts of capital in China even when the political situation resulted in an overall decline of FDI. Actions like that made the Chinese authorities aware of the fact that Robert Kuok is as important for them as the authorities are for him. In 1993, Kuok was appointed as one of 91 major advisors to the Chinese authorities on the future of Hong Kong (Gomez, 2006, Morf, 1994). In the same year he was also granted the privilege to become a major stakeholder and director of China International Trust and Investment Corporation Pacific (CITIC Pacific). CITIC Pacific is a Hong Kong based government agency that was formed in 1987 to secure foreign investment in China and especially from the OC (Gomez, 2006, CITIC Pacific, 2012). Kuok was furthermore selected by the Chinese authorities to be a member of a 150-member preparatory committee that was established to oversee the return of Hong Kong to China (Gomez, 2006).

His *guanxi* has been a significant business advantage for Robert Kuok's business at several occasions. He was the first choice as a joint venture partner for Coca-Cola when they tried to increase their market presence in China in 1993. The cooperation of Coca Cola and Kuok and its implications for Western firms is analysed in the next section. *Guanxi* with Beijing apparently helped Kuok's Shangri-La Hotel and Resort Group to penetrate the Chinese market more successfully and at a higher pace than any of his competitors.

The first Shangri-La Hotel in China was built in 1984 in Hangzhou which was not one of the major FDI destinations at that time. Rohan Dalziell of ING Baring Securities says that Kuok's connections to Beijing make the investment in his Shangri-La Hotels a low-risk investment choice. His contacts to high-profile policy makers and other influential officials help him to overcome bureaucratic inertia and complete his projects in schedule (Kandell, 1997). Dalziell (Kandell, 1997, p.2) said that "One of the beauties of investing in his [Robert Kuok's] Shangri-La hotels is the certainty that they will be on as fast a track as possible". The subsequent fast and successful growth of the Hotel Chain in China can thus partly be explained by active government support. Smart and Hsu (2003) write that Hong Kong and Taiwanese investors tend to do more business in location with a good infrastructure in the country-side whereas Western MNEs tend to invest only in the largest cities. Through the initial focus on cities that were rather unknown to Western competitors in the hotel business, Shangri-La enjoyed a first mover advantage in these cities.

Tan and Yeung (2000) argue that the implementation of investment ventures is considerably more successful and faster with the support of political figures. His *guanxi* with Beijing involved Kuok's company in one of the most prestigious projects in China, the construction of the China World Trade Center in Beijing in the 1980s (Kandell, 1997).

However we have seen in the literature review that *guanxi* has a strong reciprocal element which is an important element to strengthen the relationship. In 1993, Beijing was worried that the influential South China Morning Post could fall under "outsider control" during the final and most sensitive phase of Hong Kong's reversion to China. Kuok bought the South China Morning Post and was thus in a position to dispel Beijing's fears (Heng, 1997, Kandell, 1997). Gomez (2006) argues that the purchase was politically motivated and an

attempt to bring the control and ownership of this newspaper into the hands of businessmen associated with the authorities in Beijing.

#### **4.5. Implication for Western companies investing in China**

Western MNEs that wish to invest in China often face several constraints due to their unfamiliarity with regulations, languages, and customs in the host country (Gao, 2003). We have seen that OC enjoy significant advantages because of their close guanxi relationships with family members, class mates, government officials and so on. Guanxi networks are however highly exclusionist which means that business is mostly conducted within these guanxi networks and it is very difficult for strangers to gain access and to penetrate these networks (Gambe, 1999). Western MNEs are thus unable to compete head-to-head with local companies in China due to insufficient guanxi (Yeung, 1999).

Ostry (1997 cited in Crawford, 2000, p.83) writes that “language, culture, and history are capabilities necessary to navigate the labyrinth of the Mainland”. The literature review provided us with a common solution that is pursued by many Western companies that come to China. They hire employees with extensive guanxi to promote their operations. This is however not a sustainable solution because these employees could decide to leave the company and consequently take their guanxi with them (Hutchings and Weir, 2006). A long-term solution to this problem is the establishment of an own guanxi networks which takes unfortunately a lot of time or alternatively the cooperation with a local company that has similar business interests.

Many Chinese state-owned enterprises (SOE) are however denounced as inefficient. Their management structure and goals are often not compatible with Western MNEs. Many SOE in China are more interested in political motives, such as the creation of employment, than in

economic motives (Beamish, 1987). Further problems for Western companies arise from the uncertainty of the business environment which complicates the access to reliable information as well as the speed of change, and the impenetrability of networks (Redding, 1996).

Many OC businesses entered the Chinese market in the early stages of liberalisation which provides them with valuable operating experience as well as sector and industry specific knowledge (Yeung, 2006). In contrast to Chinese SOE managers, OC managers are much more familiar with Western management techniques, know not only about the local but also about the global business environment, and work most importantly for the same purpose: profit (Smart and Hsu, 2004). Their historical and social ties are another advantage that allows them to bridge differences in organisational structures and business practices (Crawford, 2000, Lu, 2012).

The bundling of MNEs and OCs business interests in a joint venture offers a win-win solution because of their complementary objectives, skills and resources. Beamish and Lupton (2009) write that the cost of coordination and control that arise from the creation of a joint venture are often higher than the establishment of a wholly owned foreign entity but the access to new resources and capabilities easily exceeds such costs. The cooperation with the OC reduces the market uncertainty and the investment risks for Western firms considerably. They furthermore offer capital, market access, and access to top-level officials through *guanxi*. Especially the abundance of capital of OC enterprise, their business orientation, and their extensive *guanxi* networks that cover not only China but many countries of East and Southeast Asia are important benefits that distinguish these companies from Chinese firms. Western companies on the other hand offer access to advanced technology, brand names, and sophisticated marketing strategies (Gambe et al, 1998, Smart and Hsu, 2004, Yeung, 1999).



Coca Cola entered the Chinese market in 1979 through bottling and distribution agreements with local companies. The gradual liberalisation of the Chinese economy allowed Coca-Cola to expand its operations further in 1984. The company faced however problems like the limited ability to influence the management of the bottling plants, marketing strategies, and opportunistic behaviour (Mok et al, 2002). The insufficient knowledge about the financial difficulties of the state-owned joint venture partners was another setback. Financial security of its Chinese partners was however a basic requirement of Coca Cola's long-term expansion strategy. The soft drink producer was in the red for several years because of the slow implementation of major decisions that had to be approved by ministries and local government, opportunistic behaviour of the local partner, and because of the lack of experienced managerial staff (Mok et al, 2002).

Coca Cola had to rethink its marketing and management strategy in China. In 1993 the company decided to team up with Hong Kong based Swire Group and Robert Kuok's Kerry Group (Tanzer, 1997). There were several reasons for the teaming up of these companies: Both joint venture partners possess high amounts of capital compared to the Chinese SOE. We have seen earlier in the characteristics of the OC business that OC tend to save a lot and maintain a high share of their capital in liquid form (Haley et al, 2009). Swire and Kerry Group offered moreover sufficient management resources and local know-how to position Coca Cola successfully in the market (Clifford, 1996). Coca Cola's new joint venture partners have furthermore strong political connections with Beijing. This enables them to obtain permits etc. faster than even local government officials or managers of SOE could. Government officials and SOE managers are constrained in their ability to obtain permits rapidly from the central government because they have to go through all instances of the government administration and cannot approach decision makers directly. But most

importantly Coca Cola and its OC joint venture partners share the common goal of long-term profits and market share maximisation which has substantially reduced the risk of investment for Coca Cola (Mok et al, 2002). The collaboration of Coca Cola with OC businessmen additionally improves the company's competitive position in the Chinese soft drink market.

Robert Kuok was effectively chosen as joint venture partner because of his skills to quickly implement strategies in Mainland China (Tanzer, 1997). The cooperation with Robert Kuok offered Coca Cola various advantages, such as an improved competitive positioning in the Chinese market and helped to position the company for the long-term while understanding the short-term dynamics and implications of the Chinese market far better (Haley, 2010).

Even though Kuok had no experience in the drink industry, he was taken in because of his excellent guanxi (Tanzer, 1997). John Farrell (President of Coca Cola) said: "What could take us ten to 24 months [Kuok] could do in two months. His whole life has been built around building networks with the OC and in China. [Kerry's] ability to do things fast is incredible" (Tanzer, 1997, p.2). Kuok's extensive guanxi network with various top-level leaders in the government offered guidance to the political scene, provided information, and access to local markets and labour markets including access to managerial resources. He even provided funding, access to local distribution channels, and knowledge about local marketing practices (Haley, 2010, Redding, 1996). Kuok's contacts throughout East and Southeast Asia enabled him to leverage his contacts with local officials profitably and to cut effectively through red tape. This enabled Kerry Group to build the bottling plants at a far greater pace than Coca Cola's former Chinese joint venture partner (Clifford et al, 1996).

All these benefits that arose from Coca Cola's cooperation with Robert Kuok resulted in the first profit of Coca Cola in more than a decade (Haley, 2010). In 2012, Coca Cola had 42

bottling plants in China (Li, 2012). Some of the plants are directly controlled by Coca Cola while the majority is managed in form of a franchise agreement by Swire and Kerry Group (Mok et al, 2002).

#### **4.6. Conclusion and summary of discussion**

We have seen that the OC possess unique investment and business advantages over their Western competitors in China that derive from their knowledge and use of guanxi. This can be explained by their cultural and social ties with Mainland China and their familiarity with the Chinese culture which still has a fundamental impact on their life styles. OC are well aware that trust and commitment are fundamental elements of guanxi and that they constitute an important aspect for business success. OC use their family, business, and political guanxi skilfully to gain access to limited and controlled information, to obtain licenses, to enter new markets, etc. (Gu et al, 2008, Luo, 2007). This allows them to reduce their transaction and investment costs significantly.

In the case of Robert Kuok we have seen that he is involved in some of the most prestigious projects in China and that he served as a member of several committees for the Chinese government in Hong Kong. Kuok's involvement in the construction of the China World Trade Center in Beijing and the incredible fast expansion of his Shangri-La Hotel and Resort chain in China could not have been possible without his close contacts with local business partners and his close relationships to officials on local and central levels of the government. Kuok's business success in China is a proof of his excellent guanxi with the Chinese government and proof of his excellent understanding of the Chinese business etiquette. This knowledge provides him with a set of superior business skills. Haley and Haley (2006) argue that Robert Kuok has always focused his attention on strategy and relationship building

across his immense number of operations. His guanxi with government, but even with consumers and employees gives him an enormous advantage over his competitors in his home country and host country operations.

The institutional arrangement and strong ethical business guidelines of Western MNEs limit their deal making capabilities and their use of guanxi for business deals severely. Their management shows a much lower degree of flexibility and many decisions have to be presented to the senior management or supervisory board before a decision can be made. This is however not in line with the Chinese business etiquette where many deals are made over a cup of tea (Fan, 2002). The ethical guidelines set by MNEs further decrease their manager's capability to establish and maintain guanxi because gift giving or the reciprocating of favours is not in compliance with Western business culture (Steidlmeier, 1999).

The success of the OC in China is also due to the nature of their businesses. Many OC operate in sectors that are traditionally not served by local Chinese or Western companies. Besides the hotel business operated by Robert Kuok's Shangri-La Group, this also includes for example the agriculture business of Thailand's Chareon Group, another OC business conglomerate (Samphantharak, 2011). Redding (2000 cited in Yeung et al, 2000) observes that the OC are unlikely to compete directly with global corporations in high-tech and value-added industries because the business conditions in their home countries that were rather favourable for many OC businesses have not prepared them sufficiently for competitive business in a global market place. It is thus difficult for OC companies to expand outside Asian markets where they cannot fall back on one of their core competencies: the capability to network (Yeung, 1999).

## 5. Conclusion

Guanxi or interpersonal relationships has been a fundamental part of the Chinese culture for centuries. There are two major explanations for the existence of guanxi. Gao (2006), Park and Luo (2001), and Tsui and Farh (1997) say that guanxi emerged together with the teachings of Confucius and helps to coordinate the life in society. Guthrie (1998) and Xin and Pearce (1996) argue that guanxi emerged as means to circumvent the inefficiencies of the Communist bureaucracy in China in the 20<sup>th</sup> century. Lasserre and Schuette (2006) and Kao (1993) combine these explanations. They write that cultural reasons such as the impact of Confucian teaching are responsible for the emergence of guanxi while political and economic developments are responsible for the continuation of guanxi's importance today.

A common identification or guanxi base is necessary to establish a long-lasting and mutual beneficial guanxi relationship. Jacobs (1979) defines three major guanxi bases that describe the various depths of guanxi relationships in the Chinese society: Jia-ren (family), Shou-ren (friends), and Sheng-ren (acquaintances). The level of trust, affection, and commitment towards the partners in these relationships decreases however significantly with the level of intimacy of the guanxi base.

We have seen that guanxi still has considerable impact on business operations in China. Contacts with government officials or businessmen enhance a company's business performances significantly. The most beneficial advantages comprise amongst others the access to top-level decision-makers, access to superior information, the reduction of search and operation costs, or the reduction of business and operation uncertainties (Liu, 2001, Gao, 2006, Gu et al, 2008, Park and Luo, 2001, Zou and Gao, 2007). There are however several negative aspects of guanxi too. One of the most important is the perception of guanxi as

bribery, corruption, or nepotism (Fan, 2002, Steidlmeier, 1999). Another drawback is the very strong reciprocal element of guanxi that makes the reciprocating of an inconvenient, unethical, or even illegal favour necessary (Wilson and Brennan, 2010).

There are conflicting opinions about the future of guanxi. Some scholars, such as Dunfee and Warren (2001), Gu et al (2008), Luo (1997 and 2007), Michailova and Worm (2003), and Yeung and Tang (1996) believe that guanxi will continue to play an important role in the Chinese society. Guthrie (1998), Hutchings and Weir (2006), Kiong and Kee (1998), Kao (1993), and Wilson and Brennan (2010) on the other hand are convinced that the influence of guanxi will diminish in a near future. The fundamental role of guanxi in the Chinese society today makes it however necessary for foreign to understand the implications of guanxi (Hutchings and Weir, 2006).

The OC of East and Southeast possess a significant advantage over their Western competitors due to their familiarity with guanxi and their possession and energetic cultivation of networks with local business partners and government officials. We have seen that Robert Kuok has been able to obtain a significant investment advantage in China for his Shangri-La Hotels because of his contacts with high-level officials in China and his several commitments to the government in Beijing after the Tiananmen Square incident of 1989 or the purchase of the South China Morning Post. However it is not sufficient to conclude that the guanxi bases of OC and Mainland Chinese are the only reason that triggered off OC investments in China. Gambe (1999) writes that Chinese businesses generally tend to follow kinship and regional ties. The shared ethnicity merely helps to introduce two parties and is not the basis for business. Other reasons for the high capital flows are the geographic proximity, low psychic distance, and economic and political factors (Gomez and Huang, 2001, Johansen and Vahlne,

1977). Gomez (2006) suggests that not only voluntary organisations but government leaders in China, Malaysia, and Singapore actively promoted OC investment in Mainland China.

OC have crucial advantages over Western companies due to their successful leverage of guanxi in Mainland China. The skilful use of guanxi with politicians and businessmen alike enables them to make well-informed decisions, speed up business operations, find sufficient sources of finance and capital, or to conclude new business deals. The OC use their guanxi networks skilfully to protect these advantages and core competencies by leaving their competitors in an informational void. This informational void shields them from foreign companies that have competitive advantages in R&D, product and process technologies, marketing skills, or logistics and finance (Haley, 1996). Foreign companies have to tap guanxi networks in order to tap sources of information and to operate successfully in the Chinese market. One way to establish guanxi rapidly is to hire well-connected individuals that can take charge of the guanxi management of the firm. This strategy has however certain drawbacks should the employee decide to leave the company (Luo, 2007).

Coca Cola went an alternative way and entered into a joint venture agreement with Robert Kuok's Kerry Group. The Malaysian Chinese entrepreneur is not only familiar with the business model of the American company but has excellent guanxi with Beijing, and most importantly follows similar entrepreneurial goal. This joint venture provided Coca Cola with instant access to the highest governmental circles, essential market information, and other benefits that greatly facilitated the expansion of Coca Cola in the Chinese market. Kuok profits from his involvement in the production and distribution of one of the most successful and popular soft drinks world wide.

Samphantharak (2011) however concludes that OC and Western companies investing in China will increasingly have to rely on their specific business competencies rather than ethnic ties and relationships in order to stay competitive in a rapidly changing market. However until this turning point is reached, Western companies that wish to conduct business in China are highly disadvantaged. The disadvantages derive from the organisational structure of their firms that does not allow them to enter and cultivate fruitful guanxi relationships with Chinese or OC businessmen. The ability to build and maintain guanxi is highly limited because the most fundamental elements, such as gift giving or regular exchange with their Chinese partners, is not considered ethical by the management and supervisory boards of these companies (Steidlmeier, 1999).

As the Chinese economy and Chinese business become more and more globalised and competitive, the reliance on guanxi for investments and business operations in China will fade. China's accession to the WTO in 2001 contributed to a significant reduction of investment risks (Smart and Hsu, 2004). A further indication for this trend is the declining relative contribution of OC investment in China since the mid-1990s. Lu (2012) finds in this research that 74.4% of the OC and 57.9% of non-Chinese investors in China agreed or highly agreed that the gradual emergence of a more sophisticated legal system will reduce the importance and impact of guanxi in China. This development and the increasing familiarity of Western corporations with the concept of guanxi reduce the level of market and business uncertainty in China. The introduction of advanced management techniques and the access to external financing decreases the dependence on guanxi further (Park and Luo, 2001, Yeung 2006). Robert Kuok introduced a modern management style early and was not afraid to take in foreign and Western senior managers unlike many other Chinese family enterprises (Tanzer, 1997). He reacted therefore promptly to these developments and reduced the



influence of guanxi in his business operations. The crucial decisions are however still made by Robert Kuok personally. The emergence of information and communication technologies allows a more equal access to information. These factors will result in a reduced competitive positioning of OC businesses in the medium to long-term and force them to rethink their business model (Lasserre and Schuette, 2006).

Lovett et al (1999) emphasise that the Eastern management techniques should not be dismissed as inferior to Western technique because they are perfectly adjusted to the local market environment. A hybridisation of Western and Eastern management techniques may therefore even be essential for Western companies to stay competitive vis-à-vis Asian competitors. A hybridisation allows to reduce transaction costs and to enhance overall operational flexibility in Asia.

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