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When Does *Guanxi* Matter? Issues of Capitalization and Its Dark Sides

Guanxi refers to the durable social connections and networks a firm uses to exchange favors for organizational purposes. This study examines how and when *guanxi* operates as a governance mechanism that influences firm marketing competence and performance in the transitional economy of China. Drawing on social capital theory, the authors propose an integrative framework that unbundles the benefits and risks of *guanxi* and delineates the organizational processes to internalize *guanxi* as a corporate core competence. The authors surveyed senior executives in 282 firms in China's consumer products industries. The findings confirm *guanxi*'s direct effects on market performance and its indirect effects mediated through channel capability and responsive capability. The authors also confirm that technological turbulence and competition intensity can be effective structure-loosening forces, thus reducing the governance effects of *guanxi*. The findings suggest that firms can improve market access and growth through *guanxi* networks, but managers need to capitalize on them from the personal to the corporate level. In addition, managers should be aware of *guanxi*'s dark sides, which include reciprocal obligations and collective blindness. This study shows that personal networks are popular universally, but in China, they have unique, distinct ways of operation.

Keywords: *guanxi*, personal connections, transitional economy, social capital theory, China market

An unavoidable challenge for firms entering China to capitalize on its enormous market potential is to determine how to navigate within the confines of China's powerful institutions (Child and Tse 2001; Davies and Walters 2004). The institutions, including formal organizations (e.g., social, economic, and political bodies), and social norms and rules (North 1990; Scott 1995) are known to govern how individuals, firms, and governments behave. Studies across disciplines, including sociology, economics, and management, have noted how these institutions foster collusions among firms and between firms and local governments to create regional economic warlords (Walder 1995) and network capitalists (Boisot and Child 1996), thus twisting free product flows in the country. Within the firm, these institutions command the way internal firm resources are valued and allocated (Hoskisson et al. 2000); outside the firm, these institutions define the complex firm-to-firm and firm-to-government relationships in China's treacherous and changing marketplace (Lau, Tse, and Zhou 2002).

A common way to help firms circumvent institutional barriers is the use of *guanxi*, commonly conceptualized as interpersonal ties. Heide's (1994) seminal work on channel governance delineates the various relationship governance mechanisms and their operating processes. Recent studies have confirmed the critical role of governance mechanisms

in supply chains (Wathne and Heide 2004) and export markets (Zhang, Cavusgil, and Roath 2003). In China, *guanxi* goes deeper as a governance mechanism; it is a direct outgrowth of the Chinese collectivist culture (Hwang 1987; Xin and Pearce 1996). For centuries, the need to maintain harmonious interpersonal relationships has created a system of reciprocal exchange of gifts and favors that unites and expands interpersonal ties among the Chinese people (Bond 1991, 1996). Although *guanxi* is an aspect of daily life, it also becomes an alternative mechanism when formal mechanisms fail (Peng and Heath 1996). At the firm level, *guanxi* opens dialogues, builds trust, and facilitates exchanges of favors for organizational purposes (Hoskisson et al. 2000). It also enables firms to overcome institutional barriers and instability in the face of regulatory changes (Luo 2003; Park and Luo 2001). The extant literature confirms that *guanxi* "dominate[s] business activities throughout China" (Lovett, Simmons, and Kali 1999, p. 231), affecting firm performance across industries and regions. Within the emerging literature on *guanxi*, three issues are relevant to marketing strategy in China's transitional economy.

The first issue centers on the relevance of *guanxi* to market performance in China. Recent studies by Guthrie (1998) and Law, Tse, and Zhou (2003) have noted *guanxi*'s declining role in explaining firm performance in China. Their findings suggest that a firm's government ties, though significant, are much less salient than a firm's strategies in driving performance. Their findings echo both the request by the global community and the country's continuous economic reform (Child and Tse 2001). The growing forces of globalization and the country's effort to meet World Trade Organization (WTO) commitments may lead to the question, Does *guanxi* still matter to firm performance, such as market expansion and growth in China?

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The second issue is related to how firms can capitalize on *guanxi* at the corporate level to influence performance. Firms in China are known to hire staff with strong *guanxi* (Xin and Pearce 1996), but if *guanxi* remains at the “raw,” “uninstitutionalized,” and interpersonal level, firms will always be held hostage by staff with strong *guanxi*. As the staff leaves, interfirm or firm–government relationships may be at risk, an issue that is central to both foreign and local firms operating in China (Lovett, Simmons, and Kali 1999; Tsang 1998). The strategic challenge lies in how managers can capitalize on *guanxi* to build core competences that enable the firm to compete.

The third issue is related to the dark side of *guanxi*—that is, its potential damaging effects on firm performance. *Guanxi* has been instrumental in helping firms navigate China’s complex, institution-ridden terrain, but remaining inside the *guanxi* network demands that firms return the favors of or exchange favors with other firms (Luo 2003) and local governments (Walder 1995). Scholars have pointed out the potential negative consequences of *guanxi*, including personal indebtedness by executives (Van-honacker 2004), domino effects when firms within the *guanxi* network fail (Uzzi 1997), and collective blindness when the market environment changes (Wellman 1988). Although interpersonal obligations can be alleviated through compensations, domino effects and collective blindness affect a firm’s future. If a firm’s ability to react to market changes is compromised, it can have fatal consequences to firms in fast-changing markets (Moorman and Slotegraaf 1999).

Our study draws on social capital theory (e.g., Adler and Kwon 2002; Burt 1997; Nahapiet and Ghoshal 1998) to delineate the information, trust, and control benefits of interpersonal ties and to postulate that *guanxi* operates as a salient governance mechanism that affects firm market performance in China. We empirically test the links between *guanxi* and both corporate channel capability and responsive capability to understand how firms can best capitalize on *guanxi* to enhance competitive competences. We also examine the moderating effects of market uncertainty and technological turbulence to assess the potential dark sides of *guanxi* when the corporate environment changes. In short, our study addresses the following questions: (1) Does *guanxi* still matter? (2) How does *guanxi* affect firm performance? and (3) When does *guanxi* exhibit negative impacts?

We test our hypotheses using a survey of senior executives in 282 strategic business units (SBUs) across 48 categories of consumer products in China. Compared with other industries, such as mining, utility, finance, high-tech, and public services, China’s consumer products industries are more open to foreign firms and are regarded as the country’s least regulated markets. Thus, our study assesses the salience of *guanxi* in a relatively conservative context.

Conceptual Framework and Hypotheses

Why Guanxi Matters

The significance of social connections in affecting interfirm exchange has long been recognized in the relationship mar-

keting literature. Seminal work by Heide and John (1992) and Morgan and Hunt (1994) highlights the salience of social norms and trust in governing interfirm market exchange. The relational exchange paradigm suggests that by using norms, trust, and other governance systems (Wathne and Heide 2004), firms can foster interfirm cooperation, commitments, and loyalty to weather environmental uncertainties (Zhang, Cavusgil, and Roath 2003). This paradigm, founded in the context of an individualist culture with established legal and professional institutions, has been the central tenet underlying much of marketing channel and supply chain research over the past decade.

In contrast, scholars in sociology (Walder 1995), psychology (Bond 1996), economics (Scott 1995), and management (Luo 2003) note variances in systems of relational exchange across cultures and use *guanxi* to refer to a particular form of Chinese social governance mechanism. Table 1 summarizes *guanxi*’s unique features and its differences from current thoughts on social exchange in terms of the construct’s origin, operating mechanism, and effects. *Guanxi* originates from a collectivist society in which interpersonal harmony is an important terminal value (Yang 1994) and the relational core is paternal (Fukuyama 1995). A child born into a specific paternal *guanxi* network whose members give him or her favors is obliged to reciprocate them in the future. The *guanxi* network that is instrumental in the daily lives of the Chinese people (Gold, Guthrie, and Wank 2002) has since evolved into a core feature of their daily operating system (Lindsay and Dempsey 1983). Indeed, as a source of social capital (Burt 1997) that individuals and entrepreneurs draw on when formal institutions and resources are unavailable, *guanxi* has also become a salient governance structure in China’s business community (Xin and Pearce 1996).

To appreciate the uniqueness of *guanxi*, it is necessary to recognize that in countries that follow individualist cultural orientations, social networks are often formed by voluntary associates who have complementary skills and qualifications (Fukuyama 1995) that enable them to bond and help one another. Voluntary associates tend to consider alternative partners at the outset and to assess the partnership’s cost–benefits and potential disengagement thereafter (Dwyer, Schurr, and Oh 1987). Thus, relational exchange in an individualist context involves conscious social accounting aimed at maintaining a fair and even relationship. In contrast, *guanxi* is a bounded solidarity aimed at deepening relationships over time (Yang 1994).

Guanxi as a Governance Structure in China and Other Collectivist Cultures

Guanxi’s distinguishing features can be delineated by social capital theory (e.g., Adler and Kwon 2002; Burt 1997; Portes 1998). Social capital is the resource that arises from strong community ties, and it exists in cultures that treasure such ties (Putnam 2000). Portes and Landolt (1996) note that Jewish diamond merchants in New York would lend sacks of jewels to one another for examination without signing any paper. The ability to conduct expeditious exchanges while saving legal fees is a result of a tight social circle, in which misdeeds would render a person cut off from the community.

TABLE 1
Contrasting Relational Exchange and *Guanxi* Network

As a Construct	Relational Exchange (According to Relationship Literature)	<i>Guanxi</i> Network
Nature of construct	Social networks that an individual builds	A form of social ties and connectiveness popular in Chinese culture
Cultural context	<ul style="list-style-type: none"> •Individualist •With legal and professional institutions well established 	<ul style="list-style-type: none"> •Collectivist–familistic (Fukuyama 1995) •Family bonds above all other social bonds and loyalties
Operating rules (i.e., norms)	Conscious social accounting involving cost–benefit analysis and consideration of alternatives before acting	An in-group approach that views an individual as part of a web of social relationships, strong in-group favoritism
Initial formation	Mostly by individuals through their social behaviors and activities	Paternal in nature, born in family and villages
Growth and extension	Mostly through increasing social activities of the individual	Through increased social activities and network growth, expandable by transfers
Operating mechanism and processes	Trust and social norms that drive cooperation and commitment	Favoritism and reciprocity that drive commitment and loyalty
Social capital (source of)	<ul style="list-style-type: none"> •Voluntary association of individuals or firms with complementary skills •Loosely organized (Fukuyama 1995) •Infrequently done, exceptional 	<ul style="list-style-type: none"> •Kinship and variants •Tight social ties •Often done, becomes a norm
As corporate resource	Seldom used	Important resource for entrepreneurs and firms that do not have other resources

As Governance Structure	Relational Exchange	<i>Guanxi</i> Network
Relational benefits	Few and weak, typically stay at the interpersonal level	Can be strong because it obliges all in the network to help, can be transformed to corporate level
Shared values in network	Some common values but often not enforced to converge	Strong, at times may be enforced to converge
Maintenance process	<ul style="list-style-type: none"> •Interfirm agreements and contracts •Being fair and even 	<ul style="list-style-type: none"> •Reciprocity, indebtedness, and gift giving •Deepen through accumulated obligations
Daily use	Occasional	Frequent and in many facets of life
Antecedents	Interdependency, the ability to provide others with reward and obtain profits in return	Bounded solidarity; ties based on: <ul style="list-style-type: none"> •Ascribed traits (kinship, native place) •Achieved characteristics (e.g., same school) •Shared experience (long March)
Positive effects	<ul style="list-style-type: none"> •Sustain commitment through trust and norms in uncertain environment •Fairness and openness to build strong relational commitment 	<ul style="list-style-type: none"> •Respect/face (prestige, status) •Privileged access to information and resources (accomplish tasks) •Sustain in uncertain environment
Negative effects	<ul style="list-style-type: none"> •Uncertainty because of open competition •Costs of disengagement 	<ul style="list-style-type: none"> •Bribery, corruption •Obstacle to the rule of law •Overdependence, domino effects
Transferability and duration	<ul style="list-style-type: none"> •Limited transferability •Heavily dependent on the identity of each party •Can withdraw/disengage 	<ul style="list-style-type: none"> •Organic process, transferable •Bounded solidarity •Can pass from generation to generation

Social capital draws its resources from different core social relationships. People in collectivist cultures, such as China, Italy, Israel, and South Korea, draw on family and kinship ties as important social resources. This is also true in Latin cultures in which family ties constitute an important social resource. In short, *guanxi* in China has its counterparts in other collectivist cultures, but the way it operates in China is unique.

Guanxi in China is shaped by both its collectivist cultural norm and a value system that favors durable kinship ties over all other social ties. Japan, which is also a collectivist culture, differs from family-centric societies in that it developed centuries ago the institutionalization of nonkin social relationships (e.g., formal adoption of nonkin as household and organizational leader), which accumulates social capital in intermediate organizations, such as a corporation managed by professionals with no biological ties to the founder or owner. Thus, Japanese culture emphasizes social clan (corporate) loyalty over family loyalty. The *Keiretsu*, a privileged elite circle (Boisot and Child 1996), allows nominally separate organizations to share capital, technology, and personnel in ways that are not open to firms outside the network (Fukuyama 1995).

Over time, *guanxi* in China has evolved into a powerful governance structure with unique expansion rules, operating mechanisms, and impacts on firm behavior. Ascribed traits, achieved characteristics, and shared experiences (Gold, Guthrie, and Wank 2002) provide the natural bases for *guanxi* to expand. *Guanxi* can also be created through interpersonal transfers of trust and relational ties (Peng and Luo 2000). When Person A introduces Person B to Person C, Person A is transferring trust and relational ties to “endorse” the relationship between Person B and Person C. In so doing, *guanxi* expands into a rich pool of shared ties and obligations (Chang and Holt 1991), a process especially useful to individuals and firms lacking natural ties with a diversity of partners. This is in contrast to relational exchanges that are often not easily transferable.

The exchange of gifts and favors that is formalized to reflect a continuum of differential social ties in Chinese culture (Joy 2001) is of great importance in maintaining *guanxi*. Yang (1994) notes that from early childhood, most Chinese recognize the importance of and master the art of forming harmonious sociorelational networks by exchanging gifts and favors. Bond (1991, 1996) and Hwang (1987) point out that *guanxi* is maintained because receivers are obliged to return favors as a result of an implicit reciprocity norm. Powered also by the need to “save face” (Bond 1991; Hwang 1987), the receiver is “required” to pay back a favor; thus, an interlocking and mutually obligating relationship is formed over time. Note also that in more marketized regions of China, such as Hong Kong and Taiwan, in which other formal institutions for exchanges are present and efficiently maintained, the salience of *guanxi* is less frequently noted.

Relational Exchange (and Personal Favors) Across Cultures

As we delineate the uniqueness of *guanxi* in China, we note that personal favors (a core mechanism for *guanxi* to oper-

ate) exist in most cultures. Indeed, the term “old boys’ network” implies that interpersonal networks of trust and friendship are salient and popular in many cultures. Existing literature points out that in most Western cultures, relational exchanges are typically weak, infrequently used, and involve no strong common values, whereas *guanxi* in China is frequently practiced and, at times, evokes shared values (Lovett et al. 1999; Vanhonacker 2004). As Table 1 summarizes, this article postulates that *guanxi* is a country-specific form of relational exchange that is shaped by China’s institutions. In short, whereas the salience and rules of relational exchange apply across all cultures, the lack of other balancing institutions and governance mechanisms in China has allowed *guanxi* to evolve into the unique form that scholars have uncovered. Indeed, relational exchange and its principal rules are universal in nature, but its dominance and operating rules in China makes the effects of *guanxi* globally distinct.

Guanxi as a Corporate Resource and Capital in China

Most of China’s business infrastructures and related institutions are inefficient. Thus, *guanxi* is often transferred from the individual level to the corporate level to facilitate interfirm exchanges (Peng and Heath 1996). This transfer can occur in two ways. The first is through the concept of the extended self (Bond 1996). In the Chinese value system, a person’s possessions and works are viewed as part of his or her extended representations that others are “obliged” to treat with respect. Thus, if Person A approaches Person B, with whom he or she has interpersonal ties, for a favor in a business exchange, Person B is obliged to treat the exchange the same way he or she would treat Person A. Otherwise, Person A may feel disrespect or loss of “face.” This process bundles interpersonal *guanxi* with corporate *guanxi*.

This process also operates in the opposite direction. Person A can pay off his or her personal obligation to Person B by giving favoritism to a business exchange Person B is involved in, such as helping Person B’s firm to a better deal or providing timely information. By doing so, corporate exchange (and favoritism) is personalized, a process that is outlawed in most developed economies, including Hong Kong. Because these processes cross over personal and corporate boundaries, labeled as “boundary blurring” (Peng and Heath 1996), managers could use interpersonal networks to create a pattern of corporate obligations that enables firms to gain broader access to needed resources or protection that may be unavailable otherwise.

Guanxi provides an alternative mechanism that enables firms to bypass institutional hurdles (Boisot and Child 1996). Xin and Pearce (1996) regard *guanxi* as “institutional substitutes” when institutions are weak or nonexistent in China. Using resource-based theory (Barney 1991), management researchers argue that *guanxi* is a firm resource that can be deployed to enhance firm competitive advantages and performance (Luo 1997; Peng and Heath 1996; Peng and Luo 2000). An emerging body of ideas conceptualizes how *guanxi* operates and takes effect at the corporate level. Boisot and Child (1996) argue that through *guanxi*,

entrepreneurs and managers form a network of kinship elites (fiefs) and capitalists (clans). By colluding with local governments, firms become regional economic powers and warlords (Walder 1995). However, *guanxi* is a potential double-edged sword. The network of obligations functions as a corporate liability (Vanhonacker 2004) because it can drag managers and firms into misconduct and disasters (Vaughan 1999). We extend these works and postulate a multifaceted model of how *guanxi* operates to affect market performance in China (see Figure 1). The model describes *guanxi*'s direct impacts, its indirect influences through firm capabilities, and its effects moderated by market forces.

Does Guanxi Still Matter? Direct Effects of Guanxi on Brand Market Performance

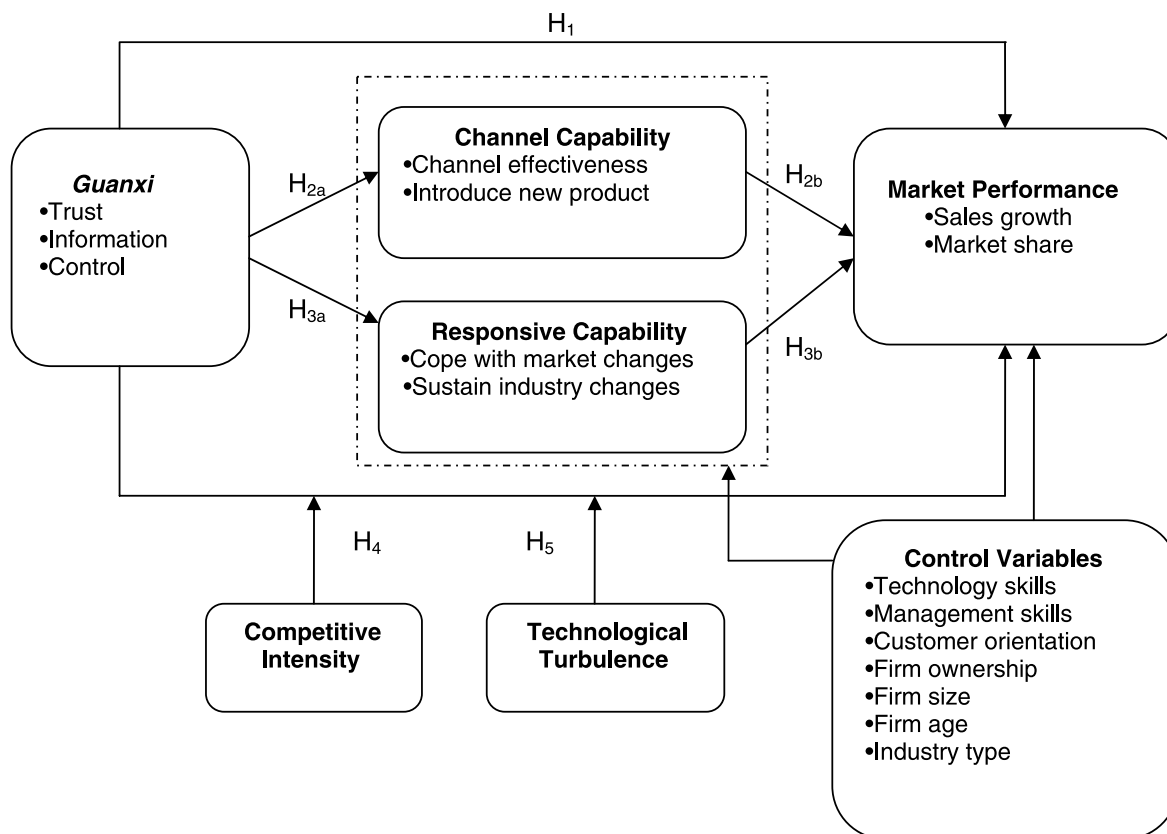
Because of its salient role in enhancing resource accessibility in business operations, firms cultivate *guanxi* and solicit it from their staff. This form of interfirm exchange is especially important to firms with poor asset endowments, and endowment and ownership rights dictate to a large extent the availability of resources for firms in China (Xin and Pearce 1996). It is much easier for state-owned enterprises (SOEs) to secure capital because they are favored by banks that are mostly state owned—that is, until recently. Thus, *guanxi* with SOE managers may open up opportunities for financial resources. Collective-owned enterprises, often

jointly owned by local governments and individuals, enjoy greater protection and more favorable tax rates (Lau, Tse, and Zhou 2002). Partnering with these firms provides a critical strategic move that gains embeddedness into local and regional markets (Granovetter 1985). *Guanxi* with government officials enables firms to understand the rules of the game better and, thus, to achieve an advantageous position, for example, in obtaining land, licenses, and distribution channels (Child and Tse 2001). Managers often get past their problems by calling on interpersonal favors. Thus, *guanxi* with external entities serves as a firm's "convertible" assets (Coleman 1988) that affect firm performance.

Gold, Guthrie, and Wank (2002) note that China's recent reforms have helped develop efficient business infrastructures that fundamentally change the role of *guanxi* in firm operations. However, given the deep cultural roots of *guanxi*, despite changing influences, *guanxi*'s impact remains salient. Our study centers on *guanxi*'s effect on how consumer product brands perform (sales growth and market share) in China. As is noted in seminal works, channel access is of pivotal significance to these products (Frazier 1983; Heide and John 1992). Given China's complex, multilevel distribution systems and inefficient logistics, we hypothesize the following:

H₁: A firm's *guanxi* network has a positive effect on its brand market performance.

FIGURE 1
Conceptual Model of How and When *Guanxi* Affects Brand Market Performance



How Guanxi Can Be Capitalized: Corporate Channel and Responsive Capability

After firms cultivate effective *guanxi* networks, capitalizing on *guanxi* to build competences at the corporate level is the next challenge. Boundary blurring, in which a manager is considered “the firm” as well as an individual, elevates personal *guanxi* to the level of a corporate resource. We postulate that when properly managed, a successful firm can incorporate its staff’s *guanxi* resources to benefit its channel and improve its responsive capabilities (Moorman and Slotegraaf 1999), which is known to affect a brand’s market growth and share performance in today’s network economy (Frazier 1983; Wathne and Heide 2004).

Corporate channel capability refers to a firm’s ability to manage its channel to ensure that its products are delivered to its target markets efficiently (Heide and John 1992). Because China’s fragmented local markets are interconnected by ineffective logistic systems and ill-coordinated infrastructures, having strong channel capability constitutes a core competitive advantage for a firm (Ambler, Styles, and Wang 1999; Davies and Walters 2004).

Corporate responsive capability refers to a firm’s ability to scan and respond effectively to market changes. Extant literature in marketing and strategy suggests that responsive capability is a key competence in markets in which environmental uncertainties are high, a feature that is typical of transitional economies, such as China (Hoskisson et al. 2000). In addition, industrywide reforms in China are both necessary and frequent. Thus, a firm’s ability to decode and navigate through such changes is invaluable to its success (Child and Tse 2001; Lau, Tse, and Zhou 2002). Social network theory, a subbranch of social capital theory, identifies trust, information, and control as the three core benefits derived from social connections (Adler and Kwon 2002; Nahapiet and Ghoshal 1998; Uzzi 1997). In the context of our study, they constitute the benefits of *guanxi* networks that enhance firm channel capabilities and responsive capabilities in ways we discuss next.

Guanxi Enhances Firm Channel Capability

Through the accumulation of trust, *guanxi* helps nurture goodwill and cooperative norms among partners in a channel system (Doney and Cannon 1997). These shared values and norms are critical ingredients that offer a platform for channel partners to work together to expand their markets (Heide and John 1992). This is especially true with distribution channels in China’s fast-growing consumer markets. Mutual trust in channel members’ reliability and integrity, when verified and reinforced over time, encourages collaboration (Dwyer, Schurr, and Oh 1987). Channel members also help firms resist environmental threats because channel partners bonded in a *guanxi* network would assume sacrifice in anticipation of reciprocal rewards when the threats subside (Zhang, Cavusgil, and Roath 2003). In short, *guanxi* reduces transactional costs and suppresses opportunistic behaviors that are typical problem areas in interfirm relationships (Doney and Cannon 1997).

Guanxi also enhances channel capability through its intrinsic control benefit. Given the complex web of favors and obligations, control benefits of *guanxi* operate at both

the firm and the individual levels. At the corporate level, China’s SOEs and local-government-owned enterprises are known to first “cooperate” with their likes before working with others (Boisot and Child 1996). The shared organizational culture and operating procedures enable them to be more effectively monitored, leading to effective channel governance. This also makes interfirm transfer of favors easier.

At the individual level, *guanxi*’s control benefits are also strong. Vanhonacker (2004) notes that some managers are more effective than others because they have built up a set of obligations with other managers, and they can get things done by using people who “owe” them. Brand managers in China cultivate *guanxi* among managers of a channel system and among government officials (Park and Luo 2001) to accumulate obligations from others. The managers have increased control over *guanxi* partners’ attitudes, decisions, and behaviors because of a surplus of obligations. Through mutual obligations and reciprocal favors, corporate channel capability is strengthened with better controls. In summary, we expect the inherent benefits of *guanxi* to affect firms’ brand market performance positively through improved channel capability.

H_{2a}: A firm’s *guanxi* network has a positive effect on its channel capability.

H_{2b}: A firm’s channel capability is positively related to its brand market performance.

Guanxi Enhances Firm Responsive Capability

Guanxi also enhances firm responsive capability through its information and control benefits. There are two types of information benefits: information access and information decoding. First, connections to a *guanxi* network enable firms to gain access to more diverse information sources and, often, high-quality information on time and at lower costs (Burt 1997; Coleman 1988). From the transaction cost perspective, as *guanxi* partners exchange information for mutual benefits, they effectively lower their information search costs (Williamson 1975). The informational advantages in diversity, quality, and timeliness are crucial because they help build firm readiness to reduce firm vulnerability against environmental threats.

Second, as the Chinese government continues to alleviate industry and business operating restraints, it is extremely critical for firms to be able to decode the disseminated information correctly (Peng and Heath 1996). For foreign firms, ambiguity of information may be related to the high-context culture of China (Hall 1959); as Boisot and Child (1996) note, however, much of the Chinese government’s disseminated information remains at an uncoded level, leading to potential confusion. In this regard, firms in *guanxi* networks are able to decode information regarding the country’s changing profile, its market characteristics, and government policy intents with help from government officials within the network.

Guanxi networks provide members with control benefits or, more precisely, the ability to anticipate and prepare for changes (Zhang, Cavusgil, and Roath 2003). On the basis of ethnographic fieldwork with 23 entrepreneurial firms, Uzzi

(1997) finds that firms in a *guanxi* network are able to call on partners to make real-time changes to capitalize on major environmental shifts. These joint actions and collaborative norms (Heide and John 1992) equip firms with greater control over uncertainties. In line with the agency theory perspective, greater control that develops from better alignment between individual firms in a *guanxi* network (Bergen, Dutta, and Walker 1992) will significantly enhance a firm's responsive capability and, in turn, its market performance. Consistent with this argument, existing research indicates that in a "managed" economy, such as China, *guanxi* networks provide a pragmatic response to regulatory distortion and information asymmetry (Buckley and Casson 1988). By engaging in preferential, reciprocal, and highly personalized *guanxi* networks, managers gain valuable information about the environment, including policy changes and industry reforms, to respond in a timely and effective manner. We propose that *guanxi* drives market performance through indirect routes, such as corporate responsive capability. Thus, we hypothesize the following:

H_{3a}: A firm's *guanxi* network has a positive effect on its responsive capability.

H_{3b}: A firm's responsive capability is positively related to its brand market performance.

When Guanxi Hurts: Moderating Roles of Market Forces

In every society, resources, capabilities, or systems of actions inevitably generate secondary consequences that may run counter to their objectives (Merton 1936; Vaughan 1999). Purposive actions may impede changes or prove to be a liability in light of environmental dynamics (Jap and Anderson 2003). *Guanxi*, a governance system that depends on the institutional structure of a society, also creates liabilities that become salient under certain conditions. At times, the negative bundles of *guanxi* may offset its benefits for the people and firms involved.

Among the negative bundles of *guanxi*, two aspects have been noted. First, the ties that bind may turn into the ties that blind. A strong *guanxi* network may create over-embeddedness that reduces the flow of new ideas into the network (Gargiulo and Benassi 1997) and limits the openness to alternative ways of doing things (Nahapiet and Ghoshal 1998). In this way, *guanxi* may produce collective blindness to the firm within the network. Second, *guanxi* may overload a firm with obligations to its network members. As Uzzi (1997, p. 59) notes, "feelings of obligation and friendship may be so great between transactors that a firm becomes a 'relief organization' for other firms in the network." This state of obligation may cause *guanxi* to be cost inefficient. Given the dark side of *guanxi*, an environmental contingency perspective is required to assess the boundary conditions for its effects (Guthrie 1998; Lovett, Simmons, and Kali 1999).

In this study, we use competitive intensity and technological turbulence to capture the forces that change institutions in China. As the country undergoes reform and marketization, these two forces characterize the processes by which powerful connections in the past would decrease in value. Indeed, these market forces are regarded as

"structure-loosening" changes (Wellman 1988) in the power institutions in China, shaking the very core of *guanxi* networks.

Competitive intensity refers to the degree to which a firm faces competition within its industry. Intense competition is characterized by fierce price wars, heavy advertising, diverse product alternatives, and more players in the market (Porter 1991). Faced with the imperative to differentiate their products, firms seek to achieve dynamic strategic fit by meeting a variety of customer needs (Davies and Walters 2004). For firms operating in highly competitive markets, survival rests in the ability to maintain sales at a profitable level. However, this financial interest may cause friction and conflicts in a relationship, especially for firms within the same value chain. Disagreements and priority for survival may undermine mutual commitments and discontinue support to other network members (Skarmas, Katsikeas, and Schlegelmilch 2002).

Competitive intensity often fosters alternative ways to obtain similar resources. As alternative sources become available, a firm's dependence on *guanxi* partners declines. Hung, Gu, and Tse (2005) note that consumer product firms do not rely on or commit to the same agency as more and more advertising agencies enter China. These changing corporate attitudes reflect the loosening of *guanxi* networks. Former powerful firms may stand to lose their network benefits, whereas less resourceful firms may gain as competition intensifies in China (Madhavan, Koka, and Prescott 1998; Wellman 1988). In short, collective blindness and increased obligation created by unwarranted reliance on *guanxi* become detrimental under highly competitive circumstances.

H₄: Competitive intensity dampens the positive effect of *guanxi* on a firm's brand market performance.

Technological turbulence refers to the rate of technological advancement in an industry, and it runs counter to the need to maintain long-term relationships with members in a *guanxi* network. Thus, in an industry undergoing rapid technological changes, firms with newer technology and greater productivity will likely emerge and challenge existing *guanxi* (Lovett, Simmons, and Kali 1999). By dealing only with existing members, a firm may deprive itself of more capable and efficient partner firms. As Yang (1994) observes, *guanxi*'s inward-looking system is relatively slow in accepting new members because it takes time to form strong particularistic ties.

The hesitation and inertia for managers to work with new entrants can potentially lead to the loss of competitive positions as they lose their technological edge. As an important structure-loosening force powered by accelerating globalization, technological changes reallocate opportunities, shift industrial standing, and redistribute power in the industries and among members in a network (Madhavan, Koka, and Prescott 1998; Wellman 1988). In intense technological changing markets, it becomes increasingly inefficient or even misleading to rely on old friends to get things done. Thus, we hypothesize the following:

H₅: Technological turbulence dampens the positive effect of *guanxi* on a firm's brand market performance.

Other Effects

We also include in our model several variables that have been consistently identified as affecting firm capability-building processes and market performance in China. Technology and management skills (Park and Luo 2001) refer to perceived corporate strength in developing and using advanced technologies and managerial competence in leading and motivating employees, respectively. Customer orientation reflects a firm's emphasis on understanding the target customers to create superior value for them continuously (Narver and Slater 1990). We also include firm demographics, such as size, age, ownership, and industry, to account for their effects on firm capabilities and market performance.

Method

Sampling and Data Collection

The unit of analysis in our study is a firm's individual brands in different consumer products industries. In China, this is the closest analogy to an SBU in a developed economy. Typically, the brand unit is responsible for formulating and implementing the brand's marketing and sales strategy plan and managing brand sales. The key informant in our study is the senior manager (e.g., marketing director, general manager, regional brand manager) directly involved with the strategic and tactical operations of the brand.

In line with our research objectives, our sampling frame consists of 48 consumer products industries, including home appliances, beverages, snacks, cosmetics, apparel, cigarettes/liquors, cleaning products, automobiles, and personal computers. The senior managers in these industries would likely develop *guanxi* networks as a resource to facilitate market entry and expansion, and they would be able to assess *guanxi*'s role and contribution to the brand.

Local research contacts are key means of obtaining reliable and valid information in an emerging economy (Hoskisson et al. 2000). By Chinese law, all nonlocal people/firms are not allowed to conduct surveys themselves. Thus, our data were collected by a national marketing research firm that has a long-standing reputation in marketing research services and owns branches and affiliates in China's key cities. The data collection was conducted in three stages. In the first stage, in-depth interviews were conducted with 20 brand managers who work directly on market expansion in China. The interviews provided insights into the nature of *guanxi* between managers and their partner firms in the channel.

In the second stage, respondents were identified through a multistage sampling procedure. First, a sampling frame was acquired from the China Marketing and Media Study, a well-recognized brand share report published by the Sino-Monitor International Company. Second, brands were selected using a stratified random sampling technique. Brands in each product category were divided into two groups: leading brands (top 10 brands of the category) and nonleading brands (the next 20 brands of the category). From each group in each product category, at least 3 brands were selected at random to avoid potential biases due to

overreliance on successful brands, as is known to exist in typical firm surveys. In total, we sampled 150 brands from the first group and 250 brands from the second group in our survey.

In the third stage, one senior manager and two midlevel managers of each brand unit were contacted for personal interview. All respondents were informed in advance of the confidentiality of their responses, and an enclosed letter explained the academic purpose of the project. Each respondent was rewarded a gift (valued at US\$25) and was promised a copy of the survey report. Among those contacted, 22% did not complete the interview for two main reasons: busy travel plans and time clashes. We assessed nonresponse bias by comparing brand units that completed the interview and those that did not in terms of annual sales, number of employees, and types of ownership (Armstrong and Overton 1977). No significant differences were found.

A total of 312 brand unit surveys, each with responses from one senior and two midlevel marketing managers, were completed and returned. After screening and deleting missing data and outliers, we retained 282 usable surveys. Of these, we compared the senior managers' responses with the averaged responses from the two midlevel managers in each brand unit. We found no significant differences in their perceptions of key constructs: *guanxi* ($p = .245$), channel capability ($p = .367$), responsive capability ($p = .910$), competitive intensity ($p = .636$), and technological turbulence ($p = .442$). The multi-informant approach suggests that response biases, including common method bias, if they exist, are not strong. Thus, we concluded that the senior managers had taken organizational perspectives and faithfully reflected organizational resources, capabilities, and the surrounding environment. We retained the senior managers' responses for further analysis. In total, we received an effective response rate of 70.5% (282/400), demonstrating high data collection efficiency. Of the 282 brand units, 122 came from a leading brand group (43.7%), and 160 came from a nonleading brand group (56.3%), showing a balanced mix of performance. Firm size also showed a wide variety: 19.6% of the firms had fewer than 200 employees, 42.1% had 200–1000, 26.6% had 1000–5000, and 11.7% had more than 5000 employees. Ownership types included SOEs (29.7%), stock companies (23.3%), and joint-venture firms (47.7%), representing a fair diversity of firm ownership.

Measures

In the literature review, we identified measurement scales and modified them to suit the research purpose of our study. We supplemented the modified scales with interviews with senior managers involved in marketing activities. All the measures were professionally translated and back translated to ensure conceptual equivalence. All the scales ranged from "strongly disagree" (1) to "strongly agree" (7), unless indicated otherwise (see Table 2).

We integrated items from multiple sources to grasp the key dimensions of *guanxi*. The core concept underlying *guanxi* is the personalized relationships with important people (Davies et al. 1995; Xin and Pearce 1996; Yang 1994), which are fostered by information asymmetry,

TABLE 2
Scale Description and Measurement Model Results

Measures	Standardized Loading
Model 1: $\chi^2 = 153.67$, d.f. = 80, $\chi^2/\text{d.f.} = 1.92$, $p < .01$; GFI = .94; AGFI = .90; CFI = .94; IFI = .95; and RMSEA = .057	
Guanxi	
1. Our senior management has personal relationships with important people.	.74*
2. Our senior management is able to obtain valuable and important information.	.81*
3. Our senior management is able to obtain government approvals.	.85*
4. Our senior management is able to obtain resources like land and electricity from local authorities.	.77*
5. Our senior management is able to obtain financing or list stocks.	.80*
Channel Capability	
1. Our brand owns effective distribution channels.	.60*
2. Compared with our top three competitors, our speed of distributing new products.	.61*
Responsive Capability	
1. We are able to respond properly to market changes.	.57*
2. We are able to sustain advantage during industry changes.	.87*
Competitive Intensity	
1. There are too many similar products in market; it is very difficult to differentiate our brand.	.63*
2. This market is too competitive; price wars often occur.	.66*
Technological Turbulence	
Over the past five years, we see that in the industry where our brand operates	
1. The diversity in production technology has dramatically increased.	.51*
2. The leading foreign firms have introduced their state-of-the-art products into China at the same time as their home market.	.50*
With China entering WTO, the impacts on the industry where our brand operates include	
3. More new product ideas.	.72*
4. More new opportunities.	.51*
Model 2: $\chi^2 = 126.39$, d.f. = 56, $\chi^2/\text{d.f.} = 2.26$, $p < .01$; GFI = .94; AGFI = .90; CFI = .96; IFI = .96; and RMSEA = .067	
Technology Skills	
1. We are able to use complicated technology to develop new products.	.62*
2. Our products provide many technological advantages.	.76*
3. We actively engage in developing new products.	.54*
Management Skills	
1. Our managers effectively lead and motivate employees.	.86*
2. Our managers have strong communication skills.	.84*
3. Our managers encourage team work, group decision-making, and internal communications.	.88*
4. Our managers are capable of solving internal conflicts.	.80*
Customer Orientation	
1. Our competitive advantage is built on the understanding of customer needs.	.61*
2. We are committed to creating greater value for our customers.	.68*
3. We constantly measure customer satisfaction.	.53*
Sales Growth^a	
1. Compared with our top three competitors, our sales growth in the past two years is....	.98*
2. Compared with our top three competitors, our sales growth in the past five years is....	.88*
Market Share^a	
Compared with our top three competitors, our market share is....	—

* $p < .001$.

^aItem is measured on a scale ranging from "extremely inferior" to "extremely superior."

Notes: GFI = goodness-of-fit index, AGFI = adjusted goodness-of-fit index, CFI = comparative fit index, IFI = incremental fit index, and RMSEA = root mean square error of approximation.

required in conditions of entry barrier (Keep, Hollander, and Dickinson 1998), and used to obtain different types of resources (Peng and Luo 2000; Xin and Pearce 1996). We confirmed these academic insights into the nature of *guanxi* during in-depth interviews with managers who practiced *guanxi* extensively in their task environment.

Channel capability refers to firm competitiveness in distributing products to different markets. It is a measure of the efficacy and efficiency of the firm's distribution channels. We developed the scale from manager interviews and referenced *China Hand*, a professional publication prepared by the Economist Intelligence Unit (2004) on China. The scale items highlight the degree to which firms own effective distribution channels and their comparative efficiency in distributing new products in China. Responsive capability refers to the speed of response by firms in fast-moving markets (Nayyar and Bantel 1994). In our study, it refers to a firm's efficiency in properly responding to two types of changes: changes in the industry and changes in the market.

We measured competitive intensity and technological turbulence using scales adapted from the work of Jaworski and Kohli (1993). Competitive intensity described the availability of alternative products in the market and the intensity of price competition. Technological turbulence captured respondents' perceptions of technological advancement over the past five years and their perceived opportunities brought on by China's entry into the WTO. We follow prior studies and operationalize brand market performance along two dimensions: sales growth and market share, compared with the top three competitors (Park and Luo 2001; Peng and Luo 2000).

Using scales adapted from the work of Park and Luo (2001), we controlled the effect of technology and management skills on firm capabilities and market performance. The customer orientation scale originated from the work of Narver and Slater (1990). We operationalized firm size, a proxy for firm financial strength, as the logarithm of the number of employees in a firm (SBU). We used the number of years of operation to indicate firm age. We coded three types of firm ownership (a proxy for organizational culture) as two dummy variables: SOE and joint venture (1 = yes, 0 = no). Finally, we included industry as a dummy variable to control for potential variations between "nondurable" (coded as 1) and "durable" (coded as 0) products.

We examined construct validity as follows: First, we ran exploratory factor analyses for *guanxi*, channel capability, responsive capability, competitive intensity, technological turbulence, technology skills, management skills, and customer orientation. Factor solutions were consistent with theoretical postulates. Second, to assess the convergent and discriminant validity of the constructs, we separated the constructs into two groups and conducted confirmatory factor analyses (Li and Atuahene-Gima 2002). We allowed the latent constructs to be correlated while constraining the measurement items and their error items to be uncorrelated. Both models provide satisfactory fit (for fit statistics, see Table 2), indicating unidimensionality of measures (Anderson and Gerbing 1988). Loadings of items on their respective factors are all positive, high in magnitude, and statistically significant, showing that the scale had satisfactory

convergent validity (Anderson 1987; Anderson and Gerbing 1988). We conducted a series of confirmatory factor analyses, as Bagozzi, Yi, and Phillips (1991) recommend. The results suggest that for every pair of factors in the measurement model, a two-factor model fits the data significantly better than a one-factor model, demonstrating satisfactory discriminant validity (Anderson 1987; Bollen 1989). Taken together, the measures have good convergent and discriminant validities.

Results: Test of Hypotheses

We used composite scores of each construct in a series of ordinary least squares regressions. Table 3 shows means and standard deviations, as well as correlations among the variables.

Using regression analysis, we assess the effects of *guanxi* on market performance and mediating constructs (Table 4) and the effects of mediating constructs and interaction terms on market performance (Table 5). We mean-centered the variables in interaction terms to avoid problems of multicollinearity. Variance inflation factors showed no significant bias (ranges from 1 to 2). The R-squares for all the regression runs ranged from .313 to .486, suggesting that the proposed predictors have satisfactory explanatory power. H_1 suggests that *guanxi* has a positive impact on market performance. Table 4 shows that *guanxi* registers a significant influence on brand sales growth ($\beta = .43, p < .001$) and brand market share ($\beta = .61, p < .001$), in support of H_1 .

We propose that *guanxi* is positively related to channel and responsive capabilities (H_{2a} and H_{3a}), which in turn positively affect brand market performance (H_{2b} and H_{3b}). To test the mediation hypotheses, we regressed *guanxi* and other predictors on channel and responsive capabilities (Table 4). The results show that *guanxi* significant affects firm capabilities (for channel capability: $\beta = .30, p < .001$; for responsive capability: $\beta = .26, p < .001$), in support of H_{2a} and H_{3a} . We then included both mediators in the regression (Table 5) to evaluate (1) their impacts on dependent variables and (2) their impacts on the coefficients associated with *guanxi*. Both mediators had significant impacts: Channel capability has a significant effect on sales growth ($\beta = .23, p < .001$) and market share ($\beta = .23, p < .001$), and responsive capability significantly affects brand sales growth ($\beta = .12, p < .05$) and brand share ($\beta = .20, p < .001$), in support of H_{2b} and H_{3b} . Compared with model results on Table 4, the effects of *guanxi* drop from .43 to .32 for brand sales growth and from .61 to .49 for brand share. If we take these findings together, H_{2a} , H_{2b} , H_{3a} , and H_{3b} are supported; both channel capability and responsive capability are partial mediators, and *guanxi* exerts a positive influence on brand market performance.

H_4 proposes that competitive intensity moderates the relationship between *guanxi* and brand market performance. The findings in the last two columns of Table 5 show that the two-way interaction of competitive intensity and *guanxi* is negatively related to brand sales growth ($\beta = -.09, p < .05$) and brand share ($\beta = -.02, p > .10$). Although the interaction effect on brand share does not reach a significance

TABLE 3
Descriptive Statistics of the Constructs

Construct	1	2	3	4	5	6	7	8	9	10	11	12	13	14	15
1. Sales growth	1.00														
2. Market share	.54*	1.00													
3. <i>Guarxi</i>	.47*	.62*	1.00												
4. Channel capability	.45*	.46*	.42*	1.00											
5. Responsive capability	.39*	.43*	.39*	.50*	1.00										
6. Competitive intensity	-.28*	-.17*	-.07	-.18*	-.18*	1.00									
7. Technological turbulence	.02	.11	.18*	.13**	.16*	.00	1.00								
8. Technology skills	.02	.08	.21*	.25*	.22*	-.01	.38*	1.00							
9. Management skills	.18*	.18*	.21*	.32*	.46*	-.06	.09	.28*	1.00						
10. Customer orientation	.02	-.01	.10	.20*	.30*	.03	.25*	.43*	.28*	1.00					
11. Firm size	.25*	.12	.22*	.24*	.17*	-.15**	.02	.00	.03	-.04	1.00				
12. Firm age	.02	.13	.13	.08	.04	.00	.02	.08	-.09	.18**	.04	1.00			
13. SOE	-.09	.00	-.09	-.18*	-.14**	.03	-.04	-.03	.00	-.03	.04	.00	1.00		
14. Joint venture	-.04	-.06	.03	.04	.03	.05	-.06	-.02	.02	-.07	-.19*	-.09	-.61*	1.00	
15. Industry	.04	.03	-.05	-.02	.02	-.01	-.05	-.06	.07	.04	-.26*	.17	.02	.03	1.00
M	4.35	4.00	4.47	5.09	5.46	4.19	5.51	5.34	5.73	5.87	2.03	7.36	.30	.47	.72
SD	1.46	1.67	1.08	.94	.89	1.40	.90	1.01	.83	.77	.72	4.78	.46	.50	.45

* $p < .01$.

** $p < .05$.

TABLE 4
The Effects of *Guanxi* on Market Performance and Firm Capabilities

	Market Performance (H ₁)		Channel Capability (H _{2a})	Responsive Capability (H _{3a})
	Sales Growth	Market Share		
Independent Variables				
<i>Guanxi</i>	.43***	.61***	.30***	.26***
Competitive intensity	−.22***	−.11**	−.12*	−.13**
Technological turbulence	−.04	.03	−.01	.04
Control Variables				
Technology skills	−.08	−.04	.10	−.02
Management skills	.09	.08	.20***	.35***
Customer orientation	.00	−.09	.07	.17**
Firm size	.12*	−.04	.14**	.09
Firm age	−.03	.05	.02	.00
SOE	−.12	−.01	−.18**	−.13*
Joint venture	−.10	−.09	−.05	−.03
Industry	.08	.04	.01	.02
Overall Model				
F-value	11.44***	17.03***	11.24***	14.64***
R ²	.317	.408	.313	.372

* $p < .05$.

** $p < .01$.

*** $p < .001$.

Notes: t-tests are one-tailed for hypothesized effects and two-tailed for control variables.

level, the combined results suggest that when the market becomes increasingly competitive, *guanxi*'s contribution to brand market performance is weakened.

H₅ predicts that technological turbulence mitigates the positive influence of *guanxi*. The results show that the moderating effect does not register significantly for brand sales growth ($\beta = -.02$, $p > .10$) but is significantly related to brand share ($\beta = -.08$, $p < .05$), providing partial support for H₅.

To illustrate visually how *guanxi*'s effects are moderated by market forces, we plotted Figures 2 and 3. Figure 2 illustrates the impacts of *guanxi* and competitive intensity on brand sales growth (Panel A) and brand share (Panel B). At a lower level of competition, *guanxi* has a positive impact on both, but when competition level is high, *guanxi*'s impact is slightly lower (Panel B) or negative (Panel A). The interaction effect reinforces that competitive intensity is a definite threat to brand performance, but the negative influence is much stronger when firms rely heavily than lightly on *guanxi*. Likewise, Figure 3 shows that the impacts of *guanxi* are much stronger when technological turbulence is low than when it is high. In particular, the effects of *guanxi* went from highly positive to negative (Panel B) or slightly positive (Panel A) when technology turbulence changed from low to high. Thus, technological turbulence is only slightly damaging when *guanxi* is low, but it becomes severely detrimental when *guanxi* is high. Taken together, Figures 2 and 3 illustrate the mitigating effects of market forces on the relationship between *guanxi* and brand market performance, providing additional support for H₄ and H₅. Indeed, competition and technological turbulence are highly effective structure-loosening forces in the China market.

Discussion and Conclusion

Our study is a modest but bold attempt to conceptualize the salience of *guanxi* as a governance structure in China, its capitalization at the firm level, and its damaging effects when the market environment changes. The findings provide several contributions. We find support for direct, indirect, and moderated effects of *guanxi* that shape brand market performance in China. The results provide inputs into the following hotly debated issues in the literature:

- Because *guanxi* operates as a complementary mechanism to circumvent China's institutional barriers, will *guanxi*, a deep-rooted cultural governance structure, continue to operate as China develops formal institutional mechanisms?
- In what ways does *guanxi* lead to firm performance? What organizational processes are needed to foster its contributions? Which corporate capabilities does *guanxi* enhance?
- What are the boundary conditions on which contributions from *guanxi* change course?

Our study confirms that the salience of *guanxi* as a governance structure is strong and persistent. Our postulate traces *guanxi*'s operating rules by means of the Chinese cultural value system. The findings confirm that the *guanxi* network exerts direct impacts on brand performance in China's least regulated consumer product markets amid the country's institutional reform. Thus, the effects of *guanxi* on brand sales growth and brand share performance cannot be ignored. These findings reinforce the notion that behaviors and operating rules with deep-rooted cultural values die hard. In the era of globalization, it is equally important for managers to develop deeper cultural knowledge to understand international markets.

The resource-based view prescribes that firms need to combine heterogeneous and imperfectly mobile resources to succeed. Managers can enrich their firms' endowment by sourcing and capitalizing on valuable, rare, and nonimitable assets that offer sustainable competitive advantages (Barney 1991). Indeed, *guanxi* is an asset that leads to firm competence in managing channels (H_2) and developing responsive strategies (H_3). By leveraging interpersonal ties to the corporate level, managers can reduce transaction costs in distribution channels and gain wider market coverage. Managers also lower information cost generated from close relationships and enhance control over the task environment to cope with market changes. In addition, they can capitalize on a firm's channel and responsive capabilities to "house" the benefits drawn from interpersonal *guanxi* networks. These findings provide some clues to the organizational processes whereby *guanxi* becomes a firm's sustainable competitive advantage. To the best of our knowledge, this is the first empirical investigation of the capitalization of *guanxi*.

Importantly, our study confirms that the dark side of *guanxi* as a governance structure is indeed salient (H_4 and H_5). Drawing insights from Wellman's (1988) structural explanation, our study delineates and verifies the possible negative impacts of *guanxi* in the context of structure-loosening forces, such as competition and technological turbulence. The results echo findings in interfirm relationship

research that suggests that ongoing relationships can develop characteristics that destabilize and destruct the relationship from within, revealing the dark side of long-term relationships (Jap and Anderson 2003).

Our study confirms that competitive intensity and technological turbulence are salient moderators for the effects of *guanxi*. These findings remind us of the transitional and developmental stages of many emerging economies in which *guanxi* is a fundamental part of economic and social life. As these economies approach the true market system, the moderating effects of interpersonal ties are likely to decrease. Although our study confirms two such moderating effects, it also points to the fallacy of overreliance on this mechanism when operating in transitional economies. Indeed, the danger of overburden by reciprocal obligations and collective blindness is damaging and potentially fatal.

Social networks are common in all cultures and are known to be powerful influencers of business procedures. Our findings suggest that social networks as powerful governance structures need to be recognized and understood. How each culture manifests such social influences is a key to understanding international markets. In this regard, our findings suggest that cultural factors, such as individualism/collectivism, and core social relationships, such as kinship, help manifest social influences in each culture. Thus, although our study examines *guanxi* in China specifically, other countries that have similar cultural orientations (e.g.,

TABLE 5
Mediating Effects of Firm Capabilities and the Moderating Effects of Market Forces

	Market Performance (H_{2b} , H_{3b})		Market Performance (H_4 , H_5)	
	Sales Growth	Market Share	Sales Growth	Market Share
Mediating Variables				
Channel capability	.23***	.23***	.23***	.23***
Responsive capability	.12*	.20***	.12*	.19***
Moderating Terms				
<i>Guanxi</i> × competitive intensity	—	—	-.09*	-.02
<i>Guanxi</i> × technological turbulence	—	—	-.02	-.08*
Independent Variables				
<i>Guanxi</i>	.32***	.49***	.33***	.50***
Competitive intensity	-.17***	-.06	-.17***	-.06
Technological turbulence	-.05	.02	-.06	.00
Control Variables				
Technology skills	-.10	-.06	-.08	-.06
Management skills	.00	-.04	-.02	-.04
Customer orientation	-.04	-.14**	-.05	-.14**
Firm size	.08	-.09	.08	-.10*
Firm age	-.04	.04	-.03	.05
SOE	-.06	.06	-.08	.06
Joint venture	-.09	-.07	-.08	-.06
Industry	.08	.04	.07	.03
Overall Model				
F-value	12.43***	19.59***	11.06***	17.29***
R ²	.375	.486	.383	.492

* $p < .05$.

** $p < .01$.

*** $p < .001$.

Notes: t-tests are one-tailed for hypothesized effects and two-tailed for control variables.

South Korea) may have related forms of social influences. Although social networks are etic and universal, an emic study approach is necessary.

Managerial Implications

This study provides several implications for firms entering and expanding their operations in China. Although the importance of personal *guanxi* networks is widely acknowledged as a crucial mechanism, it is important to understand the essential cultural norms, rules, and processes through which *guanxi* operates. Many firms are aware of the key roles of *guanxi* and actively build their *guanxi* networks by

developing relationships with partner firms and government officials and recruiting overseas and local Chinese as managers. We argue that it is crucial to grasp the nature of this deep-rooted resource, to understand the capitalization process, and, importantly, to be aware of its negative effects.

Guanxi offers benefits in major ways: It helps firms connect to partnership firms and government offices, gain access to “insider” information, decode government policy intents, and open up needed resources that are otherwise unavailable. These factors are especially important when firms attempt to capture China’s regional markets in which

FIGURE 2

How Market Forces Moderate *Guanxi* Effects: Interaction Between *Guanxi* and Competitive Intensity

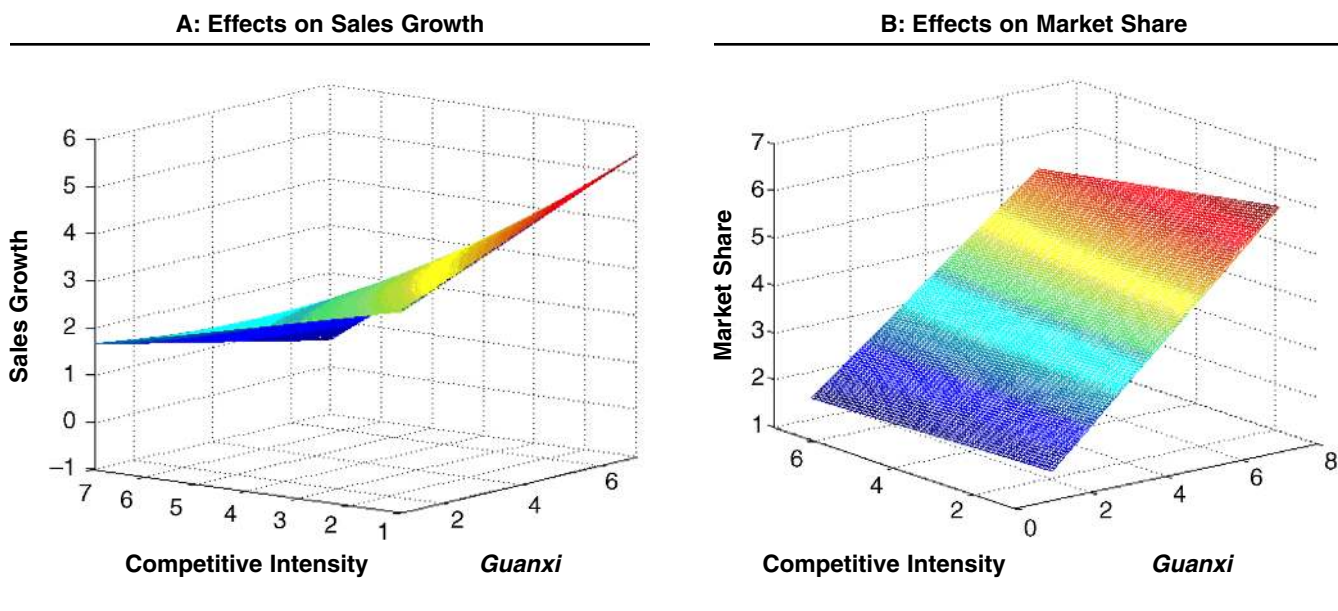
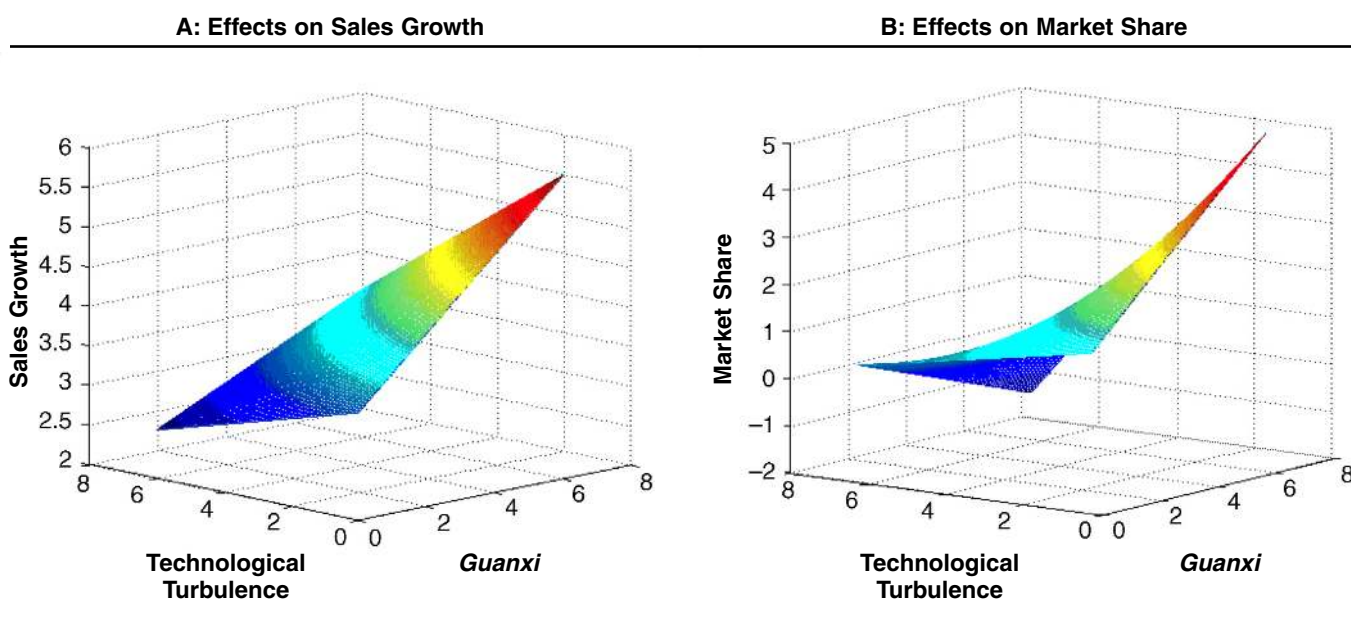


FIGURE 3

How Market Forces Moderate *Guanxi* Effects: Interaction Between *Guanxi* and Technological Turbulence



protectionism and entry barriers are high. The economic value of helping firms maneuver among marketing channels, value chain firms, and government officials is unquestionably invaluable. Our findings in the relatively open consumer product markets in China provide support for this popular strategy. A substantial number of firms (both foreign and local) consider the *guanxi* network an attribute of their management staff. In June 2007, new Web sites that offer the chance for a person to have lunch or play golf with senior managers or government officials for a fee became available. In a highly interpersonal society, strong embedded social ties remain a core value.

We argue that firms can “corporatize” interpersonal ties to the level of corporate networks by understanding and managing the boundary-blurring process. By actively transferring interpersonal trust to interfirm trust, such as providing quality business-to-business services and ensuring that the partner firms are aware of such exchanges, firms may be able to depersonalize and corporatize such networks. Our study finds that two firm competence areas, channel capability and responsive capability, could benefit from the corporatizing of personal *guanxi*. Thus, the ability to develop *guanxi* into a valuable, rare, nonimitable, and nontransferable resource for a firm can be a pivotal challenge.

As much as it is a valuable resource, *guanxi* can also be a major liability. Management and marketing scholars have warned against *guanxi*’s dark side, such as the overburdening of corporate obligations, domino effects when a network fails, overreliance, and collective biases. These negative effects are real and highly damaging. Although a firm can benefit from its managers’ *guanxi* networks, it is obligated to reciprocate favors that it may not be able to offer. The greatest danger can emerge if such obligations affect the firm’s decisions and even its future. Thus, it is important for firms to develop a check-and-balance system to reduce such exposure. Some firms (e.g., HiSense, a top Chinese home appliance manufacturer) maintain a periodic position-rotating system to ensure that the regional managers do not stay in the same place for more than two years. Although the effectiveness of such systems is unknown, the awareness of the danger regarding *guanxi*’s dark side is clear.

Our study confirms that competitive intensity and technological turbulence can mitigate the effects of *guanxi*. As China develops more open-market infrastructures and institutional mechanisms (e.g., rule of law), *guanxi*’s effectiveness may be reduced through these structure-loosening forces. However, we caution against this sweeping general-

ization because *guanxi*, a socially embedded practice (Uzzi 1997), can be contextualized to local conditions and thus may be perpetuated (Gold, Guthrie, and Wank 2002). There is reason to be hopeful because the *guanxi* network in a particular Chinese society—namely, Hong Kong—does not interfere or twist business exchanges. How much time and cultural adaptation such a transition would take for other areas remains a major challenge.

Limitations and Further Research

Our findings need to be evaluated with regard to the following limitations: First, our study delineates and confirms both the benefits and the costs of *guanxi* as a governance structure. We did not investigate how managers make such benefit-cost trade-offs. Further research could address the question of how managers rationalize their decisions and how they manage their *guanxi* portfolio to boost brand performance and firm profitability.

Second, this study investigates *guanxi* from a holistic perspective to delineate its theoretical underpinnings. The study does not examine the differential implications of different domains of *guanxi*. For example, *guanxi* connections can be further classified into *guanxi* with governments (central, local, and city governments), firms (competitors and those in the marketing channel), customers (firms and end consumers), and stockholders. A multidomain approach could provide a portfolio of overlapping influences and obligations that enrich the knowledge on *guanxi*. Note also that in our study, we measure several constructs by two-item measures rather than the more common three-item measures. Whenever possible, more items in a measure are preferred to achieve strong measurement reliability and validity.

Third, our study included only brands in the consumer product category. The choice of this context is appropriate for our research purpose. However, how *guanxi* evolves in China’s industrial sectors, the protected financial community, and highly monopolized industries (e.g., telecommunications, the energy sector) should also be examined.

This study assessed the effects of two structure-loosening forces: competition and technology. The salience of these forces provides useful implications to global agencies (e.g., WTO, The World Bank) to understand other emerging markets. In this increasing globalized and technological world, the effects of such forces demand more comprehensive work and research efforts.

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