



UNIVERSITY OF GOTHENBURG  
SCHOOL OF BUSINESS, ECONOMICS AND LAW

# 关系

**The impact of *guānxì* in Chinese business**  
*A study of Swedish SMEs in Beijing*

Master thesis  
Management Accounting  
Spring semester 2010

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Gothenburg, June 2010

Måns Gellerstam

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# Abstract

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**Master thesis in Management Accounting, School of Business, Economics and Law, University of Gothenburg, spring 2010.**

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## **The impact of guanxi in Chinese business**

*A study of Swedish SMEs in Beijing*

**Background and research problem:** China is today the world's third largest economy and, consequently, a rising number of Swedish companies see great business potential in the Chinese market. Foreign companies are often advised to make an effort to understand the cultural aspects involved in the Chinese business context. The way the Chinese handle their relationships and networks is called *guanxi*. The combination of Swedish SMEs eager to be part of the Chinese market on one hand, and the dynamics of Chinese business culture on the other hand, makes *guanxi* and its effects on business an interesting subject to look into. With this background, our research questions are the following:

*How does guanxi affect business relations? To what extent is guanxi affecting management control? In what way can guanxi be considered a key success factor in Chinese business?*

**Purpose:** The purpose of this thesis is to explore *guanxi*'s impact on Swedish SMEs' operations regarding networking, control mechanisms and strategic choices, factors critical to business success. Our aim is that this study will be helpful to Swedish entrepreneurs in China.

**Method:** The empirical data is based on interviews in Beijing with four company representatives and a professor of Accounting. The empirical data has been analyzed from a theoretical frame of reference collected in advance.

**Result and conclusion:** Firstly, three different views on the importance of *guanxi* can be observed. The first view, represented by Chinese natives, implies that *guanxi* is important to business success. The second view implies that *guanxi* affects business relations in some industries. The last view implies that *guanxi* is overrated, and that it has no direct affect on business relations. Chinese natives consider *guanxi* to be of greater importance to business relations, than do Westerners. Secondly, *guanxi* has no effect on formal control mechanisms. Informal control mechanisms, however, is influenced by *guanxi*. For that reason, *guanxi* can make social control more important as an informal control mechanism hence affect management control. Lastly, *guanxi* is not an overall key success factor, but it is still an important factor for business success.

**Suggestions for further studies:** Since the subject is relatively unexplored, several ideas could be interesting to pursue. For example, it would be interesting to explore the impact of *guanxi* on business-local government relations. Furthermore, carrying out a study on Chinese SMEs only would possibly give a different view of *guanxi*. Finally, it would be of great interest to do the same study but in a less developed region, perhaps in central China.

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# 1. Introduction

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*In this introductory chapter, we describe the background of the chosen subject. Furthermore, we explain the problem formulation and continue with the aim of the study. The chapter ends with an explanation of the study's delimitations.*

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## 1.1 Background

*“A global company has to be present in Asia to have a possibility to sustain competitive advantage” Göran Andersson, CFO at Alfa Laval in Shanghai (Lannebo Direkt, 2010 p. 12)*

Ever since China initiated the reform policy back in 1978, the country has experienced the fastest economic transformation in modern time, with an average growth of nine percent annually. Today, China is the world's third largest economy and is believed to reach the second place in just a few years (The World Bank, 2009). The number of Swedish companies established in China continues to grow and there are already approximately six hundred Swedish companies engaged in the country. The number of Swedish businesses dealing with China amounts to more than ten thousand. China is the most important market in Asia and plays a central role as a base for Swedish companies, especially in the field of production, purchasing and research & development (The Swedish Embassy in Beijing, 2010).

In late March 2010, Chinese carmaker Zhejiang Geely Holding Group (Geely) sealed a deal to buy Gothenburg-based Volvo Car Corporation from Ford Motor Company. This was the largest acquisition of a foreign carmaker ever made by a Chinese company (Financial Times, 2010). This is yet another example of the shift in the global industry's centre of gravity from Europe and the United States towards China. In Gothenburg, the second largest city in Sweden, politicians and business people are facing east. Municipally-owned company Business Region Göteborg (BRG) has a strong focus on Chinese business relations and will participate in Expo 2010, this year's World Fair (Göteborgs-Posten, 2010). The Expo 2010 in Shanghai takes place May to October and is expected to attract many visitors and extensive media coverage. Göran Johansson, Chairman of BRG, claims that Expo 2010 is a golden opportunity to promote Gothenburg in the global economy (Göteborgs-Posten, 2010).

Yet another indicator of the increased Sino-Swedish exchange was the recent visit of an influential Chinese dignitary. Vice President Xi Jinping, expected to become China's next leader, visited Sweden March 27-30 to celebrate the 60<sup>th</sup> anniversary of diplomatic relations between China and Sweden. Xi Jinping emphasized that small and medium-sized enterprises (SMEs) are a key to future growth and jobs in both countries, and an agreement on cooperation in the SME area was signed (The Swedish Embassy in Beijing, 2010). A study of Swedish start-ups in China, made by Skandinaviska Enskilda Banken and the Swedish Trade Council, shows a trend that Swedish small businesses are currently investing in China. Over

half of the companies that were established in China in the last 12 months have fewer than one hundred employees worldwide. The typical company is small, has limited resources and starts on a small scale in Shanghai or Beijing with just one or two employees. Industrial products are still the most central category, but the service and consumption sector is growing in importance (Swedish Trade Council, 2010). This indicates that the Chinese market is important not only for global companies, but also for smaller players striving to sustain and develop competitive advantage.

As mentioned above, an increasing number of Swedish companies see the business potential in China. However, Swedish entrepreneurs striving for success in "the economic engine of the world" also encounter obstacles that are not related to tariffs and legal codes (Lee & Wong, 1999). Awareness of the cultural aspects involved in running an enterprise in China is often stressed as being of great importance (Björkstén & Hägglund, 2010). The way Chinese handle their relationships and networks is called *guanxi* (Björkstén & Hägglund, 2010). *Guanxi* describes the basic dynamics of personalized networks and relationships, and is a central idea in Chinese society and commercial life. *Guanxi* is based on long-term relationships with mutual trust and reciprocity. A study made by Tung and Worm (2001) states that foreign companies consider building and maintaining *guanxi* significant to achieve long-term business success.

The increased interest from Swedish SMEs willing to be part of the Chinese market on one hand, and the dynamics of Chinese business culture on the other hand, makes *guanxi* and its effects on business an interesting subject to look into.

## 1.2 Problem definition and discussion

*"Successful people management is the only way to achieve sustainable business performance" Ian Duffy, President at IKEA Asian-Pacific (Björkstén & Hägglund, 2010)*

According to Björkstén and Hägglund (2010), *guanxi* is an important concept when doing business in China. At the same time, it is one of the most misunderstood and over-mystified concepts. Building *guanxi* takes time, requires hard work and a well-developed network of contacts (Swedish Trade Council, 2010). Ulf Landin, marketing manager at BRG, highlights the importance of personal relationships in China; they have to be long-term and beneficial to both parties (Göteborgs-Posten, 2010).

A problem for Western companies in general is that they lack understanding of the implications of *guanxi* and how to run a company in a Chinese context (Li et al, 2000). In Western countries, business relationships are viewed functionally and evaluated by both sides on a benefit basis. Managers from China base their relationship on moral and social norms of *guanxi* as a part of the Chinese culture, and relationships are highly personalized and built on consistency. Engagement in business exchange by these different cultures can create problems; *guanxi* must be understood and managed by Western companies established in China (Wilkinson et al, 2009). According to several studies, for example Tung (1993), misinterpretations of *guanxi* is one of the reasons to business failure in China. Clegg et al



(2007) found that *guanxi* appeared to be critical to small, but not large, companies. Well-developed *guanxi* reduced transaction costs and helped securing resources and information, enabling companies to run operations more efficiently.

Inter-organizational relationships (IORs) is a research area that has gained increasing focus lately. IORs are defined by Kraus and Lind (2007) as various types of cooperation between independent organizations: “When companies cooperate and, consequently, to some extent adapt their activities and resources to suit each other, they become more closely tied to one another” (Kraus & Lind, 2007 p.12). This type of cooperation tends to be more long-term and creates various benefits. *Guanxi* networks are similar to Western networks (a type of IOR). The difference is that the *guanxi* network is based on a personalized relationship and is not an organizational commitment (Luo, 2007). IOR is a well-recognized concept in the management accounting area, whereas *guanxi* is not. This makes it interesting to explore how *guanxi* affects management control systems.

*Guanxi*'s impact on business success has recently been questioned. Researchers as Guthrie (2002) and Clegg et al (2007) imply that *guanxi*'s impact on business is decreasing. Factors like globalisation, information accessibility and regulations have made *guanxi* less important. However, other studies state the opposite (Yeung & Tung, 1996: Luo, 2007). Considering different opinions in today's research, we want to find the answer as to what extent *guanxi* can be considered as a key success factor.

In China, where *guanxi* is a part of the ancient culture, the question arises whether companies involve *guanxi* in their operational processes. For example, can *guanxi* improve a firm's competitive advantage? Because of the increased focus on China among Swedish SMEs, the question arises whether a cultural difference like *guanxi* has an impact on firm performance.

The discussion above leads to the following questions:

- How does *guanxi* affect business relations?
- To what extent is *guanxi* affecting management control?
- In what way can *guanxi* be considered a key success factor in Chinese business?

### **1.3 Aim of the study**

This study aims to investigate in what way *guanxi* affects a particular company. *Guanxi* has been discussed in numerous articles and literature. In Swedish research, mainly student thesis', there has been a special focus on *guanxi*'s role in the establishment process for Swedish subsidiaries in China. Our thesis will contribute to earlier research by exploring and investigating *guanxi*'s impact on Swedish SMEs operations regarding networking, control mechanisms and strategic choices, factors critical to business success. Our aim is that this study will be helpful to Swedish entrepreneurs in China, and that it will provide information regarding a number of aspects useful to their business.

### **1.4 Delimitations**

This study delimits to investigate Swedish SME companies already established in China, and three Swedish companies and one Chinese are represented as respondents. The respondents all

have network relationships, which was required for us to achieve the aim of the study. The SME focus leads to an exclusion of Swedish subsidiaries belonging to Swedish MNCs established in China.

The study is also locally bounded, to investigate the capital of China, Beijing. This implies that the respondents will be established there and nowhere else in China, and that cultural differences regarding *guanxi*, between regions, will not be included. Furthermore, this thesis investigates business relations and there will be no focus on business-government relationships.

## 2. Method

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*This chapter describes the approach we have chosen to apply to the study. Subsequently, we describe the interview methods and how information has been assembled. The chapter ends with a critical review of the sources and a list of definitions.*

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### 2.1 Research approach

After having reviewed literature about *guanxi* and business in China, we saw a shortage in studies relating *guanxi* to company operations. We therefore decided to use an explorative method when approaching the thesis. To gather the information needed we intended to interview respondents active in Swedish entrepreneurial companies in Beijing. After some discussion, we decided that a qualitative interview approach would give us deeper insight and knowledge of our field of interest (Bryman & Bell, 2005). The method of choice may answer the question as of how a small number of companies reflect on certain issues. We cannot oversimplify and make conclusions on how *guanxi* is seen upon in Swedish companies in general. However, a qualitative study with a larger number of respondents would increase the possibility to draw wider conclusions.

### 2.2 Gathering of primary and secondary data

Primary data is data gathered first hand from interviews. There are different ways of collecting data and each way has its pros and cons. When the aim is to compare results, surveys are often used since all the respondents answer the same queries. Interviewing gives the researcher a chance to follow-up with questions and also to explain and clarify questions that are unclear to the respondent (Esaiasson et al, 2007). Secondary data is information from previous research in form of articles or literature.

### 2.3 Qualitative method

Esaiasson et al (2007) state that you have to consider both pros and cons when you chose between conducting a qualitative or quantitative study.

#### 2.3.1 Pros

Esaiasson et al (2007) states that there are many pros with a qualitative study. The response rate is expected to be higher. It is easier to forget and throw away a questionnaire than to reject an interviewer. Furthermore, the possibilities of control is naturally greater hence the potential for follow-up questions. Personal interviews are to prefer when it comes to asking many and complex questions that may need to be repeated and explained. This also reduces the risk of misunderstandings.

### **2.3.2 Cons**

The main disadvantage with the selected method is its limitations. An analysis and conclusion including four companies creates no broader understanding of how companies in general act in accordance to *guanxi*. Another weakness is undesirable effects caused by the interaction between the interviewer and the respondent, for example unconscious influence of the interviewee (Esaiasson et al, 2007).

## **2.4 Interviews**

This thesis is an explorative study, collecting qualitative data from interviews. A qualitative approach is suitable for our purpose since this is a better way to gain a greater understanding as to what extent *guanxi* affects management accounting than, for example, using a quantitative approach. One of the advantages with interviews is the possibility to start up openly so that the respondent can speak freely about the subject. At the same time, the interviewers can at any time change direction and focus on more specific areas.

### **2.4.1 Selection of respondents**

Aiming to make the most of our study, our goal was to interview as many relevant companies as possible. However, as we soon realised that the interviews had to take place in Beijing, we set the goal to four companies. We choose to interview one Chinese business representative, in order to give a wider perspective on *guanxi*'s business implications. Grant McCracken (1998) gives recommendations on how to choose respondents for an interview; Pick a small number (1) of strangers (2) that are not "subjective experts" (3). Criteria one and three have been satisfied. The second criterion has been more complicated to satisfy. This is because it is much easier to find and initiate contact with large Swedish MNCs than to establish contact with enterprises defined by the SME criteria. Fortunately, we were able to use our contacts in Beijing from our time as exchange students at *Beijing Technology and Business University*. Consequently, two of the companies that were interviewed are run by Swedish acquaintances. In the other two cases the Swedish Chamber of Commerce assisted us with contact information to companies that could be of interest to our thesis.

We also performed an interview with professor Jianwei Ma (see Appendix 2) from *Beijing Technology and Business University* to get an academic perspective of our subject of interest.

### **2.4.2 Interviewing technique**

The quality of the information from the interviews was vital to the thesis – we could not easily go back to Beijing for complementary interviews. Two of the concepts involved in conducting an interview are the degree of standardisation and the structure of the questions (Esaiasson et al, 2007). This thesis has been using a semi-structured method with descriptive questions for the interviews (see Appendix 1). The interview has been divided into different subject areas with thematic questions as well as follow-up questions. (Esaiasson et al, 2007). Our definitions of some of the words used in the questions were initially explained to the respondents.

- *Questions*

After reviewing articles and literature in our field of interest, the interview questions were constructed. With a foundation in the theoretical framework, fifteen questions divided into four main areas were designed (see appendix 1).

- *Contact*

Firstly, we established contact with the subjects of the interview through email where we also explained the purpose of our study. Secondly, the questions were sent out in advance to give the respondents a picture of what areas we were interested in. Thirdly, we stressed the importance of the respondents' contribution to the thesis.

- *Location*

In all cases, the interviewee was given the choice as where to conduct the interview. The purpose of this approach was that the interviewee would feel relaxed and safe in a known environment (Esaiasson et al, 2007).

- *Time*

The interviews took approximately one hour – this is often the maximum amount of time that working people on a tight schedule can spare.

- *Technical equipment*

A dictaphone was used during the interviews. This gave us a chance to focus on the answers and listen and ask follow-up questions.

### **2.4.3 Analysis approach**

When analysing the empirical data we followed the structure from the questions, which were all based on a theoretical foundation. The empirical data was divided into main categories; *Business relations*, *Management control* and *Key success factors*. Subsequently, each interviewee's answers were sorted and analysed with these main categories as an outline. The theoretical framework and the empirical study were later used to formulate the analysis chapter. Finally, the analysis was used when answering the research questions in the concluding chapter.

## **2.5 Credibility**

### **2.5.1 Validity**

Oxford Reference Online defines validity as:

*A measure (such as a question, series of questions, or test) is considered valid if it is thought to measure the concept or property which it claims to measure. (Oxford Reference Online, 2010)*

Generally, validity is obtained when there is a strong correlation between what we say that we want to study, and what we actually do study (Seidman, 1991). To increase the validity of this

thesis, a number of safety measures were taken. To begin with, we stated at an early stage what problem to direct in the thesis. After that, we made a list of definitions to clarify to ourselves, and later to the respondents, what we meant by different terms and formulations. Then followed the formulation of the purpose of the thesis. At this point, with the general guidelines set, we started collecting our primary and secondary data.

### **2.5.2 Reliability**

Reliability means whether or not a measurement procedure actually measures what the researcher supposes and to what degree results can be repeated in similar studies.

Consequently, careful and systematic collection of data is vital in order to gain a high level of reliability in this thesis. Nonetheless, this study covers a specific area that is comparatively unexplored until now which might result in a lower reliability compared to a study conducted in a previously researched area (Esaiasson et al, 2007).

### **2.5.3 Criticism of the sources**

There are three important aspects to keep in mind when writing a thesis; objectivity, credibility and actuality (Esaiasson et al, 2007). The credibility of the sources is critical to make the outcome of the thesis reliable. All the way through the writing process, we have tried to be as impartial and objective as possible when collecting information from literature as well as in interviews. All data used in the study has been assessed by the authors and selected for its relevance to the research approach.

As for the interviews, it is inevitable that the respondents are subjective and also influenced by the interviewer. However, our purpose is to gather information about the interviewee's situation, not to explain broader patterns. The fact that the interviewer influences the respondent can be problematic (Esaiasson et al, 2007). Therefore, we have used carefully developed questions and a tried to maintain a professional attitude towards the interviewee at all times. Nonetheless, it is difficult to get around this problem completely.

Secondary data such as literature and articles derives from different locations in the world, for example the United States, Australia and China. Researchers from well-known universities, mainly active in management, have written most of the literature. The articles are published in a variety of forums like *Issues in Management Accounting*, *Management Accounting Research* and *Accounting, Organizations and Society*. Articles are reviewed thoroughly before being published in these journals, this implies that the sources are credible. The actuality of the sources is at an acceptable level with most articles being published within the last five years.

## 2.6 Definitions

**SME** Small and Medium-sized Enterprise

Enterprise category	Headcount	Turnover	or	Balance sheet total
medium-sized	< 250	≤ € 50 million		≤ € 43 million
small	< 50	≤ € 10 million		≤ € 10 million
micro	< 10	≤ € 2 million		≤ € 2 million

(European Commission, 2010)

**BRG** Business Region Göteborg

BRG is dedicated to strengthening and developing trade in the region of Gothenburg. BRG are a non-profit organization representing 13 member municipalities. Their goal is to contribute to sustainable economic growth, a high level of employment and a diversified economy (Business Region Göteborg, 2010).

**IOR** Inter-Organizational Relationships

**IOMC** Inter-Organizational Management Controls

**MNC** Multinational Corporation

MNCs are enterprises operating in several countries but managed from one (home) country. Generally, any firm or group that derives a quarter of its revenue from operations outside of its home country is considered a MNC (Business Dictionary 1, 2010).

**Guanxi** *Guanxi*, literally meaning "relationship", stands for any type of relationship. In the Chinese business world, however, it is also understood as the network of relationships among various parties that cooperate together and support one another (New Palgrave Dictionary of Economics, 2010).

## 3. Theoretical Framework

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*The theoretical framework of this study defines guanxi and its relation to business, network and operational work. The chapter also intends to provide information regarding inter-organizational relationships and key success factors and their interconnection to guanxi.*

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### 3.1 Guanxi

#### 3.1.1 Concepts

The Chinese word *guanxi* (pronounced *gwan-shee*) literally means “relationship” (Concise English-Chinese Chinese-English Dictionary, 2005). The word *guanxi* consists of two characters, *guan* 关 and *xi* 系. *Guan* means “a door”, or “to close up”. Thinking metaphorically, someone who is inside the door “is one of us”, whereas someone outside the door barely exists. Furthermore, *guan* can refer to “doing someone a favour”. *Xi* means to extend relationships, such as kinship or family, and implies hierarchy. The word is also used when referring to development and maintenance of long-term relationships (Tung, 1993). *Guanxi* refers to “the concept of drawing on connections in order to secure favours in personal relations” (Luo, 2007 p. 2). Chinese tend to be well in sync with the needs and sentiments of others and are also used to asking for and providing support. *Guanxi* forms a relational network that the Chinese develop subtly but consciously (Björkstén & Hägglund, 2010).

*Guanxi* is one of the major dynamics in Chinese society, and so it has been for the last centuries (Luo, 2007). In the business world, it binds companies together in a web, both socially and business wise. Li et al (2000) recognise *guanxi* as a key business determinant of firm performance. So and Walker (2006) state that building and maintaining *guanxi* is a calculated science that engages everyone from low-level managers to government officials. Face value is a term that is associated with *guanxi*. “Giving face” means that you care for another person, for example, by

*putting the other party in good light in front of other people, especially superiors and other influential persons. (Björkstén & Häggsten, 2010 p. 23)*

The opposite is, by lack of respect, to cause someone to “lose face”. This can be done by criticising someone in public or referring to someone’s mistakes (Björkstén & Häggsten, 2010).

*Guanxi* is a complex term and can have several implications depending on the context. The following three examples are taken from Tung (1993). Firstly, an example of mutual benefit: “I have great *guanxi* with the local water bureau – I helped them apply for their Visas to Australia last year, and they have solved the factory’s water problems on several occasions.” Secondly, a statement of confidence of support: “Our local manager has great *guanxi* with the mayor, so we can always ask him for support if we have problems.” Thirdly, giving face and



establishing relationships: “I have great *guanxi* with their chairman; I invited him to give a speech at the opening of our new Shanghai branch.”

### 3.1.2 Principals

According to Luo (2007), seven principles work as a base for the conceptual content of *guanxi*. *Guanxi* is:

- *Transferable*  
If person X has *guanxi* with person Y and Y is a friend of person Z, then Y can recommend or introduce X to Z. If not properly introduced, contact between X and Z is unlikely. The grade of success of transferability depends on the satisfaction felt by the included parties.
- *Reciprocal*  
*Guanxi* is built on mutuality. If a person refuses to return a favour, that person will be considered unreliable.
- *Intangible*  
Established with an anticipation of future exchange of favours, *guanxi* is intangible.
- *Utilitarian*  
*Guanxi* is in essence practical rather than emotional, when two individuals bond together. A *guanxi* relation that is not based on reciprocity and mutual benefits is easily broken. It is important to stress that *guanxi* is not the same as friendship, which involves affection. Nevertheless, strong *guanxi* and mutual trust can lead to affection and, hence, friendship.
- *Contextual*  
Building and maintenance of *guanxi* is entirely contextual. What is considered a gift in one context can be seen as a bribe in another context. Therefore, implementing *guanxi* in practise, in an appropriate way, is difficult.
- *Long-term*  
Every *guanxi* bond is built up and reinforced through continuous interaction. Some *guanxi* relationships can, if maintained properly, continue from one generation to the next. By contrast, in Western society, social transactions are generally seen as unique events with emphasis on instant return from the interaction.
- *Personal*  
*Guanxi* between organisations is built upon personal relationships. As a result, the organisation loses the *guanxi* when the person who brought the connection leaves. This means that *guanxi* has no group implication. This is commonly described as the key difference between *guanxi* and inter-organizational networking in Western countries.

### 3.1.3 Western organizational trust versus *guanxi* trust

In a study made by Yeung and Tung (1996), more than 80 percent of managers doing business in China believed that trust was an essential condition for *guanxi*, and that *guanxi* could not exist without trust. Organizational trust is an area that has been investigated by Western academics over the years, and is believed to have an impact on relations within and between organizations (Rousseau, 1998).

Schoorman et al (2007 p. 246) believes there are three factors that decide trustworthiness; ability, benevolence and integrity. The combination of these dynamics leads to trust, which is defined as “the willingness to take risk” (Schoorman et al, 2007). Firstly, *ability* is the group of skills or competences that enable a party to have influence within a particular field. Secondly, *benevolence* is the degree to which a trustee wants to do good to the trustor. Lastly, *integrity* is about following a set of principles that the trustor finds acceptable. All factors presented by Schoorman et al (2007) can also be applied to trust in the *guanxi* context. The following example of Western organizational trust could also be applied to *guanxi* trust:

*Consider a supplier-buyer relationship. The buyer may believe that a supplier is able to provide a quality product in a timely fashion. However, this only assures that the supplier could perform. This does not mean that it will perform, and, therefore, the supplier will not necessarily be trusted. The perception that the supplier has integrity, benevolence and/or ability increases the willingness to take a risk in the relationship. (Schoorman et al, 2007 p. 345)*

However, dissimilarities are also to be found when reviewing the literature on organizational trust and “*guanxi* trust”. Chinese business emphasise personal trust, while Westerners value systems trust. Trust is placed in the system, not in specific individuals. In systems trust, agencies, which are part of a system function, generate trust. The involvement of an external agency decreases the personal element of transactions and boosts rationalism. In the Chinese context, however, managers still view personal trust more important; historically, financial and legal systems have not functioned correctly. Nonetheless, over time, there may be a gradual shift from personal trust (e.g. verbal agreements) to systems trust (e.g. written contracts) as the financial and legal framework develops (Luo, 2007).

Scholars believe that task-orientated Western cultures have a higher level of initial trust of strangers, which leads to a higher tendency to take risks. Relationship-orientated cultures (e.g. Chinese), on the other hand, need time to develop relationships before working on a task (Schoorman et al, 2007). Furthermore, one of the basic concepts of *guanxi* is the principle of reciprocity and mutuality. Someone that refuses to return a favour will be considered unreliable (Luo, 2007). According to Brower et al (2000), trust is not automatically mutual and is not reciprocal.

### 3.1.4 Business implications

It has been recognised for some time that doing business in the Chinese environment is different from doing business in, for example, Great Britain or Sweden (Li et al, 2000). One key difference lies in the importance of *guanxi* in the Chinese business context, whereas its Western equivalent relies on enforcements of contracts (Luo, 2007). Business people from China and Western countries approach a new relationship from opposite ends.

Commercial law is deep-rooted in Western thinking, and emerged in Europe in the 18<sup>th</sup> century to give traders assurance that deals would be honoured (Luo, 2007). At this time, relationships were fragile and legal sanctions were needed to make sure that obligations were met. Consequently, the Western way of conducting business is to start with a standard contract and go from there, revising it to fit specific circumstances (Luo, 2007). When negotiations are finished, both parties sign the contract to seal the deal.

Historically in China, commercial law barely existed. Use of commercial law indicated bad faith and business clauses at the most formed a functional agenda (Tung & Worm, 2001). Commitments came from relationships and trust. A draft legal contract was seen as unsuitable and more importantly: it carried no sense of commitment (Luo, 2007).

In present time, Chinese authorities have recognised the need of a developed commercial law, mostly to meet Western expectations, but few business people can yet rely on it entirely (Luo, 2007). Consequently, *guanxi* offers a complement (Luo, 2007). It is logical to honour a transaction, as long as the relationship itself is worth more than the transaction. Differences and issues that appear along the way will be solved without too much effort, as long as there are long-term benefits for everyone involved (Tung, 1993).

Business transactions in China will possibly involve meeting obligations with individuals who have no direct connection to the matter at hand (Clegg et al, 2007). In the collectivistic Chinese culture, the decision-maker may be the network as a whole, not just one single person (So & Walker, 2006).

### **3.1.5 Importance of *guanxi***

Literature on *guanxi*'s role in a business context can be divided into three camps. Each portrays *guanxi* differently.

1. The first camp consists of academics that state that *guanxi* is a key to corporate success in China (Luo, 2007; Tung, 1993). Tung (1993) argues; “*guanxi* is an integral component of doing business in China required at all stages in the company’s operations”. According to Luo (2007), *guanxi* reduces transaction costs, operation uncertainty, information costs and competitive threats. In addition, *guanxi* enhances institutional support, economic return, business effectiveness and strategic capability.

2. The second camp considers *guanxi* valuable but focus on certain areas of business operations (Clegg et al, 2007). For example, businesses in Hong Kong investing in Mainland China rely greatly upon *guanxi*, especially in the initial stages of entering the market. The second camp report benefits of *guanxi* in form of reduced transaction costs and smooth operations from securing resources and information (Clegg et al, 2007).

According to Björkstén and Hägglund (2010) the concept of *guanxi* is overrated. Firstly, they believe that there is nothing “mysteriously” Chinese about it; *guanxi* is rather a straightforward and operational business concept. Secondly, history has shown that trusting *guanxi* claims of consultants and local representatives can cost companies greatly. However, in some industries, good *guanxi* is still the best way of minimizing your company’s exposure.

For example, a company that suffers from frequent electricity burnouts might reduce its exposure by developing *guanxi* with the local government, in order to help solving the problem (Björkstén & Hägglund, 2010).

3. The third camp state that the importance of *guanxi* is declining, or that its benefits have been relatively exaggerated (Guthrie, 2002). Relations are important in business everywhere, but the product and the price often comes first when choosing a supplier. Furthermore, developing and maintaining *guanxi* demands time, resources and is expensive. This can make *guanxi* a disadvantage instead of a benefit and hold back the reduction of transaction costs (Fock & Woo, 1998).

Table 3.1. *Guanxi's impact on business, as seen by a selection of academics.*

Different ways to view and portray <i>guanxi</i>	Example of academic proponents	<i>Guanxi's</i> importance	Pros			Importance decreasing/ constant/ increasing
			Reduction of competitive threats	Reduction of transaction costs	Helps local government relations	
Group 1	Luo (2007), Tung (1993)	Important in all Chinese business.	Yes	Yes	Yes	Constant
Group 2	Clegg (2007), Björkstén & Hägglund (2010)	Important in certain business areas. More important to smaller companies.	No	Occasionally	Yes	Decreasing
Group 3	Guthrie (2002), Fock & Woo (1998)	Not more important than relations are in the West.	No	No	Occasionally	Decreasing

After studying medium and large industrial firms on the East Coast of China, Guthrie (2002) argues that the importance of *guanxi* is declining. Clegg et al (2007) found that “*guanxi* appeared to be a critical concern to small, but not large, Australian companies in China”. Large companies would gain *guanxi* automatically because of size, prestige and international connections. Small companies, on the other hand, had to make greater efforts to build *guanxi*, for several reasons. To start with, smaller companies needed connections to acquire land, for

government approvals or to secure supplies (Clegg et al, 2007). Small companies lacking *guanxi* experienced problems in court cases with insufficient enforcements and long delays. For example, in rural areas, locally important companies were often “protected” by the local government (Guthrie, 2002).

## 3.2 Inter-organizational relationships

### 3.2.1 *Guanxi* networks

*Guanxi hu* is the Chinese name for inter-organizational *guanxi*. *Guanxi hu* is built and expanded through personal relationships that form a network. The way Chinese people handle their business relationships and networks differs in some respects from the Westerners way of doing it. Firstly, the relationships contain a social obligation of mutual exchanges. Secondly, Chinese keep their social status by “giving face”. Lastly, *guanxi* depends on personal relationship creation and development while Western inter-organizational relationships (IORs) are an organizational commitment. When a personal relationship is used in an organization, *guanxi* becomes an organizational concern.

*The Chinese build a relationship and, if successful, transaction and profits will follow whereas Westerners believe that one should build a transaction and, if they are successful, a relationship will follow. (Luo, 2007 p. 51)*

According to Luo (2007), *guanxi* has an impact on inter-organizational dynamics and relations. The *guanxi* business networks in China include managers at other firms, for example:

- Suppliers - Relationships with suppliers can increase quality, service, delivery and it can also reduce purchasing costs.
- Buyers - To have good *guanxi* with firm customers can lead to long-time loyalty and in the long run cost-reductions in marketing.
- Competitors - *Guanxi* between managers of competing companies can lead to inter-firm collaboration and reduce information asymmetry, which serves to decrease transaction costs.

The *guanxi* business network also includes relations with the government and regulatory authorities. Choosing the wrong partner in China can be a cause of business failure. If you do not have a *guanxi* relation, it is possible that your suppliers, for example, pirate your products or produce extra products for selling (Björkstén & Hägglund, 2010). According to Luo (2007), the *guanxi* network has a direct impact on firm performance by contributing to sales growth and reducing transactional cost. Through enhanced management business relationships with Chinese managers, Western companies can improve their products and services. *Guanxi* can open a dialogue, create trust, and facilitate exchange in order to move organizational goals forward (Wilkinson et al, 2009). In some Chinese firms, reward systems exist for a manager’s personal *guanxi* cultivation in the form of commission and bonuses (Luo, 2007).

### 3.2.2 Inter-organizational relationships in the West

In recent decades, organizations and their business relationships to customers, suppliers, partners and competitors have changed. The importance to look beyond organization boundaries has increased, which has created a demand for new inter-organizational control mechanisms and a will to understand the management effects that influence the organization and its surroundings (Samuelson, 2004).

The globalisation, rapid technological development and high technological complexity are the main drivers for this new way to handle IORs. The globalisation leads to tougher competition as customers see new opportunities emerging at a higher pace. A rapid technological development makes it difficult to maintain in-house expertise and companies are therefore strained to outsource some of their activities to stay competitive. These main drivers have led to new trends regarding IOR, namely closer relationships between companies and development of independent units through outsourcing. These types of interaction tend to be more long-term and create new benefits (Kraus & Lind, 2007). Successful relationships can offer firms varying types of benefits; improvements in efficiency, flexibility, organizational learning, and knowledge transfer (Claro et al, 2003).

There are several types of IORs; joint ventures, strategic alliances, technological licensing, research consortia, strategic partnerships, supply chain relationships, business relationships and outsourcing relationships. These types are categorised as dyads or networks. Dyads are the most frequent IOR. They are vertically organized and long-term, for example joint ventures and strategic alliances. Networks, on the other hand, are characterized by an interaction between different parties. This interaction can be bounded or unbounded.

### 3.2.3 Inter-organizational relationships versus *guanxi* networks

The increased focus on IOR in management accounting has made it a well-recognized concept (Kraus & Lind, 2007). The definition of the *guanxi* network, on the other hand, is vague. There are several similarities between the *guanxi* network and IOR (see figure 3.1). They are both characterized by interaction; X and Y can affect Z. The interaction does not necessarily have any formal or legal boundaries. Furthermore, trust is important to both networks. They are also characterized by exchange of resources and activities through organizational cooperation. In contrast to the Western IOR networks, *guanxi* is based on personal relationships (social capital), and not on corporation-to-corporation relationships (Luo, 2007). Goal congruity and compatibility are important for the organizational and strategic fit between Western networks. This is also important for *guanxi* networks but is not required for building and sustaining the network. For example, two companies with different strategic goals in different industries can maintain good *guanxi*. The *guanxi* network is based on favour exchange and not necessarily mutual organizational interest (Luo, 2007).

Figure 3.1. Inter-organizational relationships versus guanxi networks.

Network characteristics	IOR	Guanxi
Exchange of resources and activities	X	X
Based on trust	X	X
Embeddness - interaction between X and Y can affect Z	X	X
Long-term	X	X
Well-recognized concept in management accounting	X	
Organizational commitment	X	
Personal commitment		X
Social obligations		X

### 3.2.4 Inter-organizational relationships and control

The increasing presence of IORs has developed activities of interest both to the organization and its partners. This has created a demand for other forms of management control. Management control is important to the IORs' performance and the control mechanism chosen for the company is critical to its success (Dekker, 2004). In the long run, this may lead to a change in the company's identity and core competences. Mutual trust needs to be created in order to change control mechanisms. Information exchange is one way to develop trust in a relation (Mouritsen et al, 2001). There are three significant organizational drivers that have a positive effect on trust: international experience, management commitment and resource commitment (Lu, 2009). According to Dekker (2004), IORs lead to two problems: management of appropriation concerns and the coordination of tasks. In order to manage these control problems firms should develop control mechanism that are informal and based on trust.

Inter-organizational management control (IOMC) is defined as a mechanism used in the control process to influence the behavior of people within the IOR to work towards the same goal. IOMCs differentiate between three types of management controls: outcome controls, behavior controls and social controls (Kraus & Lind, 2007). Outcome controls, such as open book accounting and target cost management/functional analysis, create new possibilities for management intervention (Mouritsen et al, 2001). Research on IOMCs has shown that values, norms and culture are also important influences on behavior in the IOR, which are related to

social control. Social control can be achieved through choice of partner, joint activities and negotiations. Experience of working together and similar cultures is important criteria's when deciding on a partner for an IOR. To maintain social control it is also important to create trust. Trust can be developed through learning and adoption, for example through regular meeting and establishment of performance measures. If trust is established, it will be easier to agree on mutual goals and regulations, and work as at team (Kraus & Lind, 2007).

A comparative study made on Finland and China reveals that trust is even more important in China. In Finland, where companies have elaborate institutional frameworks and a stable legal system, trust was less important. Shared goals and visions were more important to the Finns. The concept of *guanxi* affected trust in China, demanding a high degree of trust before potentially valuable knowledge and information could be shared (Clegg et al, 2007).

Figure 3.2. Formal and informal control mechanism in IOR (Dekker, 2004).

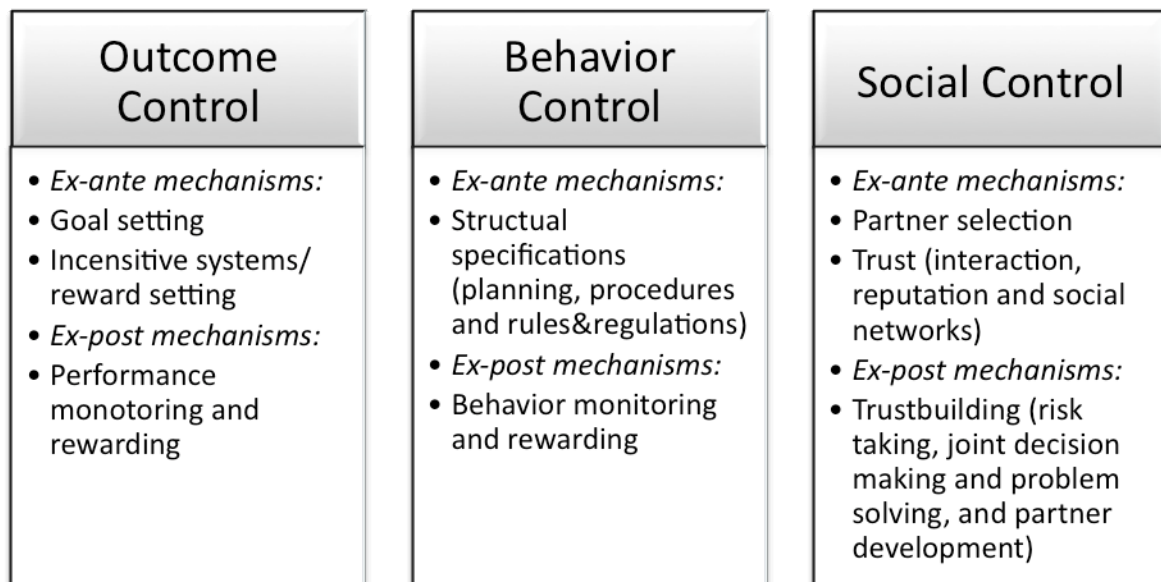


Figure 3.2 identifies and classifies the control mechanisms in the IOR. It also explains the interaction between formal control (outcome and behavior control) and informal control (social control). Ex-ante mechanisms should decrease control problems through reducing coordination needs. Ex-post mechanisms are issues after implementing the IOR (Dekker 2004). Organizations investing in social control, e.g. in good relationships, can reduce the need of formal control. According to Dekker (2004), increased trust may reduce the difficulty with appropriation concerns and coordination of tasks.

### 3.3 Key success factors

#### 3.3.1 Definition

A Key Success Factor is an element of organizational activity that is identified as crucial for success to be reached and maintained. For example, a key success factor for an Information Technology (IT) project to be successful is user involvement. Business Dictionary (2010) defines it as a



*limited number (usually between 3 to 8) of characteristics, conditions, or variables that have a direct and serious impact on the effectiveness, efficiency, and viability of an organization, program, or project. Activities associated with KSF must be performed at the highest possible level of excellence to achieve the intended overall objectives. Also called Critical Success Factors (KSF) or Key Result Areas (KRA). (Business Dictionary 2, 2010)*

### **3.3.2 Guanxi's impact on key success factors**

*Guanxi* is important to the business success, since the business network depends on *guanxi* relations (Li et al, 2000). The *guanxi* network may form the core competence of a company and a distinctive competitive advantage that can create a successful business in China. A study made on overseas Chinese in Singapore showed that Singaporeans, because of their ethnic Chinese background, had a competitive advantage when investing in China. Overseas Chinese share the same language, ethnicity, kinship and culture as those in Mainland China (Clegg et al, 2007).

It is not *guanxi* itself that creates competitive advantage; it is the different business variables in which *guanxi* are embedded (Luo, 2007). According to a study by Luo (2007), sales force marketing and credit liberalization are two major *guanxi*-based business variables. For example, if a firm's product attributes are less competitive than its competitors, good *guanxi* can make the poorer product more popular. Furthermore, *guanxi* may affect the strategic choice of organizations. Managers who devote time and effort to develop interpersonal *guanxi* can, for example, contribute to the sales growth of their organizations through sales force marketing. Companies with a *guanxi* network act like resources to each other exchanging human resources, information, capital, facilities and political favors. A *guanxi* network functions as a strategic mechanism to overcome competitive advantage through exchange of resources (Luo, 2007).

*An understanding of guanxi's crucial role in affecting all the major dimensions of firm performance, and knowing the ways of creating and maintaining guanxi networks, are quite necessary for corporate success. Foreign investors can gain an edge over their competitors by understanding and incorporating the guanxi factor into their business decisions. (Luo, 2007 p. 79)*

A study made on New Zealand SMEs in China revealed that they did normally not possess the same advantages as MNCs. To SMEs, individual traits among managers and their personal relations with business people in China were more critical. The study also stipulates that *guanxi* is an important factor that contributes to the success of business in China (Cremer & Ramasamy, 2009).

There are, however, scholars who have other opinions of *guanxi* and its affect on firm performance. Fan (2002), for example, states that the potential benefits of *guanxi* are tactical rather than strategic. The *guanxi* network is like an investment in the stock market (Fan, 2002); it is volatile and can become worthless. At the same time, *guanxi* is a personal asset, which makes it non-transferable. Therefore, *guanxi* cannot be a competitive advantage. Hence, *guanxi* is necessary but not sufficient for achieving business success (Fan, 2002). However, *guanxi* is an important business concept in China. A strategy cannot be successful through *guanxi*, but as a tactical asset it can improve the strategy work.

## 4. Empirical Study

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*Chapter four contains information that was gathered from the qualitative interviews. The empirical data was collected through interviews with representatives from four companies; Chinese company Sinda and Swedish companies Emotron, P1 and SSBA. The chapter starts with an interview with Professor Jianwei Ma.*

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### 4.1 Jianwei Ma, Professor of Accounting, Beijing Technology and Business University

#### 4.1.1 Characteristics of Chinese business

In China, personal relationships are important in many business decisions, Jianwei Ma says. When he was working at a university in the United States, relations were also important but not to the same extent. Chinese business people rely on the individuals behind a deal more than a written contract. In the United States, contract law is involved in every aspect of business.

#### 4.1.2 Definition of *guanxi*

According to Ma, many Chinese speak of *good* and *bad guanxi*. Family and helper *guanxi* are examples of *good guanxi* that is totally moral or even desirable. Business *guanxi*, on the other hand, is sometimes regarded as *bad guanxi*, a grey area even if it is not implicated with corruption. To many Chinese, business *guanxi* is associated with favouritism, nepotism and unfair competition, Ma says.

Ma personally thinks that *guanxi* is an essential factor for everyone: “We can use it to expand our business, and we can also use it to make more friends in our daily life, and so on. That is to say, we cannot live without it.”

#### 4.1.3 *Guanxi* and business relations

*Guanxi* can broaden a company's business scope, and help it move faster, Ma says. For example, relations to government can help it get close to new policies and regulations; therefore, it can adjust its business in time. What is more, relations to suppliers and customers can help it do business more effective.

So, can *guanxi* be more important in some relations, and less important in others? The answer differs depending on the company characteristics, Ma explains. If you sell consumer goods or industrial products to small corporate customers, it is more important to work on great customer relations than high-level government relations. To large corporations in heavily regulated industries, on the other hand, government relations can be more important. Cultivating good relations with local officials can be a great asset if problems arise in the day-to-day running of your company, Ma says.

It is important to remember that *guanxi* should be built in advance, before you need a favour. *Guanxi* grows through contact and mutual support. A company can build *guanxi* from recruitment and communication, and maintain *guanxi* by good collaboration, Ma says.

Ma believes that *guanxi*'s significance in business has changed compared to ten-fifteen years ago. The liberalization of the Chinese market, the economic growth and the fierce competition between companies there has created a situation where product and price is more important than personal contacts: "Obviously, *guanxi* is important, but high quality of business is becoming the more important factor. If a company has both of them, it can develop faster."

#### **4.1.4 Key success factors**

For individuals; good education and good personality are essential. For a company, teamwork spirit, high quality of product, sincerity, and good social relationships are important, Ma concludes.

## **4.2 Sinda Security**

Yazhao Yang was born and bred in Beijing. After graduating from *Renmin University*, majoring in Business Administration, a friend recommended him to apply for a position as project manager at Sinda Security (Sinda). Sinda was founded seven years ago and is today a small but fast-growing company specializing in guarding, monitoring and consulting retail businesses in Beijing. Since Yang started working for Sinda five years ago, the number of employees has increased from 14 to 75 people.

### **4.2.1 Business relations**

Yizhao Yang says that you have to know the history in order to understand the present. Historically, insecure times with lack of law and order made people afraid to lose their business. Consequently, relationships and connections grew more important and *guanxi* in business became increasingly important. Yang believes *guanxi* can be both good and bad. Firstly, *guanxi* is good since it can make business transactions more secure. Business is made easier since, even though you might not trust contract law, you can trust your personal relations. However, *guanxi* also works in a bad way. For example, if a competitor has good *guanxi* with a local government, you may not be able to compete for procurements or contracts on the same terms.

*Guanxi* is not equally important to all businesses. According to Yang, *guanxi* is more important to large companies that rely on local or central government to run their business. For example, a large company in a power-intensive industry must be certain that the authorities will do their best to minimize power failures. On a personal level, Yizhao Yang explains, *guanxi* can open doors. In a big city like Beijing, competition among students is tough, to say the least. Your families' or your own *guanxi* can lead to a better job and a better salary.

### **4.2.2 Management control**

Sinda Security use budgets to control operations on top and medium level. Surveillance personnel are controlled by action controls in form of manuals and precise instructions. Every

week, Yang has informal meetings with the people involved in his project. Direct contact is important since memos and email correspondence are not always accurate. The face-to-face dialogue is the best control tool in his position, Yang says.

#### **4.2.3 Key success factors**

Yizhao Yang believes that *guanxi* is a key success factor. However, *guanxi* is one of many aspects you need to control to achieve success. For instance, if you have well-developed *guanxi* but lack competent employees, resources and financing, then it will be very hard to survive. However, if you have an experienced workforce, sufficient financing and a good quality product, *guanxi* will increase your overall chances to be successful.

### **4.3 Emotron**

Tommy Liu was born in Sweden with Chinese parents. After studies at *School of Business, Economics and Law* at University of Gothenburg, Tommy started doing business in China in 1973. Tommy has helped a number of Swedish companies to establish in China, including Tetra Pak. In addition, he was one of the founders of the Swedish Chamber of Commerce in Beijing (officially opened in 1998).

Emotron was founded in 1992 and is active within monitoring, controlling and design of electrical motors and of processes driven by electrical motors (The Emotron Group, 2010). In 2008, the number of employees was 170. Tommy Liu, Manager China Operations, states that Emotron has established a position as an innovative and quality-driven company on a competitive market. Competition is fierce with opponents like Siemens and ABB. Emotron has chosen a differentiation strategy with specially developed products.

#### **4.3.1 Business relations**

Emotron's most important relations in China are the ones to their two distributors, Tommy says. The distributors handle all customer contacts. A close relation makes problem solving easier. This is not typical for China, relationships are important everywhere. The foundation for solving problems is a good relationship, which in China is the same as *guanxi*. In China, most business is carried out between individuals rather than companies. Consequently, direct contact, face-to-face, is a necessity. This becomes interesting when a problem occurs. If the concerned part does not prioritise to set up a physical meeting, this sends signals that the problem is not a real problem. This is an example of not "giving face" to the other part. According to Tommy, this is sometimes difficult for Westerners to understand.

Tommy Liu says that a good relationship with his distributor increases their effort to fulfil their obligation. In this case, it is about giving face to Tommy. In China, people are just as honest, or dishonest, as everywhere else. However, due to the huge population (1.3 billion) and large number of business people active, the probability of encountering a non-serious businessperson is higher. Consequently, a good relationship and mutual trust becomes essential. In China *guanxi* is important when choosing a business partner, because there are countless alternatives to choose from. Tommy says that *guanxi*, maybe not under the same name, exists in every country. In England, for example, your background and family name is

important. Going to the right primary school can be the best career move you ever make. Hence, many people around the world rely on connections and social bonds.

The increasing amount of information has affected the importance of *guanxi*. Access to reliable information has given an opportunity to learn about potential partners, both foreign and domestic. Personal relationships have been replaced by knowledge, indicates Tommy Liu. Earlier, when China was a closed country, the knowledge of foreign business players did not exist. Therefore, personal relationships and trust to foreign representatives, and vice versa, was more important.

#### **4.3.2 Management control**

Emotron is a company that relies generally on results control. It is important to hit the revenue sales figures as stated in the budget. At the same time, social control also plays a significant role in controlling the organisation. The social control takes shape in form of regular meetings; Tommy Liu has a daily contact with his distributors. Once a week, he meets them face-to-face even though this demands time and recourses. Moreover, Emotron arranges education and delegation trips for its distributors and customers.

#### **4.3.3 Key success factors**

To gain a long-term relation with a Chinese business partner you must be able to offer something in exchange. Tommy Liu states: “You have to commit to China, if China is to commit to you”. China is just like any other market; you need to have a competitive price and product. To foreign companies, infrastructure and service in after-sales on the Chinese market is an absolute necessity to stay competitive.

### **4.4 P1 Media**

Svante Jerling, born in Stockholm, moved to China two years ago. Svante was offered a position at newly established P1 Media (P1), a company founded by four former classmates from Stockholm. Today, Svante Jerling works as director for P1.

P1 is a private social network, similar to Facebook, but you have to be invited. Members of P1 share an international lifestyle, common values and interests. Through the network members can meet like-minded individuals, expand business networks, share experiences and participate in events. Currently, the network consists of more than 500,000 individuals in Beijing, Shanghai, and Hong Kong. The members belong to Chinas over mid-class and have spending money on shopping and entertainment in common. This is what makes the network an attractive marketing platform to international luxury brand products. P1’s revenues come from membership fees (50 yuan every month. Nearly 60 SEK, exchange rate 2010-05-25), advertisement, and commission from other companies when members have found their offer on the P1 homepage, Svante says.

#### **4.4.1 Business relations**

Svante Jerling means that the company itself is a one big network. This means that P1 has relationships to their members as well as to their partners; nightclubs, restaurants, malls, boutiques and marketing agencies. For example, P1 is collaborating with Jones Lang Lasalla,

owner of several luxury malls in Beijing. Another important relationship is the one with the Chinese investors. Furthermore, P1 collaborates with many of the world's top brands, like Bentley, Canon and Versace to deliver interesting and exclusive experiences for their members. Most of P1's relations are with international companies, in these cases *guanxi* does not exist. *Guanxi* becomes a factor when dealing with Chinese partners and investors. According to Svante, there is nothing particularly special with *guanxi*; it is just a way to handle relationships with more personal involvement. For example, instead of just making a phone call to a potential partner, he pays a visit to his/her office so that they can meet in person. Of course, it takes more time, but in exchange Chinese partners invest more time and interest in P1.

#### **4.4.2 Management control**

P1 is, due to demand from its Chinese investors, managed through results control. In addition, results control is the best way to control short-time projects where sales targets are the number one concern. Because of the large number of short-term partners, informal control systems are not necessary at present, Svante Jerling explains.

#### **4.4.3 Key success factors**

Svante believes that it is difficult to increase market shares in their trade. P1 has a strong network, and the company's management has a good knowledge about the Chinese market. The success of P1 has spread through word-of-mouth. According to Svante, it has grown to be the "it" thing, and are leading in its segment. Chinese "brats" is a target group with strong purchasing power that has increased fast, and before P1 came along, they did not have any website to communicate on. Furthermore, China did not only survive the economic crisis, but also continued to expand. This is really the place to be when it comes to dealing with luxury consumption. The Chinese internet industry is already the world's second largest. Many Chinese networks are bad copies of American websites, and has not created a niche to any specific target consumer. According to Svante, this is an area where Swedish companies are better than Chinese.

The key to success for P1 is to maintain focus on its members. If we do not focus on our members needs and demands we will not continue to grow, Svante Jerling says. In the end, P1's strategy is to be a high-end social network and private club. The strategic positioning focuses on rich people in China, who spend around 4000 yuan (about 4600 SEK, exchange rate 2010-05-25) each month on consumer products. By tradition, Chinese people prefer to save money instead of spending them. Rich people in China, however, want to live and consume with an international style (spending about 40% of salary on entertainment, beauty, food and shopping). Their lifestyle change fast, and it is important that our company can fulfil their needs, Svante concludes.

### **4.5 Sino Scandinavian Building Advisor**

Jimmi Liu first came to China in 1993 working for Peran, which was then part of the Swedish company Perstorps AB that is in the specialty chemicals market. Before joining Sino Scandinavian Building Advisor (SSBA), he worked at a firm called Spiro, which was a part of manufacturing company Lindab AB. Jimmi helped starting up Spiro's Chinese operation. At

the moment, apart from being director of marketing at SSBA, Jimmi Liu owns two Korean restaurants in Beijing.

Sino Scandinavian Building Advisor (SSBA), founded in 2004, specializes in construction production management. There are currently approximately forty people employed at the company. According to Jimmi Liu, SSBA serves as the customer's construction department before, during and after the project period, providing integrated construction project consultancy and management services for companies all over China.

#### **4.5.1 Business relations**

Jimmi says it is important to understand that his business background in China is exclusively within sales. At SSBA, his main task is to identify, contact and keep potential customers. The customers are foreign companies, for example IKEA, which SSBA assists in building projects. For this reason, another important relation is with the Chinese building companies. Everywhere, companies need to do their groundwork in order to set up a business. This includes market research to identify customers or product attributes. In China, market research is more difficult than in, for example, Sweden. Various tools used in marketing, like registers of different sorts, do not exist in China. Additionally, foreigners seldom understand the characteristics of the Chinese market; they lack the right sense of "feeling". *Guanxi* may possibly open doors but, just the same, the groundwork is most important, Jimmi Liu argues.

In a situation where you have *guanxi* with a Chinese business contact, this *guanxi* might be lost if you change business approach. For example, a Swedish company, with its operation located in Sweden, purchases products from a Chinese company. If the Swedish company decides on a new business strategy that involves starting up production in China, the companies suddenly become competitors and the *guanxi* will be lost.

In some industries, it is impossible to penetrate the market if you lack *guanxi* and the right network. One example is the coal industry, the backbone of Chinese energy supplies. No matter how superior product, price and quality you offer, the door will be closed if you do not have the right *guanxi*. However, in general, Jimmi Liu means that the increased access to information and tougher competition ("all the big actors are here") has made *guanxi* less important.

#### **4.5.2 Management control**

SSBA apply a project management system including controlling budgets, quality and time control. The objective is to simplify all procedures and ensure real-time management at each point of the process. To guarantee the foreign customer that full control is maintained, SSBA meets, at a regular basis, with the Chinese builder and concerned subcontractors. Jimmi claims that to achieve the desired control effect, a Western management is required. The risk with Chinese management is that they focus on protecting their own territory; what is good for them and not the company. Furthermore, you cannot degrade a Chinese manager without making the manager "lose face" which in turn is unfavourable for your organisation.

### **4.5.3 Key success factors**

After more than fifteen years in China, Jimmi Liu believes that Chinese try to protect their territory and obtain benefits to a larger extent than other nationalities do. One explanation could be that the competition among individuals in China, from the cradle to the grave, is so harsh. Even if a Western company has the best price and best product (“yes, price always comes first, then comes product quality!”), Chinese companies often win the procurement. In these cases, Jimmi believes that *guanxi* between Chinese actors play a significant role. Therefore, *guanxi* can be seen as a key success factor to Chinese companies.

All companies that Jimmi has been a part of had similar key success factors. This is an interesting pattern, he continues. The key to success is to minimise the risk of problems with different parties by having the whole process in China. This means production, distribution and after-sales must be located in China in order to keep a competitive price and still offer equivalent quality. In SSBA’s context, this has been achieved by developing a system called Our Way to Work (OWW), specially designed to the Chinese market.



## 5. Analysis

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*In this chapter, we analyze the empirical study and the theoretical framework. When referring to the respondents in the empirical study we will mention them by their company's name, and not by the names of the interviewees. This does not include Professor Ma, since he is not a company representative. The chapter is divided into three sections that represent the main areas covered in the empirical study and the theoretical framework.*

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### 5.1 Guanxi's impact on business relations

In the empirical study, the respondents had different views on the importance of *guanxi* in business relations. Professor Ma and Sinda both consider *guanxi* more important than the other interviewees. Emotron also consider *guanxi* relatively important, even though its significance has decreased. An interesting observation can be made; the respondents with a Chinese background believe *guanxi* to be more important than their Swedish counterparts. Previous research could be divided into three groups that all portray *guanxi* differently. The first group, here represented by Luo (2007) and Tung (1993), both Chinese natives, believe that *guanxi* is a key to corporate success in China. Professor Ma and Sinda share many of these views, and Professor Ma believes that *guanxi* can broaden a company's business scope. The second group thinks that *guanxi* is a necessity in some business areas, but not important in others (Clegg et al, 2007). SSBA has the same opinion and states that the right *guanxi* is needed in order to penetrate some industries, for instance the coal industry. P1 view *guanxi* less important to business, and just like Björkstén and Hägglund (2010) believes that the concept is overrated. Based on our study, there is a pattern; native Chinese, both our respondents and scholars, consider *guanxi* more important to business relations than Westerners. One factor that may play a role, at least to our interviewees, is that to Chinese people, private *guanxi* – *guanxi* with family and friends – is part of daily life and “spills” over to business relations. Another factor could be that changing old cultural traditions takes time and is difficult hence *guanxi* remains important to many Chinese.

Even though the interviewees have different opinions regarding the importance of *guanxi* in business, most believe that the importance has decreased. Interestingly, the explanations to the decrease vary. Emotron has a somewhat contradictory view. On the one hand, Emotron believes that the intense competition has made *guanxi* more important, since too many actors make it difficult to find a trustworthy partner. On the other hand, the company argues that increased access to reliable information has enhanced knowledge about other companies hence reduced the need of *guanxi*. Emotron means that you can search for potential business partners on the internet instead of using your *guanxi* network. SSBA also considers information accessibility one reason to the declined significance of *guanxi*. Nevertheless, the

main reason is the fierce competition; everyone wants to be on the Chinese market. Large Western MNCs apply their own business traditions, which do not include *guanxi*. Professor Ma has the opinion that *guanxi*'s importance has decreased due to the liberalization of the Chinese market and the rapid economic growth ("quality and price is today more important than *guanxi*"). One of the reasons that the researchers often emphasize is not mentioned, namely the improvements that have been made regarding contract law and commercial law (Luo, 2007).

According to recent research on IOR, globalisation, rapid technological development and high technological complexity has led to closer relations between companies (Kraus & Lind, 2007). Globalisation leads to tougher competition, and therefore, cooperation is often needed in order to sustain a competitive advantage. Consequently, IOR research states that harder competition leads to increased networking and relationship building (Samuelson, 2004). If this is correct, the Chinese way of handling networking, through *guanxi*, should reasonably be more important in times of fierce competition. This contradicts some pieces of information gathered in the empirical study; all interviewees but one believed that *guanxi* becomes less important as competition increases.

The concept of transaction cost benefits is often discussed in literature and articles about *guanxi*. Luo (2007) and Tung (1993) state that reduction of transaction costs is one of the main benefits of *guanxi*. Fock and Woo (1998), on the other hand, say that development and maintenance of *guanxi* demands time and is expensive which holds back the reduction of transaction costs. Sinda is the only respondent that mentions transaction costs; they believe that "good *guanxi* can secure transaction costs".

In the empirical study, both Chinese respondents (Professor Ma and Sinda) explained the concept of *good* and *bad guanxi* in business relations. Good *guanxi* improves moral and secures business transactions. Bad *guanxi* can involve nepotism and corruption. Interestingly, the way of describing *guanxi* as *good* or *bad*, that seems so obvious to professor Ma and Sinda, is not described the same way in the literature we have reviewed.

To this study, which has a focus on SMEs, the discussion whether company size affects the impact of *guanxi* is particularly intriguing. Clegg et al (2007) made a study on medium and large industrial firms in China's East Coast, that revealed *guanxi* to be critical to small, but not large, Australian companies. Large companies did not need *guanxi* because of their size, prestige and international connections. In the empirical study, Sinda and professor Ma believe the opposite; *guanxi* is more important to large firms. According to Sinda, large firms are more dependent on government relations in order to reduce tax, find skilled employees and to receive information about future policy changes. Professor Ma declares that good *guanxi* with the local government can be a great asset if problems arise in a company's daily routines, especially for large corporations in heavily regulated industries.

One reflection made by P1 is that it is possible, due to the high density of foreign enterprises, to do business with non-Chinese companies only. Therefore, *guanxi* is not important to these companies, even though they operate on the Chinese market.

## 5.2 *Guanxi*'s impact on management control

In the empirical study, all companies practised formal controls, but none of them directly declared that they used informal controls (e.g. social control). Sinda practised budgeting and control through regulations. Tommy Liu, representing Emotron, states that their formal control consisted of result controls based on annual profit as compared to budget expectations. P1 is controlled by results and profitability. SSBA use controlling budgets, quality and time control. In the construction business, finishing projects on time is fundamental. In all four cases, result and budget control (outcome control) seem to be the most important control mechanism.

According to Mouritsen et al (2001), IORs has an impact on management controls leading to outcome control mechanisms such as open book accounting and target cost management. These types of outcome controls should create new possibilities for management intervention. The *guanxi* network, on the other hand, does not, according to our empirical results, have an impact on outcome controls. Luo (2007) states that while Western IORs are an inter-organizational commitment, *guanxi* depends on personal creation and development. Consequently, this implies that IOR has an impact on outcome control, whereas *guanxi* has not.

According to Kraus and Lind (2007), social control is just as important as outcome or behaviour control. Social control includes trust-building and partner selection. In the empirical study, Emotron is the only company that explicitly says that social control plays a significant role to manage the organization. Interestingly, all companies talk indirectly about social controls throughout the interviews when responding to the question about *guanxi* and business relationships. Sinda says that you can trust a good relation more than contract law. In management controls, face-to-face contact is always desirable. P1 believes that Chinese networking is more about personal involvement in comparison to Swedish networking. Emotron says that business is about solving problems that you encounter. In China, you have to solve problems in person, face-to-face. Tommy Liu from Emotron means that mutual trust is far more important in China than in West, since the number of players is so large. He believes that *guanxi* is important when choosing a business partner, since there are innumerable alternatives to chose between. Tommy Liu meets his two distributors once a week, which means that he has to travel across China at several occasions every month. This shows that *guanxi* may have an impact on management control through social control. Trust and choice of partner is essential in building *guanxi* as well as in social control mechanisms. Dekker (2004) argues that investing in social control, meaning investing in good relationships, can reduce the need of formal control. According to Schoorman et al (2000), trustworthiness is determined by *ability*, *integrity* and *benevolence*. All these factors presented by Schoorman, in research on Western organizational trust, also apply to *guanxi trust*.

A study made by Clegg et al (2009) showed that trust was more important in Chinese business relations than in Finnish, mainly because of the lack of regulation in China. Sinda shares this view and believes that the absence of contract law has made trust, meaning *guanxi*, in a relation important. The study also illustrated that *guanxi* affected trust in China by “demanding a higher degree of trust before potentially valuable knowledge and information

could be shared” (Clegg et al, 2007). Mouritsen et al (2001) states that trust can be developed through information exchange. Consequently, there is a difference in what comes first: a high degree of trust before information exchange or information exchange resulting in trust. Research on Western organizational trust shows that task-orientated Western cultures have a higher degree of initial trust than relationship-orientated cultures (e.g. Chinese). Relationship-orientated cultures need more time to develop a relation before working on a task (Schoorman et al, 2000).

In an IOR, social control can also be developed through learning and adoption, for example through regular meetings (Kraus & Lind, 2007). This is another example of differences between IORs and *guanxi* networks. In a *guanxi* network, the relationship demands regular and direct meetings in order to “give face” to your partner, and not primarily to develop trust (trust already exists in this relation). To maintain social control (in the IOR) you have to create trust, in the same way you have to create trust in order to maintain *guanxi*. Increasing trust may reduce two typical problems when managing an IOR; appropriation concerns and coordination of tasks (Dekker, 2007).

### **5.3 *Guanxi*'s impact on key success factors**

Luo (2007) states that *guanxi* is a key success factor. Some variables are more affected by *guanxi*, for instance sales force marketing and credit liberalization. When it comes to credit liberalization, *guanxi* improves trust hence allowing extended terms of credit. *Guanxi* becomes important to business success since business networks depend on *guanxi* (Luo, 2007). Fan (2002) is of another opinion, claiming “*guanxi* cannot be a competitive advantage”. The reason is that *guanxi* is a personal asset, which makes in non-transferable (Fan, 2002). Luo (2007) and Fan (2002) represent two different views of *guanxi*'s impact on key success factors. In the empirical study, different views were presented regarding the complexity of *guanxi* and its affects.

Professor Ma and Sinda mean that *guanxi* (“good social relationships”) is one of many key success factors. *Guanxi* alone will never make a company successful, but it can be one factor that makes a company achieve better than its competitors. Emotron and SSBA have the same experience of what have been their key success factors in China; long-term commitment and having the whole process chain in China. Emotron and SSBA both believe that low price and high quality, in that order, is more important than anything else in China. Guthrie (2002) shares this view and believes that relations are important in all business, but that product and price often comes first. On this matter, Luo (2007) is of the opposite opinion, claiming that *guanxi* can make up for a poorer product, since loyalty-based *guanxi* increases market demand. SSBA believes that *guanxi* can be a key success factor for Chinese companies since they often win procurements even in cases where Western firms are more qualified. P1's whole concept is that it is a Western company attracting customers/members that embrace a Western lifestyle. Therefore, P1 are not involved with many Chinese actors and their exposure for *guanxi* is limited. In the empirical study, one observation is that Chinese respondents claimed that *guanxi* had more impact on key success factors, as opposed to the Swedish respondents. The Swedish interviewees believed that other factors determine business success.

In a study made on New Zealand SMEs in China, Cremer and Ramasamy (2009) reach the conclusion that *guanxi* is an important factor that contributes to business success. These findings are different from the ones in this study of Swedish SMEs. This difference is interesting. One factor that could explain the discrepancy is that the data from the New Zealand SMEs was based on companies active in services or investments. When investing in China, keeping up with regulations and policies is essential in order to avoid failure. The Swedish SMEs in this study are not in the same industry as the New Zealand SMEs. *Guanxi* is more important in some industries than in others (Clegg et al, 2007; Björkstén & Hägglund, 2010).

## 6. Conclusion

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*In the final chapter, the thesis is concluded on basis of the research questions. Furthermore, we will give our own reflections based on the material from the theoretical and the empirical framework. Finally, we will give suggestions on areas for further research.*

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### 6.1 Conclusion

#### *How does guanxi affect business relations?*

This study finds that *guanxi* affects business relations. For instance, *guanxi* is a necessity in certain business areas, such as the mining industry. Furthermore, *guanxi* reduces transaction costs through credit liberalization. *Guanxi* affects business relations in different ways. In previous research as well as in our empirical study, three different views on the importance of *guanxi* are distinguished. The first view, represented by Chinese natives, implies that *guanxi* is important to business relations. The second view implies that *guanxi* can affect business relations in some industries. The last view implies that *guanxi* is overrated, and that it has no direct effect on business relations. In previous research, Westerners represented this view. Interestingly, our study confirms the different views described in previous research; that Chinese natives consider *guanxi* to be of greater importance to business relations than do Westerners. This study also verifies that the importance of *guanxi* is decreasing. The reasons are increased access to reliable information, liberalization of the Chinese market, improvements in commercial law and tough competition.

#### *To which extent is guanxi affecting management control?*

This study finds that *guanxi* affects management control by promoting informal control rather than formal control. We find that *guanxi* has no effect on formal controls. Informal control (e.g. social control), on the other hand, is affected by *guanxi*. *Guanxi* is about choosing the right partner, mutual trust and personal involvement. Social control has the same elements; partner selection and trust building. Trust is essential for building and maintaining both *guanxi* and social control. A well-developed *guanxi* network functions as a social control mechanism. Therefore, in Chinese management control, *guanxi* makes informal control more important since it functions as social control.

#### *In what way can guanxi be considered a key success factor in Chinese business?*

In some industries, *guanxi* is a key success factor and makes a company achieve better than its competitors. However, *guanxi* alone is not enough for business success. This study concludes that vertical integration or product attributes are key success factors to Swedish SMEs on the Chinese market. The Chinese natives consider *guanxi* as more important to achieve success,

than do their Swedish counterparts. Previous research is divided as to whether *guanxi* is a key success factor. This study finds that even though *guanxi* is not an overall key success factor, it is still an important factor for business success.

## **6.2 Reflections**

During this project, we have made some personal reflections. *Guanxi* is a vague concept and has different meanings depending on whom you ask. Chinese people believe that *guanxi* is more important than most Westerners do, and that it affects family, friends and business. We believe that it would be rewarding for Westerners to learn more about *guanxi*. Not only because of its possible business impact, but also in order to learn more about a concept so central to many Chinese in their social relations.

## **6.3 Suggestion for further research**

After doing this study we would like to express ideas for further research. Since the subject is relatively unexplored, we believe that several ideas could be interesting to pursue. Three proposals for further research are stated below.

The magnitude of local government is frequently mentioned in *guanxi* literature as well as in our thesis. It would be interesting to explore the impact of *guanxi* on business-local government relations.

Carrying out a study on Chinese SMEs only would possibly give a different view of *guanxi*. It would be interesting to compile their data and see what conclusions can be made.

This study was conducted in Beijing, which is one of the most modern cities in China. It would be of great interest to do the same study but in a less developed region, perhaps in central China.

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# Appendix 1

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## I. General questions

1. What is your company's business area?
2. How would you describe your role in the company?
3. What, in your opinion, is characteristic the Chinese way of doing business?
4. How do you control your business (Management Control Systems)?
5. Why have you chosen this MCS?

## II. Business relations

6. What actors (e.g. suppliers, partners, customers, competitors, "local government") do your company have a relation to?
7. In what way has the Chinese actors tried to maintain the relation to your company?
8. Do you have relations to non-Chinese actors in China? If yes, how do you treat these relations compared to your relations to Chinese actors?

## III. *Guanxi*

9. What does *guanxi* mean to you?
10. How does *guanxi* affect you company?
11. How does your company build/maintain *guanxi*?
12. Do you think that the importance of *guanxi* has changed, or is changing, due to rapid changes in Chinese society and around the world?

## IV. Key Success Factors<sup>1</sup>

13. Do Swedish companies have any special advantages that may be useful for long-term relationships, compared to companies from other Western countries?
14. What are your company's key success factors?
15. What key success factors do you believe are essential to be successful in China?

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<sup>1</sup> The factors that are a necessary condition for success in a given market.

# Appendix 2

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## Questions to Professor Jianwei Ma

1. What, in your opinion, is characteristic of the Chinese way of doing business?
2. What does *guanxi* mean to you? How would you define *guanxi*?
3. In what way do you think *guanxi* affects a company's relations? (e.g. relations to government, suppliers, customers, competitors)
4. Can *guanxi* be more important in some relations, and less important in others? (e.g. relations to government, suppliers, customers, competitors)
5. How can a company build and maintain *guanxi*?
6. Do you think that the importance of *guanxi* has changed, or is changing, due to rapid changes in Chinese society and around the world?
7. What key success factors do you believe are essential to be successful in China?