

Gift Giving, *Guanxi* and Illicit Payments in Buyer–Supplier Relations in China: Analysing the Experience of UK Companies

Andrew Millington
Markus Eberhardt
Barry Wilkinson

ABSTRACT. This paper explores the relationship between gift giving, *guanxi* and corruption through a study of the relationships between UK manufacturing companies in China and their local component suppliers. The analysis is based on interviews in the China-based operations of 49 UK companies. Interviews were carried out both with senior (often expatriate) staff and with local line managers who were responsible for everyday purchasing decisions and for managing relationships with suppliers. The results suggest that gift giving is perceived to be a significant problem in UK-owned companies in China. However the relationship between these payments and established understanding of gift giving within *guanxi*-networks appears to be weak. Gift giving appears to be associated with illicit payments, corruption and the pursuit of self-interest. Firms seek to reduce the incidence of illicit transactions by changing staff roles, instituting joint responsibilities, which include the separation of different

aspects of sourcing/purchasing, increasing the involvement of senior staff in the process and through the education of employee and suppliers.

KEY WORDS: *Guanxi*, buyer–supplier relationships, China, corruption

Introduction

Recent studies highlight significant differences between Chinese business culture and Western or Japanese business culture (Lu, 1997; Steidlmeier, 1999). In particular *guanxi* – a system of personal connections that carry long-term social obligations – are held to play a significant role in business relationships in China (Fock and Woo, 1998; Lovett et al., 1999; Park and Luo, 2001; Yeung and Tung, 1996). They provide a mechanism through which firms can seek and develop working partnerships in an environment that is characterised by uncertainty and a relatively weak legal framework (Luo, 2003; Standifird and Marshall, 2000; Wong and Chan, 1999; Xin and Pearce, 1996; Yang, 2002). In this environment *guanxi* may provide a moral and ethical framework within which transactions can take place since the emphasis on trust and the maintenance of long-term relationships encourage appropriate forms of behaviour within the cultural context (Wong and Chan, 1999). Indeed some authors have suggested that *guanxi* may reduce transaction costs and provide an efficient mechanism for transactions under these conditions (Lee et al., 2001; Lovett et al., 1999; Xin and Pearce, 1996).

Andrew Millington is Director of the Centre for Business Organisations and Society at the University of Bath. His current research interests focus on the interface between business and society in China and corporate philanthropy. He has published widely including papers in the Journal of International Business Studies, Journal of Business Ethics, Journal of Management Studies and the Cambridge Journal of Economics.

Markus Eberhardt is a postgraduate student in Economics at the University of Oxford. Her pursued his first degree in Modern Chinese Studies at the University of Freiburg, People's University of China and the University of Leeds, and holds a Masters degree in Development Economics from the University of East Anglia.

Barry Wilkinson is a Professor in International Business at the University of Bath. He has published widely in the area of business and management in the Asia-Pacific. He is the author of The Japanization of British Industry (with Nick Oliver) and Labour and Industry in the Asia-Pacific.

However, the emphasis on reciprocal favours and gift giving (Steidlmeier, 1999), within a system which is based on the individual rather than the organisation (Chen, 1995) has led both Western businessmen (Yang, 1994) and academics (Pearce and Robinson, 2000; Wong and Chan, 1999) to identify aspects of *guanxi* with corruption, or at least with “a set of ethical priorities that differs from the Western norm” (Wright et al., 2002, p. 157). Although a culture of gift giving may be confused with or hide a system of corrupt or illegal payments for services, clear distinctions can be drawn between gift giving within *guanxi*, which is concerned with the building of relationships, and bribery which is targeted at illicit transactions (Brand and Slater, 2003; Guthrie, 1998, 1999; Lovett et al., 1999; Steidlmeier, 1999). Rapid changes in China, which include urbanisation, privatisation and the influx of Western companies with fundamentally different ethical and operating systems, may have weakened *guanxi* ties (Lovett et al., 1999) in a society which is characterised by a decline in ‘professional morality and social responsibility’ (Wright et al., 2002, p. 157) and a weak legal system (Dunfee and Warren, 2001; Tung and Worm, 2001). Under these conditions behaviour which was characteristic of *guanxi*, and controlled within it, may provide avenues for corruption (Yang, 2002). Such behaviour has been observed in the public sector in China where bribes to state functionaries may be dressed in the clothes of *guanxi* (Lovett et al., 1999).

This paper explores the relationship between gift giving, *guanxi* and corruption through a study of the relationships between UK manufacturing companies with local manufacturing operations and local suppliers. In each case relationships are analysed from the perspective of the buying firm. Buyer–supplier relationships between UK companies and local suppliers were selected for empirical analysis because they are clearly open to illicit practices but at the same time may stand to benefit from the close business relationships implicit within *guanxi*. Indeed modern manufacturing methods such as Just-in-Time (JIT) or Sequenced Production have been characterised as being dependent on close business relationships and ‘partnership sourcing’ (Oliver and Wilkinson, 1992; Womack et al., 1990).

The paper makes three contributions to the literature:

1. Although the application of *guanxi* to firm–state relationships has been extensively analysed (e.g., Guthrie 1998; Park and Luo, 2001; Tung and Worm, 2001; Xin and Pearce, 1996) this is one of the first attempts to analyse inter-firm relationships, answering Yang’s call for research into the “encounter between *guanxi xue* and capitalism, its practices and institutions” (Yang, 2002; p. 460).
2. This paper investigates the relationship between gift giving, *guanxi* and bribery within the context of the relationships between UK firms and local suppliers. Although the relationship between *guanxi* and aspects of firm performance form the basis of an extensive literature (e.g., Luo, 1997; Wong and Chan, 1999; Yeung and Tung, 1996) this is the first study to provide a systematic analysis of the evolving role of *guanxi* within supply relationships, complementing recent work which has investigated the attitudes of purchasing managers towards business ethics and *guanxi* through hypothetical scenarios. (Su et al., 2003).
3. The paper explores the impact of gift giving and corruption on the management and control of purchasing activities. Our concern therefore is not only with the incidence and characteristics of gift giving and *guanxi* in buyer–supplier relationships but also with the implications of these factors for the development of managerial processes and controls in the business environment of the PRC.

In the first stage of the analysis the characteristics of *guanxi* are reviewed and the relationships between *guanxi*, gift giving and bribery are developed. The sample and survey methodology are then discussed in the second section and a qualitative analysis of gift giving which is drawn from interviews in the China-based operations of 49 UK companies is then introduced. These interviews were carried out both with senior (often expatriate) staff and with local line managers who were responsible for everyday purchasing decisions and for managing relationships with suppliers. In each case our concern is with the UK manufacturer and its relationship with indigenous suppliers. The conclusions and policy implications are then discussed in the concluding section.

Conceptual development

According to Bian *guanxi* literally means “relationship or relation, but its essence is a set of interpersonal connections that facilitate exchanges of favours between people” (Bian, 1997, p. 369). Bian (1994b, p. 96) notes that *guanxi* can refer to the “existence of a relationship between people” (‘indirect relationship’ or *jianjie guanxi*, Bian, 1994a, p. 974), “actual connections or contact between people” (‘direct relationship’ or *zhijie guanxi*, Bian 1994a, p. 975), and “people with whom one has a strong connection” (*guanxi hu*, *ibid.*). The rationale for *guanxi*-networks (*guanxi wang*) is the satisfaction of personal interest through an exchange of mutually beneficial favours (Bian, 1994a). *Guanxi* are present not only in commercial environments, they also relate to social practices (Davies et al., 1995). Crucially, *guanxi*-networks should not be seen as merely an extension of family relationships (Bian, 1994a). While these definitions help us understand what *guanxi* can refer to, we also need to grasp the characteristics of *guanxi*, which are applicable to all three meanings outlined above. First, there is a hierarchy of *guanxi*, whereby the individual is more inclined to exchange favours with people who are closely rather than weakly tied. Second, although indirect ties do exist, *guanxi* nevertheless fundamentally rely on mutual trustworthiness. Third, “and perhaps the most important characteristic of *guanxi* is reciprocal obligation” (Bian, 1997, p. 369). Failure to reciprocate may result in the loss of one’s social network and the multiple resources embedded in it. Within the corporate or business context Guthrie (1998) echoes Yang (1994), drawing a clear distinction between *guanxi* which draw on social networks to “establish good business relations” (Guthrie, 1998, p. 255) and *guanxi xue* or *guanxi practice* which “involves the exchange of gifts, favours and banquets; the cultivation of personal relationships and networks of mutual dependence; and the manufacturing of obligation and indebtedness” (Yang, 1994, p. 6). *Guanxi* networks may offer significant transaction cost advantages in a society with high search costs and a weak institutional and legal structure (Standifird and Marshall, 2000; Wright et al., 2002; Xin and Pearce, 1996). However, while *guanxi* practice is “based on the social connections that are inherent in the institution of *guanxi*” (Guthrie, 1998, p. 257), the use of such

practices to circumvent formal processes and procedures is often considered a corrupt or backdoor practice (Guthrie, 1998).

Yang (1994) has suggested that the growth in *guanxi* practice can be associated with the breakdown in social order during the Cultural Revolution and as a product of economic reform and the emergence of capitalism.¹ In the first case people are seen to rely on connections cemented through gifts and favours as a response to the breakdown in formal structures while in the second case it may reflect the growth of individualistic patterns of behaviour within a weakly regulated society. As Harvey (1999) comments “inadequacies in both laws and enforcement have weakened professional morality and social responsibility while a cult of money worship has arisen” (p.157). The continued importance of *guanxi* and in particular the role of *guanxi* networks in the creation of successful business relationships has been emphasised in much of the recent literature (e.g., Bian, 1994a, b, 1997; Davies et al., 1995; Lovett et al., 1999; Yang, 1994, 2002). Indeed Yang (1994) and Bian (1997) have suggested that people will turn to social networks *because* the state is receding. However Guthrie (1997, 1998, 1999) has questioned the long-term significance of *guanxi*, and in particular *guanxi* practice in the business environment. Drawing on 155 in-depth interviews with Chinese officials and industrial managers in Shanghai in 1995, he hypothesises that *guanxi* practice is slowly losing its relevance due to “the emergence of a legal system, formal rational bureaucracies at the firm level, and increasingly contract based agreements in growing factor and product markets” (Guthrie, 1998, p. 265). According to Guthrie (1997, 1998) *guanxi* practice may have been necessary in the command economy to gain access to distribution channels or to source components or commodities, but the move to a free market has reduced the salience of these factors placing emphasis on the creation of relationships with potential business associates in competitors, suppliers and markets which are largely independent of ties and favours based in *guanxi* practice.

The emphasis on gift giving, banquets and the exchange of favours within relationships which are characterised by obligation and indebtedness (Yang, 1994) has led some observers to question the ethical consequences of *guanxi*. According to Steidlmeier

(1997) *guanxi* may result in a set of ethical priorities that are different to the Western norm and both nepotism and corruption have been associated with *guanxi* (Pearce and Robinson, 2000; Xin and Pearce, 1996; Yeung and Tung, 1996). However, Steidlmeier suggests that “within Chinese culture itself, there are, indeed, moral parameters to distinguish morally proper gift giving from bribery and corruption” (1997, p. 121), or as Luo comments “many Western business people are often in danger of overemphasizing the gift giving and wining and dining components of a *guanxi* relationship thereby coming dangerously close to crass bribery or to being perceived as meat and wine friends which is a Chinese metaphor for mistrust” (1997, p. 48). In essence a distinction can be drawn between the reciprocal exchange of gifts which is designed to develop and cement personal relationships within the Chinese context, “gift giving, for example, is expected behaviour, which shows respect to another person and strengthens relationships” (Steidlmeier, 1997, p. 122), and gift giving which seeks to elicit “behaviour that is not an integral or legitimate part of the set of transactions at hand” (Steidlmeier, 1997, p. 124). In this sense gift giving is associated with bribery when the receiver is invited to pursue personal interests at the expense of the legitimate aims and objectives of their employer. *Guanxi* practice may, therefore, offer opportunities for illicit behaviour both because gifts and favours are exchanged and as a consequence of the personal rather than corporate nature of *guanxi*.

The preceding discussion raises two issues that lie at the core of this study. First, the development and incidence of *guanxi* practice in an economy that is characterised by market liberalisation, increasing regulation and formalisation in local foreign-owned enterprises, and secondly, the relationship between *guanxi*, *guanxi* practice and bribery. In the latter context the earlier discussion suggests that any analysis of gift giving in buyer–supplier relationships should focus on three elements of the transaction. First, the cultural context within which gift giving takes place. Second, the objectives of the donors and in particular the degree to which gift giving is designed to elicit particular favours rather than to develop relationships. Third, the extent to which the gift encourages behaviour by the recipient which is at variance with the legitimate aims of their employer.

Modern supply management practices emphasise the importance of long-term relationships rather than market-based transactions between the buyer and the seller. They are characterised by relatively advanced formal structures within which suppliers are managed and selected, and are often not subject to formal contractual relationships. This emphasis on relationships has some resonance with the importance of relationships and their development within *guanxi* networks. However, while similarities exist (Björkman and Kock, 1995; Fang, 1999; Worm, 1997) significant differences are also present. In particular *guanxi* is a social rather than corporate construct and *guanxi* relationships are both personal and may extend beyond the business context into the social structure (Tung and Worm, 2002). The emphasis on long term relationships with suppliers rather than the market may therefore pose particular problems for firms in China since long-term relationships reduce the importance of the market as a governance mechanism and supply managers may seek to satisfy individual rather than corporate goals within *guanxi* relationships. However, the presence of significant formal processes may be expected to reduce or control the impact of illicit or corrupt practices within the organisation (Guthrie, 1998, 1999).

Research design, research methods and data analysis

Our basic research questions were: (a) what role do *guanxi* and *guanxi* practice play in the supply relationships of UK manufacturing companies in the PRC? (b) What is the nature and perception of gift giving between suppliers and staff within UK manufacturers located in the PRC?(c) What processes have been put in place by UK manufacturers to control inappropriate or corrupt relationships with suppliers. These basic questions were pursued through answers to open-ended questions in several areas, supplemented by a set of Likert scales that were designed to measure different dimensions of trust and cooperation between buyer and supplier. English and Chinese versions of the questionnaire were provided. In order to ensure consistency between the Chinese and English versions of the questionnaire the English questionnaire was trans-

lated into Chinese by a native speaker with a sound technical knowledge of buyer–supplier relationships. A fluent Chinese speaker then translated the questionnaire back into English and any inconsistencies were identified and resolved. The questionnaires were then piloted in face-to-face interviews in five companies and any remaining issues were resolved.

With regard to question (a) we asked about the ambitions and intentions of the MNC with regard to partnership sourcing with local firms. How they go about this was explored by asking whether there were expectations of long-term relationships with local suppliers, and the extent of mutual commitment between buyer and supplier in relationships. We also asked about the willingness of both buyers and suppliers to invest in the relationship, and the nature of those investments, as a concrete indicator of commitment. We furthermore explored the nature of the governance of buyer–supplier relationships, with prompts for commentary on societal-specific differences between the UK and China, as well as questions on information sharing and performance monitoring. This provided a context within which *guanxi* practice could be assessed.

Questions on the nature and perception of gift giving between suppliers and staff within UK manufacturers located in the PRC (question (b)) gave respondents the opportunity to elaborate on a range of problematic issues and invited senior managers to discuss any difficulties they had experienced with under-table, back-door practices or red-envelopes² in supplier relationships in China. We provided prompts regarding the extent to which *guanxi* practice was common in supplier relationships in China. In each case the respondents were asked to illustrate their comments with examples drawn from recent corporate experience. With regard to problems identified by respondents, we invited commentary on what had been done to remedy or limit any negative impacts (question (c)). As Liedtka (1992) and Brand and Slater (2003) comment, respondent recall of representative examples enhances the research and improves the reliability and validity of interviewee responses.

Information on the population of UK manufacturing operations in China was assembled from the company reports of the population of UK-based companies listed on the FTSE. This was supplemented and checked through contacts and

interviews in the British Chamber of Commerce and the British Embassy/Consulate Generals in China and the China Britain Business Council. All of the manufacturing companies identified on the Eastern Seaboard of China were then contacted and interviews have been carried out in 49 UK-owned companies which comprised over 50% of the population. The sectoral distribution of the sample is not significantly different to the population and the analysis is, therefore, based on a representative sample of UK manufacturing operations on the Eastern seaboard of China, the most economically advanced area in the PRC. The parent companies range in size, measured by turnover, from just under £100 million to more than £5 billion with a mean of £2.8 billion, and the number of employees in the Chinese operation ranges from less than 25 to 1500 with a mean of 220. With respect to ownership 24 were wholly-owned subsidiaries and 25 were equity joint ventures (EJVs). All were under the control of the UK parent.

Our research consisted of face-to-face interviews with managers in 49 UK-owned manufacturing operations in the PRC between January and December 2003. Face-to-face interviews were selected in order to allow respondents to develop and support their statements within a sensitive area of research. In all but seven cases more than one manager was interviewed. In all cases there was an interview with a senior manager, typically the general manager, managing director or plant director. In a few very large firms, the supply chain director or manager was interviewed. Fifteen of the respondents were Chinese nationals, 11 were classified as overseas Chinese, in most cases from Hong Kong or Taiwan, and 21 were of Western, usually of UK origin. In addition, in 42 cases the first interview was followed up by interviews with purchasing managers, who were asked to provide a detailed account of relationships with one or more specific suppliers. The majority of interviews with senior managers were in English, while the majority of interviews with purchasing managers were in Chinese. Combined, the interviews generated a general commentary on supply chain management in 47 firms (two respondents declined to answer questions on illicit action), together with specific commentary on supplier relations between 42 of those firms and 116 of their suppliers.

At each firm interviews began with the provision of assurances of firm anonymity, then briefing respondents on the purposes and nature of our research. We made clear that we would like to understand 'typical' examples of buyer–supplier relationships. The initial general discussion of sourcing policies and practices in the PRC (with a senior manager) gave us a detailed overview of sourcing policies and practices. We then asked one or more purchasing managers to discuss in detail 'typical' examples of sourcing relationships with other firms in China for which they were responsible. We asked respondents to restrict examples to other firms that supply components or materials that are directly fed into the MNC's manufacturing process, avoiding items such as stationery or office equipment. We cannot be certain that there was no systematic bias in the choice of supplier firms by interviewees, though checking the component-specific interviews against the general interviews with senior managers for each firm revealed no obvious problem in this regard – the two types of interview were generally consistent in the overall picture generated, with very little by way of contradictory comments.

In the majority of cases interviews were taped. Where this was not possible, extensive field notes were documented. Data analysis was first undertaken in the light of our prior understanding of key issues in China and other developing and transitional countries, as derived from our reviews of partnership sourcing principles, problems in sourcing in transitional and developing countries, and the Chinese economic and institutional context. This allowed us to code interview materials into categories derived from the literature. Consequently, in the manner of grounded theory as suggested by Strauss and Corbin (1990), the categories, and their linkages and relationships, were further developed in a lengthy process of data combing and analysis that allowed us to uncover what appeared to be the most important recurring themes and issues.

Research findings

Under-table, back-door and red-envelopes

While some interviewees felt that 'under-table' practices in China were decreasing in incidence,

almost all expressed the view that these were still commonplace in China today, and believed that their purchasing staff would be likely to occasionally if not frequently encounter offers of bribes. Although many firms were well aware that under-table deals were going on, exposing and proving their existence was commonly reported as extremely difficult. For instance one firm found out that a buyer was about to get married to the salesperson of a supplier. The account was moved to someone else because it was felt such a buyer–supplier relationship was inappropriate. It was later discovered that the price agreed between the buyer and the salesperson was well above the market price. This looked suspicious, but solid evidence of corruption was not found. Similarly, a senior manager found that "one part was terribly expensive, I raised this issue for two months, but nobody wanted to touch it. In the end I just said we will change this by the end of the week." A distinction is therefore drawn between cases where bribery or illicit practices had been observed and those where it was suspected. The interviewee was often able to give examples of bribes that had been offered. These ranged from the "offer of a car of your choice" to a *per diem* payment for each ton of a product ordered from the supplier. They were also able to identify some of the costs of illicit payments within the organisation. These ranged from the tripling of some input prices to restrictions on supplier choice. In one case, a member of his QA staff handed in "bribes" of 2000 RMB (US\$240) given to him by a supplier on several occasions – such a bribe may not seem large in Western terms but must be placed in the context of the Chinese economy where the monthly salary of a buyer is only 2000–3000 RMB (US\$240–360).

The revealed pattern of under-table or back-door activity is shown in Table I. Table I breaks down the incidence of illicit or under-table activities into observed and suspected cases and categorises the respondents into three groups, Chinese nationals, overseas Chinese and citizens of a Western country in order to investigate whether the nationality or ethnic origin of the respondent affects the incidence of illicit or under-table activities or the willingness to disclose such information (see Brand and Slater, 2003; Guthrie, 1998).

The results reveal that almost two third of the sample companies either observed or suspected

TABLE I
Respondent ethnicity and perceptions of illicit actions

Respondent ethnicity	Observed illicit action		Suspected illicit actions		Illicit actions		Procedures in place		
	<i>N</i>	<i>N</i>	%	<i>N</i>	%	<i>N</i>	%	<i>N</i>	%
Chinese	15	5	33	3	20	8	53	13	87
Overseas Chinese	11	5	45	2	18	7	63	10	91
Non-Chinese	21	7	33	8	38	15	71	16	76
All respondents	47	17	36	13	28	30	64	39	83

Notes: Data was constructed from qualitative responses in an elaborate process date combing and analysis. It represents explicit mention of the above issues. Two respondents in the sample declined to answer questions in this domain. The column 'illicit actions' represents the combination of 'observed' and 'suspected' illicit actions.

under-table activities in their purchasing operations. Seventeen firms had direct experience of purchasing staff accepting bribes from supplier firms, and another 13 firms suspected that such illicit activity may be going on. In 14 of these 30 companies staff were identified as having left because of disciplinary action taken as a consequence of such activities. Of those 17 that had not experienced or suspected bribery, 13 had taken pre-emptive action to make 'under-table deals' difficult. Although the sub-samples by ethnic origin are relatively small the results do not suggest that the perception of these payments as illicit is a culturally conditioned phenomena; the incidence of actual and perceived bribery is not significantly different ($p = 0.05$) whether the respondent is a Chinese national, Overseas Chinese or non-Chinese.

In many cases the respondents suggested that under-table practices were part of the established business culture in China. Over half of the sample firms had either experienced under-table practices in their supply operations or suggested that it was a common problem in China. Typical perceptions were:

"In China, 70–80% of suppliers give advantages to buyers in form of vouchers, or even ATM cards! This situation cannot be eradicated, but you can limit it through control and stringent systems... The situation in China in this regard will not change for the next ten to twenty years, due to the opportunities [to use back-door practices] in a booming market with high expectations of pay and increases in personal living standards."

"My people usually don't seem to think that this kind of hidden bribery is strange or unjustifiable on ethical

grounds. They think it is common practice. I tell them that I don't care whether everybody else in China is applying this practice, but that it is against our corporate ethics."

Senior management also suggested that under-table benefits were frequently seen as a financial benefit that was attached to the role of the purchasing manager. The examples shown below illustrate the essentially personal nature of under-table activities and suggest, since the goals of the individual are clearly separate and at variance with those of their employer, that it should be categorised as bribery within the ethical taxonomy presented by Steidlmeier (1999).

"The management in many Chinese companies simply accepted that purchasing staff make a little bit of 'private money' out of under-table deals. The only fear of these employees is being fired on the spot, so they may make sure that their private deals do not go against company interests too much."

"Often, in sales and purchasing in China people seem to be asking 'what's in it for me?'"

"The purchasing department, in the colleagues' eyes, is a goldmine. However the status of a job in purchasing is not highly rated in China, it is not like other management positions. There's a Taiwanese saying: 'For the purchasing guy, salary is only a pocket-money' – and it's the same in China, especially since the monthly salary of a buyer is only 2,000–3,000RMB [US\$240–360]. The buyers can increase this salary two or three times through red envelopes."

Differences were, however, apparent in the attitudes of managers who were Chinese nationals regarding the future development of these practices and their ethical basis. Chinese managers were more likely to suggest that these practices were of declining importance in the PRC and these comments resonate with the earlier findings of Guthrie (1998). However, within the sample as a whole, managers were as likely to suggest that under-table practices would continue into the medium and long-term. To some extent this may reflect differences in the historical and cultural context within which the respondents evaluate the evolution of these practices, and it is interesting to note that both overseas Chinese and Western managers considered that under-table practices were likely to continue. With respect to the ethical consequences of *guanxi* senior managers who were Chinese nationals clearly identify under-table activities or red envelopes as distinct from *guanxi*, but in some cases their responses suggest that it is an acceptable form of behaviour and question whether such practices should necessarily produce negative consequences for the firm. Such practices were however viewed as part of the established business culture in China and this was reflected in the views of some of the respondents who took a neutral line to the ethical consequences of under-table activities. As two of the respondents commented:

“It’s not the supplier’s fault if they offered this type of payment – it’s a general sales art, maybe our sales people use the same methods!”

“As long as price and quality are right I don’t really care whether my staff receive red envelopes... that’s their private matter.”

The relationship between guanxi-networks and under-table or back-door dealings

The respondents did however draw a clear distinction between gift giving and dining which was designed to build relationships, and under-table or back-door dealings. These differences were reflected both in the nature of the exchange (where relationship building was concerned, the gifts were typically small and often structured around public

holidays in the PRC) and in the language used to describe them (where bribery was concerned it was usually referred to as under-table/back-door practice or red-envelopes).

“We strive to get good relationships with the supplier through frequent contact, often of the social kind: lots of dinners, going out in order to make sure any problems can be swiftly solved on the basis of these friendship dealings. *Guanxi* is to sort out minor problems and to have the relationship run smoothly, based on trust and without too much lengthy administration – but if the fundamentals of quality and price are not there, merely *guanxi* will not hold up the relationship.”

“You have got to understand quickly that you have to put the resource in, because things take longer in China, meetings take longer, *guanxi* can go on for hours. It’s part of building a relationship. If you try to ignore the relationship with your supplier, it can become difficult. All the costs, the time and money [of relationship building] is negligible compared to the benefit you can get from it.”

However, the importance of network *guanxi* and the *guanxi* building process should not be overestimated. In spite of extensive evidence of partnership buyer–supplier relations, senior management only reported socializing outside the workplace in 11 cases, and this was limited to occasional meals. There was no reporting of close personal relationships between buyer and supplier staffs that went beyond the workplace, and there were no suggestions that close personal relationships were being established.

These findings were supported through information collected on the purchasing behaviour of junior staff within the organisation. Purchasing managers were asked about the degree of social interaction with particular suppliers across a range of dimensions, which included social interaction outside the workplace, interaction over meals and conversations about extra business activities. The strength of these interactions was measured using a five-point scale (never = 5 to very frequently = 1) and the results are presented in Table II. Information was collected on a set of relationships including suppliers with a range of ownership structures which encompassed international joint ventures (IJVs), wholly-owned foreign enterprises (WOFEs), private Chinese enterprises (PCEs) and state-owned enterprises

TABLE II
Social interactions and ownership of supplier

Supplier ownership	Meet outside work	Non-business discussions	Meals	
<i>N</i>	<i>mean value</i>	<i>mean value</i>	<i>mean value</i>	
IJV	22	4.784	4.273	4.545
WOFE	27	4.713	4.000*	4.185
Private Chinese	36	4.750	4.222	4.333
SOE	31	4.702	4.355	4.516
All suppliers	116	4.735	4.216	4.388

Notes: Above values represent mean scores on a 5-point Likert scale (5 = never, 1 = frequently). Reliability analysis of above results were carried out, with the Cronbach alpha for the total sample 0.8539. Values statistically different from the total sample mean are indicated in following manner: * at 10% level of significance, ** at 5% level of significance, *** at 1% level of significance.

(SOEs). Since earlier work suggests that *guanxi* orientation is dependent on ownership type (Su et al., 2003) separate estimates are provided for each of the ownership types as well as the total. Although some evidence of social interaction over meals and in the workplace was discovered, at the aggregate level, the results suggest that this is limited and almost no evidence was found of social interaction away from the workplace. When disaggregated by the ownership type of the supplier the scores for interaction are higher for SOEs and IJVs than for PCEs and WOFEs. The estimates are, however, not significantly different ($p = 0.05$). The estimates in Table II provide broad support for the limited importance attached to social relationships by senior managers and provides at best tentative support for differences in social interaction based on the ownership type of the supplier.

In order to further investigate the nature of buyer-supplier relationships and their relationship with *guanxi*, purchasing managers were asked about two aspects of trust: supplier credibility, which is usually associated with Western concepts of openness and competence, and supplier benevolence, which incorporates a set of factors which can be associated with *guanxi*. The measures of credibility and

benevolence were based on those developed by Ganesan (2000). The estimates are presented in Table III. Lower scores are associated with higher levels of credibility and benevolence. The significantly lower scores on the credibility construct compared to benevolence ($p < 0.01$) suggest that these supply relationships are characterised by openness and competence rather than features such as the reciprocal exchange of favours and co-operation which characterise *guanxi* relationships. While credibility is consistently lower when the results are disaggregated by ownership type ($p < 0.01$), showing no significant differences in between ownership types, the scores attached to supplier benevolence differ significantly between type of supplier providing some support for the findings of Su et al. (2003). Thus supply relationships with private Chinese suppliers appear to have a stronger association with *guanxi* related characteristics than those with SOEs ($p < 0.05$).

While some difference can be observed between the relationships of UK firms with Chinese and non-Chinese owned suppliers the results, taken together, are not indicative of strong relationships built on personal contacts and the offer of reciprocal favours.

TABLE III
Credibility, benevolence and ownership of supplier

Supplier ownership	Supplier credibility	Supplier benevolence	
<i>N</i>	<i>mean value</i>	<i>mean value</i>	
IJV	22	2.985	4.145*
WOFE	27	2.753	3.785
Private Chinese	36	2.523	3.300***
SOE	31	2.790	4.122*
All suppliers	116	2.736	3.792

Notes: Above represent mean scores on a 7-point Likert scale (1 = strongly agree, 7 = strongly disagree). See Appendix A for more details on the variables. Reliability analysis of above results were carried out, with the Cronbach alphas for the total sample 0.7710 (credibility) and 0.8383 (benevolence). Values statistically different from the total sample mean are indicated in the following manner: * at 10% level of significance, ** at 5% level of significance, *** at 1% level of significance.

Corporate responses to illicit practices

Under-table or back-door practices were clearly of concern to most of the sample companies and over 80% identified internal procedures that would restrict the incidence of such behaviour. These responses are summarised in Table IV and can be grouped under three headings: sanctions (dismissal), education and formal structures.

Responses to proven or suspected *corruption* in MNC buyer–local supplier relationships are targeted at both MNC purchasing staffs and at suppliers. Purchasing staff are typically told that the consequences of corruption will be dismissal. One manager stressed that “*anybody found receiving red envelopes or involved in under-table dealings would be dismissed. This kind of problem is linked to an individual behaviour, to their renpin [moral character]*”. In some cases suppliers are informed that the supply relationship will be terminated if illicit activities are uncovered: “*if we uncover illicit activities dealings with the supplier are stopped immediately and the supplier has to bear the cost of this disruption to our business.*” Just over a third of the sample companies identified dismissal of staff or suppliers as part of their strategy and just over a quarter had dismissed staff for under-table activities.

Just under a third of the respondents identified education as part of their strategy towards red envelope or under-table activities. Education could be targeted at employees within the company or at suppliers. As a manager commented, “*the best way to avoid under-table deals is to train your people and stress best practice*”. Staff integrity and professional behaviour standards are often paid attention in training and

development activities, and sometimes employment contracts include a clause on honesty and openness. One firm reminds its purchasing staff of the need to avoid corruption with a sign in the sourcing office that reads: ‘no gifts will be given, no offers will be made’. This is targeted equally at buyer staff and the supplier staff who frequently visit the office.

Formal structures appear to play a key role in the control of *guanxi* practice within the purchasing operations of the sample companies. The findings appear therefore to support earlier work by Guthrie (1997), which suggests that the formal structures that characterise modern business activities would curtail *guanxi* practice. The results provide some support for this hypothesis with some evidence that the relatively sophisticated supplier approval procedures, which characterise modern purchasing practice (Oliver and Wilkinson, 1992), reduce the likelihood of *guanxi* practice.

“We only buy from validated and approved suppliers, which are reviewed on an annual basis. The initial supplier approval process is rather lengthy... After very frank discussions about commercial issues and the testing of the component sample back in the UK we use a formal evaluation procedure to rate the supplier. Usually a few of us go to the supplier plant and carry out this process, so afterwards we can compare our evaluation sheets and scores awarded.”

There is however persuasive evidence that the prevalence of under-table or back-door practices has resulted in changes in the formal structures within which purchasing takes place in these companies. Over half of the companies have chosen to separate

TABLE IV
Measures against under-table dealings

Respondent ethnicity	Policy prescribing dismissal		Education		Separate sourcing & purchasing		Senior management involvement		Regular external audits		Staff rotation	
	N	%	N	%	N	%	N	%	N	%	N	%
Chinese	15	47	6	40	9	60	3	20	1	7	1	7
Overseas Chinese	11	9	3	27	5	46	4	36	1	9	1	9
Non-Chinese	21	43	4	19	9	43	10	48	7	33	4	19
All respondents	47	36	13	28	23	49	17	36	9	19	6	13

Notes: Data was constructed from qualitative responses in an elaborate process of data combing and analysis. Two respondents in the sample declined to answer questions in this domain.

aspects of the purchasing process ensuring that more than one employee is involved in the transaction, and several companies have chosen to rotate staff between suppliers in order to reduce the development of 'cosy' personal relationships between staff in the two companies. In most cases these actions were taken as a direct response to ongoing concerns about under-table or back-door behaviour.

"We have decided to split up sourcing and purchasing into two different departments, this won't totally get rid of any possibility [of corruption] because the two could be in it together but it's a precaution."

"I had to change some people in the purchasing department, and I had to split sourcing and purchasing. Now if you wanted to bribe somebody you would have to pay everybody, the quality department, the purchasing department and the sourcing department and me!"

The interview results also provide compelling evidence that senior managers and in particular non-Chinese senior managers have become involved in the supply management process as a direct response to the perceived or actual threat of illicit behaviour, authorising supplier selection and countersigning purchase orders. This type of response was identified in just over a third of the sample and in almost half of those cases where the senior manager was non-Chinese.

"I cannot afford to let under-table payments become something that makes us take the wrong decisions about a supplier. Therefore I am personally involved in all decisions about suppliers, you could call this managing at a micro-level. Over here I find that you have to micro-manage much more. It's much easier in the UK."

"Two safeguards against abuse are the point-system during supplier selection [cross-functional teams approve supplier, no single individual can make the decision] and I sign off all purchase orders."

Conclusions and discussion

This study has investigated the relationship between *guanxi*, illicit payments and bribery within the supply relationships of a representative sample of UK-invested firms in China. The results suggest that gift giving is perceived to be a significant problem in

UK-owned companies in China. However the relationship between these payments and the established understanding of gift giving within *guanxi*-networks appears to be weak. Gift giving appears to be associated with illicit payments, corruption and the pursuit of self-interest in a society where traditional structures are breaking down and new institutional structures are in transition.

Although *guanxi* has popularly been connected with illicit practices, the case evidence does not suggest that illicit behaviour is associated with *guanxi* networking. Rather, the evidence suggests that supply relationships are subject to significant levels of bribery, which are concerned with individual gain rather than corporate benefit, from the point of view of the purchasing company. Companies are seen to draw a clear distinction between gift giving within the *guanxi*-network, which is designed to build business relationships, and illicit payments, a finding which is consistent with earlier work by Brand and Slater (2003). Although earlier work has identified similar patterns of behaviour within SOEs (Lovett et al., 1988) these results suggest that it may be important in a range of economic contexts. Although Guthrie (1998) has suggested that illicit behaviour, which is associated with *guanxi* practice, may decline as legal and regulatory structures develop in China, the results in this study suggest that almost a decade after Guthrie's fieldwork illicit behaviour continues to be a significant problem. Firms must remain vigilant if illicit practices are to be avoided.

Formal structures appear to play a central part in this process. The evidence suggests that the formal structures associated with large multinational companies and modern supply relationship management may preclude or limit the incidence of illicit behaviour. The results also suggest that formal structures may be strengthened or established in direct response to the threat posed by illicit behaviour. In this case operating structures in the PRC may be significantly different to those that characterise the operation of the parent company in other national markets. Education appears to play an important role in this process, but firms also seek to reduce the incidence of illicit transactions by changing staff roles, instituting joint responsibilities (which include the separation of different aspects of sourcing/purchasing) and increasing the involvement of senior staff in the process.

The costs of illicit behaviour are therefore not restricted to the cost or performance consequences that may flow from preferential treatment for particular suppliers, but may also include the organizational costs that flow from increasingly bureaucratic procedures and the inefficient use of JIT manufacturing systems. In this context staff circulation and purchasing systems which are based on multiple bids, may be expected to undermine the long-term relationships that are central to JIT systems. Contrary to the expectations of Lovett et al. (1999) the impact of *guanxi* practice may be to *reduce*, rather than encourage, the development of long-term business relationships in China. In part the separation of different aspects of the ordering process may reduce the likelihood of illicit transactions but it may also enable the organisation to capture *guanxi* within an organisational rather than personal context.

China has been subject to significant change during the past decade, which has been characterised by the decline of established family and local networks as privatisation has taken place and business has been subject to rapid transition. These effects are likely to be heightened where suppliers seek to do business with Western companies that are subject to different legal and cultural norms. The results in this study suggest that *guanxi* processes play little part in the ongoing supply relationships of UK companies; this may reflect the relative power of the participants and the ability of Western companies to impose their working practices under these conditions.

The study is limited to a single aspect of corporate behaviour (supplier relationships) in a sample of UK firms located on the Eastern seaboard of China. The results should therefore not be seen as representative of Chinese firms in general or of economic activity in other areas of China. They do suggest however that *guanxi* practice poses particular problems for supply relationship management for Western firms in some of the most advanced economic areas within China. Future work could usefully examine the consequences of the evolving pattern of *guanxi* practice for other aspects of corporate behaviour in China. Particular emphasis could be placed on the relationship between government and business, an area where UK firms may be expected to have less power and where, therefore, different patterns of *guanxi* behaviour may be expected to evolve.

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Notes

¹ As Yang comments "corruption and bribery may be one outcome of the encounter between *guanxi* culture, official culture and a money economy" (Yang, 1994, p.461).

² Giving 'red-envelopes' originates from the traditional Chinese custom of handing money presents to relatives and/or friends in small red-envelopes (*hong bao*) on special occasions – this tradition continues in ethnic Chinese communities around the globe. In our interviews with senior managers, some respondents used 'red-envelopes' to signify illicit money payments ('bribery') by supplier firms to individual buyers.

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Andrew Millington
School of Management,
University of Bath,
Claverton Down,
Bath BA2 7AY,
UK

E-mail: mnsaim@management.bath.ac.uk

Markus Eberhardt
St. John's College,
Oxford OX1 3JP,
UK

E-mail: markus.eberhardt@sjc.ox.ac.uk

Barry Wilkinson
School of Management,
University of Bath,
Claverton Down,
Bath BA2 7AY, UK

E-mail: mnsbw@management.bath.ac.uk

Appendix A: Measures used in the analysis

Table 2 (Social interactions)

Respondents were asked 'How often do and other people from your firm interact with this supplier in these ways?', rating their reply on a 5-point scale as follows: 1 = very frequently, 2 = often, 3 = sometimes, 4 = a few times, 5 = never.

The 'meet outside work' variable is constructed from

- Meet away from the workplace
- Attend entertainment events (sports, cinema, karaoke, etc)
- Get together primarily to have fun
- Get together with other family members

The 'non-business discussions' variable is constructed from

- Talk about family, sports or other personal interests
- Talk about common interests besides work

The 'meals' variable is taken directly from

- Meet over breakfast, lunch, dinner
-

Table 3 (Credibility and benevolence)

Supplier credibility

Respondents were asked to rate the following statements on a 7-point scale (1 = strongly agree, 7 = strongly disagree):

- This supplier's representative has been frank in dealing with us
- Promises made by this supplier's representative are reliable
- This supplier's representative is knowledgeable regarding his/her products
- This supplier's representative is open in dealing with us
- If problems such as shipment delays arise, the supplier's representative is honest about the problems
- This supplier's representative has no problems answering our questions

The 'credibility' variable was then constructed from the responses to the above six statements

Supplier benevolence

Respondents were asked to rate the following statements on a 7-point scale (1 = strongly agree, 7 = strongly disagree):

- This supplier's representative has made sacrifices for us in the past
- This supplier's representative cares for us
- In times of shortages, this supplier's representative has done more for us than we could possibly expect
- This supplier's representative is like a friend
- We feel that this representative has been on our side

The 'benevolence' variable was then constructed from the responses to the above five statements
