The Guanxi Strategies of Taiwanese Firms in China’s Economic Reforms

Jeng-Min Wong, Department of International Trade and Logistics, Overseas Chinese University, Taiwan

ABSTRACT

Over the last twenty years, global foreign direct investment has been increasingly attracted to China. The rapid economic growth and abundant opportunities presented by the Chinese market also has attracted much attention from academics in exploration of the key success factors for foreign investors operating in China such as issues of guanxi strategy.

Taking the perspective of Taiwanese firms investing in China, this study tries to explore the guanxi-based business practice in the evolving of China’s FDI policy in the economic reform, and how Taiwanese investors adjusted their guanxi strategies in complying with the environmental changes.

The analysis of this study will provide contribution to guanxi management literature and shed light on managerial implications for firms to deliberate on their guanxi strategy operating in China.

Keywords: China, economic reform, guanxi, Taiwanese firms, the 12th-Five Year Plan

INTRODUCTION

Over the last two decades, global foreign direct investment (FDI) has been converged to China owing to China’s opening up and rapid development of economies. China has risen to second place after the United States in the global ranking of the largest FDI recipients since 2009 (UNCTAD, 2011).

Despite the abundant opportunities presented by the Chinese market, many foreign investors operating business in China have commented to recognize the importance of cultural and institutional differences between China and the West. In contrast to the West’s transaction-based business context, Chinese business society is relationship-based (Ai, 2006; Chen, 2001).

It has long been widely recognized that personal connections or social relationships (guanxi) is a key business determinant of firm performance in Chinese society. For centuries, guanxi has bound millions of firms into a social and business web. Any enterprises in this web, including local firms and foreign investors, inevitably face guanxi dynamics (Luo, 1997). Even in the reform era of contemporary China, guanxi has been well documented as being an essential part of doing business in China (Ai, 2006; Xin & Pearce, 1996; Zhao, 2005).

Guanxi in Chinese society has been traditionally viewed as a cultural practice (Fei, 1992; King, 1991). But others have argued that guanxi can be explained in terms of the institutional environment presented by China’s transition to market-based economy (Guthrie, 1998; Peng & Heath, 1996; Lee & Ellis, 2000). As China continues with economic reform, guanxi might evolve and perform different roles with different strategic implications for firms in the changing institutional environment (Peng & Zhou, 2005; Wilson & Brennan, 2010).

Taking the perspective of Taiwanese firms invested in China, this study tries to explore the role and strategic implications of guanxi in Chinese market as the economic reform processes. Therefore, this study is designed to shed light on three research questions: (1) What is the guanxi-based business practice in China? (2) How China’s FDI policy evolves in economic reform? (3) How China’s economic reform affects the guanxi strategies of Taiwanese firms in China?
AN OVERVIEW OF GUANXI-BASED BUSINESS PRACTICES

Business perspective of guanxi

Guanxi literally means ‘relationship’ or ‘connection.’ The Chinese word ‘guanxi’ consists of ‘guan’ (gate) and ‘xi’ (connection). One must pass the gate to get connected to network. Guan originally meant a door, and its extended meaning is to ‘close up.’ Today guan is often used to mean a ‘pass’ in various sort of economic barrier. Xi meant to ‘tie up’ or ‘link’ and extended into ‘relationship’ or ‘system.’ Xi can also be used to refer to maintaining long term social or business relationships. Thus, the term ‘guanxi’ can be referred to the concept of drawing on connections in order to secure favors in personal relations. In other words, guanxi is an action taken the use of personal connections deliberately for a specific purpose such as political or economic benefits (Fan, 2002; Luo, 1997; Wang, 2007).

In the perspective of business practices, guanxi can be defined as the process of finding business solutions through personal connections (Fan, 2002). According to the parties involved, business guanxi can be classified into two categories: (1) B2B guanxi, if both parties are business persons, such as supplier-customer relationship; (2) B2G guanxi, if one party is a business person and the other a government official (Fan, 2002; Park & Luo, 2001).

Benefits of business guanxi

Guanxi is a valuable asset for its possessor and aids in creating economic value. It is a form of social capital, a resource that a firm can tap into when there is a need to find help. Based on guanxi network, in the view of B2B relationship, firms coordinate activities, pool resources, and pursue joint growth. These efforts help to overcome a firm’s problem of not having enough resources to accommodate growth. In the view of B2G relationship, guanxi is helpful in dealing with Chinese bureaucracy. It provides a solution to the cumbersome Chinese bureaucracy by giving firms a way to circumvent rules through the activation of personal relations (Luo, 1997, 2000).

In sum, the main benefits of business guanxi in China including: (1) It helps to obtain information on government policies, market trends, and business opportunities. (2) It helps to improve efficiency by reducing the transaction cost of uncertainty. (3) It helps to secure necessary resources (eg utilities, local supplies of labor and materials) and business opportunities (eg government licenses) against competitors (Davis, Leung, Luk, & Wong, 1995; Fan, 2002).

The effects of China’s economic reform on guanxi

After China’s reforms and opening-up since 1979, China has been undergoing unparalleled institutional transitions. Enterprise in China is widely acknowledged for its extensive use of guanxi management as adaptive strategy (Park & Luo, 2001; Ren, Au, & Birtch, 2009).

In the reform era, macro-environmental changes appear to be the overriding factor affecting business guanxi. As China continues to experience rapid legal and economic development, B2G guanxi seems to be the predominant form of business guanxi in China because B2G guanxi represents a way to bypass laws and regulations through personal connections with government officials and to obtain special treatment or scare resources (Fan, 2002; Wilson & Brennan, 2010).

THE GUANXI STRATEGIES OF TAIWANESE FIRMS IN CHINA

Taiwanese firm’s guanxi strategy before the 12th Five-year Plan

The amount of investment in China by Taiwanese firms has grown enormously since the mid of 1980s, encouraged by the abundance of cheap labor and raw materials, as well as the geographic and cultural proximitities.

In OEM (original equipment manufacturing) operations, the competitiveness of Taiwanese firms has been embedded in a production network comprising a large number of small firms. In the initial stage of foreign investment, Taiwanese firms have to keep a tight linkage to Taiwan’s production networks to maintain the competitive advantage in the target market (Chen & Ku, 2008). In addition, being a member of the Chinese Commonwealth, Taiwan has been deeply influenced by Confucian traditions. Taiwanese firms have the advantages in languages, culture, and guanxi base comparing to Western investors in China. So the target investment sites of Taiwanese firms were selected primarily in
China on the basis of the geographic and cultural proximities.

In the early stage, most of Taiwanese firms investing in China can be classified as ‘resource-seeking’ or ‘defensive’ FDI. Cost reduction to secure international competitiveness was the main motivations of these Taiwanese firms. The primary strategy of Taiwanese investors was to form effective relational linkages (B2B guanxi) with their international customers and with local suppliers in China to secure both the steady foreign customer’s order sheets and the flexible, low-cost supply of export goods. They relocated the production network from Taiwan to China. Each network comprised a large number of small firms located in one geographical area and operated as a cohesive entity with highly flexible and low-cost production (Chen & Ku, 2008; Ku, 2006).

In B2B guanxi practices, Taiwanese firms use guanxi ties to establish an integrated export-oriented commodity chains. A group of small and medium firms are joined together to produce commodities that has been ordered by a foreign customer.

Besides, in B2G guanxi practices, unlike the Western investors which mostly negotiate with the national central government, Taiwanese firms have had closer relationships with local Chinese officials. This is because local Chinese officials have demonstrated greater flexibility in their negotiation with Taiwanese investors and minimized bureaucratic holdups. With their newly-gained economic autonomy, the local Chinese officials became the important partners of Taiwanese firms investing in China (Hsing, 1997). Research on the economic reform of China near thirty years, Cheung (2008) stated that the local Chinese officials are world-class in convincing each and every investor that he or she is special. So, Cheung stated that he never met an investor who did not believe in exploiting special connections (B2G guanxi).

The evolution of China’s FDI policies

To utilize FDI as a driver of economic growth has been one of the basic reform policies of China. Prior to China’s entry to the World Trade Organization (WTO) in 2001, China’s main efforts to attract FDI included preferential tax treatment, cheap land and market opening policy. Since joining the WTO, China has shifted emphasis to indigenous development and the attraction of technology for domestic firm’s upgrading (Kao, 2007).

For many years, China has been known as ‘the factory of the world’ that exports a huge volume of labor-intensive cheap merchandise. But such a low-cost, labor-intensive and export-led growth model faces many challenges in the changing business environment such as the trends of rising wages and other costs of production in China, more and more trade disputes with other countries, as well as the squeezing of exporting enterprise’s profits that threatens their survival in the long term (Li & Song, 2011). The Chinese government recognizes the need to rebalance the country’s mode of economic growth and has implemented policy measures to this end.

In China’s 11th Five-year Plan period (2006-2010), China aimed to transform the country from a workshop of cheap exports into a manufacturer of homegrown global brands by emphasizing self innovation and technology development (Solt, 2007). In the newly ratified 12th Five-year Plan (2011-2015), China outlines the government’s commitment toward reforming its economy and increasing its domestic consumption to decrease its dependence on exports for future growth. Other initiatives include upgrading industry, promoting the service sector, balancing regional development, closing the income gap, and protecting the environment (Wen, 2011).

For future growth, the major priorities of China’s FDI policies include: (1) Upgrading technology to make China’s industries more competitive. (2) Focusing on the development of higher value-added manufacturing and moving away from low-cost, labor-intensive processing manufacturing to create and secure reasonable profit. (3) Stimulating domestic demand especially increasing domestic consumption to expand the scale of the domestic market for supporting the future growth.

Taiwanese firm’s guanxi strategy in the future

The above-mentioned changes of China’s FDI policies, in conjunction with rising wages and other production costs, would put downward pressure on the profit margins and restrain the growth of some Taiwanese firms in China. Especially, the 12th Five-year Plan likely to have a substantial and direct impact on Taiwanese firms currently engaged in export-oriented processing manufacturing.
Taiwanese investors should closely follow the policy trends and act cautiously to adjust their mode of FDI and operation strategies in adapting the institutional changes. Taiwanese investors shall change from a defensive, low-cost focus, and export-oriented FDI (i.e. resource-seeking FDI) to an actively competes and market expansion focus FDI in China’s local markets (i.e market seeking FDI) in response to China’s efforts in increasing its domestic consumption to decrease its dependence on exports for future growth.

On the operation strategies, for most small and medium Taiwanese firms, one of the important adjustments is to shift their prime business from low value-added, labor-intensive, and export-oriented processing manufacturing to higher value-added activities in the stages of value chain such as R&D or marketing. In another words, Taiwanese investors had better replace the past OEM operations with ODM (original design manufacturing) or OBM (own brand marketing) operations. Even for firms that are unable to develop their own brands, they also need to upgrade and replace the processing manufacturing with producing high value-added product or key components and parts.

From the business guanxi perspective, Taiwanese investors have to reconfigure the guanxi network in complying with their new mode of FDI and operation strategies. On the B2B guanxi, for engaged in market seeking FDI, the past strategy that emphasized on forming relational linkages with international customers and with local suppliers in China to secure foreign order sheets and the supply of export goods need to adjust and shift the focus on building relational linkages with local distributors and customers to explore market opportunities and conduct effective marketing.

Considering the far-reaching effects of the global financial crisis in 2008, Chinese government decides to continue to closely integrate government control with market forces (Wen, 2011). So on the B2G guanxi, Taiwanese investors had better continue to cultivate and maintain a proper relationship with local Chinese officials convenient for working out their cooperation protocol (Wu, 2001), obtaining information on government policies, and securing necessary resources (e.g. utilities, licenses).

CONCLUSION

There is a popular saying that “China is a land of guanxi...Nothing can be done without guanxi” (Tsang, 1998). Guanxi is part of the ‘stock knowledge’ of Chinese in their management of everyday life. It is used as a cultural strategy in mobilizing social resources for goal attainment (King, 1991). In the contemporary view of business practices, guanxi can be referred to the process of finding business solutions through personal connections (Fan, 2002). In the preceding pages, this study intended to describe and explain the guanxi-based business practice in China, China’s FDI policy evolves in economic reform, and how Taiwanese investors adjusted their guanxi strategies in complying with the environmental changes.

Although it has long been recognized that guanxi networks is a major dynamics in the Chinese business world. It is more appropriate to say that, in the modern intensive competitive era, guanxi only helps if you are competitive. In other words, guanxi networks would be a necessary, but not sufficient, condition for business success in China (Guthrie, 1998; Tsang, 1998).

Besides, guanxi networks cannot be viewed as a panacea in China. The effective utilization of guanxi networks depends on its fit with institutional environment and enterprise’s attributes (Park & Luo, 2001). As the role and implications of guanxi is changing in stride with the institutional transition in the era of reform, foreign investors conducting business in China had better contingently configure their business guanxi networks.

REFERENCES


