

# The role of *Guanxi* in supply management practices

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## Abstract

*Guanxi* has been identified as having an important influence on business behavior. This paper investigates the influence of *guanxi* on three elements of supply chain management: strategic purchasing, outsourcing, and supplier development. Survey data was collected from 175 companies in the electronics sector of Hong Kong. The results indicate that *guanxi* has a significant influence on these three supply management constructs. The managerial implications are examined from a relationship perspective and in terms of transaction cost economic theory. The failure to appropriately assess the impact of *guanxi*-based supply management practices can have a detrimental effect on organizations attempting to enter the Chinese market.

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## 1. Introduction

With the economic ascendancy of China, much has been made of its future economic prospects. The movement to a market economy and high growth rates has encouraged significant foreign investment. Many investors were drawn initially by the attraction of China as a low-cost manufacturing base and more recently as a market for consumer and industrial goods in its own right. One of the main concerns facing investors is the lack of a stable legal and regulatory system and the need to

rely on trust-based personal relationships as a means of obtaining resources (Fan, 2002).

In the literature, China is often described as being a relational society, where concepts such as *guanxi* (relationships or connections) have a major influence on both social and business norms (Tseng et al., 1995). *Guanxi*, in many respects, is analogous to the concept of supply management, involving mutual obligations, assurance and understanding, a long-term perspective and cooperative behavior (Arias, 1998).

However, foreign investors often experience highly transactional behavior, with the focus being on the short-term and the immediate benefits emanating from it, which seem to dominate business dealings (Styles et al., 2000). Thus, within the Chinese business context there is this ambiguity between elements of the long-term business relationship and the short-term transaction.

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It is therefore important for foreign investors to understand the implications of *guanxi*. The development of an effective *guanxi* network has an important role in helping to gain a commercial foothold. Foreign investors most often establish business linkages through a joint venture or wholly owned subsidiary. Under either option, they must be able to gain access to the appropriate *guanxi* webs, through their Chinese partners, in order to facilitate quick acceptance of the investor.

In regard to supply management, while suppliers have been widely considered as one of the effective sources of competitive advantage in the past decade (e.g., McCutcheon and Stuart, 2000; Dyer and Ouchi, 1993), a number of studies have estimated the failure rate of adopting closer or partnering inter-firm relationships to be around 30–50% (Anderson and Jap, 2005). This implies that a firm's decision to adopt supply management practices must proceed with extreme caution. Consequently, considering the wide prevalence of *guanxi* culture in China, a study investigating how *guanxi* impacts on the adoption of supply management should offer useful insights to managers. Nonetheless, studies exploring the association between *guanxi* and supply management are limited in the literature.

This paper investigates the relationship between *guanxi* and supply management practices. It is divided into a number of sections. Firstly, the literature is presented with the term *guanxi* being defined and its linkages to supply management practices. Secondly, a conceptual framework is developed and a number of hypotheses are proposed linking strategic purchasing, outsourcing, and supplier development to the *guanxi* concept. The study concludes with the need for organizations to take into consideration both a short- and long-term orientation in developing supply chain relationships with firms in China.

## 2. Conceptual background

### 2.1. Defining Guanxi

Together with other East Asian countries such as Japan and Korea, the culture of China is deeply affected by Confucianism. With a history of more than 2500 years, Confucianism has exerted a fundamental influence on the Chinese and East Asian modes of thinking and ways of behaving. One of the key values of Confucianism is its strong emphasis on inter-personal relationships and

conducts (Ghauri and Fang, 2001). Confucianism suggests that human relationships are dictated by the five cardinal relationships (Wulun), which is, the relationships between the ruler and subject, father and son, spouse and spouse, elder and younger brothers, and senior and junior friends. This social philosophy encourages the development of social harmony, order and stability by appropriate behaviours—the seniors must be loving and benevolent to gain the respect and loyalty from the juniors, and vice versa. *Guanxi* (the Chinese term for relationships, connections, or contacts) which stems from the strong emphasis on personal relationships, has been suggested as relationships or social connections based on mutual interests and benefits (Yang, 1994).

*Guanxi* is deeply embedded in the mindset of Chinese and in every aspect of their personal and organizational interactions (Park and Luo, 2001). In the Chinese business world, it is also understood as a special form of relationship that ties the business partners by reciprocal exchanges of favors and obligations regularly and voluntarily (Alston, 1989; Luo, 1997). Within the literature of management, the performance impact of *guanxi* in Chinese business environments has been well documented (e.g., Park and Luo, 2001; Tsang, 1998; Yeung and Tung, 1996). Hence, although *guanxi* is in general considered as an important element of the national culture of China, it can also become an asset and a corporate culture at the firm level as personal relationships are dedicated to and used by the firm. In this study, we focus on firm-level *guanxi* which emphasizes the use of personal relationships in facilitating operations or problem solving in business transactions. More specifically, we define *guanxi* as a corporate culture that has a strong emphasis on the relationships between business partners for achieving mutual benefits and involves the use of personal and/or inter-firm connections to secure favors in the long run.

*Guanxi* is important in a Chinese business context in that when a situation arises which is beyond an organization's or individual's capacity, the *guanxi* network could be called upon to achieve the desired results (Redding and Ng, 1982). In the literature, an empirical study conducted by Davies et al. (1995) suggests that there are three major benefits resulting from the establishment of *guanxi*. First, when the information on domestic markets is limited for foreign investors, the *guanxi* network may be an important source of information on market trends

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