



Promise keeping, relational closeness, and identifiability: An experimental investigation in China



C. Bram Cadsby^{a,*}, Ninghua Du^b, Fei Song^c, Lan Yao^d

^a University of Guelph, Department of Economics and Finance, 50 Stone Road East, Guelph, ON N1G 2W1, Canada

^b Key Laboratory of Mathematical Economics and School of Economics, Shanghai University of Finance and Economics, Shanghai 200433, PR China

^c Ted Rogers School of Management, Ryerson University, Toronto, ON M5G 2C5, Canada

^d School of Economics, Shanghai University of Finance and Economics, Shanghai 200433, PR China

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ABSTRACT

We experimentally investigate some key features of internet peer-to-peer (P2P) lending: the borrower specifies the amount of money required and makes a contingent promise about the value of the generally higher repayment prior to the investor's decision to lend the required sum or not. We examine the role played by two factors related to traditional Chinese culture and ethics: whether (i) *guanxi*, relational closeness between the actors and (ii) the ability of the actors to observe each other's identity after the repayment decision (identifiability or *mianzi* concerns) affect the borrowers' decisions to make the promised repayments and ultimately the consequent aggregate realized social benefits. Using a two-by-two factorial design, we conduct four experimental treatments in China and also perform the identifiability treatment in New Zealand as a cultural control. We find that in China both manipulations were positively and significantly related to the probability of a repayment promise being kept. Moreover, these two factors were substitutes for each other. In New Zealand, there was no significant identifiability effect on promise keeping. Over time, relational closeness and identifiability both led investors in China to accept more proposals, resulting in more investment and the creation of greater social surplus.

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1. Introduction

Many small firms have no or limited access to formal financial services. A recent report from *CreditEase* shows that only 30% of small firms in China apply for bank loans, and of those only 15% actually get the loans (*CreditEase*, 2011). Thus, informal networks such as internet peer-to-peer (P2P) lending have become important providers of credit in the past decade.¹ As reported by *Chinanews*, there were more than 500 microfinance websites and more than 25

billion RMB worth of internet loans in mainland China by the end of June 2013 (*Chinanews*, 2013). The standard internet lending procedure is as follows. A small firm (or an individual borrower) briefly describes the project on the web and specifies the amount of money required, the promised interest rate, as well as the date of repayment. After examining the information, private investors and/or lenders (we will use the terminology investors throughout the paper) decide whether to invest in the project. In theory, a borrower's promise to repay a loan can be enforced by formal contracts and sanctioning systems. In practice, however, imperfect monitoring, information asymmetries, moral hazard, and transaction costs often make the enforcement of binding contracts infeasible or prohibitively costly. According to *Chinanews*, several microfinance websites have gone bankrupt since a substantial proportion of borrowers did not repay as promised (*Chinanews*, 2013). For example, *allwingsz.cn* registered in April 2013 went bankrupt in August 2013 with 100 million RMB in bad debts. Both financing from private investors and the honoring of promises to repay those investors are essential to realize potential gains: without investment beneficial social exchanges could

* Corresponding author. Tel.: +1 5198216569; fax: +1 5197638497.

E-mail addresses: bcadsby@uoguelph.ca, bcadsby@yahoo.com (C.B. Cadsby), ninghua.du@mail.shufe.edu.cn (N. Du), fsong@ryerson.ca (F. Song), yao.lan@mail.shufe.edu.cn (L. Yao).

¹ Examples of P2P lending websites in China include lufax.com, renrendai.com and yirendai.com. The leading P2P website in the UK is www.zopa.co.uk, while in the US, www.lendingclub.com provides a P2P lending service. In September 2014, www.harmony.com became the first P2P lending site in New Zealand. Grameen Bank in Bangladesh and Kiva.org worldwide provide microfinancing platforms with a charitable orientation.

not begin and without the promised repayments they would not continue.

The ethic of “promise keeping” has generally been regarded as one of the most important ethical norms governing behavior in business practice (e.g., Oakley and Lynch, 2000 and the literature review contained therein). Gert (1998) identified promise keeping as one of the 10 universal moral rules spanning all societies. However, a recent empirical investigation using US participants and a rating scenario suggests that keeping promises is actually not a high priority in a business context (Oakley and Lynch, 2000). Oakley and Lynch (2000) did find that promise keeping was enhanced when participants were told that the promise was legally enforceable. They also examined whether or not there was a link between promise keeping and a number of demographic factors i.e., age, gender, religious beliefs, and supervisory experience. Only age proved to be significant with younger people placing a higher priority on keeping a promise.

In this paper we study two interpersonal, relational factors that potentially affect whether or not borrowers honor promises to meet their debt obligations in China. First, social ties are particularly salient in Chinese society. Moreover, in a traditionally collective society such as China the obligation of reciprocity permeates many facets of life, and is closely intertwined with the social ties or relational closeness between people involved in a transaction (e.g., Song, Cadsby and Bi, 2012). Keeping a promise to repay borrowed money with either interest or a share of profits is an example of such a reciprocity obligation. Thus China is an ideal setting in which to examine the influence of relational closeness on the role played by unenforceable contingent promises to repay borrowed funds on surplus-creating economic transactions. We ground our research in the indigenous Chinese folk psychology of *guanxi*. The term *guanxi* literally means relationship, and refers to particularistic ties rooted in a common background and experiences that facilitate exchange (Tsui and Farh, 1997).

Second, *mianzi* (face) is also a salient feature of Chinese society. In Chinese culture a person's reputation and social standing rest on maintaining or gaining *mianzi*, which is somewhat associated with the Western concepts of dignity, respect and social image concerns (e.g. Shutte and Thoma, 2014). According to Qi (2011), *mianzi* defines one's place in his/her social network. Maintaining or gaining *mianzi* requires one's actions to be observed by others. Given that keeping/breaking a promise is universally a desirable/undesirable act, we anticipate that the extent to which one's decision is observable or identifiable as coming from a particular person will have a positive effect on the likelihood of a promise being kept.

A key methodological challenge in investigating promise-keeping behavior is the difficulty of obtaining reliable data in a naturally occurring environment. While there are published figures on the general incidence of financial fraud and other business misconduct, which may be related to the breaching of promises, the reliability of these figures is questionable because of the unwillingness to report and the difficulty of uncovering such offenses. Moreover, such aggregate data provide little information on the circumstances that led to such misconduct. Currently, much of the research on business ethics relies heavily on self-reports based on the questionnaire survey methodology. This raises a number of important methodological concerns such as social-desirability and self-presentation bias, selection issues related to participation and response rates, and memory/cognitive issues. A laboratory environment, while unable to eliminate all of these problems, offers several unique methodological advantages, all related to exerting control over the decision-making/behavioral environment. First, by holding constant factors that might affect variables of interest, we effectively minimize the influence of such confounding factors that can be extremely difficult to isolate in the field. Second, we place participants in a real economic/social situation with the adoption of salient financial incentives and social cues in order to simultaneously establish both inter-

nal validity of the experiment and the generalizability of the experimental results.

In this study we investigate experimentally a new variant of the trust/investment game (Berg, Dickhaut and McCabe, 1995) that captures the key features of internet P2P lending: the borrower proposes the amount of money needed and promises repayment prior to the investor's binary decision to invest or not. In our experiment, we set up a two-by-two design to examine whether the level of relational closeness (with a classmate versus non-classmate manipulation) and post-decision identifiability (with an identifiable player vs. an anonymous player manipulation) affect the terms of the proposal made by the potential borrower, the borrower's decision to make the promised repayments, the investor's decision to accept the borrower's proposal, and the consequent realized aggregate social benefits. We conducted all four treatments at Zhejiang University in Hangzhou, China. We find that in our Chinese data there are both significant relational-closeness and post-decision identifiability effects, and that these two experimental factors are substitutes for each other: people keep promises in transactions with an anonymous classmate, and they keep promises to a non-classmate whose identity they will learn and who will also learn their identity. However, contrary to our expectations, when people interact with a classmate whose identity they will learn and who will also learn their identity, the level of promise keeping, though higher, is not significantly different from either the anonymous-classmate or the identifiable-non-classmate treatment.

We also conducted the two treatments, manipulating identifiability versus anonymity, at the University of Canterbury in Christchurch, New Zealand, to explore whether culture moderates the identifiability effect on promise keeping. We chose our New Zealand site as a cultural comparison because New Zealand is an English-speaking country with a British heritage. Hofstede (1991) used a questionnaire methodology and factor analysis to argue that such countries possess highly individualistic cultures and attitudes compared to East Asian countries like China that are relatively collectivistic. Moreover, Hofstede (1991) identified another cultural dimension known as Confucian dynamism. According to Hofstede (1991), Confucian dynamism is associated with a long-term orientation, and reflects the impact of core Confucian values such as “protecting your face” and “reciprocation of greetings, favors and gifts.” While China is ranked first among all countries in Confucian Dynamism, New Zealand is ranked 35th (Hofstede 1991, p. 166). Moreover, English-speaking subjects in Canada, a country with a similar heritage and culture to New Zealand, have demonstrated less sensitivity to identifiability concerns than Chinese subjects in the context of a voluntary-contributions (VCM) game (Kachelmeier and Shehata, 1997).

We find that in contrast to China, there is no significant identifiability effect on the proportion of promises kept in New Zealand. Unfortunately, we could not run parallel classmate versus non-classmate sessions in New Zealand to act as a cultural control for relational closeness. This is because classes are organized differently in China than in New Zealand. In many Chinese universities, classmates take almost all of their courses together, and often live together in the same room or adjacent rooms within the same dorm. This was true at Zhejiang University, the site of the experiment in China. Being classmates is a basis for *guanxi* or relational closeness (Jacobs, 1979), or more specifically *shouren guanxi*, a particularly close category of *guanxi* that also includes relatives other than immediate family, friends, teachers, neighbors, and co-workers (Su and Littlefield, 2001, p. 202). Although two unacquainted students from different classes might share some *guanxi* by virtue of attending the same university, the level of such relational closeness would be considerably lower than between two classmates (Jacobs, 1979). In particular, their relationship would be in the more distant *guanxi* category of *shengren guanxi* (Su and Littlefield, 2001), comparable to employees in the same large company. Since there is no analogous

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