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The Ethical Challenges of Corporate Governance in the Chinese Context: The *Guanxi* Perspective

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Abstract:

As China increasingly integrates with the world economy, business ethics becomes a focal research topic. Researchers started paying attention to the correlation between ethics and guanxi, which is often regarded as a special business relationship in the Chinese context that often leads to insider-based actions. This paper reviews the competing concepts on guanxi, its roles and challenges in the Chinese corporate governance, and its dynamics with Confucianism. Specifically, this paper argues that the Confucian values of a virtuous and benevolent mind in guanxi have been neglected. This sunny side of guanxi, apart from mere reliance on hard rules and laws, should help enhance the Chinese corporate governance. In addition, ethics education if consolidated well in management training can help mitigate the dark side of guanxi. It is believed that Chinese influences on corporate governance norms will spread and prevail in the future.

Keywords: China, Confucianism, corporate governance, directors, ethics, guanxi, relationalism

1. Introduction

Business ethics becomes a controversial research topic as China got closer to the global platform, denoted by her accession to the World Trade Organization (WTO) in 2001. Investors and researchers, local or foreign, become more concerned about the correlation between business ethics and corporate governance in the Chinese context (Ho & Redfern, 2010). Apart from this increased opening of the China economy, the wider impacts of the Asian and global financial crises over the last decade, the increasing demands for integrating with the various developed world dominated professions, and the rising concerns over proper legal business relationship are alleged to be the major reasons behind the increasing awareness of business ethics in China.

Drawing on the updated research in the said area, this paper aims to review the dynamics of the Chinese-specific business ethics, particularly '*guanxi*', and their relevance to Confucianism and other schools of thoughts, as well as their implications on the Chinese corporate governance. By examining different applicable models, practical insights and appropriate strategies are developed on how business ethics can be strengthened to enhance China's corporate governance.

2. Background

Owing to increasing liberalization of capital markets, the China economy becomes more and more vulnerable to the influences of global financial deregulation and corporate scams and frauds like 'Enron', 'WorldCom', 'Lehman Brothers', and 'AIA' over the last decade or so. While both regulators and enterprises are facing increasing pressures to espouse sound corporate governance practices (Davis & Marquis, 2005; Essen, Oosterhout, Pursey, & Heugens, 2013; Yoshikawa & Rasheed, 2009), China is no exception. It is not unusual for researchers and business investors to falter in their move as the special features of Chinese business networking as well as its implications on business operation and the corporate governance level are yet to be explored and researched into (Low & Ang, 2013; Szeto, Wright, & Cheng, 2006).

Against this backdrop, there is rising research attention in recent years for incorporating the Chinese cultural perspectives and insights into the dynamics of business ethics and corporate governance. For instance, Low and Ang (2013) have tried to link Confucian ethics with the stakeholder theory in support of more proactive business leadership style for enhancing the Chinese corporate governance level. Importantly, Miles and Goo (2013) argue that "Confucianism has much to offer in enhancing director conduct and corporate governance standards" (p.23). Other related research in recent years includes implications of *guanxi* in business decision making (e.g. Fu, Tsui, & Dess, 2006) and employee commitment (e.g. Wong & Wong, 2013), and on the concept of '*guanxi* gateway' in Chinese-Western business relationship (e.g. Gao, Knight, & Ballantyne, 2012).

Following a methodology of meta-review on prevalent literature and studies on business ethics and corporate governance, the ensuing sections look deeper into the dynamics of the Chinese-specific business ethics (importantly "*guanxi*") and their implications on the Chinese corporate governance.

3. Conceptualizing the Ethical Challenges

3.1. A Glance at *guanxi*

Reflecting the plethora and richness of Chinese words, the complexity and difficulty in offering definitions to *guanxi* always challenge scholars and researchers.

Guanxi is a Chinese term, refers to the relationship between two or more individuals. The concept of *guanxi* seems quite easy to understand, however it is very complex to explain (Chen & Layton, 2003). People have different interpretations when the perspective and level change (Chen, Chen, & Xin, 2004), and there is no single definition appropriate for all situations. Fan (2002b) summarizes the roles of *guanxi* in business in eight aspects, known as connection, exchange, friendship, network, particularistic ties, process, resource and relationship. Bell (2000) understands *guanxi* as a mechanism for individuals to achieve his/ her personal, family or business objectives.

In another direction, echoed by Chen et al. (2004), Wong and Chan (1999) consider *guanxi* being a peculiar type of relationship between two or more parties, where it contains favour, inter-dependence and trust. It is believed to be leading to certain insider-based advantages or favoured business decision in the industrial environment. Wilpert and Scharpf (1990) observe that this relationship can be further developed into different kinds of social networks. Be them formal or informal, they are regulated by some kind of unwritten norms around the core of reciprocity. To members inside such networks, *guanxi* becomes a powerful tool for concrete interests like high business performance and efficiency. In the worst case, it will cross the line of legality. Since *guanxi* is being groomed within some kind of intra-network obligations by reciprocity, it is nearly impossible to reject it among insiders or inside circles. In business sense, *guanxi* can also be translated as a competitive strategy for performance (Li, Poppo, & Zhou, 2008; Li & Zhang, 2007).

3.2. The Categorization of *Guanxi*

As studies on *guanxi* draw across diverse disciplines like business administration, cross-cultural management, economics, law, psychology, etc., it is hard to derive a universally applicable typology for analysis. That said, Chen, Chen, and Huang (2013) suggest three main streams of analysis with which the literature on *guanxi* can be classified. They are the individual/interpersonal stream, the organizational stream and the social moral stream. A similar classification is adopted by Wong and Wong (2013). The individual level of *guanxi* includes the relationship based on blood ties, marriage, family and clan members (Su & Littlefield, 2001). There are three types of *guanxi* bases, including 1) common social identities; 2) that anchored in specific social institutions with clear social or even physical boundaries; and 3) common third party (Chen and Chen, 2004). Under the individual/interpersonal stream, the ties or networks formed by individuals are developed mainly for attaining personal benefits and favours like career advancement and better workplace rewards (e.g. Xiao & Tsui, 2007). Such favours may not be readily transferrable to the organizational level (Van Buren & Leana, 2000).

For the organizational stream, it explores intra-entity, inter-entity and entity-to-government *guanxi* and has a focus on resulting financial outcomes (e.g., Luo, 2003). Organizational *guanxi* can be understood as business *guanxi* which uses personal connections to find out business solutions (Fan, 2002a). Dunfee and Warren (2001) argue that the *guanxi* practices at this level would easily lead to the corrosive aspects when they bring unjustified benefits to a few at the expense of the society at large. Provis (2008) emphasizes on their potential threats to the public ethics and to the rule of law rather than merely a matter of fairness. Following Provis' (2008) argument, Lin and Si (2010) consider that the peculiar *guanxi* features in the Chinese business context were formed due not only to the scarcity of economic resource but also to cultural uniqueness. While market fragmentation would result, state intervention bringing in tightened legal controls appears inevitable for healthy economic growth in China.

Taking the organizational aspect further, *guanxi* is always viewed as a form of relationship marketing in China as both of them are about relationships (Geddie, DeFranco, & Geddie, 2005). However, Lam and Lin (2003) argue that *guanxi* is the Chinese system of doing business by using personal relationship, which is different from what is expected in the Western world. In other words, the practices of *guanxi* are different from the relationship marketing in the West. Geddie, DeFranco, and Geddie (2002) compare the concepts of *guanxi* and relationship marketing in their study. The authors state that both systems are cycles, but there are three differences between the two concepts. In *guanxi*, 1) relationship is built before having transaction; 2) the company and the customer adapt to each other and 3) they are one cooperative unit. However, in relationship marketing, 1) the relation builds on "satisfactory transactions"; 2) a company often helps customers to adapt to it by providing product knowledge and supports, in order to maximize its own benefit; and 3) the customer is more likely treated as a subset of the company.

Normally, individual *guanxi* is stronger, more stable and longer lasting than organizational *guanxi*.

In either case, however, if people want to build up *guanxi* with others, they need to pay attention to *mianzi*. *Mianzi* is a Chinese term which means "face", people should give *mianzi* to others and must not cause them lose face. Otherwise, the *guanxi* between individuals could be damaged (Smith, 2012). Other than that, *xinyong* (trust) is also the key of building up *guanxi*, especially when doing business. Failure of reciprocation may ultimately destroy the *guanxi*.

3.3. Relationalism – the Confucian Perspective

The third stream in examining *guanxi* can be better captured under the Confucian perspective of 'relationalism', which refers to the specific social moral system in society (Chen et al., 2013; Dunfee & Warren, 2001). Confucianism emphasizes on personal relationships, loyalty, harmony, social order and authority. It shapes the cultural values of Chinese people and underlies the development of the Chinese society. Confucianism emphasizes on *Wu Lun*, the "Five Cardinal Relationships", i.e. relationship (a)

between ruler and subject, (b) between father and son, (c) between husband and wife, (d) between brothers, and (e) between friends. These five cardinal relationships therefore focus on the structuring of relationships based on ethical stance between people (Du, 2015). Scholars further believe that *guanxi* is deeply tied into the Confucian heritage (Yeung & Tung, 1996). It affects the interactions between people in China. The Confucian relationalism is humane as it attaches high importance to personal relationship, which is considered as the basic unit in the Chinese society (Hwang, 2009, Su & Littlefield, 2001). The underlying commitment and dedication, however, vary across different personal relationships according to the extent of “closeness” between parties. There are different levels of *guanxi*, starting from the centre of the circles, “the ego”, followed by family members, acquaintances and strangers. The importance of *guanxi* declines according to the distance from the centre (“the ego”) – closer to the centre, more important the *guanxi*. People need to think about the interests of different *guanxi* party when making decisions. They cannot offend the people who are in the inner circles. Otherwise troubles could result in daily life or in business. In the 18th century, people must sell their land to the one who lived in the same village first (Pomeranz, 2000). This shows that *guanxi* could affect the choices of people seriously. Su and Littlefield (2001) attribute the favoured exchanges between close family members and friends in the Chinese society to the impact of Confucian relationalism. By further capitalizing on the personal relationships in management, the business boundaries from the family or close-friend relationships will be blurred (Chen and Chen, 2009; Chen et al., 2013). This should also explain the phenomenon of an excessively large number of dominating family-owned businesses in Chinese communities that renders structured corporate governance not readily embedded in the management hierarchy. That said, Wank (2002) contends that *guanxi* in Chinese communities is performing a lubricating role in building up social capital which Putnam (2004) regards as the “collective value of all ‘social networks’ and the inclinations that arise from these networks to do things for each other” (p.15). *Guanxi* is therefore believed to be a kind of cornerstone for business activities. This line of interpretations is consistent with Fukuyama’s (1996) argument that social capital built up from networking is the foundation for economic success of a country or its continuous growth.

In other words, people who belong to the same “imagined community”, or social capital, would have advantages. One of the best examples is among the Chaozhou entrepreneurs. This ethnic group have been migrants historically, especially to South East Asia and Hong Kong. In the culture of Chaozhou, people emphasize on the concept of “ga ki nang”, in English “one of us”. When they go to a new market, they are more willing to cooperate with the people who are from the same home province of Chaozhou. Owning shares in different Chaozhou enterprises is the norm of Chaozhou entrepreneurs. This business *guanxi* can create economies of scale as they monopolize different industries, and make more money by lowering costs and restricting new market entrants. Finally, a solid business network is formed with Chaozhou entrepreneurs as the winners.

3.4. Correlation with Business Ethics

Ethics is the value, general principles or rules regulating what is correct or incorrect, what ends the common people should go for, and what movements they are expected to take (e.g. Buchholz & Rosenthal, 1998; Low & Ang, 2013; Szeto et al., 2006). Viewing business ethics as a division of the discipline under ethics, one may regard business ethics as the conventionally accepted standards and rules guiding the business behaviour.

Guanxi, as a form relational business practice, plays an important role in the Chinese business world. People need to build up *guanxi* before doing business. Thus, *guanxi* (being in place among contracting or involved parties) underlying a particular business action is therefore a topical study area of business ethics. However, it is a situational and contextual decision by stakeholders whether a particular act in business dealings is ethical or unethical, correct or incorrect (Szeto et al., 2006). The stakeholders comprise shareholders, directors, management, workers, suppliers, customers, regulators, competitors and concern groups, etc. The impact of *guanxi* can either be favourable or unfavourable in influencing the acceptance or rejection by stakeholders collectively or by community at large on the particular business action under consideration. Many Western researchers remain sceptical about the dynamics of *guanxi* in the Chinese context as conventionally it is regarded as connecting to an unethical process (e.g. Chen & Chen, 2013; Su & Littlefield, 2001), like corruption (Snell, 1999; Szeto et al., 2006). They view *guanxi* as a corrupt and “backdoor” practice (*zouhoumen*) (Guthrie, 1998) to obtain privileged treatment. Because of the differences in the cultural background, many Chinese people may perceive effective *guanxi* in business dealings as the only means for carrying on business in places where the legal infrastructure is immature (e.g. Chen & Chen, 2013; Ho & Redfern, 2010; Wong & Chan, 1999). For instance, many would believe that if they have a close bond with native customs officials, they would receive faster-than-normal customs clearance for speedy conveyance of goods or materials, or even a lower payable amount of customs duty. Some scholars even argue that *guanxi* is inevitable when doing business in China and it is the key to success (Abramson & Ai, 1999). As this is the social norm, everyone is doing this, it is ethical.

The role of *guanxi* in Chinese business has been diminishing since China entered the world market in the late ‘90s as rising foreign investment encourages the change of business norms (Dunfee & Warren, 2001) in China. China has to follow the Western practices and adopt their legal concepts and procedures. Although this is the new trend, *guanxi* remains an indispensable factor in Chinese business.

4. The People’s Republic and Corporate Governance

4.1. The Nature of Corporate Governance

Like business ethics discussed above, governance can be contextually based. The root and development of a country’s culture, history, law, and conventional practices have collectively affected how governance progresses. Although the idea of governance is ancient, there is no single or universally accepted definition when one refers to ‘corporate governance’ (Tricker, 2009). The

Organization for Economic Co-operation and Development (OECD) defines for its member countries that corporate governance “involves a set of relationships between a company’s management, its board, its shareholders and other stakeholders” (OECD, 2004). Cheng (2002) contends that corporate governance also refers to the process how the entity is managed, how the managers are governed, how the concerns are addressed by the board of directors, and how their accountability is reported to shareholders. In addition, corporate governance can be viewed as the control system adopted by the entity for efficient, effective and economical running of its activities whilst protecting the legitimate interests of all stakeholders (Cheng, 2002; Hermalin & Weisbach, 2012). To enrich further the definition of corporate governance for the sake of completeness, the term should cover the operation of the underpinning legal regulatory framework, e.g. prevailing company and securities law, listing rules, directors’ fiduciary duties, and codes on best governance practices, etc. Industrial practices and self-regulatory measures as adopted by professional bodies of lawyers, accountants, and chartered secretaries also have an important role to play in shaping working definitions.

4.2. *Setting the Scene for Corporate Governance in China*

China opened the state’s doors to the outside world from the late 1970s. Deng Xiao Peng’s ‘Four Modernization Policy’ released the productivity of farmers through market incentives and also allowed the growth of various forms of enterprises. The biggest reform came with the changes in political infrastructure for accepting a market economy with ‘socialist’ flavour. Private participation in business operations began to be formalized. Between 1984 and 1993, a transitional governance model was adopted for the state owned enterprises (SOEs) which had previously been heavily subsidized by the banks by allowing them more operational autonomy to improve productivity and profitability (Huchet & Richet, 1999). In December 1990, the Shanghai Stock Exchange and the Shenzhen Stock Exchange were officially established. Following the conclusion of the 15th Communist Party Congress, a set of corporate governance directives was introduced in 1997. They included the adoption of a clearer legal framework for property (including intellectual property) rights, a transparent guide on the establishment and orderly exit of commercial companies, a more predictable level playing platform for competition, an initial dispute resolution mechanism for promoting investors’ confidence, and a focus on fighting economic crime and corruption (Paverelli, 2006). Accompanied by the establishment of the State-Owned Assets Supervision and Administration Commission (SASAC) in 2002, another bold move by the Chinese government was to turn a large number of SOEs into listed companies. By listing them in Hong Kong, London, and New York, the Chinese authority effectively transferred control to the market from the state. Importantly, it allows the firms to enter the global arena for better corporate governance by referring to a spectrum of governance practices with reference to the Anglo-American model, e.g. fiduciary duties borne by directors, appointment of independent directors, minority shareholder protection, etc. (Miles & Goo, 2013).

4.3. *Integrating with the Globe*

Ever since the opening up of the Chinese economy in late 1970s, various kinds of new private business ownerships have emerged. They include ‘town and village enterprise’, ‘individually-owned enterprise’, ‘conglomerate’ (or ‘*jituan*’ spinning-off from SOEs), ‘limited company’, and ‘foreign-invested enterprise’, etc. The actualities of immense reforms in the Chinese economy came alongside her accession to the WTO in 2001 (Szeto *et al.*, 2006). Consequently, China’s trading partners expressed repeated and incessant concern on the protection of rights and the regulated trading environment in support of the rule of law. Such developments, obviously not appreciated by the Chinese authorities, turned into an ongoing debate across the Pacific. To mend the trade relations especially with the European countries and the North American partners, the Chinese authorities launched a series of legal reforms on different industrial sectors. Naturally, these reforms touched not only on the trading areas, but also corporate management areas like enhancing business ethics through legal requirements, e.g. more stringent legal protection on intellectual property rights. With these developments, understanding the business practices of Chinese executives and their perceptions on various ethical and moral issues, e.g. influences of *guanxi*, had become more and more necessary; not just for scholars but also for ‘foreign’ businessmen and professionals, particularly lawyers and accountants who conduct businesses with or in China (Ho & Redfern, 2010). Results of research can help explore the ways of practising *guanxi* in the Chinese context versus their ethical principles at home. In turn, the cultural interactions bring about positive impact on China’s integration with the global community at the corporate governance front. With an overflow of speculative money into companies amid domestic investors’ chasing for quick returns, China stock markets experienced bull runs in the run up to 2007. Fearing price bubble bursts, domestic investors started to realize that listed companies could be overvalued at different junctures. Demands for better corporate governance surfaced as domestic investors came to believe that proper governance of listed companies would protect and enhance corporate valuations. The appeal for good corporate governance also came from institutional and international investors. Attracted by the strong prospect of economic growth and vast market opportunities with potentially lower political risks, international investors began to make sizeable investments in China from late 1990s onwards. Alongside other countries in the emerging markets such as South Korea, India, Indonesia, and Vietnam, China has become an ‘investment darling’ of the Western investment community including large equity funds and pension funds. For instance, Warren Buffet invested in PetroChina a decade ago when Carlye Group (a large private equity), followed by Blackstone, also looked for promising investable companies in China. As a result, the foreign investors’ call for a higher level of legitimate protection for their investments sided with that of the more sophisticated domestic investors. Specifically, they requested the institutionalization of explicit elements of good corporate practices like higher levels of transparency in decision-making, the disclosure of financial information and risk management, and a clearer segregation of management from ownership, etc. To satisfy both old and new money, these governance practices were aimed to be on par with the prevailing international standards.

4.4. Moves for Further Integration

In 2001, with China's accession to the WTO, i.e. the battlefield of the world's markets, came direct competition with minimal constraints from usually more efficient foreign counterparts in the Chinese market. The Chinese government realized the urgent need to deal with the problems of the domestic markets, including counterfeits, corruption, poor corporate governance, and bureaucracy. At the turn of the 21st century, researchers already believed that an increasing number of Chinese professionals had been criticizing the ethical environment of Chinese companies for not progressing in line with the world's pace, though there was little support to nurture reforms (Szeto et al., 2006; Wu, 1999). In response, the China Securities Regulatory Commission (CSRC), which was formed in 1992 by the Chinese government, released the Code of Corporate Governance for Listed Companies in January 2002. The Code detailed the legal relationships between directors and shareholders, management and executives, and the role of trustees. It also set out the binding disclosures requirements on company performance and the state of corporate governance. As in other developing countries, the need to enhance the company laws is a continual process in China. The *Company Law* and *Securities Law* of 1999 became obsolete upon the stipulation of the new laws that became effective on 1 January 2006. The new laws made crucial modifications on simplifying the procedures for forming companies, improving the management structure of listed companies, increasing the liabilities of directors and supervisors, and imposing new responsibilities on securities brokers. Such convergent moves with the world's standards are continuous with the launch of the Sessional Meetings on economic affairs by the Standing Committee of the National People's Congress.

The need for convergence does not arise merely at the legal front. With the accompanying philosophical encounters in doing businesses, the accounting profession is believed to be one of the typical professions first noticing the likely clash between business ethics and *guanxi* in China. Being at the forefront position in checking and reporting financial performance of enterprises, the accounting profession looks for earlier integration with the worldwide standards (Szeto et al., 2006). It is particularly so when many SOEs are now listed overseas in developed markets like Hong Kong, London, and New York. Back to early 1990s, the Chinese Institute of Certified Public Accountants (CICPA) began revising the financial reporting system to incorporate modernized practices that were adopted by the Western world, e.g. mark-to-market valuation, etc. There are also re-organizations on tougher professional appraisal in respect of a company's internal controls, including the reliance of several computer-aided techniques in auditing. Advancing external auditors' skills is a new topical area taken up by the CICPA recently.

Another driving force for the global integration of corporate governance in China is the 'market-push' in business development. Over the recent two decades, there has been a rising business focus on customer relationship management (CRM) to achieve stable growth in business. A recognized strategy is that the more sophisticated the CRM framework it is, the more likely that the company develops competitive advantages. This will lead to the capitalization of profits in the long run. Lovett, Simmons, & Kali (1999) argue that the rising focus on CRM among the developed countries is due no less to the emergent role of research on *guanxi* management. Many scholars believe that the discipline of business ethics will continue to grow in China and the management of *guanxi* draws more attention, especially among new candidates entering the market (e.g. Chen et al., 2013; Dunfee & Warren, 2001; Ho & Redfern, 2010).

5. Dynamics of *guanxi*

5.1. *Guanxi* in Operation

Business enterprises exist to seek profit. They have no obligation to fight prejudice. Other people may also pander to big enterprises. Motives behind parties entering into *guanxi* may therefore be higher corporate profits and/or material economic gains for themselves. Cateora and Graham (1999) refer to a report published by the Hong Kong Independent Commission Against Corruption that the direct spending and gifts for fixing *guanxi* in China represented about three to five per cent of the business running costs, in the order of a figure of around US\$4 billion each year. Although it is reasonably believed that the current figure might have gone down with a series of tightened legislative reforms over the past decade in China (since more updated data are not readily available), *guanxi* is still highly viewed as a major determinant for business success in Chinese communities (Ho & Redfern, 2010; Ren, Au, & Birtch, 2009). This is translated into a wide possible continuum of economic benefits from *guanxi*. For instance, *guanxi* might make a proprietary source of business information available only to affiliated parties (insider group) through which arrangements could be made for just allowing smoother transport for delivery to faster collecting of debt payments (Barnathan *et al.*, 1996). Researchers also suggest that being an insider of a huge *guanxi* web would mean possessing the most powerful marketing tool for conducting business in the Chinese context (e.g. Ho & Redfern, 1997). In reality, *guanxi* happens nearly at all walks of business operations in China (Li & Wright, 1999). Intra-organizational or inter-organizational *guanxi* co-exists with individual *guanxi* in business setting. Although individual *guanxi* may not necessarily connect with corruption, their existence does in turn boost the organizational *guanxi*, whether they are permitted by law (Szeto et al. 2006).

5.2. *Guanxi* in Ethical Frameworks

While it is a generally accepted view that some common dictums on business ethics are required as controls, there are still concrete differences in opinions as to what constitutes ethical management across cultures or countries (Carroll & Gamon, 1997; Snell, 1999). Stewart (1995) sets out a three-level ethical measure offering a generic scale on the 'ethics level' specifically for developing economies:

1. The level of immorality or corner cutting, where parties may consider they can run away from prosecution;

2. The level of unashamed amorality, strictly legal but with minimality, where parties abide by statutes rather than the law spirit; and
3. The level of morality and ahead thinking, where parties accept beyond the minimality of statute and material gains, extending to the societal values. (p.1-18)

Szeto et al. (2006) consider that people with tainted knowledge in conducting business in China would rate the ethics level barely at the start of level 2 under Stewart's (1995) model. Another widely used model for examining the process of 'moral reasoning' by individuals is Kohlberg's (1969) 'three-level and six-stage' model on moral development (e.g. Ho & Redfern, 2010; Snell, 1996; Tan & Snell, 2002). The respective levels are outlined below:

1. The 'pre-conventional level' whereby the reasoning is on self-interest, e.g. having reward is good and receiving punishment is bad;
2. The 'conventional level' whereby the reasoning is on conformity with social norms, e.g. pressure from peers or families, and legality; and
3. The 'post-conventional level' whereby the reasoning is on consensus of universal ethical principles, e.g. widely accepted notion of justice.

With empirical support, Ho and Redfern (2010) argue that the most common types of reasoning adopted by Chinese managers in considering *guanxi* are correlated to Kohlberg's (1969) conventional level, i.e. its second level of reasoning. In essence, Ho and Redfern's (2010) findings are comparable to, and in line with, that of Szeto et al.'s (2006) for examining *guanxi* in the Chinese context.

One will go on to ask if *guanxi* equates unethical (immoral) act such as corruption. To address this, 'favour-seeking *guanxi*' can be distinguished from 'rent-seeking *guanxi*' (Su & Littlefield, 2001). They propose that while favour-seeking *guanxi* is culturally rooted connoting interpersonal exchanges of economic possessions in a shared setting, rent-seeking *guanxi* are communal norms suggesting complicity inside a network that facilitates rewards from power exchanges. They further contend that rent-seeking *guanxi* rather than favour-seeking *guanxi* is the true root of bribery in the Chinese context. Thus, Chinese executives have a stouter *guanxi* orientation must be unethical, and vice versa (Su, Sirgy, & Littlefield, 2003).

5.3. *Guanxi* and Confucianism

Much prevailing literature looks into the influence of Chinese culture grounded in Confucianism through a study on the dynamics of *guanxi* (Chen et al., 2013). Confucianism cherishes self-development, recognition of consensus in decision-making, and preference to co-operate with all stakeholders. The Confucian values or the 'set' of Confucian feudal ethics emanate harmonious relationships, social obligations and responsibility, ethical decision-making, treasure of learning and education. As mentioned before, ingrained in the indigenous precepts of *wu lun* (the five cardinal relationships), *guanxi* is position-based and role-oriented as it exists within the five types of interpersonal relationship known as 'ruler and subject', 'father and son', 'husband and wife', 'elder brother and younger brother', and 'friend and friend' (Chen et al., 2013; Han & Altman, 2009; Ho & Redfern, 2010; Miles & Goo, 2013). The Confucian ethics is ego-centric leading to a specific form of social capital formation with 'the ego' being the centre of networks of relationships. Thus, when facing a need to achieve a high goal, the conventional Chinese type of management would incline to solicit or activate faithful kith and kin. Conflicts and problems, if any, are to be resolved around the behaviour of common consent and ritual. *Guanxi* has been a deep-rooted element of the Chinese business culture. Depending on the true mix in business companions, *guanxi* would lead to ethical (favour-seeking *guanxi*) or unethical (rent-seeking *guanxi*) behaviour, as suggested by Su and Littlefield (2001). Not surprisingly, the Confucian ethics reinforces much of the managerial thinking across the Eastern cultures, and merely on China (e.g. Chen et al., 2013; Jacobs, Guopei, & Herbig, 1995; Lee, 1996; Low & Ang, 2013; Miles & Goo, 2013). It has a growing impact on other parts of the world (Lam & Goo, 2014a).

Echoed by Ho and Redfern (2010) and Szeto et al. (2006), Jacobs et al. (1995) contend that although Confucianism as a cultural belief emphasizing harmony and hierarchical ranking has left an adverse legacy to the Eastern business culture steering towards apathy at work, the Confucian values are in fact in agreement with the Western culture in management sense. For instance, the Confucian value of harmonious relationships can be aligned with the modern business concept of team spirit and solidarity. This interpretation is shared by Lee (1996), and Wong and Tam (2000), who emphasize that modern expression of Confucianism allows *guanxi* function lively than written agreements or rules do in business environment.

However, the influence of *guanxi* has been reducing in the decision making process as Confucianism fades throughout the centuries, and may not work that well as in the past.

6. In Meeting the Ethical Challenges

Altering behavior is no easy mission as it is complicated and takes time to see result, particularly in the deep-rooted ethical value of the human psyche. To upgrade the orientation by Chinese executives on the ethical fronts for the purpose of enhancing corporate governance, sensible tactics appear to conflate concepts with market-driven policies to make both organizational and personal goals in the marketplace aligned. So far this paper has reviewed the conceptualizations on *guanxi*, the corporate governance developments in China, and the current dynamics of *guanxi* in the Chinese context. References have been drawn on the empirical findings and insights built up by researchers. In the following section, the recommended future directions for enhancing the Chinese corporate governance are highlighted.

6.1. Viewing the sunny side of *guanxi*

As reviewed, voluminous research suggests that *guanxi* has many shared features with the philosophy on relationships accepted by the Western world. The peculiarity of *guanxi* in the Chinese context originates from the embedded Confucian values for a moral, virtuous, and benevolent mind, which researchers do not normally find in the Western culture. Ho and Redfern (2010) contend empirically that some researchers have in fact mistakenly equated *guanxi* with corruptive behaviours, while Su and Littlefield (2001) indicate that it is only the rent-seeking *guanxi* possibly leading to unethical action but not the favour-seeking *guanxi* orientation. Confucianism attaches great importance to harmonious human relationships and social relations in society. Tjosuold and Moy (1998) uphold that Chinese managers who adopt an open-minded discussion with subordinates on controversial matters would have better industrial relations compared to the old approach of being authoritarian in decision making. Expanding on this, Wong and Tam (2000) find that it is sensible to link the Western theories on CRM with *guanxi* since they are similarly built from a belief of sustaining a continual business network. Given its richness in content and vibrancy in practice, *guanxi* should have much to offer in a bid to enhance the corporate governance level in China or other cultures with Confucian influences.

Taking the view of 'stakeholder theorists' on corporate governance, one will agree that a company indeed is loosely run by various defined groups of persons, each has his/her own goal and seeks different things from the company. They could be stakeholders comprising shareholders who have a direct equity interest, persons who have a financial interest including suppliers, creditors, financiers and business partners, groups who are involved in wealth creation such as employees and customers, and external groups that are directly or indirectly affected by the company's operation such as local communities and pressure groups, etc. (Australian Corporations and Markets Advisory Committee, 2005). Thus directors have a governance role in the overall direction (not with daily running of the business per se) to satisfy the legitimate anticipations on the accountability beyond the normal corporate boundaries (Tricker, 2009). As directors are supposed to enable smooth functioning of the company with the existence of stakeholders having diverse rights and obligations (Cheng, 2002), they are required to manage *guanxi* particularly under the Chinese context of corporate governance. The perceived role of directors will not change considerably by adopting the views of 'stewardship theorist' and 'agency theorists' on corporate governance. While the former view considers that directors having the fiduciary duty need to act for the entire benefit of the company, the latter sees directors as an agent of the principal act for the interest of shareholders. In short, there exists some sort of trust relationships; hence, directors' personal qualities are important because they still need to manage *guanxi* in a balanced yet productive way.

Miles and Goo (2013) argue that the personal qualities of directors could be enhanced through Confucian values which serve the same objectives of the Anglo-American model of corporate governance. Lam and Goo (2014a; 2014b) embrace that with the rising corporate malpractice in China, the promising solution should be sourced from her own cultural roots. While hard regulations and laws as the bottom line could deter misconduct with stances on penalties (Lam and Goo, 2014b), they do not necessarily enhance corporate governance quality when the inner qualities of stakeholders (principally directors) are not improved. Notwithstanding that there may be counter-arguments to this notion (e.g. Zhou, 2014), accepting the sunny side of *guanxi* should be a promising way for upgrading Chinese corporate governance.

6.2. Consolidating the Education of Ethics

Su et al. (2003) study the correlation between unethical *guanxi* orientation (as built from rent-seeking *guanxi*) and the level of Chinese ethics education. The result illustrates that proper business education on ethics would deter the dark side of rent-seeking *guanxi*. It means that people who are more ethics-trained would become less reliant on unethical actions to achieve success. Business education on ethics, if properly consolidated with the Confucianism values is believed to help much in mitigating the dark side of *guanxi* in the Chinese context.

Notwithstanding that the effort spent on management education and training in China has been notable since the opening up of the economy marked by the accession to the WTO, there is still much room for expediting the progress on the infrastructure for ethical training through grooming a necessary mass of trainers in this field (Szeto et al, 2006). Importantly, many enterprises in China still consider it unnecessary to incorporate elements of ethics into the normal business training. Wright, Szeto, & Lee (2003) and Szeto et al. (2006) believe that a major area for improvement lies in wider employer-sponsored training with emphasis on ethics education. There are few enterprises having such structured programs. They further argue that it is necessary for the senior management to alter their mindset in the first place by attaching higher importance to ethics education by incorporating this in high-level policies and practices. They believe this must be channelled through the entire management hierarchy and viewed as part and parcel of nurturing good corporate governance. Advancing the ethics education by reviving the Confucian values to influence human behaviour will help improve the integrity of directors (Lam & Goo, 2014a; 2014c) and other stakeholders in the Chinese economy. The transplanting of the common law system (or integrating with the prevailing international norms) into China will see the Confucian values as useful in guiding the behaviour of the players in marketplace (Lam & Goo, 2014c).

6.3. Concluding Remarks

The impressive and continuing economic growth in China is already leading to big demands for a better corporate governance framework. In a decade, the State Council, the CSRC, and the SASAC have set up a corporate governance framework that took more than a century to fix in the Western world. That said, corporate catastrophes and collapses will still continue as in elsewhere of the developed world and they will lead to new business processes, regulations, and laws. The current German-style two-tier board model of governance for listed companies in China will also evolve as time goes by. On the one hand, people start paying attention to the rising need for advancing the Confucian ethics education in addition to just relying on hard laws and rules for improving corporate

governance. On the other, there have been signs that China may institute in the future not very different corporate governance norms that are required of companies abroad as overseas Chinese investments grows. The development will be enchanting and fascinating to watch.

7. List of Abbreviation

CICPA	The Chinese Institute of Certified Public Accountants
CRM	Customer relationship management
CSRC	China Securities Regulatory Commission
OECD	Organization for Economic Co-operation and Development
SASAC	State-owned Assets Supervision and Administration Commission
SOE	State-owned enterprises
WTO	World Trade Organization

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