

An institutional economic perspective on management in Chinese cultural contexts

Jeremy Kwok Frsa^{1,*}

¹ Royal Society for the Encouragement of Arts, Manufactures and Commerce (RSA), London, United Kingdom

Article History

Received: 10 January 2023 Revised: 18 March 2023 Accepted: 21 March 2023 Available Online: 1 April 2023

Keywords: institutional economics, Chinese perspective, cultural management

JEL classification: B15, M14, Z13

Citation: Frsa, J.K. (2023). An institutional economic perspective on management in Chinese cultural contexts, *Review of Socio-Economic Perspectives*, 8(1), 49-58.

Abstract

The aim of this paper is to examine various theoretical approaches used to manage in Chinese cultural settings, with a particular emphasis on cultural theories from institutional economics. Institutional economics offers explanations that are well-suited to understanding the rapid growth of the Chinese economy since the 1980s, when market-led economic reforms were introduced. This chapter provides a rigorous economic analysis that makes a strong contribution to the handbook, demonstrating the impact of economic institutional arrangements on the fast-growing Chinese economy. A significant contribution here is to highlight the complexity of managing in Chinese cultural settings. This complexity arises from the constantly changing soft institutions, such as the cultural practices of *guanxi*, which can vary significantly across different regions and communities. For instance, personal networks or *guanxi* are less important in overseas private Chinese businesses, Hong Kong, and Singapore. Due to economic activity, growth, and labor migration, there is a considerable cultural difference between different Chinese communities. Hong Kong, for example, has a distinct management culture compared to mainland China, as it has a long history of British administration and is an international trade and financial hub. This is evident in differences related to governance, the influence of the central government, relationships with foreign firms, human resources, and line management. The working language is predominantly English in Hong Kong, whereas Mandarin Chinese is the sole working language in mainland China.

1. Introduction

This paper tries to illustrate the theoretical framework from institutional economics and how it can be used to understand and manage a business in a Chinese context. A strong emphasis is on institutions. The term "institution" commonly applies to both informal institutions such as customs, or behaviour patterns important to society and to formal institutions created by law and having a distinctive permanence in ordering social behaviours. Primary or soft institutions are institutions such as the family culture that are broad enough to encompass and permeate other institutions.

In order to comprehend the institution within this context, the present chapter employs the theoretical framework of institutional economics, which centres on comprehending the impact of institutional evolution on economic behaviour. Institutional economics has arisen as a dominant economic paradigm within academia and has significantly influenced our comprehension of developmental processes, organizational structures, and transformations in economic institutions.

An economic institution is defined as "the constraints placed by law and social norms on human behaviour" or in North's words "the rules of the game". The purpose of the constraints is there to help reduce transaction costs. In the North's (1992) introduction to his seminal book, for example, he defined that "Institutions are the rules of the game in a society or, more formally, are the / humanly devised constraints that shape human interaction. In consequence, they structure incentives in human exchange, whether political, social, or economic. Institutional

* E-mail: jeremykwok.pub@gmail.com & ORCID: <https://orcid.org/0000-0002-2749-9521>

DOI: <https://doi.org/10.19275/RSEP148>

Article Type: Original Paper

change shapes the way societies evolve through time and hence is the key to understanding historical change. - That institutions affect the performance of economies is hardly controversial. That the differential performance of economies over time is fundamentally influenced by the way institutions evolve is also not controversial.”

As such, there has been a strong focus from economists on institutions and transaction costs in different economies. An example is from the Ease of doing business index compiled by the World Bank¹ (Djankov, 2016). Higher rankings (a low numerical value) indicate better, usually simpler, regulations for businesses and stronger protections of property rights. The implication is that the economic growth impact of improving these regulations is strong. A nation's ranking on the index is based on an average of 10 subindices such as starting a business; dealing with construction permits, getting electricity, registering property, getting credit, protecting investors, paying taxes, trading across borders, enforcing contracts and resolving insolvency. In general, the index provides a good approximation of how much time and effort (in other words transaction costs) is needed when doing business in such a country. For example, a very illustrative sample was given in North's work (page 4) in which he used the example of a sports match to explain institutions:

“Institutional constraints include both what individuals are prohibited from doing and, sometimes, under what conditions some individuals are permitted undertake certain activities. As defined here, they therefore are the framework within which human interaction takes place. They are perfectly analogous to the rules of the game in a competitive team sport. That is, they consist of formal written rules as well as typically unwritten codes of conduct that underlie and supplement formal rules, such as not deliberately injuring a key player on the opposing team. And as this analogy would imply, the rules and informal codes are sometimes violated and punishment is enacted. Therefore, an essential part of the functioning of institutions is the costliness of ascertaining violations and the severity of punishment.”

The implications of transaction costs on an economy's development are evident when defined as previously described. A reduction in overall transaction costs within an economy is expected to improve its economic performance, as has been observed in China's economic ascent since the 1980s. Similar patterns can also be seen in peripheral areas such as Japan, Korea, Taiwan, Hong Kong, and Singapore, where successive governments have implemented measures to decrease transaction costs, resulting in unprecedented economic growth. This paper delves deeper into this theoretical framework and illustrates how it can be applied to management in a Chinese cultural context, as outlined below.

Institutional economic theories and cultural changes

This part discusses the main institutional economic theories and institutional changes. It deliberates the implication on culture because of economic institutions and cultural changes.

The prominent characteristics of Chinese business

This section outlines some of the prominent characteristics of Chinese business such as Guanxi. As a result of the rapid changes in the Chinese economy in recent decades, the accompanying culture has also changed dramatically compared to the pre-1970s. Since then, there is a convergence towards Western management and culture. However, there remains a distinctive difference when comparing the two. This part discusses some of these divergences and their implications. Although China is by far the largest economy to have Chinese businesses, a substantial population and expatriates are running businesses under distinctively different institutional settings such as Hong Kong, Taiwan, and Singapore. In this case, the cultural settings are very different due to different laws and social norms.

The Rise of China and Its Implications

This part concludes the chapter. The focus is on the rise of China. Perhaps like the rise of the Japanese economy in the 1970s and 1980s, Japanese management was exported to other countries and succeeded to some degrees. This part contemplates the managerial implications and the possible future development.

2. Institutional economic theories and changes

2.1. China's economic growth

At the time of writing, China's economy ranks as the world's second largest, with its tremendous growth since the 1970s market reforms being attributed as the primary driver of its phenomenal growth over the subsequent 50 years. The country's gross domestic product (GDP) stands at \$14.72 billion. Consider these seven nations - the USA, China, Japan, Germany, UK, India, and Russia, while all have experienced GDP growth since the 1960s, their rates of growth have varied significantly. The USA has exhibited steady growth since the 1960s, with only two minor setbacks in 2008 and 2020 due to the financial crash and the pandemic. China, which holds the second

¹ <https://www.doingbusiness.org/en/rankings>

spot, experienced an acceleration in growth in the early 1990s, reaching an average of 10% annually, and then again in the late 2000s, before plateauing in 2020. By contrast, Japan's economy has stagnated since the late 1990s following the financial crash, while a distinct group of Western European economies - including Germany, UK, France, Spain, and Italy - have exhibited growth, albeit at a slower pace, since the early 2000s. India's growth trajectory is similar to China's, with an acceleration in the early 2000s, although growth has since decelerated. Finally, Russia experienced a profound transformation in its institutions and culture following the collapse of the Soviet Union in 1991, resulting in a resumption of growth in the early 2000s, albeit through a different path than other countries, with negative growth observed recently.

2.2. Institutional Economics and Development

The explanation of the significant growth and divergent development paths of different economies is a matter of importance. Institutional economics is particularly relevant in demonstrating and explaining the resulting growth and divergences among countries. As such, it is a major contribution to the research on understanding development and growth, as noted by several scholars (Bardhan, 1989; Nabli & Nugent, 1989; North D. C., 1993; Ménard & Shirley, 2005; Tamanaha, 2015; Gray, 2016; Roland, 2016; Hodgson, 2017; Acs et al, 2018; Prasetyo & Kistanti, 2020; Bradley, 2021).

Institutions, which can be simply understood as the rules of the game, determine the costs involved in pursuing business and transactions in the economy. The ease or difficulty of such transactions, such as purchasing properties, building materials, setting up private businesses, and exporting to local and foreign customers, is determined by the country's institutions. For instance, China in the 1970s was still running a state-led planned economy in which the China Communist Party (CCP) controlled all economic decisions. This model proved to be inefficient and prone to continuous market failures, as observed in numerous planned economies.

Under such institutional arrangements, economic transactions were difficult or impossible to carry out. Property rights did not exist, investment predictions were uncertain, and private property was not the norm. Such institutional arrangements led to corruption and favoritism, which hindered development. However, the economic reforms of the 1970s in China brought about massive institutional changes in which capitalist concepts and ideas were gradually introduced. This institutional transformation had significant effects on economic growth, as changes in property rights, market development, the existence of private enterprises, and legal protection of investments were introduced.

3. Main theories in institutional economics

This section discusses two aspects of institutions – formal institutions such as laws and informal institutions such as culture.

3.1. Property rights

Property rights are the centre of research in institutional economics. The term property is very expansive, though the legal protection for certain kinds of property varies between jurisdictions. In general, the property is owned by individuals or a group such as companies.

Property rights are defined as the expected ability of an economic agent to freely use an asset (Barzel, 1997). It represents a social institution that creates incentives to use, maintain, and invest in assets. The rights of property ownership can be extended by using patents and copyrights to protect. Legal instruments such as property laws are part of the formal institution to protect the rights of property.

The enforcement of property rights is normally associated with the formal legal institution. However as demonstrated in the literature it is also possible to maintain rights by custom, norms and markets (see, for example, Ellickson 1991). Compared to costly legal resolutions, the custom is a cheaper way in addition to law and regulations for markets to process repeated transactions.

Property rights remain one of the strongest intrinsic motivations for humans to work. The reforms of the 1970s in China saw the government allowing private ownership for the first time. This gradual introduction of the property laws saw massive economic growth as the population began to reap benefits from small to medium enterprises as entrepreneurs. Under strict governance of the CCP, private property rights did not exist until the reforms.

In this first sweeping reform, the household responsibility system (HRS) has been widely adopted in rural areas which saw contracting and restructuring of state-owned enterprises (SOEs) have taken place in cities. Private

enterprises re-emerged as self-employed and other forms, and foreign-invested companies cropped up in coastal cities such as Shanghai and Tianjin etc. Property rights under the new reforms allowed the ownership of property again which has since spurred the continuous growth. Since then, a new form and structure of property rights have been added to the constitution to reflect later changes to accommodate a mixed economy (Zhou, 2020).

3.2. Transaction cost

A concise and distinctive definition was given by the dictionary (Niehans, 2018) – “Transaction costs arise from the transfer of ownership or, more generally, of property rights. They are a concomitant of decentralised ownership rights, private property, and exchange. In a collectivist economy with completely centralised decision-making, they would be absent; administrative costs would take their place.” Note that transaction cost would be absent in a completely centralised economy. However, there was never one that was completely centralised due to the information required to properly assess all components within the economy in real-time. As such, transaction cost was extremely high in such an economy not only due to the costly method of the planned economy but also the absence of property rights. In its absence, rent dissipation happened rapidly and social norms and customs were developed organically to contain the waste (see section Rent dissipation and culture).

Transaction cost is a concrete concept that we encounter in everyday business dealing. National insurance payment by the employer is an extra transaction cost when hiring a new employee. Value-added tax (VAT) is a transaction cost that consumers are required to pay when specified by the tax authority. However, other transaction costs are difficult to observe as they are implicit. For example, discount or instant access to clubs for females is often done to attract more male customers. This is done so that more females will go into the said club at lower or no cost. As such the club will have a higher number of females which in turn attracts more males. As such, there is a higher transaction cost to male customers for the entrance. This is a case of classic price discrimination in which optimised revenue can be obtained. Transaction costs also occur within the state. For example, the regulations imposed may deter businesses to create too much carbon waste as there will be higher carbon tax and fines. While a transaction cost increase can distort the agent’s intention to conduct a business, it does not imply that it is always good or bad for its overall well-being. A keynote here is that transaction cost exists and should be examined when understanding institutions.

Different economies have different levels of the transaction cost. One of the strongest arguments for the performance of a market economy over a planned economy is the much lower cost of transactions. A planned economy requires the planner to possess all information such as the precise and changing nature of supply and demand. This has greatly increased the cost compared to a market-based one in which this function is outsourced to the market by competition.

3.3. Rent dissipation and culture

Rent dissipation is an important concept in institutional economics. In a city centre like London, parking is a valuable public good that can be sold or transferred like a property deed. However, if parking is free and unrestricted, it can lead to rent dissipation where it will be used until no space is left. Rent dissipation occurs when a public good is accessed with no restrictions, and its value dissipates at the margin under competition. To avoid this outcome, restrictions such as rights to a parking lot backed by a property deed can be established to maintain its value.

Another classic example of rent dissipation is the overfishing and over-farming of public spaces, resulting in a reduction of rent to zero and waste capital known as the tragedy of the commons. Rent dissipation can also occur under communist regimes when no private ownership is established, leading to undesirable economic outcomes. Informal institutions can be established autonomously to reduce rent dissipation, such as the order of access based on seniority or family prestige for shared resources like fertile farmland. While culture is a by-product of hard institutions, it can also serve as a constraint to the action of agents. Feeny et al (1990) note that informal institutions can sometimes reduce rent dissipation, leading to a lesser extent of depletion of public resources.

3.4. Rent dissipation and culture

As demonstrated in the example of 'rent dissipation and culture', hierarchy emerges naturally in all human and animal organizations. Cheung (2010, p.47) made an intriguing observation regarding news reports of corruption and bribery during China's capitalist reforms in the 1980s. The author considered this a positive development because during the communist era, access to resources was strictly based on party rank, with higher-ranked officials having access to better quality goods than lower-ranked officials. This resource allocation was a

deliberate system created in a property-less economy to minimize rent dissipation. Thus, reports of corruption and bribery were seen as indications of the gradual shift from a rank-seniority system to a market-based system during the capitalist reforms.

3.5. Market-Based Economic Reform in the 1980s

On September 9, 1976, Chairman Mao Zedong, who had long been ill with Lou Gehrig's disease, died. Internal political struggles continued not until Deng Xiaoping had risen to supreme power in 1978. It was perhaps the most important event in modern Chinese history as Deng represented the ideas and political friction for economic reform. The goal of Deng's economic reform was simply to raise China's standard of living from dire poverty. Although the reform was led by the CCP, it did not have a clear master plan on how to achieve this. As such it was very open to new ideas and even capitalist ideology was gradually tolerated and accepted as a part of the regime of "socialism with Chinese characteristics". The reform was so novel and drastic. It was completely different compared to the rigid adherence to the Marxist and Communist ideology of the previous leadership. As a result, many popular quotes of this era captured the experimental nature of such reform such as "no matter if it is a white cat or a black cat; as long as it can catch mice, it is a good cat" and "across a river by groping for stones".

Due to the liberalisation and the general acceptance of the market reforms, many local initiatives in agriculture took place before gaining approvals from the government. In 1979, one commune responded to a drought situation by drawing up individual contracts and basing pay on productivity. Despite some criticism from local government leaders, the effect of the private contracts worked and quickly spread into other places in the country. It quickly turned into a general nationwide abandonment of the communes and a return to the family farm, or individual household, as the basic agricultural unit. Under this new institutional arrangement, property rights were assigned not to the land itself which was remained collectively owned. Rights were given to the farmers who tilled the land. Harvests and profits were achieved by the output of such individual farms. As such there was a strong incentive for farmers to outperform each other and obtain the highest yield with the most efficient input. This was drastically different to the commune farm in which farmers performed according to a set quota requested by the state and did have no profit sharing (see Coase and Wang, 2016 for a full account of the change). Soon the reform was spread into the state-run industrial sector. The most unproductive state-run factories were shut down and the responsibilities were passed onto the private market and the state encouraged entrepreneurship. By about 1992, China had become a predominantly market economy. Within a few years beginning in 1997 the state laid off more than twenty-five million workers from state-owned enterprises. By the early twenty-first century, the former China bureau chief of the Financial Times could marvel that "China today is a great deal less socialist than any country in Europe" (Holcombe, 2017).

The wholesale institutional economic reform was not matched in any economy by its scale and depth. This is one of the reasons for China's rapid economic take-off as it allowed relaxation of central controls and a widespread and obsessive focus on economic growth. A relentless pursuit of economic growth and money-making was completely endowed to the state from the top bureaus to the local office. Effectively local state officials were given a profit share if they manage to bring in new investments and improved output. Under such a competitive institutional arrangement, China can be seen as a giant corporation with tens of thousands of local sales offices each competing against each other and each developing its businesses. On top of this competition, there was a huge, relatively well-educated and unlimited supply of comparatively low-wage labour (although this supply is dwindling as of writing, partly due to the one-child policy in the 1970s, though the upper limit is three now).

Traditional Confucian ethics and culture have returned as the main values subscribed by the state and population. Again, this is a deep institutional change from the Marxist and Communist values of the 1940s to 1980s which did not provide a culture that was suitable for entrepreneurship. The traditional values of hardworking, respecting parents and valuing education have greatly provided the soft institutions as a backbone of China.

Under Deng Xiaoping, China opened to foreign investments again compared to the previous isolated regime. One significant sign of the Chinese reform is its willingness to accept foreign investments. When comparing Japan and Korea, foreign direct investments contributed up to 30% of China's GDP when it is only a few per cent in other prosperous East Asian countries. To attract outside capital and to spurn the export-led growth, four Special Economic Zones (SEZs) were initially approved in 1979 (Shenzhen, Shantou, Zhuhai, and Xiamen, all in the southeast), on the model of export processing zones elsewhere in East Asia (such as those established in Taiwan beginning in 1966), offering low taxes and other economic incentives. The SEZ at Shenzhen, near Hong Kong, in particular, then exploded from rural rice paddies into a bustling city that is now home to perhaps twenty

million people. In addition to the SEZs, new coastal cities are also opened to investments. More than 100 ports, free trade zones, economic and development zones are in China now. To put things in perspective, 40% of the top 50 largest ports are in China while the rest of 30% is shared by other countries in East Asia such as Taiwan, Singapore, Korea and Japan.

4. The prominent characteristic of Chinese business - Guanxi

Chinese business encompasses all businesses located in Greater China, which includes Hong Kong, Taiwan, Singapore, as well as other areas dominated by foreign individuals of Chinese ethnicity. Variations in historical processes and institutional backgrounds result in significant differences between a state-owned bank in China and a large global bank in Hong Kong or Singapore. Distinctions among jurisdictions are also evident at the local level, particularly for small and medium enterprises (SMEs) that are frequently family-run. Nevertheless, it is essential to acknowledge that Chinese businesses possess unique qualities that differentiate them from businesses in other regions.

The rapid economic growth of East Asian economies, including Japan, South Korea, Taiwan, Hong Kong and Singapore, is not solely Chinese but rather shares a common culture due to historical reasons. Although not Chinese, Japan and South Korea have been significantly influenced by ancient Chinese culture for several hundred years. Despite differences in language and institutional settings, all these East Asian countries have a strong Confucian culture, with Christianity dominant in South Korea, Shintoism in Japan, and a mix of atheism, Buddhism, and Taoism in China. Confucianism's salient features, such as familism, obedience, perseverance, and thrift, have explained the region's economic growth, despite 20th century wars and ideological struggles (Kahn, 1979; Clegg et al., 1990; Clegg, 1990; Silin, 1976).

Of all the characteristics or features that are shared by East Asian countries, the one that is most prevalent in organisational decision making is the concept of Guanxi (关系). It is similar to the concept of customer relationship but it is a lot more involved and personal. Guanxi refers to having personal trust and a strong relationship with someone and can involve moral obligations and exchanging favours. Below is an example of how Guanxi is more than just a customer relationship, taken from a Singaporean example (p.42, Tong and Yong, 2014)

“We Chinese are very flexible. We can change to suit the situation. Even though we may not have agreed on a certain dateline, if you (the supplier) cannot make it, you can ask, Can postpone? My shipping is not ready. And it’s possible. After the contract, you can still ask for amendments, to change this and that...If there is a good relationship, then we can make changes. If you make a request, we can oblige.”

The above example illustrates the significance of a customer's "above and beyond" approach towards building a good relationship. In this scenario, a customer firm with good Guanxi enjoys a stronger position and advantages in business. Guanxi can be defined as a network of contacts that an individual can leverage to accomplish tasks and exert influence on behalf of another. As a result, these networks can significantly impact business transactions with Chinese firms. However, this can pose a challenge for foreign entities entering the Chinese market as pre-existing Guanxi networks often hold strong influence. To navigate this challenge, it is important to recognize the reciprocal nature of Guanxi, which entails an informal obligation to reciprocate favours. Once a strong and long-lasting relationship has been established, new opportunities may emerge from a favourable Guanxi network.

There exist also a few related concepts such as Renqing (人情) and face (Mianzi, 面子). Renqing is considered to be the moral obligation to maintain a relationship. This is not only done in business but also in everyday life in which families visit each other during major holidays or festivals. These meetings are considered to be obligatory rather than causal. As a result, it is part of building Guanxi that Renqing is also considered. Face or the collective concept of social status, propriety and prestige is also very prominent in daily life and business. This concept has been so frequently understood and became part of a standard repertoire in business and everyday speech in English (e.g., saving face).

4.1 Institutional contexts

It is worth noting that Guanxi operates as an informal institution within the Chinese business landscape. In contrast to developed economies, China's formal institutions are subject to significant flux, with market reforms in the 1980s representing the most prominent institutional change. As a result, regulatory rules, government attitudes towards business, and the implementation of central guidance have all undergone substantial transformation in the space of a few decades. Against this backdrop, it is unsurprising that Guanxi has remained a pivotal factor in doing business in China. This informal institution serves to secure future business opportunities and, crucially, the livelihoods of many small enterprises. The frequent changes to formal institutions that arise from reforms can generate long-term economic benefits but also short-term disruptions and inefficiencies. As such, Guanxi functions as an informal institution that mitigates transaction costs, such as information gathering on forthcoming changes, regulatory compliance, new business organization, and guidance. Consequently, Guanxi has remained a vital component of the organic governance structure in China, as well as in Hong Kong, Taiwan, and Singapore to a lesser extent.

4.2 The bases of Guanxi

Continuing the previous institutional analysis that Guanxi serves as an autonomous mechanism to lower transaction costs in a changing business environment, we now examine what constitutes Guanxi and the form it occurs in. In a comprehensive survey by (p.41, Tong and Kong, 2014), the author interviewed business executives and owners of Chinese businesses on what constitutes the basis of Guanxi. The author noted the categories are: 1) locality; 2) kinship; 3) workplace and 4) friendship.

4.3 Locality / Dialect / Associations / Club

In the earlier stages of Chinese capitalism such as the 1960s in Singapore / Hong Kong, Guanxi was particularly important for new immigrants from China to their new hosts. The new arrivals often depend on members from the same regions in China. The local groups are often established based on the specific areas or dialects that they used in China. For example, in Hong Kong, the clans from Shanghai had a strong regionalism and formed their organisations in competition with the local Hongkonger businesses. This distinction is possible due to the mutual unintelligibility among different Chinese dialects. As such the local population, in general, cannot understand the dialects spoken by different clans from other areas of China. The same can be said of the Chinese immigrants to Singapore in the early 1960s to 1990s. Many Chinese immigrants came from South-East China such as Fujian and other parts of China. Similarly, clans and organisations are formed based on their origins. However, the author noted that the interviewees mentioned that this relation is much weaker now. This can also be said in Hong Kong and Taiwan where the local official languages such as Cantonese and English (Hong Kong), Mandarin Chinese (Taiwan) have become the main languages therefore standardised communication. As such this base of Guanxi is waning in influence when compared to an earlier time. This is also expected from an institutional perspective as formal institutions take a stronger hold, informal institutions such as membership-based on origin are likely to have less influence.

4.4 Kinship

Kinship is another important base for Guanxi. Jobs and opportunities are more likely to be given to immediate kin. There is another unusual perspective of this base, for example, people who share the same surname are more likely to gain favours. However, this is getting less important as the possibility to change surnames and travels made this selection less relevant.

4.5 Workplace

The workplace is another major of cultivating Guanxi. Years of working together provided opportunities to establish or strengthen guanxi people often get to know one another intimately. This source is common in other countries as well such as the alumni or ex-employee network.

4.6 Friendship

The last base for Guanxi is based on friendship. Friendship is often a base to further existing relationships. This often does not equate to Guanxi as Guanxi is often the criteria by which friendship can be established on.

4.7 Disadvantages

The close-knit nature of guanxi is now evident, but its patron-client relationships can also pose significant challenges for businesses. Members are often obliged to repay favours to others, leading to issues when they cannot adequately do so. Guanxi networks may also breach bureaucratic norms, resulting in corporate corruption. The line between business and social life can be blurred, as individuals rely heavily on their close relationships, potentially leading to nepotism and cronyism in the workplace. Authoritative figures often draw from family and close ties to fill employment opportunities, rather than assessing talent and suitability. Regulators are aware of the inherent disadvantages of guanxi and have created policies to counter unfair discrimination against non-members.

5. Managerial implications - Finding the Middle Way

Guanxi undoubtedly remain the main obstacle for new businesses looking to get into the Chinese market. This is however achievable given the appropriate strategy. Doing business in China and building Guanxi is like a catch 22 problem –to build Guanxi, you need an existing Guanxi network. This poses obstacles for many foreign businesses wanting to do business in China. For example, Hong Kong is a much easier base to begin a business often acts as a gateway to China. The Hong Kong administration for example operates based on the common law system which is like that in the UK. It also requires much less Guanxi to establish new businesses and conduct transactions. The same can be said for Singapore as well as it operates in a similar model attracting foreign investors. As such the business environments of Hong Kong and Singapore constitute a blend of East and West which make them the prime candidates for breaking into the China market. The strategy to build Guanxi however remains a long-term approach which can be done in several ways.

As previously discussed, Guanxi places importance on cultivating close relationships among business partners. An initial requirement is a basic understanding of Chinese culture, including language and history, which can help to reduce unfamiliarity with the market. Such knowledge can aid in establishing rapport with new Chinese contacts.

Chinese businesses often prefer to conduct business with established networks, making it important to have introductions to key networks. For instance, Hong Kong is a more business-friendly location as the working language is English and the network has less emphasis. This advantage can be leveraged for future networks and business in mainland China. Being part of a trade organization that facilitates a network for international trade flows, such as the China-Britain Business Council or similar associations for other geographies, can also be helpful. Generally, the higher the social status of your connection, the more likely you are to be successful in being introduced to the right people and key decision-makers.

The need to entertain and gift in order to establish relationships in Chinese business culture is a stark contrast to Western approaches. Personal gifts, entertainment events, and dining are often seen as necessary to foster meaningful relationships with new clients. However, this practice runs counter to Western governance, where many companies have a "no gift" policy. The ethics of gift-giving also depend on the relationship between the patron and client, and the regulatory environment of a particular region. The intricacies of gift-giving etiquette can be challenging to navigate, and regulations can vary. For example, while China's official policy in 2021 prohibits gift-giving as it can be construed as bribery, this practice still persists in lower-level business where hosting dinners or providing personal gifts are still acceptable.

6. Conclusion

Throughout this paper, it has been argued that Guanxi and other characteristics are autonomous products that were formed as a type of informal institution. This informal institution is a fusion of traditional values and the prevailing formal institutions such as laws and regulations at the time. Therefore, a strong implication is that institutions will change. The rapid changes of the Chinese economy from the 1970s to the present time have been outlined. The accompanying intuitions have shifted from a Communist/Marxist ideology to a market-based one. The rise of the Chinese economy raises the question of what it means for the rest of the world. Two points stand out: firstly, the Guanxi network is likely to gradually reduce as globalization and online businesses dominate, and secondly, the re-recognition of Chinese identity among the trend of the surging East Asian identity.

The traditional Guanxi network, which was sorted by origins, dialects, and regions, is likely to diminish due to the effects of globalization that have reduced cultural differences. Furthermore, existing Chinese organizations, which were previously formed based on local identity, now have the ability to travel to remote provinces with ease, effectively reducing the distance between different regions. Despite this, Guanxi has not disappeared but

has taken on a different form, with less emphasis on origins and more on commonalities. Research by Dahles (2004) has shown that ethnic Chinese people often gain an advantage when conducting business in China, regardless of whether they are from Hong Kong or Singapore, which are considered foreign by mainland Chinese businesses due to their different legal jurisdictions and cultures. This shift from regionalism to a broader concept of ethnicity has resulted in a move towards individual relationships beyond the family and ethnic group, in favor of professional and institutional linkages. This shift is reinforced by the fact that many younger Chinese citizens have studied abroad and brought overseas relationships into China, thus reducing the dependence on regional and ethnic identities.

A second emerging trend concerns self-identification outside of China, as many ethnic Chinese in Southeast Asia are re-identifying themselves as Chinese. These populations have been present in Southeast Asia since the 19th century, but local politics and nationalist policies at times have led to a re-understanding of their history. With China's emergence as a rapidly growing market, ethnic background is now often flaunted, and nearby countries such as Thailand, Malaysia, Korea, and Indonesia are encouraging the teaching of Mandarin Chinese in schools. As long as the Chinese economy continues to grow, this trend is likely to persist. While Chinese businesses prioritize profitability, ethnic and cultural affinities can facilitate relationships, and this chapter has shown how to analyze the economic basis of such relationships.

Profitability and economic opportunities are the primary considerations for many Chinese businessmen when making investment decisions. However, effective personal and business relationships with the China Chinese can be facilitated by cultural affinities. Chinese ethnicity is utilised as a means of ethnic networking to conduct business with co-ethnics in China.

References

- Bardhan, P. (1989). The new institutional economics and development theory: A brief critical assessment. *World development*, 1389-1395.
- Cai, F. (2010). Chinese rural reform in 30 years: An analysis in terms of institutional economics. *Frontiers of Economics in China*, 5(1), 150-168.
- Davison, R. M., Ou, C. X., & Martinsons, M. G. (2018). Interpersonal knowledge exchange in China: the impact of guanxi and social media. *Information & Management*, 55(2), 224-234.
- Djankov, S. (2016). The Doing Business Project. *Journal of Economic Perspectives*, 247–248.
- Gray, H. (2016). Access orders and the 'new' new institutional economics of development. *Development and Change*, 51-75.
- Greif, A., & Tabellini, G. (2010). Cultural and institutional bifurcation: China and Europe compared. *American economic review*, 100(2), 135-40.
- Guo, Y., Rammal, H. G., Benson, J., Zhu, Y., & Dowling, P. J. (2018). Interpersonal relations in China: Expatriates' perspective on the development and use of guanxi. *International Business Review*, 27(2), 455-464.
- Hardin, G. (1968). The tragedy of the common. *Science*, 1243-1248.
- Harriss, J., Hunter, J., & Lewis, C. (1995). *The new institutional economics and third world development*. Psychology Press.
- Herrmann-Pillath, C., 2006. Cultural species and institutional change in China. *Journal of Economic Issues*, 40(3), pp.539-574.
- Holcombe, C. (2017). *A History of East Asia*. Cambridge University Press.
- Huang, Y., 2002. Managing Chinese bureaucrats: an institutional economics perspective. *Political Studies*, 50(1), pp.61-79.
- Hudik, M. and Fang, E.S., 2020. Money or in-kind gift? Evidence from red packets in China. *Journal of Institutional Economics*, 16(5), pp.731-746.
- Kasper, W., Streit, M. E., & Boettke, P. J. (2012). *Institutional economics: Property, competition, policies*. Edward Elgar Publishing.
- Krug, B., & Hendrischke, H. (2008). Framing China: Transformation and institutional change through co-evolution. *Management and Organization Review*, 4(1), 81-108.
- Lambsdorff, G. J., Taube, M., & Schramm, M. (Eds.). (2005). *The new institutional economics of corruption* (p. 258). New York: Routledge.
- Legiędź, T., 2019. The economic consequences of the recent political changes in China: the new institutional economics perspective. *Ekonomia i Prawo. Economics and Law*, 18(2), pp.197-208.
- Ménard, C., & Shirley, M. (2005). *Handbook of new institutional economics*. Dordrecht: Springer.

- Nabli, M. K., & Nugent, J. B. (1989). The new institutional economics and its applicability to development. *World Development*, 1333-1347.
- Niehans, J. (2008). Transaction Costs. In *The new Palgrave dictionary of economics* (p. 13782). Palgrave Macmillan.
- Nolan, J., & Rowley, C. (2020). Whither guanxi and social networks in China? A review of theory and practice. *Asia Pacific business review*, 26(2), 113-123.
- North, D. C. (1992). *Institutions, institutional change and economic performance*. Cambridge: Cambridge University Press.
- North, D. C. (1993). The new institutional economics and development. *Economic History*, 9309002, 1-8.
- Roland, G. (2016). *Development economics*. Routledge.
- Rutherford, M. (2001). Institutional economics: then and now. *Journal of economic perspectives*, 15(3), 173-194.
- Schramm, M., & Taube, M. (2003). The institutional economics of legal institutions, guanxi, and corruption in the PR China. *Fighting corruption in Asia: Causes, effects, and remedies*, 271-96.
- Stanfield, J. R. (1999). The scope, method, and significance of original institutional economics. *Journal of Economic Issues*, 33(2), 231-255.
- Tamanaha, B. (2015). The knowledge and policy limits of new institutional economics on development. *Journal of Economic Issues*, 89-109.
- Williamson, O.E., 2000. The new institutional economics: taking stock, looking ahead. *Journal of Economic Literature*, 38(3), pp.595-613.
- Yong, C. T. (2014). Guanxi Bases, Xinyong and Chinese Business Networks. In C. Tong, *Chinese Business - Rethinking Guanxi and Trust in Chinese Business Networks*. Singapore: Springer.
- Yuan, D., Yau, Y., Bao, H., Liu, Y., & Liu, T. (2019). Anatomizing the institutional arrangements of urban village redevelopment: Case studies in Guangzhou, China. *Sustainability*, 11(12), 3376.
- Yuan, D., Yau, Y., Bao, H., & Lin, W. (2020). A framework for understanding the institutional arrangements of urban village redevelopment projects in China. *Land Use Policy*, 99, 104998.
- Zhang, S., Gao, Y., Feng, Z., & Sun, W. (2015). PPP application in infrastructure development in China: Institutional analysis and implications. *International Journal of Project Management*, 33(3), 497-509.