

“Guanxi” and its Implications for Business Practices in Asia

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Guanxi, an informal personal relationship, is an important element facilitating business success in China and other Asian countries that are influenced by Confucian culture. Despite recently increased research on guanxi and its roles in business context, the understanding of guanxi remains misapprehended or incomplete. This article attempts to disentangle this cultural and social phenomenon of guanxi to help Western businessmen better comprehend and manage guanxi more effectively when doing business in Asia especially in Chinese markets.

Keywords: Guanxi, personal relationship, business relationship, relational ties, network, Confucianism.

INTRODUCTION

Among the key factors leading to the success of doing-businesses in Asia, especially in Chinese markets, is the role of “guanxi” i.e. personal relationships or connections. It is considered as an informal governance mechanism to help firms overcome institutional challenges in Asian markets (Dinh & Calabrò, 2019). Although the literature on guanxi has gained attention recently (Luo, Huang & Wang, 2012); the interpretation of guanxi and how it is practiced when doing business in Asia and Chinese markets remains incomplete. Many argue that guanxi is essentially a utilitarian concept that bonds two persons through the exchange of favors rather than sentiments (Luo, 2000). As a consequence, they tend to have such connections heavily built on the business itself. Some argue that Chinese guanxi is not different from the Western concept of business networks in which connected firms can reciprocally utilize the resources of the others (Johanson & Kao, 2010). Furthermore, due to the reciprocity of guanxi, others argue whether guanxi is an asset or liability, and whether or not it is transferable (Gu, Hung & Tse, 2008; Park & Luo, 2001). The answer to these questions can be both yes and no, depending on how guanxi is perceived and practiced. While guanxi is an important factor facilitating the business success in mainland China in particular, and in some other Asian markets in general, there is lack of an appropriate cultural understanding on this social phenomenon. Through the response to a set of different questions, this article attempts to disentangle this cultural and social phenomenon to help Western businessmen better comprehend

guanxi and manage it more effectively when doing business in Asia, especially in Chinese markets.

WHAT IS GUANXI AND WHY IS IT IMPORTANT?

In Chinese, guanxi means “tie up”, “connect” or “relationships” in generic sense between two or more persons rooted deeply from Confucianism, an ancient Chinese philosophy since the Han dynasty BC 206 – AD 220 (Jacobs, Guopei & Herbig, 1995). This philosophy emphasizes two key elements i.e. the closed system of relationships among individuals (e.g. within family and collective group) and the hierarchical order of these relationships (e.g. senior versus junior) (King, 1991). Accordingly, Confucianism assumes that Chinese people live in an intricate web of personal and social inter-connections and Chinese society has been functioning as clan-like networks. Such networks can be viewed as concentric circles in which family members are the core, and outer circles including distant relatives, classmate, friends, and acquaintances are being viewed as peripheral arranged in accordance to the distances of relationships and degrees of trust (Luo, 1997). Belonging to these networks allowed ancient Chinese people to get special treatments, protection, and privileges that “outsiders” may not have. In family- based relationship, people at the core are related to each other by blood ties and the level of trust among these people is also highest as compared to those at outer circles. Therefore, it can be argued that guanxi relationships among people at the core of the concentric circles have strongest impact. As a consequence, the further the guanxi is from the core, the weaker the guanxi impact is. Meanwhile, the vertical order or the hierarchical order of guanxi relationships emphasizes that the senior in both social rank and age e.g. sovereign, farther, husband, and elder brother has more prerogatives and authority than the junior e.g. the subject, son, wife, and younger brother (Chen & Chen, 2004). Any order or decisions made by the senior must be obeyed by the junior without hesitance or defence. This hierarchy of social relationship leads to power distance in Chinese social and organizational structure (Hofstede, 1984). In the hierarchical structure, people with power and resources are at the core (e.g. sovereign, key decision makers, father). On the other hand, as characterized by closed-system of relationships, ancient Chinese people emphasized the in-group loyalty and outsiders to a collective group were considered as not trustful. Therefore, if an outsider or a person from different group wants to gain trust from this group (in order to do something or be permitted to do something) he must either find a way to be an integral part of this group or rely on his contacts at the core or nearest possible to the core to get things done (Hofstede & Bond, 1988; Dinh & Calabrò, 2019). Overtime, these principles of relationships had become the social framework and institutional system that guides Chinese people’s behaviour

including Chinese overseas, and other Asian countries and regions that are culturally influenced by Confucianism such as Hong Kong, Malaysia, Japan, Singapore, South Korea, Taiwan, and Vietnam (Dinh & Calabrò, 2019). Although the structural make-up and the nature of the relationships may have evolved since the time of Confucius, modern Chinese societies remain very much relationship oriented and *guanxi* is often used to influence some key persons' decision making to achieve desirable results (Wong & Tjosvold, 2010).

It is worth noting that the word “*guanxi*” can also be used as an affix to denote many types of relationships depending on what other words are used before it (-*guanxi*). For example, business relationships (*shang wu guanxi*), social relationships (*she hui guanxi*), husband-wife relationship (*fu qi guanxi*), or relationships among students (*tongxue guanxi*) (Wee & Combe, 2009). Therefore, when the term *guanxi* is used, its exact meaning will depend on the context which it is expressed. In the context of business (*shang wu guanxi*), *guanxi* refers to business relationships that are built on personal relationships at individual level rather than firm level because such relationships are nurtured by persons and not by the company directly (Dou & Li, 2013). It is about how two person in business context developing friendship (not just partnership) and earning trust from each other overtime. Such a relationship can extend far beyond the businesses that they have with each other. Indeed, the relationship can even extend to the families and friends of the business partners (Wee & Combe, 2009).

Due to power distance in social and organisational structure, and institutional uncertainty people in Asia, especially in Chinese-speaking societies and Confucian influenced countries tend to build informal relationship or *guanxi* before engaging in any business transaction (Park & Luo, 2001). Though, as established by trust and informal relationship, *guanxi* requires tremendous time and efforts to build. Benefits of *guanxi* are in different forms depending on which types of *guanxi* or with whom a person has *guanxi* with. In the context of business, the most common benefits that *guanxi* offers is the exchange of information, access to necessary resources and business opportunities, reduce unnecessary bureaucratic procedure, and even legal protection in hostile environments. At personal level, *guanxi* between two person is seen based on their relational ties and how one gains or gives favour/benefit to the other and via verse when one is in need. Although firm/organization may not possess *quanxi* itself, because *guanxi* is owned by an individual and working only at personal level, *guanxi* is also beneficial to firm/organization in an indirect way, through managerial level between two or more firms. This explains why enterprises in China prefer to employ those people who have wide relationship with important stakeholders (Warren, Dunfee & Li, 2004), and compensation of managers is also based on how “good” his/her *guanxi* is (Young & Tsai, 2008). In Asian countries with underdeveloped legal framework where law and legal enforcement is either absent or weak, having political *guanxi* (political connections) with key

governmental officials could help firms defend themselves against threats such as expropriation or extortion (You & Du, 2012).

Therefore, business owner prefers to build guanxi with most influential people and those who in positions of power and constantly track their career development.

In China, despite tremendous efforts of the government enacting various laws and regulations to improve the business environment, the enforcement of these formal mechanisms remains weak, and resources are either scarce or unequally distributed across firms especially between public and private sectors (as most of the resources are preserved to state-owned enterprises in China) leading to severe market competition (Dinh & Calabrò, 2019). In this context, guanxi facilitates business success because it favours the guanxi-holders by providing access to diverse resources; reduce information asymmetry and transaction costs. Thus, having good guanxi with a local business partner may help foreign firms access his market intelligence, gain further business opportunities among his networks, and even utilize his available resources through production or distribution channels to ease the expansion plan of the foreign firm in host markets (Cheng, Su & Zhu, 2012; Cheung, Haw, Tan & Wang, 2014). Alternatively, given high level of bureaucracy and constant institutional changes in China and other Asian emerging markets, having guanxi with key decision maker(s) such as politicians or governmental officials may ease approval processes, help access important information at early stage and reduce institutional uncertainty (Chung & Ding, 2010).

IS GUANXI SIMILAR TO THE WESTERN NETWORK CONCEPT?

Both guanxi and the Western network approach (Johanson & Mattson, 1988) emphasize the role of trust between the related parties in the business context. However, the process of developing trust, as well as the level of actors involved during this process is different from one another. In network approach, relationship among connected firms is developed via mutual orientation including mutual knowledge and willingness to adapt to each other (e.g. production processes and routines) at firm level within a network with little personal involvement (Johanson & Mattson, 1988). Additionally, trust is built based on results of business transaction i.e. the satisfaction and positive outcomes of reliable products and/or services being traded, and is guaranteed by specific terms and conditions in written contracts (Jansson, Johanson & Ramström, 2007). This approach, so called contract-based system, works because it is supported by a robust and efficient external judiciary system that can enforce the fulfillment of contracts (Jensen & Meckling, 1976). In contrast, as mentioned earlier, business

guanxi is a personal relationship between two or more business persons and thus trust is built through the process of personal interactions among them. Explanation to this different approach can be tracked back to the old days of China during which they did not have strong legal systems to enforce contractual obligations and arbitrate business disputes. The only guarantee that the businessman had was the word of his partner. Additionally, Confucianism preaches the importance of harmony across personal and social relationships and strongly avoids direct confrontation and disputes

because such events may lead to the loss of face/reputation and severely damage relationships (Dinh & Calabrò, 2019; Dunning & Kim, 2007). Thus, the best way to avoid possible conflicts is to carefully assess the potential business partner. As a consequence, Chinese businessmen tend to spend tremendous time and effort in order to get to know their business partners and gain a certain level of trust before engaging in any business deals (Xin & Pearce, 1996). These philosophical principles still influence the behavior of Chinese people until today even though the institutional systems in China have been improved. The typical and initial way for Chinese businessman to build trust is through socializing activities including dining, drinking, karaoke, or even visiting home of the potential partner. He has to know him well as a person and a friend so as to determine whether he can be trusted (Jansson et al., 2007). However, since it is about personal relationship, it requires equal feelings and emotions of the two persons before guanxi relationship is established. This time-consuming process requires tremendous efforts and patience from the both sides. Once the trust is there, meaning the two business partners have arrived at the core of the close-system of relationships of one another, such a business relationship that is built after the establishment of personal ties, will not be easily destructed (Yeung & Tung, 1996).

In sum, in a guanxi-oriented system, it is friendship first then business follows. Conversely, in the contract-based system, business comes first and if the repeated fulfillment of contracts is satisfactorily met, friendship may follow. Nonetheless, it has been argued that business relationship based on rigid contract is more vulnerable and easily to be broken by external market factors. Whereas, guanxi relationship is more durable and long-lasting because it is built on friendship and friends are supposed to care and help each other during the hard times (Wee & Combe, 2009).

IS GUANXI PURELY UTILITARIAN OR SENTIMENT?

It has been argued that guanxi is simply a utilitarian concept that bonds two persons together through the exchange of favors rather than through sentiment (Luo, 2000). Indeed, the answer to this statement is again yes and no depending

on how guanxi is used and aimed for (e.g. whether it is long-term or short-term oriented). Obviously, it is undeniable that the exchange of favors between the two persons is often taking place in the business context once guanxi is established. However, this practice should be understood as reciprocity such as friends helping each other when one is in need. Indeed, reciprocity forms an integral part of Chinese culture. When one is given a favor, he should treasure and never forget this kind behavior, and he is expected to return it one day. Reciprocity is not only obligation but also a value that increases the quality of relationships among people in a collective group (Warren et al., 2004). It provides the leverage or prestige one needs to successfully expand and manipulate a guanxi network (Luo, 1997). Reciprocity is perceived as an unwritten rule of guanxi relationships, and the failure of this practice is associated to the loss of prestige in the collective group.

However, in guanxi principles, when A helps B in a circumstance at a point in time, B must not necessarily “repay” this favor immediately. Instead, this favor is reciprocated when necessary either in similar or greater value of favor given. Nonetheless, in some particular circumstances, such returned favors can be in the form of lesser value depending on the need. And if guanxi relationships are sincerely nurtured and transformed into true friendship, such returned favor can just be in the form of emotional support and encouragement (Yeung & Tung, 1996; Dou & Li, 2013). Indeed, favor exchanges among members of guanxi network are not solely commercial, but also social status and reputation (i.e. social capital). On the other hand, guanxi-related ties that are aimed for only short-term utilitarian purpose, and at some point desired objectives are no longer seen to achieve, are easily broken (Dunning & Kim, 2007).

Furthermore, those who are not familiar with Chinese culture often think that gift-giving is a shortcut and the most expedient way to build relationships with Chinese partners. Consequentially, they end up spending unnecessarily large sums of money on gifts, and worse still, giving to the wrong people and/or to many different parties (Vanhonacker, 2004). This misconception that gifts can build or buy guanxi has added to already severe problem of bribery and corruption in Asia, including China. In reality, gift-giving forms only a part of the process of building guanxi, and is not a key ingredient. Instead, guanxi focuses on personal relationship and “gifts need not be used at all” (Wee & Combe, 2009). A true guanxi is not the same as bribery or corruption because guanxi is relation-focused whereas bribery and corruption is transaction-focused. Thus, the ethical practice of guanxi cannot be bought. Therefore, one should focus on understanding, showing concern and sensing possible problems that the other party may face, and offering help when necessary. This is the more appropriate way to build guanxi relationship.

IS GUANXI TRANSFERABLE?

Some scholars argue that guanxi is transferable by stating that if A has guanxi with B and B is a friend of C, then B can introduce or recommend A to C or vice versa. Otherwise contact between A and C is impossible (Luo, 1997; Luo, 2000). This argument is only partially true. Indeed, the success of “transferability” or with a more proper word, the recommendation of A to C (by B), depends on how much satisfaction B feels about his guanxi with both A and C (Dunning & Kim, 2007). Additionally, as mentioned earlier, guanxi is personal relationship involving personal feelings and emotions. Even if B introduces A to C, the guanxi established (if any) by A and C is pretty much depending on how emotionally these two persons feel towards each other. Thus, there is no guarantee that guanxi between A and C will be established. Yet, whether or not guanxi can be transferred is dependent on the nature of the guanxi. If a guanxi tie is transferred, it can only be passed on from one person to another person not to the organization (Dou & Li, 2013).

Given the personal and time-consuming characteristics of guanxi international firms tend to hire local managers who have guanxi networks and rely on them to deal with local suppliers, contractors and authorities. This is a wise move for short-term strategy; however, in a long run it exposes to a certain risk. The effect of hired guanxi (hired managers or employees who have guanxi) may be lost when the hired managers are no longer working in the firm. This is because guanxi comprises personal relationships and it needs to be constantly maintained and nurtured (Gu et al., 2008). Thus, the departure of a hired manager is likely to result in the loss of the guanxi that the manager brought in the company. Instead, Western businessmen need to utilize hired guanxi as materials and means to develop their own guanxi as an intangible asset by actively getting themselves involved during the process of establishing guanxi with local business partners (Dinh & Calabrò, 2019; Ko & Liu, 2016). While the transferability of guanxi remains questioned, this task is a challenge even for local Chinese businessmen who may wish to pass down his guanxi to the next generation. As it requires enormous time and effort, the possible transfer process may involve different stages such as profiling guanxi networks, introducing members of the incoming generation to existing guanxi parties, readjusting the roles in guanxi management, renewing guanxi parties, and rebuilding guanxi structures (Dou & Li, 2013). Yet, there is no guarantee that the quality of transferred guanxi stays the same as it was in the preceding generation.

HOW TO MANAGE GUANXI?

Guanxi can become a distinctive advantage to business success in Chinese and Confucian influenced markets and can also be an important ingredient in business strategy. As an asset, it should be managed to facilitate the business success and not be allowed to become a liability. Indeed, investment in guanxi is not costless and in many cases mismanagement and unethical use of guanxi is associated with bribery and severe corruption (Sun, Mellahi & Liu, 2011; Sun, Hu & Hillman, 2016). Therefore, managing guanxi is a challenging task and there is no perfect recipe. It is important to understand the nature of it in order to manage more effectively.

As the focus of guanxi is on peoples relationships, these relationships are dynamic and hard to predict. In other words, unlike systematic procedures, dealing with people is not an easy task especially when it involves personal feelings and emotions. Targeted guanxi to be established can be people with power and resources. However, these people may not be in the positions of power for their entire life. They might be rotated, transferred or fired anytime in future. Therefore, constantly tracking who is in, who is out, who is rising, and who is falling is important. The departure of any key person (e.g. important politicians or a top executive in a business group) within the guanxi networks can cause great discomfort (Chua, Morris & Ingram, 2009). This means that building guanxi is a continuous process, and includes spotting and cultivating connections with

potential candidates before they assume positions of power. Thus, (Western) businessmen need to have strategic approach when they determine to establish guanxi with their targeted guanxi person(s). A better approach is to identify targets that could be useful over a broader time horizon. However, it is important to understand that even good guanxi networks cannot substitute for a sound business strategy. Rather it is a tool to help implement a business strategy more effectively (Vanhonacker, 2004).

For the Western businessmen who are not familiar with Chinese markets and culture, it is fine to utilize the guanxi networks of their local managers for a short term. However, in a long run, they should acquire their own guanxi with local business partners. Indeed, Confucianism strictly emphasizes the hierarchy of social status in which Chinese business owners are often eager to meet and discuss business only with business partners who are also the owners or at least hold equivalent positions such as general director or CEO. Sending lower-ranking executive regardless he/she is the best fit professionally to the negotiation or business meetings with Chinese partners is considered as insulting. This is because they assume their social status is not appropriately respected (Graham & Lam, 2003). This is fatal mistake and severely affects the process of guanxi development.

Additionally, as mentioned, *guanxi* involves personal feelings and emotions of one person towards others and it is not supposed to be bought or traded. Therefore, businessman should not overemphasize on gift-giving or repeatedly dining and drinking to build *guanxi* even if this activity is a part of the process (Luo, 1997). The misconception of building *guanxi* may not only lead to the failure of *guanxi* establishment but may also cause inconvenience for both parties. This is because *guanxi* builder may keep giving expensive gifts on one hand; on the other hand, the targeted *guanxi* is obliged to reciprocate. When *guanxi* builder does not get what he expects in return and/or the targeted *guanxi* is not able to pay back, the situation becomes catastrophe (Sun et al., 2011). This is where *guanxi* turns into liability for the both parties.

Furthermore, *guanxi* relationships revolve not only around favour exchanges when necessary but also long-term continuity. *Guanxi* holders should not only focus on exploiting their *guanxi* networks or only “re-heating” *guanxi* relationships when they want to ask for favour. Many Western managers based in China assume that it is enough to establish a relationship and then they can call on this contact as needed. *Guanxi* is not an emergency brake. If a *guanxi* is only activated and called upon when there is trouble, one has already eliminated himself from opportunities to build roadblock to prevent troubles. And once there is trouble, it is often too late to fix the situation and his contact is unlikely to act on his behalf (Vanhonacker, 2004).

CONCLUDING REMARK

Although improvements in the institutional environment, social structure, legal and regulatory frameworks in Chinese-speaking societies and Confucian influenced countries may reduce the role of *guanxi*, the cultural heritage will remain and continue influence the behavior of people. *Guanxi* has formed Chinese culture for thousand years, thus it is not easily to be eroded in Chinese social behavior including the embedded business activities. Despite variety of *guanxi* and its practices, one should note that true *guanxi* cannot be replaced by systems, document, and procedures. It is personal relationship and is nurtured by accumulated feelings and emotions through close personal interactions and socializing. Anticipating and sensing the need of the other party is an essential way to grow *guanxi* relationship in personal and business contexts. Understanding and practicing *guanxi* properly will facilitate the business success in relationship-based markets such as China and other Confucian countries in the Asian region. Yet, it should be used as a tool and not a substitute for a sound business strategy.

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