

# Home Ground Advantage

## Foreign Internet Companies and Guanxi Utilisation in China

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## Abstract

The leading internet companies display a dominance in world markets unparalleled in many industries. Despite this, China remains a hurdle no major internet company has been able to overcome. The role of government, culture and strategic decisions are all posited as potential explanatory factors. This paper concentrates on the significance of guanxi as an explanatory factor, linking its utilisation to the firm specific characteristics of strategic orientation, size, technological capability and managerial capability. A working definition is established and applied to primary data obtained from interviews and case studies created with secondary data. The research found that while the significance of guanxi as an explanatory factor varies with firm characteristics, it regularly appears as an important consideration for foreign entities operating in China. Furthermore, it both resembles and distinguishes itself from networking in a western sense.

Keywords: Guanxi, China, Internet companies, Networking, EBay, Google, Microsoft, Relationships

## Acknowledgments

Of course no thesis is complete without proper acknowledgment of the brilliant individuals providing feedback, motivation and a welcome relief along the way.

The most heartfelt thanks must go to Stefan Brehm, my supervisor. Admittedly I did not utilise your brilliant mind anywhere near as much as I should have, but your insights were spot on every time. I am most grateful.

To my family, thanks for not only supporting, but encouraging my decision to travel across the world to study Asian Studies in Sweden. I'm incredibly lucky to have such support.

To my friends in Australia, thanks for the welcome Skype calls (P, P & S). And to those in Lund for making my academic and social life here in Lund an unforgettable one.

To my colleagues, thank you for being incredibly understanding and supportive of my studies.

Additionally, an immense gratitude is owed to the individuals I encountered, interviewed and drank too much báijiǔ with during field research. To the startup community in general, I was astonished at the work ethic and brilliance observable in both Beijing and Shanghai and it was a pleasure to witness this first hand. I can't wait to use the products and services you create in the future.

Final thanks go to the staff and students at the centre. I still don't know what Asia is, but I've learned much along the way and have developed a great deal of respect for the research and contributions you all make to understanding this fascinating, large and diverse region.

Enjoy.

Edoardo Neerhut

May 2016

## Abbreviations

B2B	Business to business
BBS	Bulletin Board Service
C2C	Customer to customer/consumer to consumer
FCPA	Foreign Corrupt Practices Act
ICP	Internet Content Provider
ISP	Internet Service Provider
KRF	Knowledge Receiving Firm
KSF	Knowledge Source Firm
MIIT	Ministry of Industry and Information Technology
MOE	Ministry of Education
R&D	Research and Development
SCIO	State Council Information Office

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# 1 Introduction

In a short space of time, a number of internet companies and technology firms have emerged as some of the largest corporations in the world. They have successfully expanded their operations across international boundaries to become leaders in their respective sectors.

Despite the monopolistic power some of these firms hold across markets, China continues to pose a seemingly insurmountable challenge. There remains to be a large, foreign internet company that has established a significant and sustainable market share in China.

Government intervention is often put forward by business commentators and spectators as the key difference between China and other markets, but even companies enjoying relatively little government intervention struggle to establish a meaningful presence in China. Literature is largely divided between sector and firm specific factors and or a range of cultural factors. Prominently raised as an explanatory factor is *guanxi*. This paper seeks to explain if indeed it is a factor and if so, how it can be utilised to lead a sustainable operation in China.

To address this dilemma, the following research questions were devised:

- *Is guanxi a relevant factor for foreign internet companies operating in China?*
- *In what ways can it be used to assist foreign internet companies operating in China?*
- *What other factors have played a role in the failure of foreign internet companies in China?*

Departing from literature and business commentary, the following hypotheses emerged:

1. Foreign internet companies have not sufficiently developed *guanxi*
2. *Guanxi* in China is distinctive from other relational networks globally

In the second chapter of this paper, literature is reviewed to cover the key themes, foreign business in China, *guanxi* and knowledge acquisition and management. The latter serves as a conceptual tool linking *guanxi* to tangible outcomes. In the third chapter, a theoretical framework is provided to establish a working definition of *guanxi*. Four additional hypotheses are introduced to help analyse the relation between firm characteristics and *guanxi* utilisation. The fourth chapter provides details regarding the research design and data collection methods as well as the ethical considerations and limitations that were encountered. In chapter 5, the data is presented, with the first section covering the interviews

and key themes that were derived. The second section of chapter 2 introduces and analyses three case studies of foreign internet companies operating in China. In the following chapter, the results are discussed, linking together data obtained from the interviews and case studies with the theoretical framework. The second part of this chapter puts forward some of the implications for foreign internet companies operating in China. The final chapter relates these findings back to the research question and hypotheses, providing closing remarks to address the research problem.

The research highlights the varied, but prominent role *guanxi* plays across firms with different characteristics. It identifies ways in which *guanxi* is distinguishable from networking in a western sense as well as areas of similarity. The interviews and case studies also raise a number of other significant factors that can both assist and hinder a foreign entity in China. Overall, the research aims to provide foreign internet companies operating in China an idea of where *guanxi* is applicable, and when strategic focus should lay elsewhere.

## 2 Literature Review

The literature review for this paper covers the main viewpoints concerning the concepts and theories inherent in the research question. For this reason, it begins with literature on foreign businesses operating in China and the challenges they face. In the second section, a review of relevant literature on *guanxi* is conducted to provide an introduction to the concept. Further clarification is outlined in the subsequent theoretical chapter. The final section of the literature review details knowledge management theory, which is often linked to *guanxi* to assess the tangible benefits *guanxi* may provide.

### 2.1 Foreign Businesses in China

It is striking how many examples there are of large multi-national enterprises that fail in China. Despite their significant resources and track record of operating successful ventures in countries around the world, China presents an insurmountable challenge for many. International Business literature presents a variety of explanations, but the nuances of doing business in China make the primacy of any one explanation or theory impractical. In his book *One Billion Customers: Lessons from the Frontline of Doing Business in China*, McGregor (2005) steps through case studies of firms in different industries to demonstrate those that have been successful and those whose China forays can largely be deemed a failure. Many of the lessons remain relevant, but a closer look at internet related ventures is necessary, given the rapid developments that have taken place in this sector since 2005, when McGregor published his book.

Internet companies make for a very interesting case study, in part due to the apparent contradiction between conventional logic and reality. An initial analysis might conclude that internet firms have significant advantages doing business in China relative to firms with a more traditional business model. For example, a company that provides its good or service via the internet is generally able to access a vast number of consumers with greatly reduced transactional costs (Zeng and Glaister, 2015: 2). China is already the largest internet market by users in the world and foreign internet companies are instantly able to access the 721.4 million digitally connected consumers (Internet Live Stats, 2016). Despite this, multinationals with vast financial and technological resources such as Amazon, eBay, Google and Groupon have not been able to develop a substantial user base in the country.



Zeng and Glaister (2015) paper uses interviews with employees of four leading multinational internet portal companies (IPCs), and contrasts the findings with employee interviews at their locally based competitors. The two lines of reasoning they employ stem from international business theory, a capabilities-based theory and the institutional view. Capabilities-based theory involves a firm's ability to apply the competitive advantages within the local, often fast changing context. Institutional view concerns the external factors that challenge a firm operating in China. These include formal rules and regulations as well as tacit understandings imbued in cultural norms. This paper focuses on the institutional element, using a similar interview based approach alongside case studies to determine how relevant *guanxi* is in an internet company's success or failure. Given the importance of relationships *guanxi* and its impact on knowledge transfer and management becomes a focal point.

## 2.2 Guanxi (关系)

*Guanxi* is a term used to describe the relationships between people and how they influence the dynamics of organisations and the behaviour of individuals. Whilst many of the characteristics of *guanxi* are evident around the world, the term signifies how engrained these relationships are in China and the more prominent role they play within Chinese society. Park and Luo (2001: 455) describe *guanxi* as “a cultural characteristic that has strong implications for interpersonal and inter-organisational dynamics in Chinese society. It refers to the concept of drawing on a web of connections to secure favours in personal and organisational relations.” In defining *guanxi*, (Wang et al., 2012) also note the reciprocal element with the “specific expectations and duties” as well as the “exchange of personal resources and valuable information” that makes *guanxi* a vital tool for business. Davison and Ou (2008: 282) go further and include “utilitarian obligation” in their definition, but also point out the Chinese people are far more likely to conduct business with people for whom they already have established *guanxi*.

In understanding why *guanxi* has become so ingrained within society, Hsiung (2013: 20) looks at Confucianism's historical role. He looks at five cardinal values and hypothesises that these are complimentary to many of the concepts within *guanxi*. Despite focusing on the personal, rather than business implications of *guanxi*, his own definition is still relevant. Hsiung identifies three elements. First, that it refers to social connections outside the family; secondly, that emotions such as trust are a core component; lastly, that it can be both a tool

for utilitarian and emotional purposes. Park and Luo (2001) also reference historical roots in Confucianism to explain *guanxi*. They draw attention to *mianzi* (“face”) and *renqing* (“obligations”) as philosophical foundations that influence the dynamics of *guanxi*. When *guanxi* is bound by *ganqing* (strong affection), the sentiment is even stronger. While not a core aspect of this paper, it is important to understand these historical linkages to appreciate how *guanxi* still plays a role in a rapidly developing economy.

Interestingly, (McGregor, 2005: 120) doesn’t explicitly mention *guanxi* as an important factor in his analysis of business in China. He uses the term only once and describes it as “overrated, temporary, non-transferable” and as residing only “in the hands of the individual who has it.” This is undermined by many of the statements and observations that characterise his book however, where he adamantly stresses the need to build relationships and understanding with government and major stakeholders. Furthermore, his assertion that *guanxi* is non-transferrable contradicts other research, which describes the transferability of *guanxi* as one of its unique traits (Park and Luo, 2001: 474). Ramasamy et al. (2006: 132) support the notion that *guanxi* is important in a market like China where centralised decision making and low structuring of activities make “*guanxi*...an enabler of transactions.” To complicate matters further, the survey data of Fock and Woo (1998: 37) suggests that “*guanxi* performs different roles and has different effects” depending on the business executive. Thus this research alludes that the characteristics and use of *guanxi* differ between industries, companies and the individuals themselves.

Overall, literature on *guanxi* seems to be divided on whether or not it is an important consideration for foreign firms doing business in China. Some of the literature contradicts itself, highlighting the abundance of relationships in business and the need to interact with government while remaining sceptical that foreign businesses need to develop relationships of their own. A closer look at internet firms becomes relevant to identify particular instances where *guanxi* may or may not be relevant. In the theoretical chapter, a definition of *guanxi* will be introduced, utilising aspects of the literature that has been outlined in this section.

### 2.3 Knowledge Acquisition & Management

While the previous section introduced the concept of *guanxi*, the following section outlines theories on the tangible influence it has on knowledge management and acquisition.

Knowledge management is a relevant part of the research as it concerns the ways organisations share information both internally and externally. As such it demonstrates some of the tangible and intangible ways *guanxi* influences firms operating in China. In a society where businesses are quite reluctant to share information, *guanxi* helps facilitate knowledge transfer between individuals and organisations (Ramasamy et al., 2006: 132). Building on from Inkpen (2000) who proposed that there are three main sources of knowledge available to the firm (internalisation, market contracts and relational contracts), Ramasamy et al. (2006) examine the link between *guanxi* and this third source of knowledge for the firm. Relational contracts includes inter-firm networks such as Zhongguancun technology hub (China Pictorial, 2002) as well as strategic alliances like the agreement between Renault and Nissan (Renault-Nissan, 2016). Their results found that foreign firms seeking to learn from Chinese firms should build trust and communication with local firms to enable knowledge transfer. They suggested that clustering organisations through industrial parks and incubators improves this process, however they raise the risk of a communication breakdown when trust is too high was. Such a risk would occur when the knowledge receiving firm (KRF) assumes that the knowledge source firm (KSF) is providing accurate information, making less of an effort to maintain communication. This could be perceived as potential risk of *guanxi*, whereby the KRF offloads some of the responsibility of knowledge acquisition to the KSF, failing to develop the capabilities internally. Nevertheless, they assert that the knowledge acquisition benefits through *guanxi* and relational contracts outweigh the aforementioned risks.

In their survey of managers in China, Davies et al. (1995: 210-211) identify some of the more tangible knowledge acquisition outcomes that *guanxi* facilitates. Transactional benefits were favoured above all else, followed by information and access to resources. Transactional benefits include the ability to collect payments more easily. Information includes details on government policies such as import regulations and restrictions. The third aspect is access to resources. In the more centrally-planned aspects of the economy such as the oil and steel industries, the State Bureau of Materials has significant sway over the production and allocation of resources. Knowing individuals who are familiar with these complexities can smooth the process of a business operating in this environment. Although the survey was conducted in 1995, before the internet became as pervasive as it is today, the results are still significant. Of the 150 respondents, 98% rated personal connections with local Chinese organisations as a major factor in their business life.

Contrasting the period in which this survey was conducted to today, many industries are now subject to market forces and internet companies in particular are less reliant upon the resources mentioned above. Thus a similar study, conducted today and focused on this sector is necessary.

As the above literature review shows, general texts concerning China market entry, *guanxi* and knowledge management are prevalent. Texts that look at how these aspects intersect with one another have also helped to improve the understanding of *guanxi* as a factor for both domestic and international businesses operating in China. Given the relatively young history of the internet sector however, there is little research that assesses how these issues affect this particular industry. The research in this area that does exist tends to focus on the e-commerce industry, as *guanxi* is easier to conceptualise when a network of suppliers is being involved. Thus the objective of this paper is to see whether the theories asserted in the literature are evident not just in e-commerce, but in other foreign internet firms that are trying to establish a foothold in China. Through a combination of interviews and case study analysis, this paper will test the hypothesis that *guanxi* remains an important consideration for foreign internet firms seeking to be successful in the domestic Chinese market. The following theoretical section serves to establish a working definition of *guanxi* and a means with which to assess its significance across varying firm types.

### 3 Theoretical Framework

To be able to identify whether *guanxi* is an observable phenomenon and indeed a relevant one for an internet company, a working definition is needed. The concept itself is nebulous with shifting definitions in the literature. For this reason, a focus will be given to the unique aspects of *guanxi*, the aspects that are more clearly distinguishable from networking in the western sense. With the definition established, the four relevant hypotheses from Park and Luo (2001: 460-466) are taken and applied in the data analysis section.

#### 3.1 Defining Guanxi

The definition of *guanxi* provided by Park and Luo (2001: 455) serves as the basis of the definition established in this paper. *Guanxi* is approached as a cultural characteristic that influences interpersonal and inter-organisational dynamics. It refers to the way individuals may utilise connections they have with other individuals to secure favours for personal and professional purposes. Favours include the exchange of personal resources and or information, with “specific expectations and duties” arising for favours granted (Wang et al., 2012: 4049).

Three characteristics from literature on *guanxi* have been adapted, to establish a consistent framework to identify instances of *guanxi* in the interviews and case studies. The first characteristic is *trust* which serves as a risk mitigation tool when conducting transactions. By operating with people you are more comfortable with and have a degree of trust with, you are minimising the likelihood of the business relationship not working out. Trust can develop from feelings of kinship, ethnicity and or shared experiences (Hsiung, 2013: 20-27).

The second characteristic is the expectation of reciprocity, which was introduced in the literature review as *renqing* (obligations). The linkage between *renqing* and *mianzi* (face), encourages stakeholders to fulfil the favours requested of them by their *guanxi* network.

The third and final characteristic that is used to identify *guanxi* its *utilitarian* nature. Rather than being subject to emotional ties, the network is sustained by an exchange of favours (Park and Luo, 2001: 457). Emotion may be involved in the formation of trust and friendships, but the aim of utility in the exchange further distinguishes the concept.

The utilitarian aspect of *guanxi* is what leads to debate over whether *guanxi* is distinctive from networking. In a western sense, one uses the connections they have developed both in professional and personal spheres to help them achieve their objectives. Two elements,

identified by (Luo, 2007: 50-52), are used to help distinguish the concept from what may more generally be described as networking in a western sense.

### 3.1.1 How Guanxi Differs from Networking

The first of these is that a Chinese firm will generally establish *guanxi* first, with a successful relationship leading to a transaction. The majority of Western businesses on the other hand begin with the transaction. A successful transaction or a series of transactions over time may then lead to the formation of a deeper relationship. This difference highlights the personal nature of *guanxi*, where one is assessed by their personal commitment to a long term partnership. As Luo (2007: 50) describes “*guanxi* is an investment in a relationship”. This contrasts to the transaction focused relationship in the West where one is assessed relative to their commitment to the organisation and its objectives.

The second difference is what Luo describes a goal congruity. This refers to the analysis Western firms conduct when forming networks. With this approach networking takes place when firms identify a “strategic and organisational fit”. For Chinese firms, goal congruity helps the viability of a relationship, but is not seen as a necessity. Consequently, firms with very different realities may find areas of synergy despite operating in completely disparate industries. It must be noted that *guanxi* may extend beyond these boundaries, but the more lenient the definition, the harder it is to validate the existence of *guanxi* with certainty. It must be noted however, that even in the absence of these two elements, *guanxi* may contain many of the characteristics associated with western networking.

## 3.2 Testing Hypotheses

To place *guanxi* in an organisational context and to assess its prevalence in the interviews and case studies, four hypotheses from Park and Luo (2001: 460-466) are tested. Their study proposes eight hypotheses, grouped into four areas: institutional factors, strategic orientation, organisational factors and firm performance. A summary of these hypotheses can be found in Appendix 1. Institutional factors concerning government ownership and economic regions are not considered, as the study focused on foreign firms operating primarily in Beijing and Shanghai. One hypothesis from organisational factors was also excluded from the research as it concerns the time a company has been operating, which was relatively similar for the companies in this study. Lastly, the hypothesis regarding *guanxi* and firm performance was

not included as access to reliable, China specific data on revenue and profitability for the companies involved was not available.

The first hypotheses selected is hypothesis 3, which comes under strategic orientation. It asserts that firms with a market oriented strategy are more likely than efficiency orientated firms to utilise *guanxi* (Park and Luo, 2001: 462). These strategies are relevant considerations in the interview stage as they highlight two distinctive ways in which foreign firms conduct their operations in China. Although firms can possess characteristics that would place them in both categories, market-orientated firms are those that are continually identifying new product and market opportunities. Efficiency-orientated firms place more emphasis on improving their existing operations through cost reductions and technological innovation.

The next three hypotheses they propose relate to the organisational characteristics of a firm. Firstly, they propose that small firms are more likely than larger firms to utilise *guanxi*, with larger firms encumbered by bureaucracy and structures that limit personal connections. Their own research proved this hypothesis inconclusive.

Additionally, they propose that firms with poor technological skills are more likely to utilise *guanxi*. They assert that firms who have a technological edge are able to leverage this advantage by developing new products and bargaining with the government. Technologically weak firms on the other hand resort to *guanxi* to minimise their disadvantage.

Lastly, they posit that firms with poor managerial capabilities will similarly compensate by developing their *guanxi* networks. Firms with strong managerial capabilities are able to focus on other areas of the business such as R&D, product offerings, pricing and marketing.

In the data analysis chapter, the definition of *guanxi* established here will be used to identify instances where *guanxi* is apparent. The hypotheses are then tested relative to the interview responses and the case studies to ascertain the degree to which it serves as a strategic tool for foreign internet companies.

## 4 Methodology

This section will outline the process of conducting the research from conceptualisation through to the analysis of data.

### 4.1 Research Design

Data for this paper was obtained through semi structured interviews and case studies which were established using secondary sources. This can be described as a cross-sectional approach as the data collection and analysis involved multiple cases at a single point in time (Bryman, 2012: 59). While cross-sectional research more frequently involves a quantitative approach, a qualitative research design can also apply cross-sectional design principles (Bryman, 2012: 62). A cross-sectional research design was selected as it facilitates the identification of patterns of association between variables at a given point in time. The interviews and secondary data used to form the case studies were analysed to identify whether there is a consistency across cases supporting a link between internet companies and *guanxi*.

### 4.2 Data Collection

#### 4.2.1 Sourcing the Interviews

A total of 11 interviews were conducted, 4 of which were formal, semi-structured interviews, the remainder being conversational and unstructured. To ensure a thorough analysis, only the semi-structured interviews have been utilised in this paper. Three of the four interviewees were engaged at networking events. The other interviewee was contacted via email, with a mutual friend serving as a means of introduction. Networking events were chosen due to the central role they play within startup communities, bringing people together from different fields (Atagana, 2013). Being able to talk to a large number of people in a short space of time is a more efficient way to identify interviewees relevant to the research. They also served as a source of general information on the startup community in China, internet companies and general trends.

Networking events were discovered on [Meetup.com](https://www.meetup.com/), a network of groups covering various topics where anyone can organise events (Meetup.com, 2016). Using this platform allowed networking events to be narrowed down to the topics of “technology”, “computer programming”, “web development”, “cloud computing” and “internet startups”. The first meetup attended is a bi-monthly event called Lean Startup Beijing, that encourages both current and aspiring entrepreneurs to discuss their businesses. Three of the interviewees were



approached at this meetup. Other networking events that were attended included two hosted by the Australian Chamber of Commerce, Beijing Tech Hive, Beijing Pitch Practice and Shanghai Wired Tech Craft. The informal interviews were conducted at these events, with the challenges facing foreign tech companies operating in China and *guanxi* utilisation the main focus points. Of the semi-structured interviews, three were conducted in Beijing, with one being conducted in Shanghai with an interviewee met in in Beijing.

Each of the interviewees in the semi-structured interviews was asked if they would be willing to take part in an interview at a later date. This was then followed up with an invitation to meet. Three of the interviews took place at the office of the interviewee and one at a café. Two of the interviewees work directly for an internet company, one in ecommerce and the other for a SaaS accounting solution. The remaining two interviewees work directly with internet companies through their roles as an IT solution provider for foreign companies operating in China and as a relationship manager for Australian businesses operating in China.

#### 4.2.2 Structuring and Presenting the Interviews

An interview guide was created prior to the first interview. Initially eight general questions were developed, with these being posed to interviewee 2. They can be found in Appendix 2. Whilst these questions elicited detailed responses from the interviewee, the focus shifted too much to areas unrelated to the research. For this reason, the interview guide was revised, with 10 questions developed under the categories of general, relationships and trust (see Appendix 3). A balance was made to ensure a degree of consistency with the previous interview guide whilst maintaining focused and relevant responses.

English was the second language for three of the four interviewees and as such some questions had to be repeated or rephrased. The interviews for which there was an audio recording were analysed and key themes and anecdotes were derived. Notes from the remaining interview were used alongside the audio recordings. Text that appears in quotes from interviewees has not been reworded and represent the expressions of interviewees exactly. In other circumstances, every effort has been made to represent the interviewees' answers as accurately as possible.

### 4.2.3 Case Studies

Case studies were selected to compliment interview data and to provide a context to better understand the significance of *guanxi* and whether the hypotheses hold. The cases may be classified as representative, or as (Bryman, 2008: 55-56) prefers, exemplifying cases. By this, it is meant that they more broadly exemplify the challenges foreign internet companies face when entering China. Each of the cases is not meant to appear as an outlier or as an exception, but as a typical example.

### 4.3 Ethical Considerations

Every effort has been made to ensure research was carried out in an ethical manner in accordance with faculty guidelines and those provided by the Swedish Research Council (Swedish Research Council, 2016). At networking events, in digital communications and preceding all interviews, an outline of the research was introduced, as was the role of the researcher and the purpose of the research as a Master's thesis. Interviewees were always asked if they were willing to participate in the research process and they were informed that their responses may be used in the final research paper. Permission was requested for both note taking and the audio recordings that took place. Additionally, interviewees were assured they would remain anonymous and that paper would appear publicly.

### 4.4 Limitations

Despite best efforts to ensure the reliability and validity of the research, there are a number of limitations inherent with the research.

Firstly, as it has been identified, *guanxi* is a nebulous concept with competing definitions put forward by researchers. The definition outlined in the theoretical section will differ to others that have been made, but represents the intention to distinguish *guanxi* from networking and other utilitarian social linkages.

Secondly, four semi-structured interviews were conducted with individuals from different backgrounds. The varied backgrounds of the interviewees served to give insights into internet companies, but a larger number of interviews may allow for greater comparability.

Additionally, the interview questions were changed after the first interview was conducted. Although this makes comparison more difficult, the aim was to ensure that interview questions were more aligned with the theoretical framework. Lastly, it would be difficult for a researcher attempting to replicate this study to find interviewees with similar profiles and

elicit responses in the same manner. This in part due to the loose criteria for selection in addition to the line of questioning that required varying levels of flexibility. Tailoring questions to interviewees to elicit more meaningful responses was seen as a worthwhile approach, despite issues of replicability.

In regards to the case studies, the main issue that arises is whether these cases are representative of foreign internet companies or simply the individual companies involved. While links are drawn between them, there are many case specific circumstances that may or may not have relevance to other firms. For this reason, the paper is careful not make generalisations, but does allude that the cases may contain explanatory factors for other foreign internet companies that have failed in China.

Furthermore, all data pertaining to the case studies is obtained from secondary sources and as such the accuracy of certain events cannot be confirmed. Many different sources were used to corroborate accounts of events where possible.

## 5 Data Analysis

The data analysis chapter is comprised of two main parts, a presentation of the data itself followed by a discussion of the implications. The presentation of the data begins with a thematic analysis of the interviews, with the identification of similarities and differences between interviews and perceptions of *guanxi* and internet companies in China. Relevant cases and examples are included alongside the interview responses.

This is followed by a review of case studies, examining foreign internet companies who have had varying degrees of success in the Chinese market.

The findings are then discussed in chapter 6 along with the implications for foreign internet companies.

### 5.1 Semi-structured Interviews

The semi-structured interviews ranged from roughly from 30-60 minutes in length. While the questions were largely consistent for three of the interviews (see Appendix 2 & 3 for a list of questions), the answers varied considerably from interviewee to interviewee, often reflecting the unique professional background each one of them had. This is interesting given that books such as *Social Connections in China* by Gold et al. (2002) open with the preface that *guanxi* is “the most important, talked about and studied phenomena in China today...important in almost every realm of life, from politics to business.”

For this reason, a thematic analysis was conducted, to see whether similar opinions are shared by individuals who live and work in China and deal with internet companies on a daily basis. A thematic analysis is a suitable method to identify common linkages in their interpretations of *guanxi* whilst retaining the essence of the personal experiences they have had. The results indicate perceptions of *guanxi* and its significance in their business and personal lives. These perceptions influence the way each of these individual’s approach *guanxi*, and whether it is a concept they consider relevant in their day to day lives.

When reviewing the interviews, six categories were created for the thematic analysis. Whilst some of these stem from topics that the research questions addressed, others were added as a consequence of the answers provided by interviewees. The categories are as follows:

*Government relations* – This category concerns the perception of government relations for companies and its level of importance in operational factors. While sector specific, the aim is

to get an underlying sense of how government relations are approached in China and whether the cultivation of *guanxi* with government is something the interviewees have perceived.

*Firm size* – Each of the interviewees was asked whether they feel larger firms are more dependent on relationship building than smaller firms and vice versa.

*Competitive advantage* – Questions regarding the competitive advantages of Chinese companies were an indirect way of assessing the significance of *guanxi* in the dominance of Chinese internet companies. If local relations and connections with government were regularly cited as being a major advantage for Chinese internet companies, then a clearer link to *guanxi* could be drawn.

*Institutions & Regulation* – In assessing how *guanxi* provides practical benefits, its ability to help avoid or better understand regulation was regularly mentioned. Additionally, the role institutions play in regulating the internet sector was examined.

*Personal networks* – This theme was established to see if there is a distinction between the way in which one uses their networks for professional purposes and the way they use it to achieve their own personal objectives.

*Uniqueness* – This was an issue raised many times in discussions and pertains to the question of whether *guanxi* is indeed a Chinese phenomenon. Perceptions of uniqueness varied, from *guanxi* embodying unique Chinese traits to being almost identical to other utility based networks around the world.

The interviewees will be referred to as interviewees 1-4, with table 1 outlining their respective backgrounds.

*Table 1*

Interviewee 1	General Counsel of a large Chinese e-commerce company
Interviewee 2	CEO of an Chinese based SaaS accounting solution
Interviewee 3	Senior Relationship Manager at the Australian Chamber of Commerce
Interviewee 4	Senior Associate at an IT advisory firm assisting foreign companies with their IT needs and market entry into China

### 5.1.1 Government Relations

When *guanxi* is discussed, it is often images of banquets attended by government officials and senior company managers that comes to mind. Indeed, much of the literature on conducting business in China stresses the central role the government plays across all facets of business. As the case studies later in this section will illustrate, there have been some high profile examples of government intervention curtailing the aspirations of internet companies operating in China. It was thus a surprise that the interviewees presented a rather subdued picture, with government intervention and relationship building more common for larger companies.

### 5.1.2 Firm Size and Government

The most frequent assertion made by interviewees 1, 2 and 4 was that larger companies are more likely to pursue relations with government. When asked if government connections are necessary when doing business in China, interviewee 2 went further, stating “with growth, it’s 90% inevitable.” Alibaba and Tencent were cited as examples of Chinese companies that faced closer government scrutiny as they become more successful and influential. Interviewees 1 and 2 have both worked for large companies and as such are speaking from direct experience. Interviewee one in particular mentioned that her company had a government relations department, but stated “Actually I think most medium sized and big companies have this department. You know I worked for [foreign company] before and even [foreign company] has this department.” Here interviewee 1 is indicating that it is not only Chinese companies that actively maintain government relations, but large foreign multinationals as well. In reference to these large multinationals, interviewee 4 stated “at that level, at these big companies providing these services for a lot of clients, at that level it is really related to the government.” This perspective was said to be drawn from industry events where leading IT multinationals discussed government legislation and how it affects their sector. At the other end of the spectrum, discussing small and medium sized enterprises or smaller China branches of large multinationals, interviewee 1 mentioned that “we don’t really see it on a daily basis.” Thus when it comes to the industries interviewee 1 has most experience in, the government did not seem as pervasive as often assumed. The experiences of interviewee 3 on the other hand were more closely connected with government. As a representative of a chamber of commerce, he links Chinese entities with both Australian businesses and government. Consequently, he operates across industries with varying degrees

of government oversight. The role also entails advocacy on behalf of Australian companies to both the Chinese and Australian governments. When asked the importance of government relations in his day to day work, interviewee 3 responded “hugely important. First of all, because of our registration with the Chinese government and secondly because we are a platform for members.” He went on to describe the difficulty in recent years that mining companies in particular have had obtaining direct access to government ministries such as the Ministry of Commerce. Consequently, the companies look to the chamber as a means of accessing Chinese ministries “to raise their opinion or lobby” using the chamber “as a channel or a mechanism to lobby more holistically on behalf of the Australian business community.” He described government departments as “siloes off”, often operating independently with one another, hampering communication flow. The implication here is that forming a relationship with government officials prior to transacting with them is more likely to result in a favourable outcome.

### 5.1.3 Regulation

The efforts of foreign companies to “raise their opinion or lobby” government through less overt means such as a chamber of commerce may be a direct consequence of their being foreign. Continuing her reference to the foreign company she formerly worked for, interviewee 1 went on to state “But of course as a US company we need to follow FCPA. Maybe that is the major difference between China and US companies.” By this she is pointing to the abidance of the Foreign Corrupt Practices Act (FCPA) as a key difference between Chinese and US companies. The FCPA is legislation that prohibits the bribery of foreign officials to obtain business. In addition to this stipulation, publicly traded companies are also required to maintain accurate books and records. Failure to comply with this legislation can result in sanctions and prosecutions for the individuals involved, regardless of the jurisdiction in which the crimes were committed (U.S. Securities and Exchange Commission, 2014). This inference of interviewee 1 may be that many common practices of Chinese organisations would be deemed in breach of FCPA legislation, leading to differing operational procedures for Chinese and US companies. The implications are likely extend to foreign companies more broadly as legislation similar to the FCPA exists throughout OECD member nations, (Organisation for Economic Co-operation and Development, 2016). Despite this suggestion, she did not explicitly reveal anything of her own experiences, either in companies she has worked for, or companies she has worked with. Another key aspect of

regulation affecting companies operating in China is the Internet Content Provider (ICP) number. This is mandatory for all websites that are operating within in China, and companies without one can be shut down at any time by the Internet Service Provider (ISP). Once a company registers and obtains an ICP number from the Ministry of Industry and Information Technology (MIIT), it can be used for any of the websites they operate (Microsoft, 2015). There are two categorisations for organisations applying for a number. The first is for “commercial ICPs” and includes ICPs that advertise online, sell goods and services, server leasing, website production and any other revenue generating activities. The second category is “non-commercial ICPs” and is designated for ICPs that are providing information to the public. This includes government departments, newspaper archives and periodicals, websites that contain product information and websites that provide a public benefit (Baker & McKenzie, 2001).

Although she did not go into too much detail on the matter, interviewee 1 mentioned that “actually we need government help to do some things like, we need to apply for a license or permit like the ICP license.” This was in reference to the role of her company’s government relations team. It was not clear if their relations with government are focused on understanding and dealing with bureaucratic considerations or if they are actively taking steps to bypass and/or fast track regulatory procedures.

For interviewees 1 and 3 at least, government relations are an aspect of *guanxi* that they deal with on a daily basis. For interviewee 1, this entails the government relations team of her company and the regulatory work they collaborate with her on. In addition to the licenses and procedures of establishing the online business, there is also the ongoing maintenance of the relationship to show that the products they are selling online satisfy their respective safety regulations from food and beverage categories to toys. In the experiences of interviewee 1, this is more of a standardised relationship rather than one that is cultivated through *guanxi* networks. She went as far as to say that for her company at least, such behaviour would be counter-productive as potentially faulty products would not be identified, leading to potential reputational and financial damage. This is a case of a company with seemingly strong managerial capabilities resisting the possibility of *guanxi* utilisation.

Interviewee 3, did not have any substantive experiences working with foreign internet companies. Nonetheless, he does engage regularly with Chinese based ecommerce companies, connecting them to Australian suppliers and advising on sector specific regulatory considerations. He also provided a unique perspective on the interaction with and



operation of government institutions, industry regulation and a foreigner's perspective on the utilisation of personal networks.

It has been evident in the previous sections and the comments of the interviewees that answers regarding aspects of *guanxi* vary considerably across industries. Interviewee 3 presented clear examples of government lobbying by foreign multinationals in the mining, food and beverage sectors, using the chamber of commerce as a substitute for reduced personal access. While this bares the hallmarks of *guanxi*, with the relationships being developed first, there is not enough information to distinguish it from traditional lobbying or networking. In the experiences of the interviewees, 2 and 4 who work in information technology, government relations were only existent when operational procedures required, and not a concerted effort to win the favour of influential government representatives.

#### 5.1.4 Guanxi and Institutions

Interestingly, the discussions with interviewees pointed to *guanxi* becoming a more important factor in circumstances where regulation is weak rather than where it is strong.

The internet especially is an area where regulation is consistently being outpaced by innovation. It was only in 2015 that about half of China's population of 1.3 billion gained access to the internet (Yang et al., 2015: 1). By contrast, 52% of adults in the United States were connected to the internet in 2000 (Perrin and Duggan, 2015). It is thus understandable that a platform like the internet, that disrupts so many industries is leaving MIIT to play catch up. Indeed, even markets such as the United States and Japan where the internet is more established there are still many regulatory issues arising. Airbnb and Uber represent two prominent examples of innovation outpacing regulation and posing substantial challenges to the hotel and taxi industries respectively (Smith, 2016). China is facing the same challenges, albeit with a different legal framework, one that in the opinion of interviewee 1 has a very different approach to regulation. She pointed out the systemic differences, China being heavily influenced by civil law and the United States being based upon common law. She described the respective merits of each system as follows, "In the US the legal system is based on common law. There are many cases. Those cases happen every day. Every day they have a valid case to become new law, a new law that they can follow. The good thing is they have a clear rule to follow, the bad thing is there are too many rules." The last point was a particularly important one when it comes to considering the impact of regulation and institutions on internet companies operating in China. Interviewee 1, a lawyer who has

studied and worked both in the United States and China is of the opinion that whilst US commercial law concerning internet companies is more up to date, it is burdened down in a way that the Chinese system is not. Thus companies emerging from these two different legal environments may adopt considerably different strategies to navigate legal challenges.

### 5.1.5 Competitive Advantages of Chinese Companies

In the previous section of the analysis, we looked at how the interviewees perceived regulation and *guanxi*. We follow on these conversations in this section, but look more specifically at how the regulatory environment, institutions, government ties and cultural factors favour local companies whilst hindering foreign competitors.

Looking firstly at regulation, the majority of foreign companies are traditionally accustomed to operating in environments where they have a solid regulatory framework. In many of the sectors internet companies operate in China, this framework is absent, favouring local companies predisposed to risk taking. Interviewee 3, describes this as their ability to “operate in the grey areas” and listed it as one of the major competitive advantages that Chinese companies have over their foreign counterparts. Not only have US and other Western companies developed in an environment where regulation is already present and government makes the first move, they are also hindered by their inability to take risks like many Chinese internet companies do. A Chinese company skirting the law will likely get a warning from the agency responsible for regulation, a foreign company taking the same risks is subject to both severe legal penalties and the corresponding PR consequences. As interviewee 3 described, a Chinese company is able to “flirt with regulations much better than an Australian company can”. He went on to provide a comparison of major players in the ecommerce industry as an example. “JD, Alibaba have been able to move really really quickly whereas eBay, Amazon, other foreign companies in the market have been more conservative because they are going to be a bigger target.” This notion that they are going to be a bigger target makes foreign internet companies, indeed foreign companies in general, more susceptible to government intervention.

This leads into the second competitive advantage commonly evident, the advantageous relationship local companies share with government relative to foreign firms.

For the last few years, car-hailing apps have been operating in a legal grey area, attracting much scrutiny from the media, disgruntled taxi drivers and the government. In China, Uber

and its biggest competitor Didi Kuaidi have been labelled as “technically illegally” by many municipal governments across the country. Despite this, both companies continue to operate in China, maintaining regular communication with government to influence draft legislation that is aimed at eliminating many of these grey areas (Waldmeir and Cai, 2015).

Uber has remained relevant in the Chinese market thus far by having an appetite for risk taking strategies. Nonetheless, Uber’s is losing over 1 billion USD a year in China subsidising drivers (Clover and Hook, 2016). The company faces tough competition from Didi Kuaidi who controls about two-thirds of the market to Uber’s one-third. In 2015 alone, Didi Kuaidi facilitated 1.4 billion rides, more than Uber has arranged since it started operating in 2009. With both Alibaba and Tencent backing Didi Kuaidi, Uber has tough competition (The Economist, 2016). Operating within these grey areas requires companies to minimise uncertainties as much as possible. This is where *guanxi* becomes a factor that can further distinguish local companies from foreign competition. In August 2015 Didi Kuaidi secured investment from China Investment Corp., China’s sovereign wealth fund (Carew, 2015). In this case, it appears the government has a vested interest in the success of Didi Kuaidi, likely at the expense of competitors. Whether this may entail developing legislation that favours Didi Kuaidi over foreign competitors such as Uber remains to be seen, but it alludes to interviewee 2’s comment that with growth, government connections are “90% inevitable”.

The last competitive advantage local companies have utilising their *guanxi hu* is their inherent localness. Their employees and company cultures are traditionally developed to operate in an environment where personal interpretations serve as a substitute for legal interpretations (Luo, 2007: 43). At a micro level, utilising *guanxi* is a way of improving efficiency by circumventing rules or obtaining preferential access to information, goods and services critical to business success. Western companies on the other hand have emerged from an environment where personal relations are seen as an impediment to efficiency, with a solid legal framework as well as equal access to information, goods and services the most desirable platform for a competitive economy. This is known as systems trust, whereas in China preference is given to personal trust (Luo, 2007: 23). These different operational methods feed into the China based divisions, often limiting access to information, goods and services.

### 5.1.6 Personal Networks

The majority of this paper has focused on identifying the characteristics of *guanxi* and to what degree they influence foreign internet companies operating in China. In addition to understanding how it directly shapes the business environment, the interviews also provided insights into how individuals use it in a personal capacity. Understanding *guanxi* at this micro level allows us to conceptualise how interconnected and pervasive these personal networks are throughout society. Additionally, they demonstrate the crucial role individuals play in developing and maintaining the *guanxi hu* that in turn forms business-to-business and business-to-government networks.

With this in mind, it was revealing that the interviewees did not express a greater reliance on *guanxi* in their personal lives. Interviewee 1 described herself as “lazy” when asked how often she uses her personal networks for self-advancement and favours. She indicated that she was networking more during her time in San Francisco to get a sense of the local culture. Now living in Beijing, she says that networking forms a less important role in her life. To distinguish from networking in the Western sense, the discussion shifted towards favours and whether she utilises her *guanxi hu* to obtain personal benefits. In terms of job opportunities specifically, she cited the professional reputation she has developed and LinkedIn as more important factors for obtaining the higher level positions she is now qualified for.

This personal anecdote and the assertion that *guanxi* becomes less important, if not irrelevant for higher level positions draws attention to hypothesis 6 of Park and Luo (2001: 462 - 463), raised earlier in the literature review. They asserted that firms with managerial deficiencies were more likely to utilise *guanxi* networks than capable firms. This is borne out of necessity (lack of resources and institutional disadvantages), and the entrepreneurial traits more prevalent in smaller, nimble organisations. Bringing this concept to an individual level, interviewee 1 expressed no need for *guanxi* in her personal life. As a successful lawyer with experience at some of the leading organisations in her sector, she is presented with sufficient resources and is free from major institutional disadvantages. By contrast, an individual whose father is in need of treatment for a serious disease may depend on *guanxi* when faced with institutional obstacles and a lack of choice. In one particular case, this individual waited for two weeks for a hospital bed to become available for his father. As his father’s situation worsened the son became more frustrated with “normal channels”. He then opted to pull *guanxi* (*la guanxi*), utilising the networks of former classmates to ensure his father was granted a hospital bed.

In a less dire example, parents may *la guanxi* to find their children a place at university. Such an exchange would occur when the child in question has a lack of resources (unsatisfactory grades) and perceived institutional disadvantage (a system that favours children with higher grades) (Riley, 1994: 800).

When interviewee 2 was posed the same question regarding the use of *guanxi* in his personal life, he struggled to recall an example. After a pause, he mentioned obtaining funds for the medical treatment of his son by calling on the assistance of a close family member. As a connection with a family member, this would not qualify as *guanxi* by most definitions. Any parent, regardless of where they come from, is likely to ask a close family member for financial assistance when a child is in need. Furthermore, it is unlikely the family member granted interviewee 2's request on condition of future benefit.

Asked for a professional example, interviewee 2 mentioned his initial reliance on the *guanxi hu* of his co-founder to raise capital for their business. She used her contacts in the accounting profession to attract investment in their new venture. Again, this anecdote in the context of raising capital through mutual contacts does not seem to be one unique to China.

Interviewees 3 and 4 were both more adamant to the importance of *guanxi* in the personal lives. Interviewee gave a pretty clear response when he replied "It's integral, yeah it's huge." In his role as Senior Relationship Manager, his primary focus is cultivating *guanxi*, utilising his *guanxi hu* to help members of the chamber achieve their objectives. Interestingly, despite the question being directed to *guanxi* in his personal life, the conversation soon shifted back to the professional relevance of *guanxi*. He mentioned the usefulness of *guanxi* to find a new housemate before going on to describe how he uses his *guanxi hu* to bring in new members to the chamber. "Sometimes if I'm trying to meet a new particular company, traditionally what I try to do is email them or phone them and I found that in China it wasn't very effective. You'll find Chinese employees won't help you unless they have to. So one way of getting around that is finding a friend who knows someone, and via that introduction the employee all of a sudden is compelled to at least hear you out as a personal favour."

Posed the same question, interviewee 4 also referred to a professional example. The consultancy interviewee 4 works for advises a number of companies in the same office complex. In an attempt to improve the IT infrastructure for their clients, interviewee 4's company suggested an upgrade of the wiring in the building to the body corporate. They were

denied with the body corporate citing a personal relationship with their electrician as an immovable obstacle.

These last two examples provided by interviewee 3 and 4 indicate that the role of *guanxi* for professional and personal purposes is blurred. A relationship with strong *ganqing* is more, not less likely to result in *la guanxi* than one characterised by strong *renqing*. A common instance of this would be the relationship between two brothers (strong *ganqing*) and the relationship between two long-term co-workers (strong *renqing*). In the West, a relationship with strong *ganqing*, characterised by mutual affection is less likely to be utilised for professional purposes. Affection in this scenario would be seen as an impediment to level-headed judgement. Contrasting this to China, such a relationship would involve a high level of trust (*xin*) and would in many cases be seen as a preferable option for *lu guanxi* over other relationships (Luo, 2007: 15). The implication for internet companies doing business in China is that transactional based relationships may not be enough to ensure strong *guanxi*. Having employees and relationships with individuals who also have strong *ganqing* will make the utilisation of *guanxi* more effective for the internet company should it require it.

Even after developing these networks however, an individual or organisation is not necessarily compelled to use them. The future cost of *la guanxi* and the risk of being seen as opportunistic are significant deterrents from becoming too reliant on one's *guanxi* network (Luo, 2007: 14). In the same vein, the relevance and necessity of *guanxi* as an opportunity for internet companies is dependent on their resources (most likely intellectual capital and the quality of their product/service) and the institutional disadvantages they face, such as an uncertain regulatory environment. These considerations are known as the principle of efficacy, as entrepreneurs and managers weigh the expected benefits of *guanxi* against the cost of cultivating it (Wank, 1996: 825).

### 5.1.7 Uniqueness of Guanxi as a Chinese Phenomenon

Literature on *guanxi* and the discussions with interviewees and various individuals during field research often raised the question, *is guanxi a phenomenon unique to China?* It was regularly pointed out that networking takes place around the world and that knowing influential people is useful in any country. If such opinions hold to be true, foreign internet companies would be well placed to operate in China, as strategy towards relationship

building would have to change little. This section attempts to distinguish the most significant differences observed using the characteristics outlined in the theoretical section.

Responses from the interviewees alluded to the distinctive characteristics of *guanxi*; relationships before the transaction and relationships in the absence of goal congruity. Interviewee 4 faced rejection, despite offering to improve the IT infrastructure for the body corporate. In this instance goal congruity was observed, but the relationship established between the body corporate and the network engineer superseded the transaction based approach of interviewee 4.

In another instance also involving interview 4, he was approached by a friend and asked if he could provide some sensitive information regarding his workplace. The friend, feeling *renqing* or possibly *ganqing* with interviewee 4, felt comfortable requesting this information going so far as to request secrecy. Interviewee had no aligning goals with the friends' request, and facing ethical and professional dilemmas, politely rejected.

A less clear-cut example was that provided by interviewee 1 earlier with regard to obtaining an ICP number. She outlined that help was needed from the MIIT to make the approval process go more smoothly. Whether her and her colleagues commence a relationship with the MIIT prior to this procedure would help to distinguish it further, however these details were not forthcoming. Thus without insight into whether this was a transaction based relationship or not, it could be classified as networking in the western sense, but with many of the characteristics of *guanxi*.

Despite the scepticism of *guanxi* as a unique Chinese phenomenon, observations, conversations and the majority of the literature on the topic continue to draw differences between the way networking is conducted in many Western societies and how it is conducted in China. These differences will be examined with reference to the following case studies.

## 5.2 Case Study Analysis

This section analyses three foreign internet companies operating in China and assesses what role *guanxi* has had in their success or failure. The interviews provided insights into how *guanxi* is perceived at an individual level and some of the impacts it has, but case study

analysis allows us to observe whether the characteristics are evident among foreign internet companies operating in China.

In the process of examining these cases, we assess other factors unrelated to *guanxi* to see whether there are pertinent factors that may have been more influential in the outcomes that resulted.

### 5.2.1 EBay

Chinese internet companies often get criticised for being clones of their successful foreign equivalents. Regardless of the veracity of such claims, China's ecommerce industry has managed to hold off foreign competition, creating one of the most challenging and cutting edge in ecommerce markets in the world. It was into this environment that eBay entered in 2003 following its purchase of EachNet.

#### 5.2.1.1 Market Entry

EachNet is a Chinese online auction company started in 1999, a time when many consumers were distrustful of ecommerce. With little competition during this time EachNet became the dominant player in China's consumer-to-consumer (C2C) ecommerce market with nearly 80% market share at the time of eBay's acquisition. Seeking an inroad into China, eBay's CEO Meg Whitman headed to Shanghai in 2001 and began negotiating with EachNet CEO Shao Bo and the company's board. EBay struck a deal in March 2002 to purchase 33% of the company, with the remaining two-thirds acquired the following year. The total acquisition cost EBay \$180 million, at the time a noteworthy sum in China's tech industry (Barnett et al., 2010). eBay's dominant hold on market share did not last long however, and following 3 years and \$300 million worth of investment, EachNet's market share had dropped to 20%.

#### 5.2.1.2 Product and Competition

When eBay acquired EachNet, the only significant competitor in China's ecommerce market was Alibaba, at the time focused on the facilitation of business to business (B2B) transactions. Sensing a threat to their business model, Alibaba created Taobao in May 2003 in a partnership with Softbank of Japan (Mangalindan, 2005). From this point onwards, Taobao and EachNet continued to take different directions, with Taobao adapting as it grew and EachNet trying to adapt to the changing landscape in China under the direction of eBay management. There are a number of ways in which the services they offered to their



customers differed. Results from a study conducted by Xiaojuan Ou and Davison (2009) showed that interviewees felt Taobao had more of a local feeling whereas EachNet came across as international.

Firstly, both attempted to devise solutions to build trust among those making their first purchases and the sellers registered on their sites. Both incorporated ranking systems, however Taobao went a step further by allowing direct messaging between sellers and their prospective customers. This feature allows users to quickly build rapport with the seller and have questions regarding the product promptly answered. It also proved popular with sellers due to the varying options available for communicating with customers (Liu, 2005). By building trust before the transaction has taken place, the features Taobao introduced mimic the unique aspect of *guanxi*, in place of the physical relationships that preceded ecommerce. A second major point of differentiation was the revenue models they adopted. EachNet was under pressure to grow revenues, and the money they were earning from advertising on the site was not enough to attract investors. As such the company began charging listing fees and commissions with pricing corresponding to the services requested (Barnett et al., 2010: 5). Taobao resisted this model for a while, avoiding listing fees and relying instead on advertising. This decision proved popular and helped the company erode eBay's market share in China.

Thirdly, both companies had to develop a trusted, reliable financial solution to facilitate transactions. In 1999 when EachNet was founded, very few internet users in China had access to a credit card or other means to pay online. As such cash on delivery became the most popular solution. EachNet successfully negotiated with courier companies to have them act as a collection point. As financial infrastructure to facilitate card transactions improved across the country, EachNet and Taobao were able to provide escrow services. Both companies created their own payment solutions, eBay with An Fu Tong and PayPal and Taobao with AliPay. These solutions act as an intermediary between seller and buyer and provide buyers insurance. AliPay has become the dominant online payment solution in China, spurred in part due to the close connections Alibaba executives developed with government officials and the banking industry. Confusion between An Fu Tun and PayPal as well as close government scrutiny, curtailed the success of eBay's solutions (Barnett et al., 2010: 2-11).

The last major difference of note was the advertising strategy adopted by each company. EachNet had access to eBay's vast financial resources and as such opted for television advertising in conjunction with exclusive deals that were negotiated with online portals

(Doebele and Chen, 2005). Without such resources, Taobao opted for a more cost effective method, posting heavily on bulletin board services (BBS) to introduce China's internet users to their website (Barnett et al., 2010: 9).

### *5.2.1.3 Relationship Building*

Although *guanxi* hasn't played as decisive role in eBay's China venture, there were a number of circumstances where *guanxi hu* allowed Alibaba to outcompete. Firstly, as mentioned in previous section, the financial challenges apparent in ecommerce were enormous. Lobbying was needed to motivate both the government and the banks to start developing financial infrastructure more conducive to online commerce. EachNet and Alibaba each played a role in the early days of ecommerce in China pushing these reforms along. The government has direct investments in most of China's major banks and as such the ability to win the trust of government is necessary to achieve outcomes in the financial sector. Alibaba's closer relations with a government meant that it was able to negotiate superior deals and provide favourable financial solutions to customers, with escrow seamlessly built into AliPay (Rein, 2007).

Secondly, the social features built into Taobao facilitated relationship building for the users of the service. The static interaction and time delay inherent to EachNet's service did not prove as popular. While not *guanxi* per se, the desire for trust to be built between buyer and seller indicates how such feelings can act as a proxy when institutions such as the legal system are weak (Rein, 2007).

Despite these shortfalls, eBay and its subsidiary have been mindful to collaborate with government officials. For example, an experiment was conducted in Shanghai in cooperation with the government to provide aspiring online vendors with space, phone and internet services within a business centre (Mangalindan, 2005). Ultimately such initiatives were not enough to compensate for the other strategic errors that eBay made during these years.

### *5.2.1.4 Internal Operations*

Less significant, but worthy of note is the way eBay managed its relationship with EachNet. Acquiring a foreign entity always creates challenges, with the acquired firm becoming subject to the interventions of head office.

Interestingly, eBay decided to appoint a German manager to head the China operation and an American to serve as the chief technology officer (Wang, 2010). Regardless of their

competency, eBay was failing to adapt to Chinese consumers and having two non-Chinese speaking managers leading operations was, in hindsight an error of judgement.

Such involvement from head office also served to isolate employees further, with former EachNet CEO claiming that decisions that previously took 9 weeks now took 9 months (Barnett et al., 2010: 13). Shao stepped down as head of EachNet in 2004. Exit interviews that were conducted with departing managers showed sentiments that eBay headquarters “did not listen to them” (Rein, 2007). It is hard to get an accurate picture of the inner workings of eBay during this time, but it’s declining market share gives an indication. In December 2006, eBay announced it would enter a partnership with TOM Online, an internet company providing multimedia products and services as well as advertising. Under the deal eBay contributed \$40 million for 49% of the new venture with TOM Online controlling 51% and investing \$20 million (Business Wire, 2006). This move signalled the end of eBay’s intent to target Alibaba head on, with the company currently focused on linking Chinese suppliers with consumers in the US rather than consumers in China (Einhorn, 2011).

While each of these decisions in isolation were not disastrous, together they show that the advantages eBay has as a global entity were damaging its prospects to be effective in China. eBay’s case study demonstrated that a number of strategic errors were conducted in product development, relationship building and internal operations. These will be reviewed in relation to other research in the final section.

### 5.2.2 Microsoft

This case study focuses on Microsoft and its trajectory in China thus far, characterised by positive and negative outcomes. Although Microsoft is not known primarily as an internet company, the company has transformed significantly since it began. In the early 1990’s, physical software sales of products such as Microsoft’s 3.X operating systems and Microsoft Office comprised the bulk of the company’s total revenue (Microsoft, 1997). In Q1 2016, cloud computing which includes Azure and Windows Server accounted for 29% of total revenue (Microsoft, 2016b). Additional revenues also come from services that are now delivered primarily online such as Skype, OneDrive, Office 365 and Bing. The company thus possesses many of the characteristics common to companies delivering goods and services via the internet.

Microsoft made its first push into China in 1992. Like many foreign companies, the allure of the world's largest population quelled concerns around the risks of China market entry. In the years since 1992 Microsoft has been very active forging relations with government, academia and its industry partners. Each of these relations formed an interwoven network between Microsoft employees, government officials, scientists and businessmen and women. Although stronger *guanxi* has allowed Microsoft to build one of its best R&D centres worldwide, China revenues continue to underwhelm.

The following sections outline the key role relations with academia, government and industry partners have played thus far.

#### *5.2.2.1 China Entry, Academia and Microsoft Research Asia*

Building *guanxi hu* was not Microsoft's first approach when entering China. Rather, one of the primary reasons Microsoft began developing relations with the Chinese government was to address the rampant piracy that was affecting its China sales. Despite having popular products in the market, the majority were pirated and sold well below what Microsoft was selling for official versions of their software. A direct legal challenge to companies using pirated copies of Microsoft products proved unsuccessful (Minter, 2016).

Following this period, Microsoft determined to take another, longer-term approach to its fledging China operations. This would mean not only treating China as a market but also a leading player in technological innovation. As former Microsoft CTO Nathan Myhrvold explained "no place in the world is going to have growth in the number of computer-science Ph.D.s...anything like the growth that's going on in Asia" (Buderi and Huang, 2006: 34). To demonstrate this long term commitment to China and capitalise on the abundant talent, Microsoft established Microsoft Research Asia (MSRA) in 2003. A key element of this decision was the recruitment of leading professionals of Chinese origin who could not only lead their respective areas, but also develop and utilise their *guanxi hu* to help Microsoft achieve its objectives. Foremost of these was Kai-Fu Lee who was selected to lead the new venture. Lee had already developed a reputation in Silicon Valley as an excellent researcher, declining offers from both Intel and Apple to take the position at Microsoft. The introduction to Microsoft was made possible by Xuedong Huang, a former visiting scientist at Lee's alma mater who was now working for Microsoft. Huang convinced Lee to decline the Intel offer and consider the move back to China to develop the research centre (Buderi and Huang, 2006: 37-45).

Based in Beijing, the centre now has strong links with government, academia and industry and has been responsible for some of Microsoft's major product breakthroughs such as Bing, Kinect, Natural User Interfaces and Windows Phone. The Centre takes a regular supply of interns from leading universities across China and collaborates with some of the country's top academics. In addition to the R&D benefits that come from a centre such as this, MSRA demonstrates a long term commitment to China. This gives the government and industry partners they cooperate with greater confidence that Microsoft will spur developments in China's computer science industry. Microsoft was able to achieve this due to Lee's relentless pursuit of *guanxi* from the very beginning. He expressed his philosophy to business based upon the following reasoning. "Part of doing business in China is to be viewed as sincere, trying to do something positive." In reference to successful foreign companies in China he stated, "It's not necessarily the better product, but they were in there saying to the government, 'We're doing things to help your country. When I prove I'm sincere, I hope you'll treat me equally or preferentially'" (Buderi and Huang, 2006: 49). This key role that trust plays serves as a risk mitigation strategy. From Lee's perspective, the government feels more comfortable dealing with individuals it has previously developed a relationship with. A give-take relationship is an understandable objective of any government, but China's large population and rapid pace of development give the Chinese government significant leverage when negotiating with foreign multinationals.

To further demonstrate support for educating China's next generation of computer scientists, Microsoft developed what was known as the Great Wall Plan. The Great Wall Plan consolidates the University Relations initiatives Microsoft is involved in, with each now part of a Memorandum of Understanding that was signed with the Ministry of Education (MOE) in 2002. Between 2002 and 2005 \$25m was spent to sponsor research projects with universities, establish joint labs, run internship programs targeting top talent, teach university courses and run conferences (Microsoft, 2016a) (Buderi and Huang, 2006: 279). Although China's technology industry could no longer be described as nascent, the next phases of this plan are now underway to support more cutting edge computer-science innovations. Microsoft has developed close relations with universities through joint research, with students through internships and with the government via a demonstration of a long term commitment to education. This has opened doors for the company, leading to key innovations in the industry, positive PR, but a disappointing contribution to China revenues.

### 5.2.2.2 Government

While relations with academia may have been the most prominent, relationship building with the government has been the core focus of *guanxi* cultivation. Indeed, many of the collaborations mentioned in the previous section had a primary or secondary objective of improving government relations. This section details how Microsoft managed relationships with government and the implications both favourable and unfavourable.

Earlier unsuccessful efforts to legally challenge piracy demonstrated that without the government onside, little could be achieved. As is evident throughout Microsoft's approach to *guanxi*, recruiting successful, respected individuals of Chinese heritage allowed the company to convey a sense of Chineseness. Beyond simply appearance, these individuals possess *guanxi hu* of their own and are able to communicate and relate to government officials in a way foreigners can't. They have earned the nickname "sea turtles", due to their propensity to return home after success abroad to help China achieve its technological ambitions. With these individuals onside, Microsoft complimented outreach and R&D efforts with relationship building. In their analysis of Microsoft in China and the role of *guanxi*, Buderer and Huang (2006) spent weeks embedded with the MSRA team and months at the headquarters in Redmond. During this time, they were first hand witnesses to the central role relationship building activities play both internally and externally.

Ya-Qin Zhang, the vice chairman of Microsoft China from 2005 to 2014 made these outreach initiatives a crucial part of his role. Subtle efforts such as drinking with a high-ranking official from the MOE complimented the high profile outreach that is the Great Wall Plan. As Buderer and Huang (2006: 279) put it, a crucial element of Zhang's role was to make "it possible for Chinese officials to interact with one person who represented all Microsoft's R&D activities in China." While in the West the government might focus on the organisation as a whole, the Chinese government was looking for one individual that would embody the organisation and with whom *renqing* could be exchanged.

The interviews earlier in the Data Analysis section highlighted the powerful position the MIIT has over internet companies, determining who is granted an ICP license. Such dynamics were made clear after Microsoft founder Bill Gates personally criticised the head of the ministry, Jichuan Wu, in his book *The Road Ahead*. Wu responded by declining the invitation to MSRA's opening and sending two lower ranking officials instead. Following

this, Microsoft was subject to some negative publicity, which was partially attributed to this incident with the ministry. To minimise future damage, Kai-Fu Lee wrote letters to all the officials who attended, as well as Jichuan Wu, thanking them for their support and setting an optimistic tone towards collaboration in the future. These letters were followed up with invitations to significant Microsoft events in China as well as updates on the collaborations taking place with the academic community.

Positive outcomes resulted when relations with a particular official or government ministry were strong. For example, Microsoft was able to circumvent restrictive *hukou* laws making it easier for new recruits to relocate to Beijing (Buderi and Huang, 2006: 278). A degree of trust had been established during the many meetings between Microsoft's arrival in China and the launch of MSRA. In this instance there was clear goal congruity between MSRA and the Central Government. In terms of transactional distinction, Buderi and Huang (2006) detail the drawn out development of relations, but it is unclear which individuals in particular if any leveraged *la guanxi*. Networking is apparent, but whether it demonstrated uniquely Chinese characteristics cannot be ascertained.

A more significant achievement was a deal that was struck with the Ministry of Education that made MSRA an official academy to train industrial researchers. This was the first time this status had been bestowed on a foreign company. In exchange, Microsoft would support the development of young researchers through fellowships and internships. Ji Zhou, the minister of education personally applauded the program and was enthusiastic about what China could learn from Microsoft.

### 5.2.2.3 Industry

The Microsoft case study demonstrated that from an R&D perspective at least, strong *guanxi* was imperative. Some of the company's most significant, financially successful innovations have come out of MSRA. Despite this however, Microsoft has made little dent in the piracy of its software since it entered the market. In fact, with the release of Windows 10, Microsoft made the decision to upgrade all users for free, including those running pirated software. The logic underpinning this decision was that it is better to retain market share and have the opportunity to introduce these users to other products in the Microsoft ecosystem than to continue legal efforts to reduce piracy. One of the main methods Microsoft has opted to

deliver the software upgrades is through a partnership with Qihoo360 Technology and Tencent, some of the largest players in China's internet space (Rigby and Carsten, 2015).

In the meantime, Microsoft has yet been able to utilise the largely favourable *guanxi* they have developed in China to raise revenue significantly. Despite China's being the largest PC market in the world, revenues in the market have failed to meet expectations. China accounted for less than 10% of Microsoft's worldwide revenues in 2015. In the latest attempt to counteract this, Microsoft has signed a partnership agreement with the China Electronic Group Corporation, a government owned corporation. While the details of the agreement are still being negotiated, the objective is to roll out up-to-date versions of Microsoft software across government agencies and government owned entities. A unique aspect of the deal is the emphasis on a "localised" version of Microsoft 10, better suited to protecting the Chinese government from cyber-attacks (Tonner, 2016). Microsoft seems to be more willing now to make concessions for the government that would unlikely have been prompted in smaller markets elsewhere.

It seems the institutional obstacles and consumer differences have forced Microsoft to significantly adapt the business strategy it adopts in China. Developing strong *guanxi* has been a significant aspect of this shifting strategy, but in many instances, Microsoft's relationship building bares resemblance to western networking. Additionally, *guanxi* alone was not enough for Microsoft to significantly raise its China revenues.

### 5.2.3 Google

Google is perhaps the highest profile internet company to fail in China, however the reasons for its exit are more nuanced than often described. While censorship and government intervention played a major role, so too did a failure to adapt its search engine for Chinese consumers. At many times Google was forced to decide to what degree it was willing to compromise its corporate values to appease the government.

This case study looks at Google's entry and its subsequent exit from the Chinese market and whether a greater focus on developing *guanxi* could have improved Google's performance.

#### 5.2.3.1 Market Entry

Google first established a presence in China in 2000 when it developed its Chinese language version of Google.com. Extensive filtering by ISPs hampered the site's performance and in



2002 the site went down completely for a period of a few weeks. It was restored again only to be blocked in December 2003 (Lau, 2010).

In 2005 Google appointed Kai-Fu Lee, founder of Microsoft Research Asia, as the Vice President of Google China. Soon after, the well-respected figure announced Google's intention to create a research centre in China. The poaching of such a prominent computer science figure sparked controversy and legal action, but Google was determined to have a leading, well connected researcher at the helm of their new venture in China. As senior vice president Jonathon Rosenberg stressed to other Google executives "I all but insist that we pull out all the stops and pursue him like wolves" (Levy, 2011). For Google, hiring top talent who could navigate the complexities of China was something they were willing to pay a high price for.

Google entered China in earnest with the registration of the Google.cn domain name. This was followed shortly thereafter with the establishment of the Google China headquarters in Tsinghua Science Park. Lee was clearly emulating his success in establishing MSRA as a blueprint for Google's market entry.

#### *5.2.3.2 Government and Relationship Cultivation*

The pivotal role the Ministry of Industry and Information plays was made evident again when shortly after registering Google.cn, Google has its ICP license revoked. The impetus for the decision was that it was unclear whether Google was operating an internet service or a news portal, with foreign companies forbidden from operating news portals. It was 18 months of negotiation with the government before Google was able to restore its ICP license, the conditions of which were not made public (Levy, 2011).

From this point Google determined to take a more active approach in managing government relations, attempting to address potential issues before they arise.

A former Sina vice president was hired for this purpose, leading Google's government relations efforts. Sina is a Chinese online media company that operates a range of portals as well as Sina Weibo, a Twitter like social interaction platform and the largest of its kind in China (Capital IQ, 2016). The employee in question, whose name has not been made public, quickly became frustrated with Google's reluctance to placate the government. According to one of her colleagues, Google was not flexible enough to create favourable relations with the government. The different approaches were brought to a head when the employee purchased

iPods using Google funds, to provide as a gift to Chinese government officials. The act was in breach of the Foreign Corrupt Practices Act and as such both the employee and the executive who approved the expense were fired, much to their surprise. Alan Eustace, retired vice president of knowledge and responsible of overseeing China at the time stated “it was the worst moment in our company”. The incident not only highlights the cultural differences that existed between employees and the company, but also the legal restrictions placed on American companies, that would be less of a concern for local companies like Sina. A common exchange in China to build trust and show long term commitment became a severe violation of US law and Google’s own values.

Meanwhile, some internet executives suspect that the interventions into Google and other foreign companies have been driven by pressure from local companies such as Baidu. In 2002 Google outcompeted Baidu with 24% to 3% of the domestic search market respectively. Some allege that this drove Baidu to use their proximity to government to highlight controversial material appearing in Google search results, having the site banned in the process. Baidu argues that such allegations are false and that their increase in market share was due to a better products and an understanding of Chinese consumers. Regardless, the scenario suggests that close relations with government could be used to obtain a competitive advantage over rival firms.

Given the complexity of continually censoring such a large volume of content, the government has placed an onus upon companies to exercise self-censorship. Thus they must determine which topics the government may find harmful to the national interest, often before any official announcements. This ambiguity creates an incentive to be proactive with government relations, staying in regular contact with bodies such as MIIT and the State Council Information Office (SCIO) to get an idea of which topics are sensitive. In fact, SCIO holds weekly meetings for executives of internet companies where officials are briefed on upcoming sensitive topics. The meetings have become known as the “wind-blowing meetings”, as they give executives an insight into what information may soon be off limits, resembling a KSF to KSR dynamic (Thompson, 2006). The greater the *renqing* established with officers in the SCIO, the better able ICP’s are to filter content earlier if ethical considerations are put aside.

Following the unsuccessful government relations of the former Sina executive, Google recruited Julie Zhu, experienced in government ministry. During her tenure there was a greater balance struck between the requests of government and the demands of Mountain View, Google's headquarters. During this period Google would continually push the limits, censoring the most controversial topics, but leaving others in the hope the government would accept the minimum. This back and forth damaged trust and reached a head in 2008, Beijing's Olympic year. The government was now requesting censorship of not only .cn domains, but other domains hosted abroad. While Microsoft and other internet companies were willing to comply with these censorship requests, Google was unwilling to censor Google's Chinese language .com domain which would affect Chinese speakers worldwide. Government pressure increased throughout 2009, with reprimands and the hacking of proprietary information significantly damaging mutual perceptions between the company and the government. The failure of Google to remove pornographic search results from its listings continued to be a source of contention with the government.

In 2010 Google co-founder Sergey Brin convinced fellow co-founder Larry Page and the board to end cooperation with the government on censorship, despite objections from CEO Eric Schmidt. Brin in particular felt that such activities went against Google's most fundamental philosophy, "don't be evil" (Levy, 2011). The Chinese site was redirected to the Hong Kong version of Google with the government shutting down Google China a few months later (Waddel, 2016). The debacle brings to attention the potential ethical questions raised when a company is trying to develop *renqing* with the government.

### 5.2.3.3 *Internal Issues*

While the previous section outlines the prominent role of Google's relationship with government, there are a number of other considerations that threatened Google's viability in China. The significance of these other factors helps us better understand how important the role of *guanxi* is overall in Google's China experience.

Firstly, political and macro factors unique to China influenced some of the strategic choices Google has made. Operationally the company has made compromises that some may argue have undermined Google's business model. To avoid scenarios where Google would be handing over personal data to Chinese authorities, Google decided that services such as Gmail, Blogger and Picasa would not be made available for China. In other markets these services play a key role in enticing users to stay within the Google ecosystem of services.

Another example is the way in which Google has treated its China based employees. One concern raised was that China based engineers did not have the same level of access to Google's production code as other employees around the world. They felt this impacted their ability to innovate and develop new products, a core part of Google's ethos. Rather than feeling empowered by working for the world leader in search technology, many felt restricted. It was unclear whether these decisions were taken to keep sensitive data at arm's length from the government or whether Google feared competitors developing internally, but it arguably damaged the motivation of Chinese based employees (Levy, 2011).

#### *5.2.3.4 Strategic Decisions and Google's Product Offering*

Internal issues were complimented by what in hindsight appeared to be strategic blunders and a failure to properly understand Chinese consumers.

Despite being known as fierce rivals; Google is a former investor in Baidu. In 2006 Google sold its 2.6% investment in Baidu which it had acquired in 2004 for \$5m. The \$60m sale was completed so that Google could focus on competing with Baidu and gaining more market share. The small stake seemed an odd investment as it signalled neither a willingness for substantial cooperation nor the intent to compete head on with China's leading search engine (Yeh, 2006). During these first few years in China, identifying key partners and establishing meaningful, operational partnerships could have assisted Google to build market share.

Significantly, some business commentators and academics believe Google's failure was more about understanding Chinese consumers than the impacts of government censorship. There are a number of features Baidu has incorporated into its search engines that appealed to Chinese consumers and helped the company become the market leader.

Firstly, Baidu was quick to notice the significant demand for users looking for pirated music files for download. Users were able to search and then quickly download files where in contrast Google provided links to stores where they could pay to access the content (Fannin, 2010).

A second feature Baidu offered were bulletin boards that could be created after entering a search term. Social aspects were also incorporated with sections like "Local Friendship" and "Campus" allowing people to discuss topics with people in their area and schools respectively (Lu, 2011). Such communities helped both attract and retain users by fostering digital communities that echo their physical reality.

Thirdly, Baidu has adopted a marketing strategy that better aligns with the demographic realities of China. While China now has more internet users than anywhere else, penetration has been growing significantly, and many people are still gaining internet access for the first time. A network of resellers in 200 cities throughout China for example, not only sells advertising to businesses, but educates them on the potential benefits while answering questions on keyword advertising (Fannin, 2010; Einhorn et al., 2010). Such initiatives have been developed internally with Chinese consumers in mind. Google on the other hand is often designing services with a global audience in mind, not all of which appeal to its user base in China.

The above are just a few of the ways in which Baidu differentiated itself by focusing on the Chinese consumer. The merits of each individual decision are hard to ascertain, but they illustrate the contrasting business models of Google and Baidu, with the former appealing to users globally and the latter very much focused on the Chinese market.

The following section will more closely examine the implications of these decisions and how significant they were relative to the *guanxi hu* of Google and the other case studies.

## 6 Discussion

The departure point of this research was to gain insight into the seemingly disproportionate failure of foreign internet companies in China. The more literature and business commentary on the matter was reviewed, the more it seemed that there was no underlying answer to this phenomenon. Nonetheless, *guanxi* was a topic that continually resurfaced in both academic research and general discourse, prompting a more thorough investigation of this concept and its relevance to foreign internet companies in China.

Field research in China further complicated the matter, as individuals with a variety of views on *guanxi* and its relevance were encountered. In the first part of the discussion chapter, the prevalence of *guanxi* is examined. The four hypotheses introduced are then examined with relation to internet firms. The second part of the chapter outlines the implications these results have for foreign internet companies operating in China.

### 6.1 Findings

To identify whether *guanxi* is a relevant factor for internet companies operating in China, the concept was first defined. Analysing the interviews and case studies presents some interesting results. While there were many instances where *guanxi* was apparent, there were also many where *guanxi* could not clearly be distinguished from networking in the western sense. In some ways this is to be expected, as the perceptions of the interviewees indicate many internal contradictions in an individuals' recognition of *guanxi* characteristics.

Additionally, the lack of any primary data in the case studies makes it difficult to identify characteristics that would either confirm or reject the existence of *guanxi* in each circumstance. Nonetheless, the identification of *guanxi* in multiple instances across the interviews and case studies suggests that it is a factor worthy of consideration.

The degree to which it is important is now examined with relation to firm characteristics and the the hypotheses of Park and Luo (2001). Firstly, firms with a market orientation are more likely to develop *guanxi* networks than those with an efficiency orientation. Each of the case studies reviewed as well as the interviews indicate that many foreign firms entering China do so with a focus on efficiency orientation, making them rigid and resistant to change, more focused improving internal operations. Microsoft demonstrated a shift in strategy, with MSRA and academic programs established to obtain market benefits.

Looking secondly at firm size, each of the large foreign internet companies demonstrated aspects of relationship building. In the case of smaller rivals, notably Taobao and Baidu, both firms exemplified a greater reliance on *guanxi*. Interviewee 1 indicated that although larger firms are more likely to gain the attention of government and other firms, it is when firms are pressed for resources and options that *guanxi* becomes a preferable alternative. This was further supported by personal examples interviewees provided, opting to utilise *guanxi* when regular means were exhausted. The cost of *la guanxi* proved a crucial consideration in these scenarios. Further studies would help to clarify whether this relates more to firm size or local advantages. As the results from Park and Luo (2001) suggested, size may not have a significant impact on *guanxi* utilisation.

Thirdly, it is evident that both technological and managerial capabilities reduce *guanxi* utilisation, in line with Park and Luo's 5<sup>th</sup> and 6<sup>th</sup> hypotheses. Baixing.com CEO Jian Shuo Wang (2013) points to the value of the firm's brand and technology. Signalling out eBay, he drew attention to a low brand value in China and technology which he feels is easily replicable by local startups. The result is intense competition, something not as evident in eBay's other markets due to the enormous size of China. Each of the foreign case studies demonstrated that firms entered with both these traits, and were reluctant to develop *guanxi* early on. As technological and managerial advantages were eroded by competition, attempts to leverage *guanxi* increased.

## 6.2 Implications for Foreign Internet Companies Operating in China

These findings lead to implications and recommendations for foreign internet companies operating in China. Firstly, technological and managerial capabilities should be analysed in the context of China. As Kai-Fu Lee puts it, "the government feels no obligation to provide access to its vast and rapidly growing market simply because a foreign firm offers great products or possesses a sterling reputation" (Buderi and Huang, 2006: 267). An analogy would be to think of two candidates attending a job interview. One has fantastic grades and relevant career experience (technical competency), the other has few skills and little experience. The latter will be relying far more heavily on charm to get the job, but the superior candidate cannot ignore charisma and rely solely on technical competency.

The second implication and one that wasn't immediately apparent; *guanxi* may serve as a means to compensate for institutional weakness and failure. Differing legal systems and an

environment where regulation is often behind prompts companies to develop relationships with government and businesses to improve their efficiency. The ability of Chinese companies to better navigate these grey areas and incur more risk puts them at a significant advantage over foreign entrants. These foreign entrants are bound by legislation such as the FCPA and operational procedures that discourage the development of *guanxi*.

The third implication concerns knowledge management and the transfer between local entities and foreign internet companies. Both the interviews and case studies correlated to show that internet companies operating in China benefit most from transactional and information benefits when cultivating *guanxi*. Transactional benefits that were evident include EachNet and Taobao's negotiation of a nationwide credit system and Microsoft's deal with Tencent and Qihoo 360 to act as software vendors. Informational benefits include interviewee 1's experience working with the government for assistance in obtaining an ICP license. Obtaining access to resources was less important for the companies analysed, but was sought after by some of the ecommerce companies that interviewee 3 works with that require access to foreign products.

If "knowledge management is a matter of connecting people so that they can think together" (Ramasamy et al., 2006: 131), EBay and its relationship with EachNet represents a breakdown in knowledge management. The experiences of employees outlined in the case indicated that poor strategic decisions were made by a failure to fully integrate the subsidiary. Little trust was developed between the two entities nor attention paid to the expertise developed by EachNet.

A fourth consideration is the relationship a foreign internet company will develop with the Chinese government. While government intervention did not appear as significant for the experiences of most interviewees, the case studies indicated otherwise. This may be representative of the size of the firms in question, with larger firms that operating in sensitive areas more likely to face scrutiny. Google and the industries that interviewee 3 cooperates with are prime examples. Government intervention and cultivation of *guanxi hu* raises some difficult moral questions. Companies are often put in a position where they must reassess or put aside their traditional values to ensure an amicable relationship with government. The companies that have been most successful are the ones that operate in areas where these considerations are less pertinent or those that have been willing to go further in complying with government demands. Google was forced to make a choice on whether to stand true to



its values or appease the government. It chose the former and was ultimately forced out of China.

The last point of note involves some of the unique characteristics of internet companies. These were brought to light analysing the competitive advantages of local companies as outlined by the interviewees alongside the literature and case studies. The first observation is that internet companies have a degree of impatience less observable in other industries. Both former EachNet CEO Shao Bo and former Google China head Kai-Fu Lee believed their respective companies gave up too soon. According to Kai-Fu Lee, the government was becoming more and more open and if Google was willing to persist, they could have convinced government to relax censorship regulations (Levy, 2011). Companies in mature industries such as Boeing and Volkswagen, by virtue of their industry have had to take a longer term approach to China. Establishing production facilities and joint ventures has made them more invested and willing to wait for long-term rewards.

## 7 Conclusion

The research set out to determine why foreign internet companies appear so likely to fail in China, in particular, whether *guanxi* was a relevant factor. Interviews were conducted to better understand the characteristics of *guanxi* at an individual level, with thematic areas derived. Three case studies were then analysed with links drawn between the responses of interviewees and the secondary data of the case studies.

The interviews and the case studies made it clear that each company faces an array of challenges, with *guanxi* utilisation varying in importance. Large, market orientated firms with a technological advantage are vulnerable to competition unless they also devote efforts to establishing reciprocal relationships with industry partners, government and academia. Lu (2011: 88) sum it up nicely, describing these forces as bottom up and top down pressures on internet companies. The data obtained from the interviews and the analysis of the case studies indicated that neither side of the equation can be ignored. China is an intensely competitive market, and if a foreign company isn't willing to focus on addressing both bottom up and top down pressures, another company will.

Regarding the first hypothesis, the case studies indicated that only Microsoft made a concerted effort to build and maintain *guanxi*. While eBay and Google both recognised the utility of government relations and transactional benefits that could arise from *guanxi*, a short term focus, competitors and ethical considerations limited its effectiveness. The interviews didn't yield significant insight into the efforts of foreign internet companies and a larger number of foreign interviewees would be needed to properly validate this hypothesis. The second hypothesis regarding the uniqueness of *guanxi* as a Chinese phenomenon is somewhat inconclusive. As a nebulous concept, different scholars and individuals apply different meanings to the term. Observationally however, and after analysing the interviews, many aspects of *guanxi* appear distinguished from networking. The approaches to reciprocity, goal congruity and the longer term approach that one must demonstrate indicates that networking in a western sense is distinctive from relationship building in China, however both were present in the examples of interviewees.

*Guanxi* is thus an observable phenomenon in China and one that cannot be ignored. In recognising its importance however, a firm must also develop competencies in a range of other, sector specific areas. *Guanxi* does not serve to compensate for deficiencies in these

areas, but can provide transactional and informational benefits to companies who possess strong *guanxi hu*. Understanding and developing *guanxi* is by no means a panacea, but attempting to do business in China as a foreign entity is less efficient and more challenging if it is ignored.

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## Appendix 1 – The 8 Hypotheses (Park and Luo 2001)

Hypothesis 1: Nonstate-owned firms are more likely to form guanxi than state-owned firms.	Institutional
Hypothesis 2: Firms in less open economic regions are more likely to develop guanxi networks with the business community and government authorities.	Strategic Orientation
Hypothesis 3: Firms are more likely to utilise a guanxi network as their emphasis on a market oriented strategy increases.	Organisational Factors
Hypothesis 4: Small organizations are more likely to utilise guanxi networks than are large organisations in China.	
Hypothesis 5: Firms with poor technological skills are more likely to utilise guanxi networks than those with superior technological skills.	
Hypothesis 6: Organisations with poor managerial capabilities are more likely to utilise the guanxi network than those with strong managerial capabilities.	
Hypothesis 7: Newer firms are more likely to utilise guanxi networks than older firms.	
Hypothesis 8: Guanxi utilisation is likely to have a positive effect on sales growth but no effect on profit growth.	Guanxi and firm performance



## Appendix 2 - First Interview Guide

The purpose of the thesis is to determine whether guanxi is a relevant factor for foreign internet firms looking to operate in China. In particular, the role of guanxi in facilitating knowledge transfers within and between organisations is considered.

With your permission this interview will be digitally recorded to make the transcribing process more efficient. You and your organisation will retain anonymity unless requested otherwise.

[Start recording]

I'm now going to clarify a few terms that will be referred to.

When we refer to **internet companies** we are talking about companies whose primary method of providing their goods and/or services to customers, is via the internet.

**Guanxi** as defined in this paper describes the relationships between people and how they influence the dynamics of organisations and the behaviour of individuals.

**Knowledge management** concerns how information is shared and received both internally and externally by a company.

You will be asked 8 questions and then we can discuss anything that needs more clarification on an ad hoc basis.

Q1. What are the most common mistakes you feel foreign internet companies make when trying to enter the Chinese market?

Q2. Can you recall an instance in the last 6 months where you have either used your guanxi for a professional favour or obliged a favour for someone else?

Q3. What is your primary method for gathering data on the customers, vendors and suppliers you interact with?

Q4. At what stage of a business's life would China entry generally be viable?

Q5. Is a local partner mandatory to enter the Chinese market?

Q6. Do you need government connections in order to do business in China?

Q7. What competitive advantages if any do you feel Chinese companies have over foreign counter parts?

Q8. What role do investors play in your business network?

That concludes the interview. Thank you very much for taking the time to discuss these questions with me.

## Appendix 3 - Second Interview Guide

The purpose of the thesis is to determine whether guanxi is a relevant factor for foreign internet firms looking to operate in China. In particular, the role of guanxi in facilitating knowledge transfers within and between organisations is considered.

With your permission this interview will be digitally recorded to make the transcribing process more efficient. You and your organisation will retain anonymity unless requested otherwise.

[Start recording]

I'm now going to clarify a few terms that will be referred to.

When we refer to **internet companies** we are talking about companies whose primary method of providing their goods and/or services to customers, is via the internet.

**Guanxi** as defined in this paper describes the relationships between people and how they influence the dynamics of organisations and the behaviour of individuals.

**Knowledge management** concerns how information is shared and received both internally and externally by a company.

You will be asked 10 standard questions and then we can discuss anything that needs more clarification on an ad hoc basis.

### **General**

Q1. Tell me about your organisation and what your role entails.

### **Relationships**

Q2. How important are government relations for your firm? How important for your own day to day work?

Q3. How important are relations with other organisations for your firm?

Q4. As your company grows, do you think relationships will become more or less important?

Q5. Do you feel it is more important for your company to focus on identifying and capitalising on new market opportunities or on improving the efficiency of existing operations?

Q6. What efforts have you made to establish relations with investors?

Q7. How often do you feel you use your own personal networks to benefit the organisation you work for?

### **Trust**

Q8. How straightforward/forthright are your relations with your Chinese business partners. How does this compare to partners from abroad?

Q9. On average, how reliable is the information you receive from your business partners?

Q10. What competitive advantages if any do you feel Chinese companies have over foreign counterparts?

That concludes the interview. Thank you very much for taking the time to discuss these questions with me.