



Review Article

"Guanxi" Versus Social Network in China: The Perspective of Independent Directors' Connections

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Abstract: The social exchange theory posits that economic and social factors are crucial for successful business relationships. Numerous studies have examined interpersonal connections across cultures. Informal relationships influence economic and social exchange, such as Guanxi in China, Yongo in South Korea, and Wasta in the Middle East. In social network literature, the concept of 'network' encompasses two dimensions: network relation and network structure. The connections among directors affect a company's efficiency from a network perspective. This study conceptualises "Guanxi" and social networks to illustrate the similarities and differences between these two concepts and how Chinese Guanxi differs from Western preconceptions concerning social networks. Given that both "Guanxi" and social networks involve social connections, it is essential to note that Guanxi does not exclusively relate to social networks or merely serves as an alternative term for social networks. Additionally, this study focuses on independent directors' social networks created by serving on multiple boards and reviews the literature on independent directors' connections in China. The methodology employed to accomplish the conceptual definition and distinction was based on a comprehensive literature review that consisted of comparative studies and analyses of other scholars' perspectives and theoretical frameworks. Guanxi" is a distinctive characteristic of Chinese culture, specifically about informal relationships. Guanxi, or "personal connections," is valued by the Chinese more highly than networking, information, and institutions, which Westerners prioritise. In the "Guanxi" concept, emphasis is placed on social capital within the circle of friends, family, and close associates. This study argues that researchers must recognise subtle differences in how informal inter-organisational directors' relationships are developed and utilised in social network and "Guanxi" concepts.

Keywords: "Guanxi"; Social network; Independent director



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1. Introduction

Social exchange theory states that economic and social factors are necessary for successful business relationships (Blau, 1964; Cropanzano & Mitchell, 2005; Lambe et al., 2001). Many studies have examined the various concepts of 'connections' in different countries and regions. Culturally based informal relationships impact economic and social exchanges, such as Guanxi in China, Yongo in South Korea, and Wasta in the Middle East (Chen & Chen, 2004; Chen et al., 2013; Guo et al., 2018; Zhang et al., 2021). In the social network literature, the concept of 'network'

involves two dimensions: network relation and network structure (Granovetter, 1992). The connections between companies' directors affect the company's efficiency from a network perspective (Burt, 1978). A company's operating, investing practices and financial behaviours can be significantly influenced by the acquisition of social capital from its social network (Cai & Sevilir, 2012; Chen, 2014; Griffin et al., 2021; Fang et al., 2022). The corporate finance literature centres on the existence and strength of network relations, i.e., whether corporate relations exist and how strong these relations are (Fracassi & Tate, 2012; Engelberg et al., 2012; Larcker et al., 2013). A director's social network relations can help a firm achieve more social capital, while a director's position in a network structure can also improve a firm's efficiency (Chen, 2014).

Organisations are embedded in an environment that constitutes various relations in social networks (Granovetter, 1992), and their resource acquisition channels depend mainly on the networks of other actors. Therefore, a firm can develop a firm-level network through its director-level network, created by the directors' or executives' personal networks. This study employs the 'connections' concept to the independent director's social network formed from serving on various director boards and differentiates the "guanxi" established by directors' relations. Moreover, it provides an overview of the role of directors' social networks in disseminating information regarding corporate practices. Research shows that heterogeneity of internal resources in firms leads to different levels of corporate efficiency (Liu et al., 2011); however, the possibility of acquiring resources from the external environment, namely the dynamic social network, has a significant impact on the corporate practises (Chen, 2014; Omer et al., 2020; Cheng et al., 2022). This study focuses on independent directors' social networks created by serving on multiple boards and distinguishes it from the concept of "guanxi" in the Chinese context.

2. Literature Review

2.1. Independent Director Social Network in Worldwide Context

2.1.1. Definition

Social networks refer to patterns of relationships among actors in a system. The social network perspective expands the focus from determinants and consequences of individuals' actions to consider links between individuals. This perspective is important to the social context. The central idea is that interactions between people and organisations transmit information, beliefs, and behaviours (Bianchi et al., 2023). Social networks facilitate access to information, constitute a source of reward and punishment, and foster trust between individuals. As a result, they have the potential to affect economic outcomes (Granovetter, 2005). Social networks are especially salient in the corporate environment, where sharing knowledge and interpersonal collaboration are key to decision-making. For example, investors, managers, corporate directors, and auditors frequently interact, communicate, share ideas, and get expert advice from each other (Bianchi et al., 2023).

In recent years, a growing number of accounting and finance studies have employed social networks to understand the role of social forces in individual and firm decisions and outcomes (Fracassi & Tate, 2012; Cai & Sevilir, 2012; Larcker et al., 2013; Griffin et al., 2021; Fang et al., 2022). Corporate board interlocks form the most studied social network in this emerging area. In this structure, firms are connected through shared board members, and these ties can facilitate knowledge, information dissemination and resource sharing (Larcker et al., 2013). Independent directors serve on multiple boards and form natural social networks, which play a significant role as an information bridge (Davis, 1991) and learning effect (Almeida & Kogut, 1999).

In the worldwide context, studies on social networks employed approximate concepts focused on Guanxi in China, yongo in South Korea, wasta in the Middle East, and blat in Russia. These concepts of connections characterise relationships among people of similar ethnic groups (Guanxi) or backgrounds related to, for example, a shared hometown (Yongo) or kinship ties (wasta). For instance, the Wasta concept refers to people with similar traits, such as shared kinship ties, tribal loyalty, and a shared language (Wahab et al., 2020; Zhang et al., 2021). A distinctive feature of many emerging economies is the contradiction between formal institutional frameworks and their informal counterparts. To mitigate formal institutional voids, many firms adopt social network or informal relationship strategies (Hearn et al., 2018). Guanxi, yongo, and wasta are informal relationships governed by culturally-based social norms (Chen & Chen, 2004; Hutchings & Weir, 2006; Horak & Taube, 2016; Yang et al., 2018).

"Guanxi" is an Eastern term for social networks, and social capital is a Western term for social networks (Huang & Aaltio, 2014). One type of social network in China, namely the Chinese 'guanxi' in social network study, can relate to Confucian capitalism and the 'East Asian Model' of Chinese firms (Chen, 2014). "Guanxi" is rooted in Confucianism and focuses on collectivism over individualism (Yao, 2000). It can be defined as a social relationship and a relationship between people, forces, and objectives (Yang, 1994; Du et al., 2019) and is considered an informal institution (North, 1990; Peng et al., 2009). Characteristics of guanxi relationships include loyalty, commitment, reciprocity, and expectation of continuing the association for the long term (Chen & Chen, 2004; Zhang et al., 2021). While Guanxi exists among family members, it can also be developed between strangers, i.e., to gain access to information and other resources (Davies, 1995; Davies et al., 1995; Wang, 2007).

2.1.2. Social Network and Information Dissemination

The boardroom is one formal channel through which directors build relationships and exchange ideas. These ideas move from firm to firm when directors hold multiple directorships. Moreover, directors who sit on well-connected boards are central to the network's overall flow of information. Therefore, more likely to learn about trends, best practices, and current challenges and have access to new information faster (Omer et al., 2020). Director networks also provide an informal channel for independent directors to communicate with each other among different companies (Cheng et al., 2022). By serving on multiple companies' boards, independent directors can access the latest trends related to corporate governance and development and pass on the information to the companies located in director networks. Prior studies provide evidence that information travels across director networks, allowing firms with well-connected directors to experience higher stock returns (Larcker et al., 2013), greater firm value (Omer et al., 2014), lower stock price crash risk (Fang et al., 2022), less tunnelling behaviour (Chen et al., 2014; Cheng et al., 2022), better post-merger performance (Schonlau & Singh, 2009), tax planning strategies (Brown, 2011; Brown & Drake, 2014) and quarterly disclosure guidance (Cai et al., 2014).

The network can be a conduit for good and bad business practices (Larcker et al., 2013). Director connectedness to other firms within the boardroom network can negatively affect governance. Well-connected directors could receive information about a common practice and allow managers to implement it. This common practice is later revealed to be of the negative type, such as stock option backdating (Bizjak et al., 2009; Snyder et al., 2009; Reppenhagen, 2010) and earnings manipulation (Chiu et al., 2013). Second, whereas multiple board memberships can lead to more information exchange, they also can reduce directors' ability to monitor effectively because of time constraints (Fich & Shivdasani, 2006; Falato et al., 2014).

2.2. Independent Director Social Network in China Context

2.2.1. "Guanxi" and Social Network Contrast

Existing literature widely uses the concept of social networks, but it is unclear how to define the social network in which directors are embedded (Xie & Chen, 2012). Regarding the network structure, most studies view companies as nodes and shared directors as ties. There is variation in the strength of board ties; the strongest tie is arguably a board interlock, and this is broadly employed in director social network studies (Cai & Sevilir, 2012; Chiu et al., 2013; Larcker et al., 2013; Chen et al., 2014; Godigbe et al., 2018; Wahab et al., 2020). While the weakest tie is the result of directors and executives sharing a common background (e.g., school ties, club memberships, etc.) (Bianchi et al., 2023), individuals link on one or more of employment, education, and social activities (e.g., social club) (Griffin et al., 2021; Fang et al., 2022), this is somewhat close to "Guanxi" concept in China context. Besides, the common background is also known as external social networks (Fang et al., 2022) or social capital (Griffin et al., 2022).

"Guanxi" can be defined as an informal institution (North, 1990; Peng et al., 2009) that is embedded in an environment comprised of relatively weak formal institutions and informal solid social ties (Li, 2007). In Chinese, Guanxi refers to social connections or relationships based on reciprocal interests and benefits (Bian, 1994; Yang, 1994). It is extensively used to describe many aspects of the links between personal relationships and business in contemporary China (Nolan et al., 2016; Bian, 2019). Guanxi's role is in organisational strategy, market-entry, and organisational performance (Bian, 2019). Guanxi strategy can be defined as the development and use of personal networks to gain a competitive advantage. Guanxi strategy might involve planning and allocating guanxi investment, namely the resources (time, money, personnel) needed to cultivate relationships and guanxi practice, the use of relationships to achieve organisational goals (sometimes referred to as 'la guanxi', or 'pulling guanxi') (Nolan & Rowley, 2020). Guanxi connections may be helpful in market entry and expansion by helping to identify potential partners and gathering information about their trustworthiness.

Those with existing solid connections to business, finance and government are more successful in navigating an uncertain and unpredictable institutional environment. While Guanxi appears to have an overall positive impact on firm performance, this varies depending on what type of Guanxi is used (business or political), which sector is investigated, and the ownership structure of the firm (state or non-state-owned, foreign-invested) (Nolan & Rowley, 2020). Moreover, while business guanxi can bring economic benefits, the effects of political Guanxi can be more ambiguous in that they may provide short-term advantages. Still, they can constitute a risk over the long term (Nolan, 2018). Therefore, "Guanxi" and social networks have distinct conceptual boundaries; they have some similarities regarding links (or connections) and access to resources. This study defines the independent director social network based on direct or indirect connections of independent directors serving on multiple boards (Xie & Chen, 2012); it differs from Guanxi, which is regarded as utilitarian and purpose-based (Horak & Taube, 2016). Besides, the fundamental unit of guanxi networks is the egocentric dyadic level, around which the network is built; a guanxi network can range from small to large depending on the ability of the ego to bond with others (Chen & Chen, 2004).

2.2.2. Past Studies on Independent Directors in China

The independent director system has been introduced into China's capital market for decades, but the practical and academic circles have not agreed on its governance effect. Scholars examine the governance effect of independent directors on earnings quality and corporate performance and conclude that the system is effective (Wei et al., 2007; Hu & Tang, 2008; Chen et al., 2019; Chen & Nie, 2020; Fogel et al., 2021). However, whether the independent directors of Chinese listed companies can play the corresponding governance role has been questioned (Wang, 2007; Xiao et al., 2009; Chen et al., 2019). Chinese politically connected independent directors significantly decrease the value of listed firms (Han & Zhang, 2018; Shi et al., 2018), whereas politically connected independent directors remarkably increase the value of firms, especially private firms in China (Tang et al., 2016; Cheng & Sun, 2019). There exist some problems in the current system of independent directors in China. First, most Chinese enterprises have concentrated ownership and are controlled by their major shareholders. Independent directors in China are often nominated directly or indirectly by controlling shareholders, whom independent directors are assumed to monitor (Wu & Dong, 2021). It causes concern that independent directors may be captured and fail to play monitoring roles effectively. There are occasional instances when independent directors in China lose their positions when they oppose proposals raised by controlling shareholders or executives (Chen et al., 2014; Cheng et al., 2022).

Second, independent directors are, in fact, outsiders to listed companies. Due to information asymmetry, they seldom have all the relevant information about the companies (Jin & Yu, 2018). Typically, they can only obtain the information that controlling shareholders or executives wish to disclose to other shareholders. Without actual information, it is quite difficult for independent directors to provide professional advice to improve firm performance, though most are experts in related areas. It is, hence, understandable that Chinese independent directors are believed to make little contribution to listed companies and are called "vase" independent directors. Board connections may threaten independence, exceptionally when board members are appointed based on social ties with management (Hwang & Kim, 2009; Fracassi & Tate, 2012; Duchin & Sosyura, 2013; Bruynseels & Cardinaels, 2014; Khanna et al., 2015). Based on this, independent directors have even been labelled "not independent", "not sensible", "inaction", "vase", and "rubber stamp" by the media and public.

3. Conclusions

In conclusion, "Guanxi" and social networks are similar concepts regarding social connections (ties). It can be defined as a social relationship. They overlap markedly in social exchange theory by Blau (1964), Cropanzano & Mitchell (2005) and Lambe et al. (2001). "Guanxi" is an Eastern term for social networks rooted in Confucianism. However, "guanxi" is a unique characteristic in Chinese culture, specifically regarding informal relationships. The Chinese value Guanxi, or "personal connections," more highly than networking, information, and institutions, which Westerners value. In the "guanxi" concept, a premium is placed on social capital within their circle of friends, family, and close associates. On the other hand, social networks and "guanxi" are not interchangeable. "guanxi" embraces social connections or relationships based on reciprocal interests and benefits. In general, its importance depends on the social context and the assumptions upon which a social network is formed. "Guanxi" is a form of social capital that brings concrete benefits and opportunities to earn benefits. There exists some disagreement as to the semantic purpose of "guanxi". From the perspective of independent directors' connections, literature widely uses the concept of social networks, but it is unclear how to define the social network in which directors are embedded. Variation existed in the strength of board ties: the strongest tie is created when directors serve on multiple boards. It is a natural channel for the formation of directors' social network; the weakest tie is the result of directors and executives sharing a common background, i.e., school ties, club memberships, fellow-townsmen relations, etc., it is close to "Guanxi" concept in China.

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