

Negative externalities of close *guanxi* within organizations

Chao C. Chen · Xiao-Ping Chen

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Abstract In this conceptual article we present a critical analysis of close *guanxi*, i.e., close personal connections, in terms of their negative externalities on organizations. We adopt a social dilemma perspective and examine how close *guanxi* parties, while cooperative toward each other, may nevertheless defect against the organization, causing negative externalities. We contend that relationalism exacerbates such negative effects of close *guanxi* and propose various institutional mechanisms and individual variables that can reduce them. Finally, we discuss research and practical implications of solving social dilemmas of close *guanxi* in Chinese organizations and strong ties in Western organizations.

Keywords Guanxi · Favor exchanges · Negative externality · Individualism relationalism and collectivism · Organizational social capital · Universalism–particularism · Social dilemma

In the pattern of Chinese organization, our social relationships spread out gradually, from individual to individual, resulting in an accumulation of personal connections. These social relationships form a network composed of each individual's personal connections. Therefore, our social morality makes sense only in terms of these personal connections (Fei, 1992/1947)

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C. C. Chen (✉)
Rutgers University, 111 Washington Street, Newark, NJ 07102, USA
e-mail: chaochen@business.rutgers.edu

X.-P. Chen
Department of Management and Organization, Michael G. Foster School of Business,
University of Washington, Box 353200, Seattle,
WA 98195-3200, USA
e-mail: xpchen@u.washington.edu

Guanxi has been widely considered as a key Chinese socio-cultural concept providing insights for understanding Chinese societies and contributing to social networking theory and research conducted in the United States (Bian, 1997; King, 1991; Lin, 2001; Tsui & Farh, 1997). However, despite the legitimacy or even the popularity of *guanxi* as a construct of theoretical and practical interest, organizational researchers face certain challenges in their efforts to advance *guanxi* theory and research in Chinese management. One of the challenges is that academic writings on *guanxi* in the field of organization and management have generally been focused on benefits for individual *guanxi* users (Bian, 1997; Luo, 2000; Tsang, 1998; Tsui & Farh, 1997; Xin & Pearce, 1996) even though *guanxi* practices may also carry negative consequences for the organization and the society at large (Bian, 1997; Chen, Chen, & Xin, 2004; Chu & Ju, 1990; Gold, 1985; Khatri, Tsang, & Begley, 2006; Leana & Rousseau, 2000; Pye, 1995). These above cited authors identified negative consequences such as cronyism, corruption, violation of organizational procedures, and the erosion of trust in the authority.

Borrowing the concept of externality from social dilemma research, we refer to these negative consequences to organizations as negative externalities of *guanxi*. Social dilemma research examines how decisions and behaviors of interacting parties affect the self-interest of individual parties as well as the collective interest of the larger, superordinate community. When a party's action affects the situation of other parties without the explicit agreement of the affected others, the action is said to have created an externality (Buchanan, 1971; Dawes, 1980). An example of negative externality can be illustrated as follows. Every department in an organization is asked to request a budget at the beginning of a fiscal year. The department can make an honest request that truly reflects its needs, or an exaggerated request that maximizes what it can get. In this case, making an exaggerated request will bring more money to the department but will also reduce the chance of getting the needed funding by other departments who make honest requests. It will also create problems for the organization to make accurate estimates of the financial needs of each department and fair allocations of organizational resources.

In this paper we adopt a social dilemma approach to the analysis of the functionality of close *guanxi*. We argue that favor exchanges between close (as opposed to moderate or distant) *guanxi* parties within an organization may negatively affect the welfare of the organization as well as other non-*guanxi* parties. In our analysis we distinguish close from distant *guanxi* in ways similar to the differences between strong and weak ties in Western social networking research (Granovetter, 1973; Podolny & Page, 1998). Close *guanxi* are network ties that are located in the most inner circle of an ego's *guanxi* net and are characterized by high levels of sentiment and obligation whereas distant *guanxi* are those ties that are located at the periphery and carry relatively low levels of sentiment and obligation (Chen & Chen, 2004; Podolny & Page, 1998). In between the close and distant *guanxi*, there could be various levels of moderate *guanxi* although in this paper we focus on close versus non-close *guanxi* without further differentiating between moderate and distant *guanxi*. Both Chinese and Western research have documented benefits of close *guanxi* or strong ties to the networked parties and their relationships, but neither have paid much attention to their negative externalities.

A critical analysis of the negative effects of *guanxi* will contribute to a better understanding of not only the complexity of *guanxi* and *guanxi* practices but also of functionality of social networks in the West.

In the following, we explore the negative externalities of *guanxi* in two levels of *guanxi* dilemmas: between individual close *guanxi* parties and between close *guanxi* (i.e., the subgroup) and the group or organization. We then propose how the negative externalities of *guanxi* can be moderated by cultural, institutional, and individual variables. Finally, we discuss research and practical implications of the social dilemma perspective on *guanxi* study.

***Guanxi* and organizational social capital**

A person's social *guanxi* (friends, colleagues, and general contacts) constitute what sociologists and organizational theorists call social or relational capital (Coleman, 1988; Burt, 1992; Soda & Usai, 1999), as differentiated from financial capital (cash and material assets) and human capital (e.g., a person's experience, skills, and knowledge). However, Van Buren and Leana (2000) further distinguish private from public social capital, with the former being privately owned and accessed by individual actors (Burt, 1992) and the latter as collectively owned by a social unit (Coleman, 1988). Accordingly, organizational researchers (Leana & Rousseau, 2000; Van Buren & Leana, 2000) have defined organizational social capital (or relational wealth) in terms of "generalized" associability and trust (Putnam, 1993) that "relies not on knowledge of individuals but on norms and behaviors generally held by those within the social unity" as opposed to "dyadic trust"—"trust between two parties who are known to each other in direct relationship" (Van Buren & Leana, 2000: 236).

Exchanging favors is "the dominant principle of interaction" among friends and "the necessary ingredient to maintain friendship" in Chinese *guanxi* development (Tsui & Farh, 1997: 66, 70). However, favor exchanges in organizations outside the private lives of family and friends often involve the use of organizational properties and positions. While they almost certainly accumulate private social capital they do not automatically contribute to the public social capital. To be sure, we do not mean to argue that all exchanges of favors (i.e., private social capital) in organizations damage organizational social capital. Heimer (1992) in her article titled "Doing your job and helping your friends" argued eloquently how in order to do your job well, you should meet your obligations to your friends in organizations. However, the author also drew a line between professional relationships and personal friendships and cautioned against emotional attachment and vicarious participation in the other party's welfare, which is very similar to what we call close *guanxi*. In effect, Heimer (1992) suggested that close relationships can be detrimental to the organization. Experimental research by Batson, Batson, Todd, Brummett, Shaw, and Aldeguer (1995) found that highly empathetic individuals are more likely to allocate resources to benefit the target of empathy at the expense of the overall collective good.

We identify some preliminary reasons why favor exchanges among close *guanxi* may reduce rather than increase organizational social capital. First, as we elaborate in the following section, organizational members are more likely to engage in favor exchanges with close than with non-close *guanxi* parties as emotional attachment

and obligations are stronger for the former than the latter. Such likelihood applies equally or even more so when the favor exchanges involve improper utilization of organizational resources or require bypassing and violating organizational procedures (Bian, 1997). Second, when a given favor is done to a close *guanxi*, credit is attributed to the individual favor giver than to the organization, even though the organization may have provided the same socio-cultural environment as well as the necessary financial resources. Accordingly, favor returns will also be more likely to go to the close *guanxi* individuals than to the organization. Close *guanxi* and favoritism therefore feed on each other, making *guanxi* more private and exclusive to other organizational members and generating particularistic rather than generalized trust. Third, the differential treatment of close employees creates a sense of injustice to non-close employees or even third party observers (Chen et al., 2004). Research on distributive, procedural, and interactive justice has found that the perception of justice is essential for organizational social capital in terms of trust in the authority and the system of the organization (Kramer & Tyler, 1996). In summary, we propose:

Proposition 1 Favor exchanges among close as opposed to non-close *guanxi* parties within an organization will be more likely to create private rather than organizational social capital.

Social dilemma of favor exchanges in organizations

To the extent favor exchanges within organizations blur the boundaries between personal and organizational motives, *guanxi* parties are often faced with dilemmas of competing interests, obligations, and moralities. To explore the dynamics of favor exchanges in organizations, we rely on the basic framework of social dilemma. A social dilemma is a situation in which a person (of a collective unit) faces a conflict between maximizing his/her own interest (defect) and maximizing the collective interest (cooperate). One of the most common social dilemmas is the resource dilemma, also known as the tragedy of the commons (Hardin, 1968), which is concerned with individuals using public resources to maximize self-interest at the expense of the interest of other community members or the community as a whole. If an organization is conceived as a pool of tangible and intangible resources such as money, materials, positions, power and influence (Mannix, 1993), favor exchanges in organizations present challenges of resource dilemmas in that organizational resources are used for the benefit of *guanxi* others with no benefit to the organization. Social dilemmas, as cogently put by Messick and Brewer (1983), are in essence trade-off decisions between the positive outcomes to the self and the negative externalities to others in a community.

Social dilemma of close *guanxi* at the dyadic level

The social dilemma paradigm was modeled on the 2-person prisoner's dilemma, which derives from an anecdote recounted in Dawes (1980) regarding two prisoners.

The two prisoners jointly committed a felony but their guilt could not be proved. They were held incommunicado and were offered a reward for confessing (i.e., defecting from the partner). If one confessed (defecting the partner) while the other refused to confess (i.e., cooperating with the partner) the person who defected would be set free but the person who cooperated would get maximum punishment. If both defected, both would receive a moderate sentence but if both cooperated, both would receive only minimum sentence.

In a dyadic social dilemma when only two parties are involved, the primary conflict of interest is between the ego and the alter. When the alter is a close *guanxi* tie, due to benevolent concern and a strong sense of obligation toward the alter, the ego will be more likely to cooperate (do favors) than to defect (let down the other party). For example when asked to do a huge favor by a close *guanxi*, the ego will be more likely to do it for the sake of the alter and for maintaining the close relationship even though doing so may incur cost to the ego. Close *guanxi* parties, being highly identified with each other and governed by a strong sense of reciprocity, may also be less likely to engage in cost-benefit calculation. Furthermore, from a pragmatic perspective of instrumentality, the interest of close *guanxi* parties are more positively aligned as the alters are expected to return the favor in future dilemma situations. Viewed this way, the benefit given to the close other is in effect a delayed benefit to the self with the cost as a long-term investment (Messick & Brewer, 1983). In short, due to mutual identification and obligation and the long-term nature of close *guanxi*, a dyadic dilemma becomes either a non-dilemma or a time delayed dilemma between short and long term self-interests for close *guanxi* parties. We therefore propose:

Proposition 2 Facing a conflict between self-interest and the interest of another party, close *guanxi* parties will be more likely to cooperate with each other than non-close *guanxi* parties.

Social dilemma of close *guanxi* at the group level

In a group level social dilemma, there will be two types of defections: individual and subgroup defections. In individual defections, each member pursues individual gains at the expense of other group members and the group as a whole whereas in subgroup defections, a subset of the group forms coalitions to pursue subgroup gains at the expense of individuals outside the coalition or the entire group (Mannix, 1993). Our theoretical interest in this discussion is the subgroup defection (e.g., through alliance with *guanxi*) against the group interest. This has been overlooked in previous research but is more relevant to our concern on close *guanxi*.

If we look at the defection versus cooperation choice from the perspective of groups, organizations or the society at large, we can see that while cooperating or doing favors pays off for close *guanxi* parties, such behavior may create negative externalities to non-close *guanxi* parties and the larger collectivity. Using the prisoner's dilemma terminology, cooperation between two prisoners who committed felonies against the community may cause negative externalities to the community at large. In other words, the personalized relational trust and reciprocity that drives

cooperation between close *guanxi* parties will not automatically translate into group or organizational level cooperation. When the interest of the close *guanxi* parties is in conflict with that of the group or organization, the interest of the subgroup is more likely to take precedence over group interest. It is worth noting that subgroup defection against other members or the whole group requires close cooperation within the subgroup. In other words, favor exchanges between the close *guanxi* parties will be more facilitative to subgroup formation and subgroup defection. We therefore propose:

Proposition 3 Facing a conflict between subgroup-interest and the interest of the group, close *guanxi* parties are more likely to engage in subgroup defection than non-close *guanxi* parties.

The role of relationalism in social dilemma of close *guanxi*

We hold that relationalism may further enhance the effect of close *guanxi* on interpersonal cooperation and subgroup defection. Even though previous cross-cultural research has generally characterized the Chinese culture as collectivistic (Earley, 1989, 1993; Hofstede, 1980; Triandis, Chen, & Chan, 1998) and documented much social and economic benefits of collectivism, other scholars, especially some scholars of Chinese ethnic origin (Brewer & Chen, 2007; Chen, Peng, Saparto, 2002; Fei, 1992/1947; He, Chen, & Hunt, 2004; King, 1991; Liang, 1977/1949), made finer distinctions between different kinds of collectivism and warned against the downside of relationalism or small-group collectivism. Relationalism, according to King (1991) refers to a social and moral system in which obligations to interpersonal and small-group relationships take precedence over both one's individual self-interest and the interest of larger institutions and communities. In his discussion of the social phenomenon of *guanxi* in Chinese societies, King (1991: 68) traced it to the Confucian society, which was a relation-based, hierarchical social system, with family being the core and the organization of other collectives being modeled on the familial relationships. King (1991: 68) asserted that the Confucian social theory "has the theoretical thrust of developing a person into a *guanxi* (relation-oriented) individual" and "that the Chinese are preoccupied with *guanxi* (relationship) building which has indeed a built-in cultural imperative behind it". In emphasizing the relation-orientation of Confucianism, King stated that the Chinese are neither individual based nor group based but relation based. Other scholars have similarly pointed out relationalism and its subgroup self-centeredness. In Chinese Cultural Essentials, Liang (1977/1949) referred to small group self-centeredness as "a very strong sense of familism, no public morality, a plate of non-cohesive sand grains, incapable of cooperation, lack of organizational ability, lack of responsibility for the nation or for public communities, exploiting the collectivity for the benefits of self." Not coincidentally Fei (1992/1947) made a similar connection between relationalism and small-group selfishness, illustrating this attribute with a Chinese adage: "Each person should sweep the snow from his own doorsteps and should not fret about the frost on his neighbor's roof." Management researchers also pointed out the linkage between small group collectivism and opportunism (Chen et al., 2002) and found evidence that endorsing

relationalism led to resistance to economic and enterprise reform (Chen, Meindl, & Hunt, 1997; He et al., 2004).

Despite the heavy influence of Confucian relationalism in Chinese history, the Chinese society and culture is enormously complex, diverse, and dynamic as it builds on multiple schools of thoughts that represent different views regarding human existence and human relationships (Chen & Lee, *in press*; Munro, 1985). While the classic Confucianists advocated a system of relationalism, Legalists upheld a view that is more collectivistic (Hwang, *in press*), whereas Daoists promoted both individualistic and collectivistic beliefs and values (Chen & Lee, *in press*).

One point that emerges from the above review is that while relationalism is a core value deeply rooted in the Chinese society and while a typical Chinese is characterized by King as having a predominantly *guanxi* self, there are other contending schools of thoughts and values within the Chinese culture that allow for different individual self construals in China. Contemporary social, economic, institutional, and demographic transformations of the Chinese society further increase the cultural diversity of China (e.g., Egri & Ralston, 2004; Guthrie, 1998; Peng, 2003). In summary we have reasons to believe that there are significant variations within the Chinese culture regarding the strength of Confucian relational values. Such within culture variations provide opportunities for researchers to explore its impact on individual differences in cooperative and defective behavior.

The relational self is more oriented toward close *guanxi* development and maintenance through thick, multiplex, and continuous favor exchanges involving cooperative behaviors (Chen & Chen, 2004). Individuals with higher as opposed to lower relationalism will be more inclined to assess allies and rivals on the basis of presence versus absence of *guanxi* or close versus distant *guanxi*. Where there are conflicts of interests between close *guanxi* parties, people with higher relationalism are more willing to sacrifice self-interest for the *guanxi* alter so as to maintain a close relationship. When facing a conflict between the interest of the subgroup of close *guanxi* parties and that of the larger group, given the *guanxi*-based self-construal and the priority on personalized relationships, those with higher relationalism will be more willing to defect against the group even though doing so may also carry cost to self. We therefore propose:

Proposition 4 Facing a conflict between self-interest and the interest of close *guanxi*, individuals with higher relationalism will be more likely to cooperate than individuals with lower relationalism.

Proposition 5 Facing a conflict between the interest of close *guanxi* parties and the interest of the group, individuals with higher relationalism are more likely to engage in subgroup defection than individuals with lower relationalism.

Reducing negative externalities of close *guanxi*

Given the prevalence of *guanxi* in Chinese societies and its potential negative externalities, one may be tempted to eliminate *guanxi* altogether. Most China experts, however, have advised against it (Kipnis, 1997; King, 1991; Pye, 1995).

First, by denouncing and suppressing *guanxi*, the positive functions of *guanxi* may also be wiped out. Second, even if it is desirable, it is hardly realistic. The most sustained and concerted efforts of eliminating personal *guanxi* by Mao and the Communist Party of China have either achieved limited success or driven *guanxi* practices underground and to the backdoor (Walder, 1986; Gold, 1985, King, 1991). Given that *guanxi* is deeply rooted in Confucianism, a dominant tradition of the Chinese culture, researchers suggest identifying ways to neutralize and modify the negative effects of close *guanxi*.

Although there is little direct evidence in how the negative effects of close *guanxi* might be mitigated, previous research on solving social dilemmas provides some useful frameworks. Dawes (1980) categorized solutions of social dilemmas into broad categories: changes in payoffs versus changes in utilities. Payoff changes involve changing the payoff structure to give incentives to cooperative behavior but punishment to defective behavior; utility changes involve appealing to socio-psychological utilities, values other than the external payoffs, such as altruism, social norms, and conscience. Later reviews (Messick & Brewer, 1983; Komorita & Parks, 1995; Yamagishi, 1986b) summarized dilemma solutions into structural versus motivational depending on whether actions are taken at the institutional or the individual level. Structural solutions include, for example, altering the payoff structure and privatizing public resources whereas motivational solutions include social values, trust in others, and organizational identity. In the following, we adopt the institutional versus individual typology but incorporate Dawes' (1980) notion of utilities and values at both levels. Further, we treat the institutional and individual characteristics as contingencies under which close *guanxi* is less likely to generate negative externalities to the organization, especially to the organizational social capital.

Institutional moderators

From the many institutional factors that have been found effective in solving social dilemmas in the U.S., we select the three that we consider most relevant to the *guanxi* dilemmas: the structure of payoffs, institutionalized ethical standards, and transparent decision making. Underlying these institutional factors is the Weberian (Weber, 1947) model of replacing traditional, personal authority with impersonal bureaucratic authority. Before applying these to Chinese organizations, we acknowledge two caveats. First, in making the proposals, we have in mind mainly large, more bureaucratic Chinese organizations rather than privately or collectively owned small organizations such as family or village and township business as research has documented significant differences among these organizations (Peng, Tan, & Tong, 2004). Research on the use and conservation of public resources has shown that converting commonly owned public resources into privately owned resources improves conservation of the resources (Cass & Edney, 1978; Messick & McClelland, 1983). To the extent that family and collectively owned businesses are congenial to a symbiotic relationship between the interests of the individual and the organization, organizational members are more likely to employ personal favors for the accomplishment of the organizational goals (Redding & Wong, 1986), hence reducing the social dilemma of *guanxi*. The second caveat is that even for some large Chinese organizations, the Weberian model is by no means the only way to reduce

the negative externalities of close *guanxi*; other alternatives include the Japanese or the Korean extended family conglomerates (e.g., Bhappu, 2000). Despite the caveats, we find it appropriate to apply Western insights on Chinese large corporations because a large proportion of mainland Chinese companies are state owned and because most large corporations (including privately owned and Sino-foreign joint ventures) profess to strive for a “modernized” Chinese management comparable with global firms in the West.

Payoff structures A payoff structure refers to the patterns of both incentives and penalties offered to cooperative and defective behaviors. We focus here on incentives and rewards and deal with sanctions in the following section. What is most relevant to *guanxi* dilemmas is whether the actual payoff of close *guanxi* is larger or smaller than that of merit in terms of competence and performance. To the extent that Chinese interpersonal trust emphasizes sentiment and loyalty more than competence, it opens the door for people with poor or mediocre task competence and performance to gain favor from managers by showing steadfast personal loyalty. Although there has been a long Chinese tradition of personnel selection based on merit, that tradition was severely undermined during the Cultural Revolution, when formal authority in organizations was illegitimate and when political and ideological correctness was held to be more important than task performance (Walder, 1986). Since the late 1970s, over decades of economic reform, as economic profit and productivity and market competitiveness have gradually gained legitimacy and dominance over socio-political missions, merit and performance has never been held higher in organizations of all kinds (Chen, 1995; Child, 1994; Dittmer, 1995). However, much competitive advantage remains to be created in overcoming personal *guanxi* to build a merit-based high performing workforce.

In this regard, we raise two issues. One is that apart from raising the bar of merit and performance, companies need to apply merit standards to all functions and roles of the organization. We observe that in functions and positions on which organizational survival depends; merit and performance tend to be the dominant operative principle in many organizations. Yet, much of the HR practices in the non-essential functions and roles still remain *guanxi* based. A second issue is how to define merit. Merit in many organizations is becoming primarily credentials rather than work performance, such that when you find people with great credentials but non-stellar performance, chances are that personal *guanxi* is working. With objectively defined performance established as the key decision criterion in HR functions such as selection, appraisal, and promotion, the pressure of favoritism itself is reduced. In our conversations with HR managers from domestic state-owned, joint ventures and foreign-owned companies, we found that those from the latter two groups received fewer favor requests from close *guanxi* but more open applications, presumably because joint venture and foreign companies were perceived to have specific and high selection standards such as task specialty and foreign language skills. Therefore, we propose:

Proposition 6 Changing the payoff matrix such that performance- or merit-based activities receive higher payoffs than *guanxi*-based activities will reduce the negative externalities of close *guanxi* on the organization.

Institutionalized ethical standards We argue for the moderating effects of institutionalized ethical standards because social dilemma research has shown significant positive effects of moralizing on cooperation induction. For example, in experiments in which the experimenter delivered a sermon about cooperation, exploitation and ethics, the rate of cooperation was significantly higher than those without such a sermon (Dawes, 1980). Research on honor codes at educational institutions also found positive effects of ethical standards on the reduction of academic cheating (McCabe & Trevino, 1997, 1993). Given the prevalence of *guanxi*, it is important that organizations develop their own ethical guidelines for dealing with *guanxi* related conflict of interests. For instance, there can be a general corporate policy of excusing managers from making important decisions that involve actual or perceived conflict of interest. Companies may also stipulate policies regarding the appropriateness of preferential treatment to *guanxi* members (such as family members, relatives, or country fellows and classmates) that violates pre-established organizational policies. Another area in need of ethical guidance is the limitation of gift giving and gift acceptance. In addition to setting and codifying these *guanxi* ethics, enforcement of ethical standards by monitoring and sanctioning systems will turn ethical rhetoric into ethical practices (Yamagishi, 1986a, 1988). In summary, we expect organizations that establish and reinforce *guanxi* ethics to experience less negative *guanxi* externalities.

Proposition 7 Establishing ethical standards for *guanxi*- related conflict of interests in an organization will reduce the negative externalities of close *guanxi* on the organization.

Decision making transparency Public disclosure of decision choices was found to increase cooperative decisions more than was anonymity (Dawes, 1980). Similarly, communication that allows subjects to discuss social dilemmas and to make explicit public promises of cooperation consistently increases rates of cooperation (Dawes, 1980, Komorita & Parks, 1995). It has been proposed that the effect of communication stems from shifting the internal processes of the subjects from individual motives to collective norms (Orbell et al., 1988). We observed one remarkable difference regarding how *guanxi* exchanges are kept open or secret in China. In people's private lives, favor exchanges tended to be open and public presumably because publicity increases the favor doer's social capital, whereas favor exchanges in formal organizations tended to be kept in private, "behind the closed door" or "through the back door". The secrecy surrounding favor exchanges in organizations suggests that they lack legitimacy according to the professed organizational norms of distributive and procedural fairness. One way to curtail *guanxi* favoritism is to increase transparency of HR decision making, especially in the personnel area, which enables the general public, the interested or the disinterested parties to see what decisions have been made, by whom, on what criteria, and through what process. Public knowledge and scrutiny about personnel decisions would not only put pressure on the application and justification of decision standards but also trigger the motivational–normative processes through which decision makers are motivated to act according to normative expectations of social responsibility and fairness (Orbell et al., 1988). Decision making transparency may

also decrease information asymmetry between insiders and outsiders of *guanxi* circles. Therefore, we propose:

Proposition 8 More transparent HR decision making will be more likely to reduce the negative externalities of close *guanxi* on organizations than less transparent decision making.

Individual moderators

Social dilemma research has identified a long list of individual variables that affect decisions of cooperation over defection (Messick & Brewer, 1983; Komorita & Parks, 1995). We focus on two individual differences that we consider as most relevant and important to the Chinese in dealing with *guanxi* dilemmas. The first is the value of universalism–particularism and the second is organizational identity. Both variables can be approached at either the cultural or the individual level (Parsons & Shils, 1951 ; Brewer & Roccas, 2001). Indeed when we were contrasting relationalism with individualism and collectivism, we had in mind cultural differences between China and other societies although we acknowledge diversity of values within the Chinese culture. Here we explore how individual value differences within the Chinese society moderate the effect of close *guanxi* on organizations, although we believe such differences can be explored between cultures.

Universalism and particularism Universalism and particularism are two opposite orientations regarding the treatment of others. Universalism obliges the self to treat all others according to general standards independent of the particular relationships the others have with the self, whereas particularism obliges the self to give priority to the particular relationship over the general standards (Parson & Shils, 1951). In other words, particularism puts obligations to special relationships such as family and friendships above obligations to the society or organizations with more general categories of memberships. The concept of universalism–particularism has some overlap with individualism–relationalism in that particularism and relationalism are quite similar. However, because individualism (especially its rugged form) does not equate universalism and because universalism is related to the rule of law, we see the utility of this concept for curbing negative externalities of close *guanxi*.

The value of universalism–particularism may differ both at the cultural and the individual personality levels (Parsons & Shils, 1951; Stouffer & Toby, 1951). Although Chinese culture is generally classified as particularistic (Trompenaars, 1994), there is likely to be wide variation among Chinese citizens as a result of the changes from the communist revolution on the one hand and economic reform and modernization on the other. Mao and the Communist party made concerted efforts to propagate comradeship, nationalism, and loyalty to the party in place of personal and familial loyalty and obligations (Gold, 1985; Vogel, 1965), and recent economic reform and modernization efforts have injected some universalistic values such as education and performance (Chen, 1995; Child, 1994). A recent cross-cultural study of Chinese and American arbitrators (Friedman, Wu, Chen, & Chi, 2007) found the

Chinese arbitrators punished inter-firm contract violations more severely than their American counterparts. While the finding was partly attributed to differences in attribution, it is also possible that the Chinese arbitrators are more mindful of the importance of sticking to universalistic business contract laws. The point is that there should be sufficient variation in universalism–particularism in the Chinese society to warrant its effect on how to solve *guanxi* dilemmas. In sum, we propose:

Proposition 9 Individuals endorsing universalism will be more likely to use favor exchanges to benefit the organization than individuals endorsing particularism.

Organizational Identity Organizational identity is the degree of oneness and belongingness that an individual feels about his or her employing organization and it is positively associated with organizational commitment and citizenship behavior (Ashforth & Mael, 1989, 1996; Pratt, 1998). Like other social identities, organizational identity affects and is affected by self and other categorization. That is, people with a stronger organizational identity are more likely to categorize themselves as well as others along organizational boundaries, which trigger organizational values, norms, and obligations. The effect of organizational identity on cooperation is evident in social dilemma research on group identity. Members with stronger group identity are more willing to put group welfare ahead of their individual welfare (Brewer & Kramer, 1986; Chen, 1996; Dawes, Van de Kragt, & Orbell, 1988; Kramer & Brewer, 1984).

Guanxi itself is a type of social identity and is also often based on social identifications such as family, birth place, school, and former organizations. One may ask: Is organizational identity sufficiently potent in affecting *guanxi* exchanges? We contend that it is. First, organizational identity is most likely more imminent than most of the *guanxi* bases that are past and latent. Second, organizational identity and its associated organizational obligations should have more legitimacy than *guanxi* or other social identities because the organization interest has primacy over individual self-interest or subgroup interest. We are not proposing that organizational identity will replace *guanxi*, but it is a potent countering force to reduce the negative externality of close *guanxi* on organizations. We propose:

Proposition 10 Individuals with a strong organizational identity will be more likely to use close *guanxi* to benefit the organization than will individuals with a weak organizational identity.

Discussion

We critically examined the personal, particularistic nature of close *guanxi*, assessed its functionality in the organization, and identified institutional and individual factors that may moderate the negative externalities of close *guanxi* on the organization. Our analysis of close *guanxi* has some important implications for research and practice in Chinese as well as non-Chinese organizations.

Research implications

The first contribution of this article is a critical analysis of *guanxi* by relating network research on close *guanxi* and strong ties to the general literature of social psychology, especially the social dilemma research. The conceptual distinctions between individual, relational, and collective selves, and between different types of collectivism and social identities may be best illustrated and tested in situations of social dilemmas which we argue should be differentiated in terms of dyadic, small group, and large group situations. *Guanxi* research therefore has the potential to contribute to a body of literature that goes beyond Chinese psychology and management.

Second, we hypothesized the institutional and individual mechanisms that could mitigate the negative externalities of close *guanxi* and proposed propositions that are readily testable. This could lead to more systematic and rigorous research on *guanxi* from different perspectives. For example, our social dilemma perspective of *guanxi* provides an excellent avenue for exploring issues of organizational justice. Previous research in Chinese organizations tended to focus on distributive justice as it relates to employee motivation, whereas *guanxi* dilemma raises concerns of procedural as well as distributive justice. Research on *guanxi* and procedural justice could offer insights on how to build institutional trust in addition to or in place of personalized trust in Chinese organizations.

Third, our attention to the negative externality of *guanxi* will contribute to an emerging balanced approach toward the functionality of networks within and between organizations. Network research in organizations in the U.S. has tended to take the perspective of the individual actors, be they single individuals or firms, and emphasize benefits to members within the networks, neglecting the perspectives of the larger community within which networks are embedded and the costs and negative externalities of networks. Our micro-analysis of interpersonal *guanxi* has the potential to inform macro research on organizational networks and networked organizations.

Lastly, although our central interest in this article is the potential dysfunctionality of close *guanxi* in Chinese organizations, one could explore similar negative externalities of strong ties in Western organizations. One needs only to heed reports on ethical challenges involving conflicts of interest to realize the central role of network ties. One would expect that the stronger the social network ties the more likely there will be actual and perceived conflict of interest. On the other hand, although we consider close *guanxi* in China as conceptually similar to strong ties in the U.S., closeness and strength are relative to other social relations within each society. Comparing across the two societies, to the extent close *guanxi* in Chinese organizations is more particularistic and more prevalent than strong ties in Western organizations; it is possible that certain negative externalities to Chinese organizations are less likely to occur to Western organizations. Of course these contentions require cross-national comparative research.

Practical implications

As China's market-oriented economic reforms deepen and its integration into the world economy increases, Chinese organizations that are poised to become cosmopolitan and global players will face unprecedented opportunities and

challenges (Peng, 2003; Yeung, 2006). With more structural barriers removed and greater mobility of the workforce, managers of Chinese organizations will be faced with the external challenge of having to compete with outsiders, those from other regions of China and other countries of the world, or with insiders when the Chinese organizations are outsiders, and the internal challenge of having to manage a workforce that is increasingly non-local and diverse. While seeking to maintain *guanxi* where it offers advantages, Chinese managers will have to learn to operate where they don't have *guanxi* or where *guanxi* is more of a liability than an asset. The institutional factors that we offered as means of neutralizing and modifying close *guanxi* can serve as useful frameworks for building non-*guanxi* based institutions.

More specifically, our critical analysis presents reform-oriented Chinese managers with a means of solving *guanxi* dilemmas and developing a more organizationally committed workforce. For starters, given the intense social, affective, and moral obligations of close *guanxi*, one way to solving the dilemma is not to get into one in the first place, namely, the avoidance strategy suggested by King (1991). There are three parts to this strategy. The first is to recuse oneself from situations that involve conflicts of interest. In this regard, managers will be greatly facilitated by the existence of explicit corporate policies on conflicts of interest. The second part of the strategy is to maintain a cordial relationship with all employees but avoid or restrict the development of intimate personal relationships at the workplace. The third part is to compartmentalize formal and economic from informal and social activities. Some managers for example insist on discussing work-related issues only during work and at the workplace instead of making or receiving visits at home, a long-time practice of the past.

A second practical implication is related to the legitimacy of self-interests, especially among people in positions of power. Whereas the state-owned organizations in the Mao era emphasized the enculturation of a totally collectivistic value of "serving the people" by doing away with any individual and material rewards, organizations will do better by aligning individual interests with organizational interests through a merit and performance based reward system. Better alignment of interests makes the pursuit of self-interest legitimate but contingent upon adding value to the organization. These alignments in essence build reciprocity between the manager and the organization in place of the person reciprocity between *guanxi* parties. When doing well for the self also means doing well for the organization and vice versa, much of the conflict of interest that is the source of *guanxi* dilemma will be removed and solved in ways that balance both individual and collective interests.

Conclusion

Our critical analysis of close *guanxi* revealed that while favor exchanges benefit *guanxi* parties, they may have serious negative externalities on non-*guanxi* parties and on the organization as a whole. We further propose that relationalist values may exacerbate such negative externalities while other institutional and individual factors may reduce them. Although our analysis is focused on Chinese close *guanxi*, the

theoretical model has research and practical implications beyond the Chinese organizations as it points to potential negative externalities of strong ties in Western organizations.

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Chao C. Chen (PhD, State University of New York at Buffalo) is professor of management and global business at Rutgers Business School, Rutgers University. His current research interests include organizational justice, emotion and charisma attribution, empowerment, and social networking.

X.-P. Chen (PhD, University of Illinois at Urbana-Champaign) is professor of management and organization at Michael G. Foster School of Business at University of Washington. Her current research interests include cooperation and competition, passion, reciprocity, cultural diversity, and Chinese *guanxi*.