

Internationalization of Chinese Firms: What Role Does *Guanxi* Play for Overcoming Their Liability of Outsidership in Developed Markets?

ABSTRACT: This article answers the question how managers of Chinese firms can use *guanxi* when entering and expanding in developed markets. The empirical basis for the investigation is formed by interviews with 29 managers at 17 Chinese B2B firms internationalizing to Europe. The results generated are twofold. On the one hand, existing *guanxi* was largely irrelevant for initially entering the European market. On the other hand, Chinese firms managed to successfully overcome liability of outsidership by building new *guanxi*-like relationships with their Western business network partners after a certain period of time. Six propositions give insights on the process for Chinese firms to become insiders in the business networks of developed countries. The propositions were combined into two comprehensive models that give implications for future research and for management practice.

KEYWORDS: Guanxi, Liability of Outsidership, Internationalization, Chinese Firms, Emerging Economy Firms

Chinese outward foreign direct investment (FDI) has increased strongly in recent years and is expected to continue its steep growth (Buckley et al. 2007; Li 2009a; Luo, Xue, & Han 2010). Previous research has focused on reasons for the outward internationalization on both the environment-specific level (e.g., Buckley et al. 2007; Cardoza & Fornes 2009; Deng 2009; Morck, Yeung, & Zhao 2008; Yang, Jiang, Kang, & Ke 2009; Witt & Lewin 2007) and the firm-specific level (e.g., Alon, Yeheskel, Lerner, & Zhang 2013; Chen 2006; Deng 2003; 2004, 2009; Hertenstein, Sutherland, & Anderson 2015; Li 2009b; Liu, Xiao, & Huang 2008; Morck et al. 2008; Banalieva & Sarathy 2011). Although first insights about the internationalization motives, modes, and market-entry strategies of Chinese firms have been gained, little empirical research has been conducted on *how* Chinese firms actually operate in overseas markets (Bonaglia, Goldstein, & Mathews 2007; Child & Rodrigues 2005; Hu & Wang 2009; Liu & Woywode 2013). This is especially true for the operations of Chinese firms in developed economies (Ge & Ding 2008).

Europe is an increasingly popular destination for outward FDI by Chinese firms (Li 2009b). The Chinese investment stock in the European Union had reached nearly 27 bn EUR in 2012 (FT 2014). Germany and the UK were ranked in the Top 10 destinations for China's outward FDI in 2013 (EY 2015). However, Chinese firms are newcomers to the European market and therefore outsiders to the established European business networks (Sohm, Linke, & Klossek 2009). Yet, Chinese firms are well known for their ability to establish, manage, and exploit personal social network ties for the companies' strategic purposes (e.g., Gu, Hung, & Tse 2008; Chai & Rhee 2010). This research

project raised the following question: what role does *guanxi* play for Chinese firms in overcoming their outsidership and in establishing trust in European business networks?

To answer this question, the recently revised network-based Uppsala internationalization process model (Johanson & Vahlne 2009) and extant research on *guanxi* were used as the theoretical guiding part; seventeen Chinese firms in a Business-to-Business (B2B) context in Europe form the empirical basis. The contribution of this paper is threefold: (1) It is one of the first studies that applies and extends the recent Uppsala internationalization process model; (2) it contributes to the theoretical concept of Liability of Outsidership by applying it in the context of emerging economy firms; and (3) it expands the stream of research on *guanxi* and trust by outlining the difference in sequence and function when moving to developed countries.

The research represents what Whetten (2009; p. 30) referred to as “the cross-context approach to foster context sensitive theorizing”. This paper explains the role of *guanxi* for Chinese firms in their effort to establish an insider position in Europe by contextualizing existing theories and concepts. In addition, the author develops new insights into familiar topics such as the Uppsala internationalization process model of 2009 and the extant research on *guanxi*. Therefore, this work contributes to the general theory development by “theorizing the findings from the case analysis” (Guo & Miller 2010; p. 268).

The remainder of this article is organized into five sections: (1) the overview of the theoretical background; (2) the description of the methodology used; (3) the presentation of the results; (4) the discussion and conclusions; and (5) implications for future research and for practice.

Theoretical background

The theoretical background is based on the revised Uppsala internationalization process model and the extant research on *guanxi*. Both concepts are introduced in this section.

Uppsala internationalization process model of 2009

Johanson & Vahlne (1977) argue in their original Uppsala internationalization process model that internationalization is a result of progressive reduction of psychic distance through managers' gradual accumulation of experiential knowledge of foreign markets. In their recently revised internationalization process model, Johanson & Vahlne (2009) modified their view toward a network perspective of the firm. Firms' business environments are viewed as webs of relationships. In the 2009 model, the authors propose that a firm can make use of its existing business relationships to identify and exploit opportunities that may lead to expansion in foreign markets. When a firm ventures into a new market where it has no existing connections, "Outsidership" in relation to the relevant network is seen as the key reason for difficulties in establishing a footprint there. Johanson & Vahlne call this phenomenon the "Liability of Outsidership" (LoO). They propose that this liability can be overcome through a learning process after which building of trust and commitment can begin. With that the firm becomes an insider in the new business network and thus, overcomes the LoO (Johanson & Vahlne 2009). In the particular case of Chinese firms, ethnic minorities abroad may reduce distance and bridge or mediate between the host-country business network and the Chinese firm. The empirical research is inconclusive with divergent results (Ellis 2011; Blomkvist &

Drogendijk 2013). Recent research also confirm the applicability of the current Uppsala process model to acquisitions by emerging market firms in developed markets (Rabbiosi, Elia, & Bertoni 2012) and decision-making about the internationalization trajectory (Hertenstein, Sutherland, & Anderson 2015).

The revised Uppsala process model, and with it a relationship-based view of internationalization, seems well suited as a theoretical starting point for answering the research question.

Concept of *guanxi*

Scholars who have extensively studied the phenomenon in the Chinese business context (e.g., Ahlstrom, Bruton, & Yeh 2008; Buckley, Clegg, & Tan 2006; Chen, Chen, & Huang 2013; Gu et al. 2008; Li, Poppo, & Zhou 2008; Luo, Huang, & Wang 2011; Park & Luo 2001; Reid & Jallat 2006; Standifird & Marshall 2000; Xin & Pearce 1996) define *guanxi* (关系) as a cultural characteristic of Chinese society with its roots in the Chinese Confucian philosophy. *Guanxi* has strongly governed the Chinese social and business fabric and modern Chinese society. The concept expresses the way in which people draw on a web of informal, interpersonal connections that are characterized by reciprocal expectations about favors in personal relations. Such relational expectations strongly affect business life in China. *Guanxi* is oriented toward long-term social relationships. It is an intricate and pervasive relational network that contains implicit mutual obligations, assurances, and understanding. Lee & Dawes found that affection or liking “is the most important component of *guanxi*, and it is so critical that Chinese people tend to mix the word *guanxi* with *ganqing* [=affection].” (2005, p. 35). Furthermore, *guanxi* can be

differentiated into different levels: *shengren guanxi* (*guanxi* with a stranger), *shuren guanxi* (*guanxi* with a known person), and *qinren guanxi* (*guanxi* with family members or strongly connected persons). The tie or bond and the level of trust and commitment increase as the *guanxi* moves to the next level (Fu, Tsui, & Dess 2006).

Analyzing the existing literature shows that much research has been published on the role of *guanxi* in the success of market expansion and operations of Western MNCs and/or Chinese firms in the context of the Chinese market (e.g., Abramson & Ai 1999; Ahlstrom et al. 2008; Buckley et al. 2006; Gu et al. 2008; Li 2005; Li et al. 2008; Park & Luo 2001; Reid & Jallat 2006; Standifird 2006; Standifird & Marshall 2000; Tsang 1998; Xin & Pearce 1996; Xing, Y & Liu, Y 2015). To better understand *guanxi* in different settings, Reid & Jallat suggest that “[t]he impact of *guanxi* on [...] internationalization may be an area of subsequent study.” (2006, p. 50). However, in this field there has been scarce research conducted on the role of *guanxi* for Chinese outward internationalization (Zhao & Hsu 2007; Zhou, Wu, & Luo 2007). Hence, extant research is pointing at the subsequent question of how *guanxi* functions in non-Chinese markets in terms of overcoming liabilities and achieving market expansion.

Trust and *guanxi*

Interpersonal trust is an important outcome of establishing *guanxi* (Chua & Morris 2006; Chua, Morris, & Ingram 2009; Lee & Dawes 2005; Song, Cadsby, & Bi 2012). *Guanxi* serves as a strong insurance mechanism for conducting business in the Chinese business environment and therefore enhances trust between two persons as it is based on reciprocity; a person that does not return a favor eventually loses face and is seen as

untrustworthy (Luo 2007). Furthermore, mutual trust formulated through *guanxi* is often a prerequisite for business in China (Lee & Dawes 2005; Luo 2007). It is not limited solely to commercial activities but always extends to social relationships, through the exchange of favors and the giving of face and status (Luo 1997b). Although some authors have argued the inclusion of trust as a component of *guanxi* (e.g., Redding & Ng 1982; Tong & Kee 1998), the majority of extant research finds *guanxi* to be a necessary precondition for establishing trust in the Chinese market context (e.g., Gu et al. 2008; Hoskisson, Eden, Lau, & Wright 2000; Lee & Dawes 2005; Wu & Leung 2005).

The Chinese characters for trust are *xinren* (信任). The first character refers to trustworthiness in terms of a person's sincerity and concern for one's well-being, while the second character is about a person's trustworthiness in the sense of dependability, usability, and employability (Chen & Glen 2004; Chua & Morris 2006). This distinction between sincerity and ability in the Chinese language corresponds well with the Western two-dimensional conceptualization of trust (Chen & Glen 2004). McAllister (1995) showed that interpersonal trust among managers in organizations is characterized by cognition-based trust and affect-based trust. The former refers to trust by using the "head," the latter refers to trust based on the "heart."

Guanxi vs. Western networks

Research found that *guanxi*, as the Chinese version of social network ties, has distinct ways of operating because of the unique characteristics that result from the special Chinese cultural setting and its contemporary political and socio-economic system (e.g., Abramson & Ai 1999; Fan 2002; Gu et al. 2008; Luo 2007). However, some works

conclude that *guanxi* is similar to or even a duplication of the concept of Western networking (e.g., Kenrick, Neuberg, & Cialdini 2007; Wellman, Chen, & Dong 2001; Zhao & Hsu 2007; Zhou et al. 2007). Previous research further argues the existence of universal commonalities such as the norms of reciprocity (Gouldner 1960) or the process of social influence (Cialdini 2008) that are not specific to any cultures. A prominent empirical research on the difference between *guanxi* and Western networking was conducted by Chua et al. (2009). They found that (1) affect- and cognition-based trust are more intertwined for Chinese than for Americans; (2) the effect of economic exchange on affect-based trust was more positive in the case of *guanxi*, while the effect of friendship was more positive for American networking; and finally (3) the extent to which a given relationship was highly embedded in ties with third parties increased cognition-based trust for Chinese but not for Americans.

This research investigates the relationship and sequence between *guanxi* and trust when it is formed and used by Chinese firms in Western countries and with non-Chinese partners. The author refers to the social network ties between Chinese and Westerners that reflect positive mutuality as “*guanxi*-like” relationship.

Methodology

To fully understand and categorize the role of *guanxi* for overcoming the LoO of Chinese firms in developed markets, this study applied a qualitative research methodology using a multi-case study design (Eisenhardt 1989; Yin 2003; Eisenhardt & Graebner 2007). Experiences from previous research on Chinese firms show that it is generally best to obtain sensitive information about strategies and tactics through face-to-face interviews (Ahlstrom et al. 2008). Hence, 29 semi-structured interviews with

decision-makers at 17 Chinese firms that operate internationally were conducted to answer the research question.

Sample

To comprehensively ascertain the perceptions of executives, viewpoints from different managerial levels were gathered (Isabella 1990). Participating interview partners represented four different levels, including the CEO, the general manager for the international market, and the overseas chief sales officer or account executive. At two large firms the author expanded the selection to include middle managers such as strategy, marketing, or project managers to gain further insights. All of the participants have extensive decision-making power for the business operation of their firm in Europe. The B2B setting is especially interesting for exploring the topic of *guanxi* because of the greater importance of client interaction and customer relationship management than in the B2C context (Coviello & Brodie 2001; Gruen 1995). In addition, the B2B context has thus far been the spearhead of successful Chinese outward internationalization, with companies like Huawei and Baosteel as frontrunners. The sample was finished when theoretical saturation was reached, which was indicated by information redundancy (Strauss & Corbin 1998). The final sample consists of 29 interview partners from 17 Chinese firms that are active in Europe and headquartered in China. The European subsidiaries investigated in this study are located in Austria, Germany, and Sweden. Table 1 gives an overview of the final sample of this study.

→ INSERT TABLE 1 ABOUT HERE ←

Data collection

To supplement and extend previous research the researcher relied on in-depth interviews with managers (Flint, Woodruff, & Gardial 2002). Interviews were semi-structured “so that the conversation could develop freely according to the answers of the informants, and to allow in-depth inquiry” of areas of special significance to the interviewee (Mäkelä & Maula 2005, p. 238). On average each interview lasted 75 minutes, with the shortest interview at 40 minutes and the longest at 150 minutes. They were audio recorded in 25 of the 29 occasions. In 4 occasions the interview partner refused the audio recording and notes were taken instead. The interviews were conducted in the native language of the participant as previous researchers suggest that this allows participants to express ideas more freely and accurately (Guo & Miller 2010; Siu & Bao 2008).

An interview guideline and an overall description of the research were sent to the participants prior to the interview to ensure their familiarity with the topics of interest. The interviews were designed to learn as much as possible about a participant’s perceptions, observations, and thoughts related to her or his firm’s internationalization to Europe, the challenges faced, and the role of *guanxi* in overcoming those challenges. The researcher tried to ensure consistency of understanding about described phenomena during the interviews by ensuring that interviewees thoroughly understood the topics when they were introduced. To reduce the chances of misinterpretations of the interviewee after the interview, the verbatim transcripts were sent to the interviewees for revision.

Qualitative information derived from the interviews was supplemented by several secondary sources to increase the reliability and validity of the data (Miles & Huberman

1994). For each of the companies included in this study, the researcher analyzed annual reports, analyst reports, company biographies, and other relevant information. The author gained familiarity with the companies and industry sectors, as well as the company's self-perception of its role in the marketplace. This background analysis reinforced and provided orientation for the statements made by the participants.

Data analysis

For the qualitative data analysis comparative analysis was used to discover theory that can be derived from the empirical data (Strauss & Corbin 1998). With the intention to recognize categories and properties of the collected data, the standard open, axial, and selective grounded theory coding processes was applied (Strauss & Corbin 1998). The entire process of coding and interpretations was facilitated by using software. The analysis moved back and forth between previously identified recurring categories of data and newly collected interpretations of phenomena. This iterative procedure is aiming to achieve a higher level of abstraction (Martin & Turner 1986), encompassing all shades of the data (Isabella 1990) modified the initial categories as necessary, removing older ones and adding new ones that accounted for newly identified evidence. The final set of codes were derived from approximately 500 pages of transcribed data. The revised Uppsala model served as a guiding framework for analysis. Table 2 presents an example of initial and final codes that evolved from the data.

→ INSERT TABLE 2 ABOUT HERE ←

Trustworthiness and transparency

The author assessed trustworthiness by applying the set of nine criteria, put together by Flint et al. (2002), that combines two overlapping sets of criteria: one set from interpretive research (credibility, transferability, dependability, confirmability, and integrity) and one set from grounded theory (fit, understanding, generality, and control). Table 3 shows how each criterion in detail was addressed.

→ INSERT TABLE 3 ABOUT HERE ←

Results

The results from the qualitative data analysis is presented in this section. It describes (1) the nature of LoO for the Chinese firms in Europe; (2) the role of Chinese firms' existing *guanxi* for overcome those LoO; (3) how those firms built new network ties with Western clients; and finally (4) the analysis of the *guanxi*-building process of Chinese B2B firms in Europe, its nature, sequence, and function. Throughout the section, the researcher derives propositions in light of the findings and extant research in order to stimulate and guide future research.

Existence of LoO faced by Chinese firms

The Chinese firms in this sample faced a LoO in their European markets. The primary reason for this liability was existing mistrust that hindered commitments necessary to initiate business relationships (Johanson & Vahlne 2009). The main challenges for the internationalizing Chinese firms were to access existing business networks and to establish trust with their potential developed market clients. The statement of Mr. Zhang is used to illustrate how this manifests:

“The European clients didn’t know our company. They have strong prejudices against products from China. They think that the Chinese can only produce cheap goods like textiles and toys. In the past, most of our clients didn’t believe that we are able to deliver high-tech solutions like [product of the company]. [...] In the case when clients knew our company, they still wouldn’t trust our products. They didn’t know about the performance and quality of our products. Our brand didn’t stand for good quality at all. In the case when the clients really decided to buy our products and services, they would be very critical about the price and demand a much lower price compared to what they would pay to our Western competitors. They would even do so when we promised and assured them in writing the same quality and service level as with the solution from the European competitor.”

It was particularly difficult for the first wave of Chinese firms to establish a position in the European business network as those firms operated in rather mature industries with strong and long-established local business networks. The interview participants remarked that LoO manifested itself in a rather subtle way. The mistrust was not openly communicated by the potential clients, but became obvious in their actions. In addition, Western competitors used the outsidership issue quite openly during tenders, arguing that Chinese firms could not be trusted. In one case, a Chinese firm was trying to enter a European country where local firms in its specific sector were of strategic importance for the economy and employment. It was first selected by the European client as a partner because of the convincing solution presented and the low price offered. However, an intervention on a higher level led to the signing of the contract being called off last moment, and instead the project was given to the European competitor. Similar incidents occurred several times after this. The interview partners suspected that both the mistrust about Chinese firms and the inability to access existing networks were the primary reasons for the loss of business. From this analysis the author concludes:

Proposition 1a: *Chinese firms in developed markets face a LoO that manifests in potential clients' distrusting their performance and hinders the Chinese firms' ability to establish a position in the Western business network.*

Proposition 1b: *Liability of outsidership for Chinese firms operating in developed markets is higher in mature industries and in those where business networks consist primarily of Western firms.*

Exploiting existing stock of *guanxi*

One way for Chinese companies to overcome LoO in Europe could be to leverage their existing *guanxi* within the (overseas) Chinese community. Exploiting their stock of *guanxi* would be a logical step in line with Johanson & Vahlne, who argue that “[...] the focal firm’s existing insidership in a relevant network may help it enter a foreign market” (2009, p. 1415). In this case, the relevant existing *guanxi* may come from the local Chinese embassy or consulate, the overseas Chinese network, Chinese firms in Europe, or other parts of the home-country business and institutional network. Interestingly, none of the interview partners mentioned any existing *guanxi*-like relationship with Western partners, e.g. from within China, that may have helped them in their market entry in Europe. In addition, they unanimously considered existing *guanxi* with institutions and businesses in China as generally irrelevant for Europe.

The finding is in line with the results from Kotabe, Jiang, & Murray (2011) that confirm the missing link between strong government ties and positive performance of new product introductions in China. However, they run contrary to research on the outward internationalization of Chinese firms (Yiu, Lau, & Bruton 2007) and other

emerging economy firms (Elango & Pattnaik 2007). Neither of those extant studies specifically looked at expansions into developed markets. Indeed, managers with work experience in other emerging markets confirmed that the situation can be quite different in these other countries. For example, one of the participants in this study cited that for large-scale projects in some African countries, home-country networks with government officials and bankers are highly important for winning the bid. The finding of the non-significance of existing *guanxi* in the developed market context of Europe may be explained by the fact that so far Chinese networks consisting of suppliers, clients, and government institutions have a rather small footprint in Europe and are not seen as relevant. Therefore, the researcher suggest the following:

Proposition 2: *Existing guanxi with the Chinese business and institutional networks from the home and host country are of no significance for first-wave firms during their entry into Europe.*

Transferring *guanxi* building capabilities from other contexts

As the existing stock of *guanxi* cannot be exploited to overcome LoO in Europe, Chinese firms feel the pressing need to develop new network ties. As such, the focus shifts from exploiting to exploring, and the dynamic capability of *guanxi*-building comes into focus. Johanson & Vahlne (2009) argue that through interaction with international partners, a general knowledge about building relationships abroad can be generated that may be transferable to new situations. Therefore, the question is whether the profound Chinese knowledge of *guanxi*-building can be transferred to other countries.

This study found that this capability can also be used and further honed in markets other than China. Five participants shared their particular experiences about relationship building in India, Latin America, and Russia. These managers agreed that their *guanxi*-building skills from China helped them to quickly understand the relationship-building process in these emerging markets. This transferability may be explained by the comparable institutional market and business environments and the similarly important role of social network ties (Lovett, Simmons, & Kali 1999). However, this transferability does not apply to the same extent for Europe, where local relationship-building knowledge had to be newly acquired through a lengthy, experiential learning process consistent with what has been proposed in previous international business research (e.g., Chang 1995; Johanson & Vahlne 1977; Nadolska & Barkema 2007). This leads to:

Proposition 3: *The extent to which knowledge about the relationship-building process from previous experiences in emerging markets can be transferred to developed countries is limited.*

Familiarity as a driver for *guanxi* building capabilities

According to the 2009 Uppsala model, an important step in overcoming the LoO is to accumulate knowledge about the ways in which relationships are formed in the new network (Johanson & Vahlne 2009). This is clearly supported by the data, in which all of the Chinese participants with education in Europe and/or with international experience of more than 10 years confirmed that they successfully managed to build *guanxi*-like relationships with Westerners, while the participants with less than five years of international experience still perceived *guanxi*-like relationships with Westerners as a

major challenge. The words of Mr. Liu from the professional services industry illustrate this process:

“Our education in Europe was very important for our marketing activities, client acquisition, and relationship management. We know the rules and cultural norms of this country. In addition, we have a certain level of academic education, which is important for our clients. This ensures respect and trust. [...] We have earned respect from some companies, even though they haven’t become our client. I think when you offer high-quality professional services to your clients; this will be appreciated by your partners. Hence, the business relationship with our partners has become a very close one over time and in many cases also a very personal and social relationship. For example, in times when the economic crisis was endangering the business, we had the feeling that some of our clients were in serious trouble. Here, we were willing to do projects free of charge for them. Only when they continue to exist can we have further business. We see the reciprocity in our relationship. Back then, when we were in trouble, we felt the support and sympathy of our closest clients.”

As discussed, extant research points to differences between *guanxi* and Western networking (e.g. Abramson & Ai 1999; Fan 2002; Gu et al. 2008; Luo 2007). The Chinese participants unanimously agreed that building *guanxi*-like relationships with Westerners is marked with obvious difficulties that have to do with the different language, culture, and an initial lack of commonalities and connections. Eriksson, Johanson, Majkgard, & Sharma (1997) referred to these difficulties as the lack of institutional market and business knowledge. In addition, building relationships in foreign countries is usually more costly than in the home country (Chen, Chen, & Ku 2004). Hence, some firms seek recruitment of Overseas Chinese to quickly overcome the lengthy learning requirement (Chai & Rhee 2010; Blomkvist & Drogendijk 2013). The statement from Mr. Chen illustrates that local *guanxi* building can be successful in developed markets, but that would require a very time consuming process:

“It is a long way and a patient accumulation process of knowledge about building relationships in Europe. On the one hand, it is about establishing mutual sympathy; on the other hand, it is a rational collaboration. But without knowledge and skills, nobody will listen to you. It is a matter of time and of knowledge. [...] Even though

the Europeans don't understand face. But also things like renqing [=unpaid obligation resulting from invoking a guanxi relationship] can be taught. [...] Yes, people are all the same. At the end of the day, they also emphasize the value of guanxi. However, you need to bridge the cultural distance first. Trust is a condition for establishing guanxi. And in Europe, of course there is mistrust. Only time can solve this issue."

From this discussion the conclusion is:

Proposition 4: *Knowledge about the local relationship-building process has to be built gradually through experiential learning in the developed country itself.*

Guanxi building as a localized process

A more detailed investigation of such network building processes leads to an analysis of the relationship between social network ties and trust. According to the recent Johanson & Vahlne (2009) framework, the necessary element for overcoming liabilities of outsidership is establishing trust, which then allows for commitments to be built. In other words, in line with previous research in other contexts (Morgan & Hunt 1994; Kumar, Scheer, & Steenkamp 1995; Kwon & Suh 2004), the revised Uppsala model sees trust – and at a minimum the absence of mistrust – as the precondition for commitment. At this point, a distinction between affective and calculative commitment is useful (Mathieu & Zajac 1990): An affectively committed party desires to continue a relationship out of a sense of sympathy, loyalty, and belongingness, while calculative commitment is based on perceived structural constraints that bind the firm to its partner (Gounaris 2005). Existing research refers to the former as “positive” and to the latter as “negative” motivation (Geyskens, Steenkamp, Scheer, & Kumar 1996). Based on previous research (Lee & Dawes 2005; Chua, Ingram, & Morris 2008; 2009), the author argues that *guanxi* and *guanxi*-like relationships are usually characterized by intertwined cognitive and affect-

based trust and positive motivation for commitment, but they do not contain the negative motivation for commitment because a “[g]uanxi relationship that is no longer profitable or based on mutual exchange can be easily broken” (Luo 2007; p. 11).

For Europe, the data indicates that the situation is different. Managers of Chinese firms need first to overcome the initial LoO in the form of mistrust by establishing some level of cognitive trust. By performing well in the initial business engagements, the Chinese manager gets the chance to add affect-based trust and create some positive commitment to the relationship in Europe. Once these two elements are added to the initial cognitive trust, a *guanxi*-like relationship is formed, further business is added, the Chinese manager and its firm become an insider, and this then further enhances trust and commitment. Like in the case of *guanxi* in China, in order to stay an insider the Chinese manager has to continuously meet or exceed the expectations of its Western partner (Lee & Dawes 2005).

Some of the Chinese firms explicitly targeted their first offerings in Europe toward overcoming distrust by tactics that include references of existing Western clients, site visits to the Chinese headquarters, or even free-of-charge projects to prove their ability. This start of the relationship-building process is mirrored in a statement from Mr. Yang from a firm in the high-tech industry describing how he and his team build cognitive-based trust:

Visits to China and the HQ of our firm are very important. Many people don't understand why, because they think this is only entertainment to the client and for building a relationship on a personal level. Actually, it is not. Why? Because we are doing this with only one purpose: They don't have the confidence in China and a Chinese firm. They only get the information from the media, and outside of China this is usually very negative press. Some think we are still in the Cultural Revolution and this kind of situation. So if you want your customer to buy your goods or systems worth USD 10-20 million, these systems must be of top quality and never fail or the

executive at the client firm gets fired. So how can you develop this confidence of your customer? We use a very simple way. We invite them to come to our HQ in [a tier-one Chinese city] and to see the rest of China. Normally, when they see the HQ and China, their attitude changes almost 100%. For example, we invited a lot of executives to visit China and I remember after one visit of a top-manager in China the face of this person looked really different because he couldn't believe that China is so advanced, and the whole day he was really upset because he compared China to his own country. [...] But anyway he started to do business with our firm."

After a solid cognitive trust base had been built and some business had been carried out, the Chinese firms tried to establish the other two elements, affect-based trust and positive commitments. Mr. Yang went on, illustrating the move from cognitive to affect-based trust and positive commitment, which is necessary to achieve a local *guanxi*-like relationship:

"People are all the same. Don't think that guanxi matters only in China and business people outside of China are very professional. That's not the case. Once you're in the upper levels – where people have established long years of relationships – you are one of them. And there is a big difference between talking about business inside those circles and talking about business when you are outside of those circles. [...] I'm representing our company in that circle. We have a business relationship. And why do we have that? Because (1) we get things done, (2) we are an essential and long-term business partner, (3) you have confidence in my abilities, and (4) you trust my person. And that's why we became business partners. After becoming business partners you have to add some personal relationship. Then you are inside the circle. [...] When we have a good business relationship, the move from a business to personal friendship is easy. I just asked them for the handicap, ask them if they do sports, and ask them about their family. But you need the business relationship first. You can't just call the CEO and ask him to play golf with you. Even when I leave the country and a new manager replaces me, he would still be part of this circle. Because he is representing our company! This means that our company is part of the circle."

Based on this discussion the propositions are:

Proposition 5a: *Chinese firms apply tactics that help to offset the mistrust and establish cognitive trust with the decision-makers at the Western clients first. At a later stage, affect-based trust and positive commitment are built up to move toward a *guanxi*-like relationship with the Western executives.*

Proposition 5b: *Establishing a guanxi-like relationship with executives of Western clients allows the Chinese firm to become an insider in the business network of the developed country and hence to overcome the LoO.*

Changing function of *guanxi*

Previous empirical research in China has shown that *guanxi* has a substantial effect on market expansion by positively influencing sales growth (Gu et al. 2008; Luo 1997a; Park & Luo 2001; Zhang & Li 2008). According to Luo, *guanxi* in China can be “the most effective (market growth) and efficient (low-cost) marketing tool” (1997a, p. 51). In terms of outward internationalization, however, extant research indicates that network linkages are less important for expanding in a developed market where a mature institutional environment exists (Chen & Chen 1998) and for strengthening business relationships when there is no business tradition of *guanxi*-like relationships (Chen & Easterby-Smith 2008). The participants confirmed the general importance of *guanxi*-like relationships in European countries, but pointed out that the primary function here shifts from initiating leads to retaining customers.

According to Holm, Eriksson, & Johanson (1999), a close business network leads to mutual commitment, which fosters mutual dependence and ultimately has a strong positive effect on (joint) value creation in a business relationship. Therefore, one can argue that for Chinese firms, *guanxi*-like relationships in Europe are both, a prerequisite and an indicator for creating significant added value in existing business relationships in those markets. A statement of Mr. Yang illustrates how this progression might work:

“No, I don’t think that guanxi works outside of China for acquiring a first project. It is not like that. You need to be very good in what you do first. You need first the hard

thing [hereby referring to the performance of the products and solutions] and then add a little softness [hereby referring to guanxi] to that, then again some hard thing and then again some softness ... that continues and you climb up and up the ladder. That's how you succeed in business abroad! For example, the executive of a large Western MNC called us to help them when our Western competitor failed to deliver. But why did he call us? It's because we have already established a good business relationship with him; he trusts us, and he can't operate without us. In this occasion when you say: "Hey, let's play golf together!" he will definitely say "Yes!"

Based on the above discussion, the suggestion is:

Proposition 6: *The function of guanxi-like relationships within the marketing mix shifts from lead generation and sales force marketing in the Chinese market context to relationship marketing in penetrating developed markets.*

Discussion and conclusions

Model for using guanxi to overcome the liability of outsidership

Based on the results of the case study research, the author proposes two models that extend the theory on social network ties and business network theory and contrast the differences of the former when working in a Chinese versus a developed country environment. The two models take a step beyond the data and speculate on cause-and-effect relationships of the constructs examined in this research. Hence, it demands further validation (e.g., through large samples and/or longitudinal studies).

Figure 1 posits that for overcoming LoO in Europe, which stems mainly from mistrust about Chinese firms, *guanxi*-like relationships with executives of the new business network have to be established for the firm to become an insider. This research argues based on the 17 cases that the key to this is establishing cognitive and affect-based trust as well as positive commitment with the new customer in the developed market. In order to achieve that a rather lengthy process of experiential learning about relationship-

building in the West is required. In addition, to overcome the initial mistrust, Chinese firms need to be competitive in terms of quality in their field and to focus on tactics that help to offset this mistrust and further build cognitive-based trust. The competitive strategy of the firm can support this relationship-building process by focusing on delivering high customer value and exceeding the expectations of the client. In some of the cases this was achieved through excellence in customer service. In developed countries those *guanxi*-like relationships function as a relationship marketing tool that supports customer retention, which again further strengthens the relationship in the business network. Contrary to the initial expectation and previous research, leveraging the existing Chinese business and institutional network is in general less important for first-wave market entrants engaged in relationship-building with Westerners in the process of becoming an insider. In addition to that, the transferability of knowledge about relationship building process from China or other emerging markets is limited.

→ INSERT FIGURE 1 ABOUT HERE ←

Guanxi-building in China and in developed countries

Extant research found, *guanxi* and *guanxi*-like relationships to be usually preceded by intertwined cognitive and affect-based trust and positive motivation for commitment (Chua et al. 2008; 2009; Lee & Dawes 2005). The findings suggest that the relationship between *guanxi* and trust changes its sequence in Europe. The next model, depicted in Figure 2, illustrates this difference in the relationship between social network ties and trust. It posits that in China, affection or *ganqing* is the first step in building a relationship

with strangers. This affectionate connection may be achieved through commonalities such as mutual friends or the same Alma Mater. *Ganqing* allows a so-called *shuren guanxi*, a *guanxi* relationship with a familiar person, to be established. When managed well, the author argues that this type of relationship further establishes cognitive and affect-based trust, which are prerequisites for business opportunities. The business relationship then allows for positive commitments to take place. After a while this *shuren guanxi* then may eventually become a *qinren guanxi*, a family or clan-like *guanxi* relationship. In Europe the situation is different. As described, managers of Chinese firms need first to overcome the mistrust by establishing cognitive trust. By performing well in the initial business relationship, the Chinese manager gets the chance to add affect-based trust and positive commitment to the relationship. Once these elements are added, a *guanxi*-like relationship is achieved, which finally allows the Chinese manager and its firm to become an insider. The statements of the interview partners indicated that the closing of this relationship-building process for Chinese managers usually takes significantly longer in Europe than in China. However, this situation may change as more Chinese firms establish a presence in Europe.

→ INSERT FIGURE 2 ABOUT HERE ←

Theoretical implications

The present research makes significant contributions to theory. This study is one of the first to offer insights from data from Chinese firms expanding into developed markets. It contributes to the revised network-based Uppsala internationalization process model

(Johanson & Vahlne 2009) by applying and extending it in the context of multi-case-study research from 29 decision makers and managers from 17 Chinese firms operating in Europe. This research confirms the causal chain from relationship commitment over host-country relationship knowledge development and network knowledge development to business development (Johanson & Vahlne 2006). Importantly, the results extend the theory by detailing the cause and effect of the process of successful internationalization to developed markets. In addition, this work bridges the literature on Emerging Economy firms' internationalization and the network-based Uppsala internationalization process model by contextualizing the important aspect of development of international social network ties from the perspective of the Chinese firm.

Secondly, this research contributes to the theoretical concept of liability of outsidership by applying it in the context of emerging market firms expanding to developed countries. Liability of outsidership is characterized by a distinct network perspective (Johanson & Vahlne 2009). This investigation extends the theory by proposing a process model, detailing antecedents, cause and effects, for Emerging Economy firms to overcome those barriers and to eventually become an insider in the business network of the developed economy. The model describes the process from the perspective of the Emerging Economy firm taking into account contextualized constructs like home country institutional network ties and host country economic environment.

Thirdly, this paper expands the stream of research on *guanxi* in particular and social network ties in general. It investigates the role of *guanxi* of Chinese firms' internationalizing to developed economies. The research takes into account the particular characteristics of *guanxi* and uses the extant research on trust (e.g., Lee & Dawes 2005)

to dissect *guanxi* into different elements in order to apply it in the different cultural context of Europe. Hence, the research offers a first step to take a dynamic view on a concept, which results from Chinese culture but is taken into the modern business environment. The findings provide insights into which elements of *guanxi* are transferable to the business networks of developed markets and give propositions about their impact and importance. The author discusses, how certain functional strategies support the establishment of *guanxi*-like relationships. Lastly, the second model gives a fine-grained understanding of the differences between the *guanxi*-building process in developed markets in contrast to the familiar process in China (e.g, Fu et al. 2006).

Managerial implications

The propositions derived in this research explain how it was possible for some front-runners from China to successfully enter developed markets and to successfully establish an insider position in a developed country business network and thereby overcoming the liability of outsidership that emerging market firms are facing.

The first model suggests that Chinese firms may overcome the liabilities of outsidership through a process of establishing *guanxi*-like relationships within the business network of the developed country. Those ties serve the primary function of relationship marketing. However, this process requires two things: (1) the company needs to go through an experimental learning process on relationship building in the developed country itself and (2) focus on building cognitive and affect-based trust as well as positive commitment. As a result, an emerging market firm expanding to a developed country should deliberately consider those requirements with respect to their HR

recruiting and Marketing & Sales strategy. Finding talent that can do not require the experimental learning process can significantly improve the speed of international expansion. Sizeable investments are also necessary for establishing a service network on par with the incumbent competition. This research shows that a strategy of service leadership, which focuses on exceeding the expectations of the customers on service, clearly supports the process of overcoming liability of outsidership.

The second model is detailing the relationship building process and contrasting the approach in Western countries to the familiar Chinese *guanxi*-building process. To initiate business in developed markets the Chinese company should first focus on building cognitive trust through quality, pricing and service that consistently exceeds the expectations of the Western customer. The departments for Research & Development, Product Management, Sales and Service of the emerging market firm need to work closely together to develop products and services that meet the market requirements of the host country and define specific area in which the expectations of the customer should be exceeded. In some cases this can only be the price, however, it needs to be ensured that quality and after-sales service are on par with the competition. At a later stage, the focus should shift to building affective trust and positive commitment. This may be achieved by stressing the long-term benefits of the partnership and focusing on expanding the business relationships with key decision makers to a personal level. In the analyzed cases, some emerging market firms used for example invitations to their home country HQ to support the relationship-building process. Having established cognitive trust, as well as affective trust and positive commitment, the Chinese firm can become an insider in the developed country's business network.

This research results provide important insights for developed country firms as well as for emerging country firms. Particularly, Asian firms striving to achieve competitive advantages in the global markets need to understand the dynamics and differences in relationship-building when they are expanding overseas. The ability to build and manage managerial network ties in different parts of the world is critical for the success of any international company. They must learn how to adapt their market expansion and *guanxi* strategy according to the changing requirements of developed markets. Also, an integrated expansion plan is required with detailed functional strategies for Sales and Service, Marketing, Research & Development, as well as Human Resources/ Recruiting.

Established Western firms need a clear picture of the relationship-building strategies of newcomer firms in order to be able to react accordingly to the new challenges. Some Chinese firms are focusing their efforts on hiring experienced sales, service and product development managers away from the incumbent players. Western companies need to have a system in place to manage retention of their key personnel. The entry of new players to the market results in greater competition and higher benefits for the customer. Western companies need to understand their strengths relative to the newcomers and develop strategies to defend their castle.

Limitations and future research

The propositions of this paper, and also the limitations suggest some fruitful directions for future research. None of the 17 firms investigated here had an ongoing JV with a European firm, either in Europe or in China. The revised Uppsala model argues that

existing insidership and know-how about building relationships with foreigners may facilitate the process of becoming an insider (Johanson & Vahlne 2009). Building on this and other previous studies (e.g., Deng 2004; Hertenstein, Sutherland, & Anderson 2015; Mathews 2006), future research should look specifically at firms that have a JV with Western firms and examine how this relationship influences the liability of outsidership and *guanxi*-building when expanding to developed countries (Zhang & Keh 2010). Furthermore, existing customer-supplier relationships with Western firms in China may also serve as a starting point for learning and cognitive trust-building and may be leveraged when the Chinese firm wants to enter new business networks in the developed country (Hertenstein, Sutherland, & Anderson 2015; Johanson & Vahlne 1990; Sharma & Johanson 1987). This aspect deserves further research as so far the focus has been on the role of Chinese *guanxi* networks for internationalization (Zhao & Hsu 2007; Zhou et al. 2007).

This research looked specifically at the situation in the European market. Some of the participants with work experience in other emerging countries described situations that were quite different. For example, large-scale projects of state-owned Chinese firms in India required the firms to build good relationships with local agents. This necessity resembles practices in China. Particular research on HR management of Chinese firms in Africa reveal crossvergence of HR practices that blend Chinese *guanxi* and African social network ties into a specific organizational culture that supports commitment to the organization and work attitude (Xing, Liu, Tarba, & Cooper 2014; Xing, Liu, Tarba, & Cooper 2016). So, the question remains: Do Chinese firms have a

competitive advantage in emerging markets compared to Western firms in this regard, as they are apparently more proficient in building and managing *guanxi*-like relationships?

Another interesting aspect in the context of emerging markets is the role of the ties to Chinese governmental institutions (Li, Yao, Sue Chan, & Xi 2011). During some Chinese M&A deals, the effect of Chinese institutions was evident; however, it is hard to grasp the overall scale and format of this involvement from the outside (Child & Rodrigues 2005; Tzeng 2008). One of the participants mentioned that projects in Africa are frequently a result of barter deals between the government of some African countries and China. These African countries provide China with natural resources, while Chinese firms help to construct and run infrastructure in that country. Moreover, these projects are usually financed by large, Chinese state-owned banks. It would be interesting to understand to what extent Chinese internationalization to Africa or other emerging markets differs to.

Extant research indicates the importance of acquiring strategic assets for the outward internationalization of emerging market firms (Cui & Jiang 2009; Deng 2009). M&A, as another strategy that Chinese firms use to overcome the liability of outsidership, should be specifically investigated in future research efforts. The example of Geely's acquisition of Volvo is an example for a strategic move to overcome a lack of trust in the quality of Chinese cars by acquiring the brand that is for decades rated in the West as producing the safest cars in the industry.

Finally, in terms of methodology, a quantitative approach would be useful to test the propositions derived in this paper. This approach may also be combined with one that investigates propositions in a different setting than here. For example, the role of *guanxi*

for overcoming the liability of outsidership could be examined in the context of the Chinese market, in other developing, and in advanced markets.

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TABLE 1: Study Sample

Name	Background information
Mr. Shen	CEO and Shareholder, mid-sized construction firm, age cluster: A3, experience category: E3, Ph.D. in Europe, previous work experience at a Chinese state ministry
Ms. Zhao	General Manager Europe, mid-sized construction firm, age cluster: A3, experience category: E2, responsible for business development in Europe
Mr. Liu	Partner and Founder, small professional service firm, age cluster: A3, experience category: E3, M.A. and Ph.D. in Europe
Ms. Zhou	Partner and Founder, small professional service firm, age cluster: A3, experience category: E3, M.A. and Ph.D. in Europe
Mr. Zhang	General Manager for Western European country, large telecommunication equipment provider, age cluster: A2, experience category: E2
Mr. Schmidt	Chief Account Manager, large telecommunication equipment provider, German, responsible for an MNC, age cluster: A3, more than 10 years of prior work experience in China
Mr. Yang	Sales Director and Account Manager, large telecommunication equipment provider, responsible for an MNC, age cluster: A2, experience category: E2
Mr. Wang	Marketing Manager, large telecommunication equipment provider, responsible for Central and Eastern Europe, CIS, and Russia, age cluster: A1, experience category: E1
Mr. Yi	Supply Chain Team Leader, large telecommunication equipment provider, responsible for supply chain in Northern Europe and training in Europe, age cluster: A1, experience category: E1
Ms. Xu	Supervisor, Bidding & Commercial department, large telecommunication equipment provider, responsible for large telecom deals, age cluster: A1, experience category: E1
Ms. Zhao	Strategy Manager, large telecommunication equipment provider, responsible for global marketing strategy, age cluster: A2, experience category: E1
Mr. Han	Project Manager, large telecommunication equipment provider,

	technical team leader serving a number of large Western telecom clients, age cluster: A1, experience category: E1
Ms. Huang	Commercial Manager, large telecommunication equipment provider, responsible for global marketing strategy, age cluster: A1, experience category: E1
Mr. Yuan sr.	CEO and Founder, small mechanical engineering firm, age cluster: A3, experience category: E1
Mr. Yuan jr.	General Manager International Business, small mechanical engineering firm, age cluster: A1, experience category: E1
Mr. Zhu	General Manager for Western European country, large shipping and logistics company, age cluster: A3, experience category: E3
Mr. Frei	General Manager Europe, large electrical equipment manufacturer, German, age cluster: A2, prior experience with Chinese firms as suppliers
Mr. Braun	Sales Manager Europe, large electrical equipment manufacturer, German, age cluster: A2, no prior experience with Chinese firms
Mr. Meng	General Manager Europe, large steel company, age cluster: A2, experience category: E2
Mr. Chen	CEO and Shareholder, mid-sized automotive supplier, Founder of a Chinese-European cultural exchange platform, education in Europe, age cluster: A2, experience category: E3
Ms. Yu	Assistant to the CEO, mid-sized automotive supplier and Chinese-European cultural exchange platform, age cluster: A1, experience category: E3
Mr. Wu	CEO and Founder, small electronic equipment manufacturer, age cluster: A2, experience category: E1
Mr. Lu	General Manager International Business, mid-sized automation and control company, age cluster: A2, experience category: E2
Mr. Feng	General Manager International Business, large agricultural machines manufacturer, age cluster: A2, experience category: E2
Mr. Wei	General Manager International Business, large steel manufacturer, age cluster: A2, experience category: E1
Mr. Lei	General Manager International Business, small electronic equipment manufacturer, age cluster: A1, experience category: E1
Mr. Peng	CEO and Founder, small biotechnology company, age cluster: A2, experience category: E2
Mr. Xue	CEO and Founder, small industrial automation company, age cluster: A2, experience category: E2
Mr. Deng	CEO and Founder, small robot automation company, age cluster: A2, experience category: E2

Notes: All participants have decision-making power for the international business operations of their respective Chinese firm. Some participants asked for anonymity; hence, all names listed above are pseudonyms.

The revenues of the small firms are below USD 100 million; mid-sized firms have revenues ranging from USD 100 million to USD 1 billion; large firms have revenues above USD 1 billion.

The range of the age clusters are: A1: 25 – 40, A2: 41 – 55 and A3: 55+ years.

The years of international experiences are categorized into: E1: 0 – 5, E2: 5 – 15 and E3: 15+ years.

All Chinese firms investigated here have operations outside of China and at least one subsidiary in a European country. However, most of the mid-sized and large companies operate around the globe.

TABLE 2: Development of Coding Categories (Examples)

Preliminary Coding Categories	Examples	Final Coding Categories
Sales tactic	Exceeding client expectations through excellence in service	Service excellence
Barriers to market entry	Inability to access relevant business networks in the developed country	Liability of Outsidership
Market expansion	Expanding to less competitive market segments first and targeting the most competitive in the last stage	From periphery to the core
Partnership	Western business partner is willing to consider Chinese supplier as strategic partner	Positive commitment
Negative brand image	Negative perception of the quality and reliability of Chinese firms	Mistrust

TABLE 3: Trustworthiness and Transparency

Criteria	Addressed in this research
Credibility Extent to which the results appear to be acceptable representations of the data	Interviews were conducted with one or sometimes two interviewers. Interviews and transcripts were done by native speakers.
Transferability Extent to which the findings from one study in one context apply to other contexts	Interviews were conducted only with key informants at the HQ of Chinese firms and European subsidiaries. Theoretical concepts were represented by data from at least the majority of the participants.
Dependability Extent to which the findings are unique to time and place	Participants reflected on past and recent experiences in Europe. Many compared it to experiences they had in China and some also to other markets, such as the United States, Latin America, Africa, and India.
Confirmability Extent to which interpretations are the results of the participants and the phenomenon	Two China-based academic members and one Chinese practitioner acted continuously as auditor and sparring partner for the research, which helped to expand and refine the interpretations.
Integrity Extent to which interpretations result from misinformation or evasion of participant	Interviews were conducted in a professional way. Every interview started with a clear definition of the topic and easy-to-answer warm-up questions. Strict anonymity and confidentiality were promised to the participants, resulting in no evasion of the topic.
Fit Extent to which findings fit with the substantive area under investigation	Concept of <i>guanxi</i> was analyzed in a new setting and captured the dynamics and complexities of the data. Revised Uppsala process model served as guiding structure for analysis.
Understanding Extent to which participants buy into the results as representations of their world	Transcripts were sent to participants for verification. Summary of the results were presented and discussed with some participants, one Chinese practitioner, and two China-based research colleagues.
Generality Extent to which findings discover multiple aspects of the phenomenon	Interviews were of sufficient length and openness to capture multiple aspects of the phenomenon. Experience and background of interviewers facilitated the exploration of multiple aspects of <i>guanxi</i> .
Control Extent to which organizations can influence aspects of the theory	Participants have direct control of their <i>guanxi</i> that is relevant for overseas business operations.

FIGURE 1: Process model for using *guanxi* to overcome the liability of outsidership

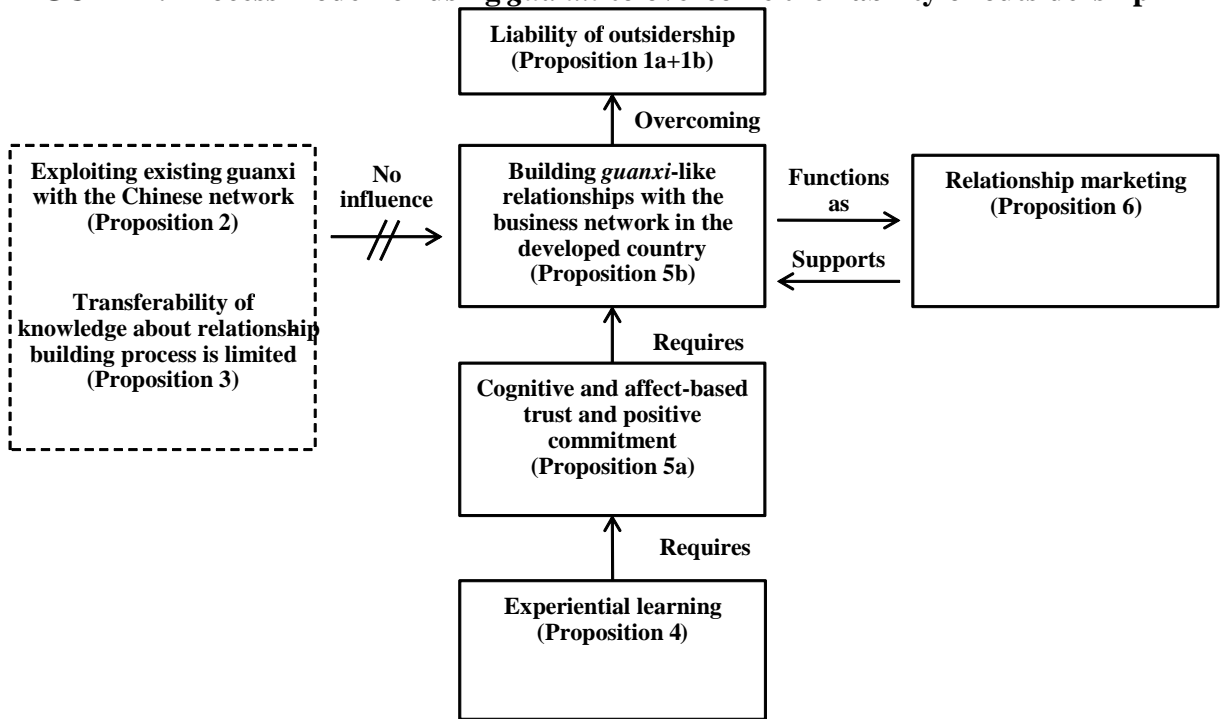


FIGURE 2: *Guanxi*-building in China and in developed countries

