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How to manage client entertainment in China

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Abstract Client entertainment is a popular business practice that Chinese managers often use to facilitate business relationships and promote sales. Multinational enterprises (MNEs) operating in China, however, have been frequently involved in corruption allegations caused by client entertainment. This article explains client entertainment's purpose, prevalence, and persistence in China and identifies the pitfalls that foreign firms often encounter when they practice client entertainment in that country. Based on field observations and first-hand experience as well as research on public and survey data, this article also provides eight prescriptive guidelines that can potentially help firms manage client entertainment more efficiently and effectively without causing ethical and legal problems.

1. Client entertainment: A popular practice worldwide

Client entertainment activities—such as eating, drinking, sightseeing, exchanging gifts, and sporting with clients—are a popular business practice worldwide. While some studies (e.g., Steidlmeier, 1999) have considered client entertainment corruptive, few firms have totally banned it. Entertainment is widely used by business managers as an important facilitator in building business relationships and promoting sales (see Beltramini, 2002).

Client entertainment's role in facilitating business relationships in modern societies can be traced back to antiquity. Throughout human history, eating, drinking, and various forms of entertainment activities have served a broader role in social and economic interactions (Kipnis, 1996). For example, Pacific Islanders, Northwestern American Indians, and Asian Eskimos practiced a ritual called potlatch—a ceremony of banqueting, dancing, and gift exchange—to facilitate transactions and exchange favors. Similarly, Mayans used banquets as an occasion for resolving disputes, exchanging gifts, arranging transactions, and nurturing social relations (LeCount, 2001; Mauss, 1925/1990).

In industrialized societies, although most business transactions are guided by market rules and legal restraints, entertainment is still prevalent in facilitating business relationships. Entertainment practices play an enabling role by strengthening trust, promoting reciprocal behavior, and building

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long-term relationships, all three of which are favorable for developing high-quality business relationships (see Carrier, 1991).

2. Client entertainment in China: The lubricant for smooth business

Client entertainment is observable in all societies, but is particularly rampant in China. The well-known Chinese business practice of *guanxi* actually represents the business networks and connections that are often built through entertainment activities (see Yang, 1994). Customarily, Chinese managers entertain their business partners at such venues as luxurious restaurants, golf courses, karaoke booths, dance halls, hiking trails, bowling centers, sauna rooms, sport arenas and stadiums, tea houses, skiing resorts, hotels, hair salons, massage and footcare parlors, et cetera. Data from the 2007 annual reports of over 220 companies listed on the Shanghai Stock Exchange (2009) indicate that these companies spent an average of over 10% of their annual profits on entertainment-related activities, a figure that signifies the prevalence of client entertainment in China.

Different from the strict regulations on client entertainment in some countries, the Chinese government recognizes entertainment expenses as a legitimate accounting item that must be recorded in a firm's operational costs. According to Chinese Accounting Standards—China's Generally Accepted Accounting Principles (GAAP)—firms must report entertainment expenses in their financial statements; failing to do so leads to severe penalties by the taxation authorities. Chinese firms can claim tax credit on 60% of actual entertainment expenses or an amount that accounts for up to 0.5% of their annual sales, whichever is lower (State Administration of Taxation, 2012). In comparison, entertainment practices are strictly regulated in the United States, where companies can only deduct a maximum of $25 for business gifts given to a client during each tax year, and only 50% of all qualified entertainment expenses can be claimed for tax credit (Internal Revenue Service, 2015).

Under its current anti-graft campaign, the Chinese government has set up strict rules to discipline officials and managers of state-owned enterprises (SOEs) regarding lavish entertainment. But entertainment spending is still skyrocketing at SOEs. For instance, the state-owned insurance company China Life reported an annual spending of 1.4 billion yuan ($220 million) on client entertainment in its 2013 financial statement. In the same year, another SOE, China Railway Construction Corporation, spent 837 million yuan ($130 million) on client entertainment. Both numbers exceed 11% of the annual net profits of those firms (Xinhua News Agency, 2013).

Client entertainment plays such a critical role in Chinese business that it may potentially affect the country's overall economic growth. Anecdotal evidence of such an impact is reported, with some analysts alleging that the Chinese government's current austerity and anticorruption campaign—which has prohibited normal business entertainment—is behind the country's slowed economic growth (Spegele, 2014).

3. Foreign firms in China: Pitfalls of client entertainment

While most local Chinese firms can practice client entertainment deftly to initiate, sustain, and consolidate business relationships, weave subtle business networks, and promote sales, some multinational enterprises (MNEs) operating in China have resorted to outright corruption in practicing client entertainment. In recent years, excessive entertainment has been the major culprit behind ethical dilemmas and even criminal charges experienced by multinational giants operating in China.

Foreign firms began to enter the Chinese market in the 1980s, soon after the country adopted its Open-Door Policy to reform the foundering economic system. But client entertainment-related corruption charges against foreign firms only started to surface after 2001, the year that marked China's joining the World Trade Organization (WTO). Since then, outsiders have acquired increasing access to more detailed market information in China, thanks to the WTO's rules of transparency regarding market conditions and firm behaviors in member countries (Evenett & Hoekman, 2005). In the meantime, the home countries of some MNEs also began to regulate those firms' activities in China. For instance, in October 2007, a German court fined Siemens 201 million euros ($284 million) over allegations that its employees used illegal activities such as entertainment to secure contracts in the international market. The company was found guilty of paying $14 million—in the forms of travel, entertainment, and cash—to Chinese medical professionals in attempt to sell Siemens medical equipment in China, thereby pulling the Chinese market into the German lawsuit (Schubert & Miller, 2008).

The most strict and extensive regulations governing entertainment-related bribery practices were legislated by the United States via enactment of