



# Strategic guanxi orientation: How to manage distribution channels in China?



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## ARTICLE INFO

### Article history:

Received 30 May 2014  
Received in revised form 6 October 2015  
Accepted 7 October 2015  
Available online 14 December 2015

### Keywords:

Strategic guanxi orientation  
Channel management  
China

## ABSTRACT

This study focuses on the role of guanxi in distribution channel management in China from the perspectives of both foreign and domestic Chinese firms. Based on a literature review and in-depth interviews with suppliers and retailers, the article provides managers with a theoretical framework for acquiring, institutionalizing and utilizing guanxi in a distribution channel system as a strategic resource to achieve long-term competitive advantages. The framework explicates three stages of strategic guanxi orientation (SGO), highlights the critical role of institutional environmental uncertainties in shaping a firm's SGO, and explores both the benefits and costs associated with adopting SGO in channel management. In addition, the study provides executives of foreign firms in China with practical guidelines on how to improve channel performance in an emerging and competitive market.

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## 1. Introduction

Despite the voluminous research on relationship management, the topic continues to capture heightened research interest among scholars in recent years (Luo et al., 2009; McFarland et al., 2008; Palmatier, 2008). This interest is predicated upon the belief that relationship management efforts enhance sales growth, market share, and profits by strengthening channel relationships (Crosby et al., 1990; Morgan and Hunt, 1994; Palmatier et al., 2007). As foreign firms increasingly seek growth opportunities in China, it is imperative to underscore important relational factors leading to success in this emerging economy (Haley, 2003; Swan and Allred, 2009). According to Haley et al. (2004), relationships in China tend to be complex and multifaceted; they reside in networks that are typically difficult to comprehend for most foreign executives. These networks, spanning from clan, business, to government, are originated from traditional families and modern business practices. We argue that, to succeed in the Chinese market, it is imperative for foreign executives to manage relationships in each of the three networks effectively.

Indeed, Chinese businesspeople are often members of multiple networks. One important benefit of participating in the networks is to share information and *guanxi*—an informal interpersonal connection with significant interorganizational implications in China (Luo et al., 2002). Decades of international business research has confirmed *guanxi* as a dominant factor in facilitating business activities throughout China (e.g., Gu et al., 2008; Lovett et al., 1999; Yeung and Tung, 1996). Managers from the East and the West have accepted it as a critical cultural and social element in this thriving economy. However, several important issues remain to be adequately addressed. First, although the use of *guanxi* as an instrument to reduce environmental uncertainty and gain competitive advantages has been well documented, previous studies have mainly focused on Chinese firms (Gu et al., 2008; Kotabe et al., 2008; Lu et al., 2008; Park and Luo, 2001; Xin and Pearce, 1996), to the neglect of foreign firms in China. This

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represents a notable research gap as important questions remain unanswered. Do foreign firms acquire and utilize guanxi in their business activities as enthusiastically as their Chinese counterparts? What are the factors influencing such a strategic decision? Do the processes of guanxi acquisition and utilization differ among foreign and domestic Chinese (domestic thereafter) firms? Due to government regulations and market conditions, multinational corporations (MNCs thereafter) such as General Motors conducting business in China frequently deal with domestic distributors and retailers. Furthermore, foreign retailers such as Wal-Mart have to rely mainly on their Chinese channel partners for supply and merchandise. Hence, examining guanxi empirically in the Chinese context by using both foreign and domestic firms helps fill this research gap, especially in the area of channel management.

Second, the extant literature primarily treats guanxi as an individual-level construct (Chang and Lii, 2005; Fan, 2002a, 2002b; Tsang, 1998). Although the effects of guanxi on business performance have been extensively studied (Peng and Luo, 2000; Xin and Pearce, 1996), it remains tacit on whether and how individual-level guanxi may be transformed into an organization asset and eventually affects organization-level outcomes (Park and Luo, 2001). Third, relying on guanxi to develop business in China can be costly, but the cost implications of guanxi have yet to be systematically investigated in the literature. As a strategic option, however, utilizing guanxi in channel management inevitably imposes costs at both individual and organizational levels. It is therefore necessary to extend the scope of the research into the domain of guanxi by exploring and comparing both the benefits and the costs of guanxi in order to assess guanxi as a strategic investment.

Fourth, the agreement on the significance and importance of using guanxi in China and the role of guanxi in the future is not unanimous. Although several researchers have argued that guanxi is and will continue to be an important factor in Chinese society for a long time in the future (Gu et al., 2008; Vanhonacker, 2004), other scholars have claimed that the importance of guanxi in the business field has been declining (Fan, 2002a, 2002b; Guthrie, 1998). For example, Gu et al. (2008) concluded that guanxi positively and significantly influenced a variety of performance outcomes such as brand sales growth, brand market share, and firm capabilities. Similarly, Kotabe et al. (2008) found that guanxi enhanced firms' resource acquisition, resulting in better financial performance. On the contrary, Guthrie (1998) found that many Chinese managers tend to view guanxi in market relationships as secondary to the market imperatives of price and quality. A more recent study on buyer–seller relationships in urban industrial China found similar results (Millington et al., 2006). In fact, their findings implied that relational contracting, instead of guanxi, plays an important role. Similarly, Kiong and Kee (1998) have argued that the significance of guanxi in understanding Chinese networking relationships has probably been inflated. These conflicting findings remain to be resolved, and represent a significant research gap in guanxi management.

It is therefore necessary to extend the research scope into the domain of guanxi management as a strategic option and examine its nomological relationships with antecedents and consequences at both individual and organization levels. The findings of such an investigation will enhance our understanding of this important area and provide strategic guidance to both domestic and foreign firms operating in China. After all, the questions of whether, to what extent, and how to adopt guanxi management into an organization have been a challenge to foreign executives after their firms' entry into the emerging market of China (e.g., Gu et al., 2008). Based on our extensive executive interviews with both domestic and foreign firms operating in China, we have identified different levels of firms' guanxi utilization. Therefore, the primary purpose of our study is to examine the various aspects of firms' guanxi management as a strategic orientation, which we call strategic guanxi orientation (SGO thereafter), and examine its antecedents and outcomes from the perspective of buyer–seller relationships.

To the best of our knowledge, researchers have yet to examine the antecedents and outcomes of SGO in the context of managing channel relationships by both domestic and foreign firms in China. In examining the issues from different perspectives, we study both foreign and domestic firms, suppliers and retailers, large and small companies to detect differences and identify similar patterns. We contribute to the extant literature on guanxi in channel management by: (1) developing the construct SGO for channel management in China, and (2) constructing a conceptual model in examining the antecedents, moderators, and outcomes of firms SGO. The scope of our study is to focus on horizontal guanxi between channel partners only, instead of that with governmental officials, which involves vertical guanxi (Park and Luo, 2001). Managerially, our study also provides foreign executives with a framework on how to manage guanxi in a distribution channel (channel for short, thereafter) in China (Wang and Nayir, 2006).

## 2. The construct of strategic guanxi orientation (SGO)

In this article, we develop a framework to provide the needed guidance to executives for guanxi management in a channel system that enhances the relationships and performance of channel partners. This framework was distilled from our extensive field interviews conducted for the purposes of exploring the challenges faced by firms, summarizing best practices in channel relationship management, and providing guidance to executives in their endeavor to enhance performance (Eisenhardt, 1989; Eisenhardt and Graebner, 2007). It depicts the process of firms' conscious effort in acquiring guanxi as a resource, institutionalizing guanxi from the individual to the firm level, and utilizing guanxi as a strategic tool to achieve long-term competitive advantages. We label this process as strategic guanxi orientation (SGO), as it reflects both the level (i.e., organization level) and the focus (i.e., guanxi management) of this construct.

Specifically, the SGO framework consists of three stages: guanxi acquisition, guanxi institutionalization, and guanxi utilization. Similar to market orientation (Kohli and Jaworski, 1990; Naver and Slater, 1990), SGO represents a philosophy of guanxi management. Specifically, SGO represents an organization-wide culture that focuses on embedded values and beliefs that guide behaviors that ultimately influence performance. Operationally, SGO refers to the extent to which firms operating in China accept using

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