

## **Unbundling the benefits and risks of Guanxi**

*Guanxi networks have served many Chinese and foreign firms well in their pursuit of Chinese consumer markets. However, will this service continue as China transitions toward a more developed and globally competitive market economy?*

### **The China environment for retail brands – where to now?**

The Chinese Central Government is currently guiding the economy to a lower and more sustainable level of growth. Within this ‘new normal’ there exists a ‘jewel’ – the number of middle-income class consumers continues to grow. For example, in November 2014 China Singles Day sales reached USD9.3 billion. As PwC reports, although the pace of retail sales in China will continue to slow, retail sales will continue to rise. The World Bank also reports that retail sales continue to remain strong in 2015. By the year 2018 China is expected to be the world’s largest market for retail products. Moreover, PwC identifies that China accounts for the bulk of retail sales in Asia where sales are expected to rise from USD6.8 trillion in 2014, to USD10 trillion in 2018.

As the market for retail products in China develops, new competitive pressures arise. Local firms are raising their competitive capabilities through leveraging their distribution channel relationships, and applying their advanced knowledge of consumer preferences. This is placing foreign brands under intense pressure to raise their understanding of Chinese consumer preferences. Ongoing developments in regulatory requirements for household and fast-moving consumer products, for example, are also adding to challenges confronting firms in China; these regulations have been particularly pronounced in relation to food safety issues.

### **Dealing with the preferences of Chinese consumers**

Reports by KPMG and the China Business Review also identify that there is a growing need for firms to develop products tailored to preferences and tastes of Chinese middle-class consumers. The US-China Business Council notes that Chinese consumers tend to be constantly seeking out the newest products. Consumers also appear to lack the emotional ties associated with brand loyalty, and express strong preferences for product novelty. When it comes to product technology, consumers tend to be early adopters.

As a result, McKinsey’s reports that brands like Xiaomi, Yunnan Baiyao, and Jahwa are now applying customer-focused innovation through collaborating with consumers to refine their product offerings. Such marketing-based strategies are enabling local firms to grow their share of middle-class consumer markets in China. One example is Haier’s smaller washing machines that are targeted to the growing urbanized single-person household market. On the other hand, to meet the needs of the growing rural household market Haier is supplying larger and more robust washing machines that are also capable of washing vegetables. Another recent example is Jiangzhong Group’s introduction of mushroom biscuits that caught foreign competitors off guard, and so they quickly captured 2% of the market.

## **It's an interesting time for brand managers, and their Guanxi networks**

How will these developments affect Guanxi? As Professor David Tse, a China marketing strategy expert from HKU's Faculty of Business and Economics explains: "The current situation in consumer product markets is putting pressure on brand managers to better understand how economic and social forces are influencing norms and rules that govern business to business behaviour in China". He goes on to explain: "In such a turbulent and competitive environment, does Guanxi have limitations? Does it always provide firms with desired outcomes?"

With these issues in mind Professor Tse, together with colleagues Dr. Flora Gu from Hong Kong Polytechnic University and Professor Kineta Hung from Hong Kong Baptist University set out to study the problem of 'when does *Guanxi* matter'? With a focus on consumer brands, data was collected from 20 in-depth interviews and 282 survey responses from senior and middle managers responsible for implementing their firm's brand marketing and sales strategies in China. The study included consumer product brands across personal care, food and beverages, electronics, housewares, and automobiles, for example. Findings from the research are discussed below.

### **When does Guanxi matter?**

The research by Professor Tse and his colleagues confirms that Guanxi continues to play an important role for consumer brand firms in China. It assists firms to access markets and grow their sales and market share. Through the process of building favours and obligations network members are obliged to assist each other. Network members provide access to 'insider' market information and assistance in decoding the intents of government policy. They also provide access to resources, including physical, financial, technological and human capital that would otherwise be unavailable. These factors are especially important for firms attempting to develop their positions in China's regional markets where protectionism and entry barriers tend to be high.

The need for firms to ensure products are efficiently delivered to target markets is also important in China. Although improving, local markets continue to be fragmented and connected by inefficient logistics systems. In China, Guanxi provides firms with important *channel capabilities*. Across the Guanxi network there exists an organisational culture that contributes to the effective monitoring and managing of channel activities. Favours and obligations built up within the network, including local government-owned enterprises, also serve to enhance the ability of firms to control channels.

The nature of the China market requires that firms build up *responsive capability*, or capabilities that enable them to effectively anticipate, prepare, and respond to changes in the market. Because China is a transitioning economy experiencing institutional market reforms, environmental uncertainties are high and responsive capability is a key firm competence for producing effective marketing strategies. The ability of brand managers to draw on obligations and information from other network members assists them to build the firm's readiness for coping with anticipated and unanticipated market changes and/or threats.

### **When does Guanxi really matter?**

These channel capabilities and responsive capabilities are unquestionably of value to the firm. However, as Professor Tse points out: “Firms need to devise ways to corporatise interpersonal ties; remaining captive to personal relationships of individuals may not assist firms to develop capabilities that can contribute to sustainable competitive advantage”. The research identifies that firms can do this in a number of ways. For example, firms like Hisense follow the practice of rotating their regional managers at least every two years. Another approach is for the firm to enhance the quality of B2B services it provides to partner firms; and it is important that partner firms recognize the value of such B2B services. The research also suggests that building valuable non-transferable resources through depersonalising and corporatising Guanxi presents a fundamental challenge to a firm.

### **When can the Guanxi ties that bind, turn into the ties that blind?**

Professor Tse suggests that an understanding of the market-based pressures that are facing consumer brands in China leads to some important questions: “Is the turbulence in the market creating any negative impacts for Guanxi network associations?” Here, the research identifies two factors that lead to the destabilisation of relationships within Guanxi networks.

- The first factor is *competitive intensity*. It exists when intense competition puts pressure on firms to differentiate products and/or seek product alternatives. As consumer product firms strive to meet the growing and also unique needs of Chinese consumers, financial pressures require the firm to maintain sales at a profitable level. When financial pressures are high, firms begin to focus on survival, which can serve to cause friction and conflict in relationships. When disagreements on how to deal with market pressures undermine mutual commitments, it can lead to discontinued support from network members. This can also cause firms to start looking for much needed assistance and resources, from firms that reside outside of the network.
- The second factor is *technological turbulence*. It occurs when technological advances result in a situation where some Guanxi members are no longer able to contribute to the needs of other members. Firms that provide consumer product brands in China are under intense pressure to develop or acquire technology to enhance product development. They are also under pressure to lower costs through productivity enhancements. Here, a dilemma arises when firms within the Guanxi network do not possess the advanced capabilities required by ‘insider firms’ to pursue much needed technological advancements. The strong particularistic ties that underpin trust and deliver information and control benefits to firms within the network take time to build, and this can result in the slow acceptance of ‘outsiders’ into the network. When a situation such as this arises and has the potential to threaten a firm’s ability to maintain its technological edge, and its competitive position, the firm will need to assess whether it should stay or

leave the network; it is possible that either option has the potential to destabilise the Guanxi network.

In conclusion, as the China market for consumer brands continues to grow, it appears that brand managers will need to continue to carefully assess the firm's market position and the capabilities of their Guanxi partners.

The research paper by Professor Tse, Dr. Gu and Professor Hung was published in the *Journal of Marketing* in July 2008 (Vol. 72, pp.12-28). The paper was awarded a special prize for being in the world's top 50 most cited papers in 2008; among 15,000 papers published in business, including all of the top-tier academic and professional journals in the world.

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