

**Guanxi as competitive advantage during economic crises:
Evidence from China during the recent global financial crisis**

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Abstract

Since 1978 China developed an economic system that heavily draws on Guanxi for its success. This so-called Guanxi-Capitalism still has to prove its stability which includes its ability to survive economic crises. This paper will provide evidence that personal connections are a strong instrument to overcome recessions. This will be underlined with a case study of Wenzhou, the first province to heavily privatize and one of the areas most severely hit by the economic crisis. As official data is not yet available on a broad basis, evidence from newspapers will be provided, to give an insight to what happens in Wenzhou in particular and China in general. It will be shown that in China it is not the corporation that survives, but rather Guanxi and thus the Chinese variety of Capitalism proves not only to be more sustainable than is believed in the conventional view but even more successful than Western economic systems.

Keywords: China; guanxi; private sector, capitalism, networks, Wenzhou, global financial crisis

Content

1. Introduction	3
2. The Western View of a rational, modern Capitalism	4
3. Guanxi and its Role in Chinese History	7
3.1. Chinese Capitalism and Guanxi	7
3.2. Guanxi in History	10
4. Guanxi and Crises	13
4.1. Guanxi and Doing Business	13
4.2. Guanxi as Strategy for Crisis Management.....	15
5. Case Study: Wenzhou and the Global Financial Crisis.....	21
5.1. Wenzhou's Rise after 1978	21
5.2. Wenzhou in the Current Crisis	25
6. Conclusion.....	31
Appendix I: Some Details on Wenzhou	34

1. Introduction

*“Although the force of global capitalism is sure to exert strong pressures for convergence among the institutional configurations of capitalist systems, it is unlikely to generate homogeneous institutional arrangements...Indeed, diverging structuring conditions, path-dependent institutional development, and transforming national events will continue to generate different patterns of national capitalisms”.*¹

Since China opened up to the global market in 1978, it formed an economic system that in the literature is often called Guanxi or network Capitalism. It presents a specific type of Capitalism, and is embedded in the cultural environment of post-1978 China. It is described as being constituted of a different set of institutions than Western type Capitalism, especially relying on personal connections to facilitate business, comprising a way of doing business ‘Chinese style’. It is often doubted that this version of Capitalism will be sustainable and many believe that over time it will transform into a system that converges to the usual contractual market institutions found in the West. Once the economy develops into a mature capitalistic society with its own functioning set of legal institutions and secured property rights, the necessity of maintaining Guanxi connections for being successful in business will come to an end. This line of argument also perceives Guanxi as less efficient and more time and money consuming than the Western contractual institutions. Western Capitalism is conceived as inevitably leading to a system with large-scale enterprises under efficient rational management that is independent of specific individuals and their personal connections.

In contrast, this paper argues that it is possible to achieve economic success with a variety of Capitalism based on a different set of institutions, depending on history and culture. In particular, Chinese Guanxi-Capitalism strongly depends on individuals and their personal connections. It will be shown that especially in times of crises it is the persona of the entrepreneur embedded in his networks that will help his company survive. Guanxi is not only a powerful instrument to overcome the challenges of an economy in transformation, but also proves to be ex-

¹ (McNally 2006, 17).

tremely adaptable and powerful in situations of crises as networks are often more durable than actual enterprises. To prove that it is not a transitional but permanent form of economic system, Guanxi-Capitalism has to show its stability and therefore its ability to survive (economic) crises. With a particular emphasis on the reaction to the current economic crisis, the question concerning the means of network connections bridging times of economic downturns will be raised.

This paper is therefore organized as follows: first, an outline of the ‘Western view’ of convergence of economic systems over time and growing irrelevance of personal connections will be given. After that Guanxi-Capitalism as a specific variety of Capitalism with its own distinctive set of institutions will be described. This will be underlined with an example of Wenzhou, the first province to heavily privatize and one of the areas most severely hit by the economic crisis. Statistical data will be complemented with more anecdotal evidence from newspapers, to give more in-depth insight to what happens in Wenzhou in particular and China in general and how Guanxi as an instrument to overcome crises is involved. It will be shown that in China it is not the corporation that survives, but rather Guanxi and thus the Chinese variety of Capitalism proves to be more sustainable than is believed in the conventional view.

2. The Western View of a rational, modern Capitalism

At the beginning of the 20th century, Max Weber described the relatively new developing economic system in Europe. Of course, other authors also presented extensive work on the subject, most prominently probably Karl Marx.² However, this paper draws on the arguments of Max Weber and Werner Sombart, whose rationale are most valuable for my purpose. Weber defined Capitalism as “present wherever the industrial provision for the needs of a human group is carried out by the method of enterprise” and “a rational capitalistic establishment” as “one with capital accounting”. The spirit of Capitalism for him described “the attitude which seeks profit rationally and systematically”.³ Max Weber assumed that it is the nature of modern Capitalism to impose a unique institutional structure on the existing traditional society to develop, with obsolescent cultural idiosyncrasies being

² (Marx 1970 [1887]).

³ (Weber 1976 [1930], 64).

replaced. A market economy arose where instead of an economic life embedded into society, social institutions served as mere accessories to the economic system. The economy became an autonomous system which was dominated by a rational spirit based on efficiency and profitability and at least similar institutions no matter where it arose.⁴

Max Weber believed that Capitalism will inevitably lead to a rising bureaucratisation and rationalisation, which does not leave space for outdated socio-cultural structures like small family businesses. Enterprises will grow in size and those large-scale enterprises will be put under efficient rational management and thus become increasingly independent of specific individuals. Impersonal bureaucratic authority replaced the traditional, personal authority. Additionally, "administrative staff should be completely separated from ownership of the means of production or administration".⁵

Similarly, around the same time, Werner Sombart⁶ described the change of attitude towards the conduct of business during the process of industrialization. In the beginning of industrialization a good citizen had to show a certain morally defined behaviour towards the outside world, including the behaviour in doing business, whereas in a mature capitalistic system the spheres of private life and business are separated. Traditionally, only a morally sound lifestyle would lead to success in doing business in creating trust in the persona of the entrepreneur. Only a person who overall exhibits moral behaviour can also be trusted in a business context.⁷ Sombart shared Weber's view that to be successful in a capitalistic environment it is necessary for corporations to grow. Specific business principles are necessary for an absolute rationality that helps to extinct the "old bonds of tradition and morality that held capitalism in check in its earliest stages".⁸ Sombart regards the level of profits as the sole sensible objective of a capitalistic enterprise that cannot consider morality but has to be unscrupulous in the choice of its means and a completely detached from any moral considerations.⁹ This is complemented by the establishment of transaction with the help of contracts and by the juridification of hitherto unofficial norms and thus the emergence of the state as regulative

⁴ (Weber, Henderson and Parsons 1947, 338f.).

⁵ (Weber, Henderson and Parsons 1947, 331).

⁶ In (Sombart, 1987 [1908-1927]) he also emphasises the importance of rationality and a certain, bourgeois spirit for modern Capitalism.

⁷ (Sombart 1978 [1930], 121f.).

⁸ (Sombart 1978 [1930], 357, 184).

⁹ (Sombart 1909, 708ff.; 1978 [1930], 185).

authority. The West has a long tradition of contracts, originating from Roman law, which regulates the relationships between individuals (*ius est ad alios*).¹⁰

Weber and Sombart describe the separation of private and business behaviour and the creation of a specific set of manners for entrepreneurs as necessary for the development of a mature Western capitalistic system. In this environment, it is not the individual personality of an entrepreneur that is important for doing business, but merely his actions in the process of business transactions. The private concerns of a businessman is not of interest any more, thus if he has a morally dubious character is not relevant. This is regarded as totally separate from his actions as entrepreneur and underlies different rules.¹¹

Due to the increasing professionalization, the organization of a corporation becomes dissociated from the character of managers and entrepreneurs but is subject to other imperatives. “Commercial honesty” equals “contract morality” and thus, “status has given place to contract” and “economic relationships” lost their “personal touch”.¹² Once a corporation is established, it is not the owner and not even the manager that is recognized as important factor to evaluate a company. It is the enterprise itself and even more so its reputation and its products that counts, the individuals behind the successful management of a firm might not even be known or are exchangeable.¹³ This means that “business relations in the West are more technical and company orientated with early recognition of the possible need for contractual formality”.¹⁴ The maximization of profit does not depend on the personality and connections of one specific individual but are replaced by contractual relations. The Western way of doing business is regarded as the only efficient and (transaction) cost minimizing one. “In the West, deals have to be secured through formal contractual arrangements that can be enforced through law if necessary [but] can incur high transaction costs. Due to the Western orientation to such arrangements, the reduction in transaction costs achievable through a formalized system of trust such as provided by Guanxi is not recognized.”¹⁵ Local economies will always be standardized after the doctrine of “individual maximization, rational-legal principles and private accumulation. [...] Older forms are seen

¹⁰ (Tilly 1995, 41).

¹¹ (Sombart 1909, 709; 1978 [1930], 187).

¹² (Sombart 1978 [1930], 122).

¹³ (Sombart 1978 [1930], 186ff.).

¹⁴ (So and Walker 2006, 7).

¹⁵ (So and Walker 2006, 17).

to present no challenge to the all-encompassing and overriding logic of Capitalism, whose development is predetermined”.¹⁶

So, from a Western point of view the idea of a specific Chinese Capitalism can only be a temporary phenomenon that in the long run will converge to the usual contractual relations conducted by large-scale enterprises. This is also believed by some Chinese authors who claim that “the personalized transactional pattern [...] will continually and expediently be transformed into the nonpersonalized transactional pattern”.¹⁷

In contrast, in the next chapter it will be shown that Weber’s thesis of an inevitable bureaucratization cannot be upheld. The flexible accumulation of the 21st century Capitalism hinges not only on huge multinational corporations but has also “achieve[d] a new competitive edge by abandoning hierarchical, capital-intensive bureaucratic enterprises for flexible smaller subcontracting firms”.¹⁸ An alternate embodiment of Capitalism depending on personal networks is not merely a temporary feature of an economy in transformation but a stable type of Capitalism.

3. Guanxi and its Role in Chinese History

3.1. Chinese Capitalism and Guanxi

While Western Capitalism required that the feudal institutions be destroyed to create an institutional environment perfectly suited for capitalistic production, it is quite different for China. After 1978, traditional institutions were revived, and the (re)construction of a private sector and entrepreneurship parallel to the state and collective sector by means of personal networks, with the (extended) family as core organisational unit, led to a success which is largely unequalled in history. In contrast to many East European countries, this transformation from command to market economy, and thus to Capitalism, was achieved very smoothly.

The Chinese expression for personal networks is Guanxi. Guanxi describes the dynamics of constructing personal relationships within networks and is a central feature of Chinese society. Personal connections between individuals consist in granting favours, receiving services or in gift-giving. It has to include *Gǎnqíng*

¹⁶ (Yang 2000, 481).

¹⁷ (Jinchuan 2004, 54).

¹⁸ (Yang 2000, 481).

(‘feeling’) even in hierarchical relations, which reflects the depth of emotion within a relationship.¹⁹ The gift-giving relations of Guanxi have their own rules and depend on the (social) status of giver and receiver. Gifts connect people outside the family by the concept of reciprocity.²⁰ Another important concept is that of face (*miànzi*, 面子) and favour: *Rénqíng* (人情 reciprocity, empathy) which means feelings found in friendship, family and kin relationships but also ‘favour’, etiquette and custom.²¹ It is the source of ritual (*li*, 礼), which is also part of the Chinese expression *liwu* (礼物, ‘gift’). Included in *Rénqíng* are also long-term ‘debts’ established by receiving a gift, enduring even generations. Failing to repay those debts causes loss of moral and social face.²² *Rénqíng* is not equivalent to private, secret emotions but is a public socially structured phenomenon with clearly identified mutual obligations.²³ Beside the notion of reciprocity, obligation and indebtedness, also trust is essential for personal relationships.²⁴ The meaning of trust in the Chinese context differs from the Western understanding of the term. In the West, trust is “often placed on a system or organization in order to reduce the reliance of personal integrity and guarantee”. It reflects the willingness “to rely on another party because of confidence in their credibility, competence and reliability”. It depends on the law to bind a contract, whereas in China default is prevented by a person’s reputation.²⁵ The Chinese version of trust is referred to as *Xìnyòng* (信用 use or usefulness of trust, but also credit). “It refers to credibility, integrity, trustworthiness or the reputation or character of a person and in business circles it refers to a person’s credit rating”.²⁶ Possessing *Xìnyòng* and being trusted means that a certain behaviour is anticipated and thus, that the rules of *Rénqíng* are followed.²⁷ Thus, it is a cultural concept with strong ethics, and serves also as “a means for disciplining not only others but also oneself”.²⁸

Guanxi is built on pre-existing links to people with whom a shared identity exist, like those from the same regional origin, classmates, co-workers, or people

¹⁹ (Jacobs 1979, 243-253, 259).

²⁰ (Joy 2001, 240).

²¹ See (Hwang 1987) for an extensive discussion of face and *Rénqíng*.

²² (Wang, Siu and Barnes 2008, 820; Hwang 2006, 277).

²³ (Herrmann-Pillath 2000, 118).

²⁴ (Yang 1994, 63, 67, 122; Wank 1999, 264).

²⁵ (Wang, Siu and Barnes 2008, 820, 823).

²⁶ (Kiong and Kee, 1998, 85).

²⁷ (Wang, Siu and Barnes, 2008, 823).

²⁸ (Hu 2007, 60f.).

known from the military or university, creating fictive quasi-kin-relationships.²⁹ These Guanxi relations are also so-called ,*tong*-relationships‘ (同, alike, similar and co-, as in co-worker, 同事, *tóngshì*).³⁰ These networks can also be described as “concentrical Guanxi circles”, extending from the family as core reference point to extended zones.³¹ Guanxi is a process of inventing and re-inventing relationships as ongoing “social engineering”.³²

Guanxi is embedded in most functions of everyday life, including political alliances, recreational and economic activities.³³ To Chinese “human life is a complex web of relations with the world, relations with the mind and relations to others”.³⁴ There is no separate network of connections for business relations. More than that, “it seems that the Chinese are not used to compartmentalizing the different roles that they have with others and so treat the other person according to the requirement of the current role”.³⁵ This goes as far as not developing Guanxi with a particular person at all to avoid the mutual commitment because “it is not possible to behave in very different ways when acting in different roles in relation to the same person”.³⁶

In contrast to Werner Sombart’s thinking, there is no separate morality and different rules for business in China. Business affairs and private life are not detached, with no separate behaviour for each sphere. In (So and Walker 2006) a manager of a large Chinese company describes that “one of the primary differences in the Chinese and Western ways of doing business could be traced to the fact that in the West business developed its own culture separate from private or personal culture, with a different set of rules and a character of its own. In the Chinese context there is no separate morality for business. There are no separate rules that divide the conduct of business from that of personal affairs, in which the key factor is proper human relations. A successful business relationship between Chinese companies begins with the establishment of a personal bond between the principal managers of the companies and is based thereafter on the careful main-

²⁹ (Whyte 1996, 12).

³⁰ (Chen and Chen 2004, 311).

³¹ (Peng 2004, 1049).

³² (King 1991, 69).

³³ (Mauss 1966, 1-3, 36f., 76-78; see also Yan 1996, 8f.).

³⁴ (Zhu 2007, 1505).

³⁵ (So and Walker 2006, 4).

³⁶ (So and Walker 2006, 5).

tenance of these personal ties”.³⁷ Certain rituals and etiquette have to be employed that reflect the social status of a person within a nexus of personal relations.³⁸ However, although it is mostly the family which is particularly important for starting a business, if people are seen as family-like and if they can be trusted because long-term relationships exist, it is possible to found enterprises or share resources with them.³⁹ The networks with non-kin based on *Gǎnqíng* are the seed from which private entrepreneurship stems. Still, the core group, even of larger enterprises, are often family members or good friends.⁴⁰

3.2. Guanxi in History

The establishment of privately-owned capitalistic enterprises within a socialist system raises a wide range of problems. During reforms due to the “pragmatic mindscape” of the Chinese people, a “regional decentralization and fiscal federalism” led local governments to promote economic development.⁴¹ Each region had its own experiments and structural learning processes which strongly depended on the tolerance and openness of local cadres. Below, Wenzhou will be taken as case study to exemplify this.

The economic reforms in general were made possible by the revitalization and creation of institutions to expand, regulate, and channel economic transactions especially and foremost in the private sector. They developed in areas where State-Owned Enterprises (SOEs) were less dominant and thus complemented the institutions existing in the planned economy for the allocation of goods and services. The (re-)newed institutions were a response to the organizational problems arising in agriculture, industry, and commerce in the course of reforms. The central government gave space to local governments in finding their own way of dealing with the reform process, than choosing the most successful structures to expost legitimize the actions in introducing legal structures and corresponding laws for enforceable rights, supporting individual autonomy.⁴² This development is enforced by the central government that gave supremacy to local officials who influenced the local development. They were often motivated to strongly support local economic growth often not complying with central state regulations. An “ar-

³⁷ (So and Walker 2006, 4).

³⁸ (Wank 1999, 264).

³⁹ (Yang 1988, 409, 411).

⁴⁰ (Krug 2002, 139f.).

⁴¹ (Zhu 2007, 1507).

⁴² (Holbig 2002, 41).

ray of essentially private ownership forms emerged [...] with the knowledge and support of sub-provincial local officials but well ahead of the regulations and laws designed to govern them”.⁴³ Private entrepreneurs collaborate with government officials, “creating and benefiting from a web of bureaucracy-business alliances. While this can be traced back to the pre-communist years, the reform and open policy did not eliminate but deepened this Chinese tradition”.⁴⁴ As local officials are often embedded into local networks, many felt compelled to protect the newly established private sector and vice versa individuals sought this protection. As a result, the Chinese legal system “has been characterized by policy experimentation, leading to informal and spontaneous legal developments, which then are legally clarified and codified”.⁴⁵ This meant in practice that “business involves not so much doing what is explicitly legal but rather doing what is not expressly forbidden”.⁴⁶

Hence, in contrast to the Western belief that secured property rights need to exist for sustained growth, the establishment of private enterprises despite unclear or stable specification proved once again the “ambiguity [that] is the imperatively important feature of Chinese mindscape”.⁴⁷ The obscure ownership structures of collective enterprises, specifically the TVEs, are an example that this pragmatism or uncertainty acceptance is an important feature of Chinese culture. As (Casson, 1993 notes: “Some cultures emphasize the importance of theory; it is important to understand the situation before acting, they maintain, and such understanding can only be provided by a theory of some kind. Other cultures are more pragmatic; they suggest that it is sufficient to know that, on the basis of experience, a certain course of action produces good results in certain circumstances without knowing exactly why this is the case”.⁴⁸ This tolerance toward ambiguity is an important Chinese virtue and a fuzzy chaotic status is interpreted as something from where “creativity can emerge”.⁴⁹

⁴³ (Whiting 2001, 145).

⁴⁴ (Zhu 2007, 1510f.).

⁴⁵ (McNally 2006, 27ff.).⁴⁵ (China Reform Foundation. 2001 China Reform Foundation. 2001. The obstacle and supply of institutions. Shanghai: Far East Press., quoted in Zhu 2007, 1508).

⁴⁶ (Wank 1999, 252).

⁴⁷ (China Reform Foundation. 2001. The obstacle and supply of institutions. Shanghai: Far East Press, quoted in Zhu 2007, 1508).

⁴⁸ (Casson 1993)

⁴⁹ (Zhu 2007, 1508).

Another aspect of the specific Chinese mindset is their ethic of entrepreneurship. This can be regarded as another important reason for the extreme growth of private companies once the country opened up. An entrepreneur is defined as “small-scale capitalist who attempts to parlay small capital into big earnings”, investing “one’s resources [...] in a long-term quest to improve the material well-being and security of some group to which one belongs and with which one identifies”⁵⁰ and thus, “collective well-being rather than individual satisfaction” is emphasized.⁵¹ Thus, the entrepreneurial ethic is not short-term but future-oriented, neither is it merely for individual benefit. The group towards which those efforts are directed is mostly one’s family and friends. To set up an enterprise during reforms was not done because of personal career considerations but first and foremost to secure long-term benefits to your network, the family in particular. So, Chinese entrepreneurs are more than capitalist ‘economic men’ just greedy for money and materialist gain but rather concerned about long-term security.⁵²

The particular problems found in the Chinese economy after their entrance in the global market were most efficiently faced with the re-utilization of the Chinese family, family enterprises and personal networks as a means to do business the Chinese way. The achievement orientation made families strive towards a “societal marketization”⁵³, which explains the mushrooming of private family-owned businesses and the hidden privatization of collectives. Past institutions were adapted and revived, also bridging the gap left by the breakdown of social order caused after the Cultural Revolution. This can also be interpreted as a “restoration of older Chinese relationships”⁵⁴ which formed new institutions based on traditional values. These institutions assisted in finding a unique way of business practises, creating a specific Chinese Capitalism based on Guanxi. Private enterprises worked according to the principles of the market economy, but still found their own way of doing business in those instable and risky circumstances.⁵⁵

On the whole, a kind of collective memory enabled the emergence of a private sector in reviving traditional long-known institutions. The collective times seemed to have built-up urge for more autonomy which then erupted in massive entrepre-

⁵⁰ (Harrell 1985, 216).

⁵¹ (Li and Li 2007, 45).

⁵² (Harrell 1985, 217).

⁵³ (Nee 1996).

⁵⁴ (Fukuyama 1995, 94).

⁵⁵ (Krug 2002, 131ff.; Gold 1985, 674).

neurial endeavours, especially in rural areas. Entrepreneurial instincts were preserved and could flourish with the institutions provided by economic reforms.⁵⁶

4. Guanxi and Crises

4.1. Guanxi and Doing Business

The logic of a Capitalism just emerging within a socialist society, which still has gaps in its legal system and lacks capitalistic institutions, has been met by Chinese entrepreneurs with institutions known from their past. This did not lead to a Western style private sector consisting of enterprises established in a rational, exact procedure, but based on Chinese networks which are built up and maintained with the help of gift-giving, in the form of ample banquets, gifts and personal favours. Especially in rural areas this had been always practised to create and maintain personal connections. „In the past, we didn't have contracts in black-and-white; no legal documents were involved. A gentlemen's agreement will do. [...] For the Chinese traders, the main thing is integrity, credibility”.⁵⁷ Informal ways of securing contracts based on mutual trust is preferred to contracting and “chatting among firm owners is the main channel for a firm to collect information on market conditions [and] technology”.⁵⁸

As a consequence, Guanxi often takes place in unofficial places like restaurants, at home or in nightclubs because business partners and customers prefer to do business on the basis of already existing relations.⁵⁹ In contrast to the often difficult negotiations in joint venture investments of Chinese state enterprises and foreign companies, investments based on Guanxi without relying on legal contracts are established much faster.⁶⁰

Increasingly, also Western companies under non-Chinese leadership engage in Guanxi to facilitate business. During the last year, dozens of studies in management journals were published with anecdotes from and guidelines for Western business managers in China to enhance their knowledge on Chinese culture and business practises, thereby reducing it to a purely instrumental phenomenon.⁶¹ “As any China veteran will tell you, it is the key to everything [...]. Fortunes have

⁵⁶ (Whyte 1995, 1015).

⁵⁷ (Kiong and Kee 1998, 84).

⁵⁸ (Li and Li 2007, 40f.).

⁵⁹ (Yang 2002, 461f.; 1999, 104f.).

⁶⁰ (Granovetter 1985, 490).

⁶¹ (Ai 2006, 105; similarly Siu and Bao 2008, 80).

been made and lost based on whether the seeker has good or bad Guanxi, and in most cases a positive outcome has meant knowing the right government official, a relationship nurtured over epic banquets and gallons of XO brandy [...] Cracking the Guanxi code still takes hard work and perseverance. [...] What's more, Chinese businesspeople are more experienced and globally savvy than they were just a few years ago. They're looking for business connections who can help them expand outside China or get their company listed on a foreign exchange."⁶²

In the West, the market depends on an elaborate legal system to enforce contracts, whereas the Chinese system depends on reputation and trust. Contrary to Western convictions, this does not increase transaction costs, but rather reduce them due to transactions taking place within flexible, but permanent networks within long-term relationships. It takes time to build up these networks but once established, they facilitate business, although admittedly also limit the system's capacity to grow.⁶³

However, it is essential to note that Guanxi is more than a purely instrumental business phenomenon. Some authors⁶⁴ argue that because of the legal institutions newly introduced by the state, Guanxi is not necessary anymore. Rather, while fading away in some areas due to the appearance of legal institutions which replaced it, it simultaneously found "new territory to colonize".⁶⁵ All in all, those changes did not reduce the extent of usage of Guanxi. The gift-economy still co-exists with the new form of commodity economy, having significance for commercial transactions, because it helps to save money and to facilitate economic transactions, in bypassing state institutions.⁶⁶ Guanxi reveals a resistance to and a mistrust of formal organizations in sidestepping official ways of, for example, obtaining supplies or credits. Large networks help small enterprises to get access to more resources, even in unstable political and economic surroundings, therefore supporting their flexibility and the ability to adapt.⁶⁷ This is for example used to obtain bank loans or supplies from unofficial sources, to make sure that in the competitive economy of China a firm can keep up with the market, raise its profit and build up good connections to officials. Networks are seen as long-term strate-

⁶² (Wang 2007; cited from Balfour 2007, 84f.).

⁶³ (Lovett, Simmons and Kali 1999, 232).

⁶⁴ See for example (Guthrie 1998; King 1991).

⁶⁵ (Yang 1994, 167).

⁶⁶ (Yang 2002, 463).

⁶⁷ (Fukuyama 1995, 106).

gic alliances to access information and resources over indefinite periods of time. It is therefore within the logic of this system that contracts are of less use as they are based on a “discrete transaction paradigm, which has a clear beginning when an agreement is finalized and a clear ending by performance”.⁶⁸ Entrepreneurs “pay more attention to the cultivation of friendship rather than simply maximising their profit”.⁶⁹

By and large, personal connections build on trust proved to be essential for doing business in China during economic reforms.⁷⁰ Hence, “social relationships built on gift exchange provide a substitute form of trust that can improve the profitability of investment and reduce the risk of arbitrary bureaucratic interference that is not in the interests of the investors”.⁷¹ It mobilizes cultural values such as obligation and reciprocity to pursue “both diffuse social ends and calculated instrumental ends”, substituting for the not yet existing and complementing already existing market mechanisms.⁷²

This system is put to the test by the current economic crisis. The reaction of networks to this severe economic situation can be a proof for their ability to soften the impact on small private enterprises, as will be analysed below. If handled successfully, it could serve as an indicator that Chinese Capitalism is a sustainable system to organize an economy.

4.2. Guanxi as Strategy for Crisis Management

Modern Western Capitalism has since the 19th century proved to successfully survive economic crises (and more than that, crises seem to be inherently connected to the capitalistic system). To be a sustainable type of Capitalism, the same has to be true for the Chinese network version.

At the beginning of the transition to a market economy in China, due to the yet lacking legal and institutional environment, entrepreneurs overcame those obstacles in establishing good relations with local cadres. They founded ‘red hat enterprises’, which means nothing else than to be registered as collective (hence wearing red caps) but being privately-run in reality. These collective enterprises, in the

⁶⁸ (Lovett, Simmons and Kali 1999, 236).

⁶⁹ (Li and Li 2007, 45).

⁷⁰ (Hamilton et al. 1990, 108).

⁷¹ (Smart 1993, 398).

⁷² (Yang 1994, 35).

beginning often in form of cooperative shareholdings (gǔfèn hézuò, 股份合作) contained the advantages of collective ownership, such as easier access to bank loans and reduced tax rates, but at the same time allowed the entrepreneur to have control over the firm's assets but "no guarantees of their rights as owners".⁷³ Still, these firms were highly dependent on the tolerance of the local government, had to share their profits with them or were else at risk that local authorities break their promise to protect the private property. The existence of red hat enterprises shows the mistrust of entrepreneurs in more formal arrangements and official government protection. At the same time, dense networks serve protective powers if cadres become too greedy and predatory.⁷⁴ Having to maintain strong ties to local officials can be interpreted "as evidence of poorly enforced legal property rights and an obstacle to the formation of a more complete market economy", which is the view mostly found in mainstream economics approaches.⁷⁵ Opposed to that David L. Wank understands this as "reasonably coherent strategies of entrepreneurs designed to produce stable expectations".⁷⁶ These networks actually seem to turn out as the most efficient and rational institutions able to deal with the specificities found in China.

During reforms, regulations and tax laws changed quickly and due to the decentralized character of the Chinese state, each province created its own set of rules.⁷⁷ This is something that resonates with conditions familiar from Chinese history. Over the most part, China was ruled by an emperor and his laws had to be implemented by local officials, of whom many were prone to corruption. This exposed people to official exploitation and caused them to distrust official institutions.⁷⁸ But also today, local authorities discriminate against entrepreneurs and put pressure on them to obtain "power shares" as "backstage bosses" of their firms.⁷⁹ In return, officials would provide information on supplies and resources or enable access to state bank loans. The property rights of these arrangements were always very ambiguous and remained fuzzy, and thus helped to bypass discrimination against legally private firms.⁸⁰ Close connections to local administration not only

⁷³ (Whiting 2001, 121f., 145, 162).

⁷⁴ (Zhu 2007, 1510f.; Peng 2004, 1057f.).

⁷⁵ (Wank 1999, 248).

⁷⁶ (Wank 1999, 249).

⁷⁷ (Krug and Mehta 2004, 54f.).

⁷⁸ (Kiong and Kee 1998, 91f.).

⁷⁹ (Liu 1992a, 305f.).

⁸⁰ (Zhu 2007, 1508; Wank 1999, 252).

facilitated to start up businesses, they also caused the entrepreneurs to anticipate the influence of the local government on their enterprise and structure the production in a way so to secure profits to their families and networks and also to minimize the impact of politicians on business. This issue became even more pressing once the private firm grew in size, as with increasing profits officials seek to get more influence on the enterprise and obtain part of the surplus.⁸¹

During the last 30 years the central government enacted all sorts of laws, also protecting property rights and establishing impartial courts.⁸² The degree to which those laws are implemented on the local level again strongly depends on the character of local cadres. As courts are still viewed as easily to manipulate and therefore corrupt and the concept of universal rights and individual jurisdiction are perceived as alien and imported from the West, solving problems within ones networks based on mutual obligations is considered far more effective.⁸³ Networks are not only able to support their members but also to enforce sanctions upon them. This incorporates the fear of losing ‘face’ and evokes the feeling of shame and loss of reputation. Not only are networks considered more effective, the recourse to the formal courts are often also viewed as failure to solve the problem through the network and at the same time not be able to follow the etiquette of society. The only exception for this is if the court is geographically distant to the place where ones business is located and if the person taken to court is not part of one’s network.⁸⁴

As a result, this institutional setting encouraged entrepreneurs to diversify their product portfolio and invest in multiply sectors. This is due to the risk of so-called “ad-hoc taxation”⁸⁵ or confiscation of profits and physical assets by local cadres. Private entrepreneurs had no control over the amount and level of “management

⁸¹ (McNally, Guo, and Hu 2007, 15f.).

⁸² A document issued on 13 May 2010 by the China's State Council “Several Opinions of the State Council on Encouraging and Guiding the Healthy Development of Private Investment” promotes the private sector. It states that private capital is allowed to establish financial institutions and encourages investments in infrastructure and basic industries. Also, it “require[s] the competent governmental departments across the nation to pay enough attention to the work on encouraging and guiding the healthy development of private capital, spare no time to work out specific measures and build favourable policy environment and public opinion atmosphere for the sound development of private investment”. See <http://www.chinaiipr.gov.cn/news/government/654035.shtml>, original document in Chinese available under http://www.gov.cn/zwjk/2010-05/13/content_1605218.htm, accessed 8 June 2010.

⁸³ (Peng 2004, 1050): “A noble man would sacrifice self-interest to honour his obligations, whereas a commoner would forsake his obligation to serve his self-interest.”

⁸⁴ (Wank 1999, 264ff.).

⁸⁵ (Krug and Mehta 2004, 55).

fees” and no possibility to protest against them.⁸⁶ This and other not ex ante anticipated changes in the political climate favours flexibility in production. Already during the mid-1980s, entrepreneurs reacted in creating a whole set of different production options, or producing in diverse industrial sectors or different localities. Also, they do not let their company grow over a certain size – they rather set up a new business that produces different products or in a different province. Another feature of this is to lease out part of the enterprise to subcontractors, which further confuses the ownership of an enterprise and its subunits.⁸⁷ This contradicts the Western belief that personal relations are less efficient and more costly than contracts, leading to an "undercapitalization" and to firms being unable to grow over a certain size. Chinese entrepreneurs have a tendency to extend their networks rather than following Western corporate strategies. Apart from the reasons already given, setting up new businesses gives also family members or other members of one's network the chance to be manager of their own firm. Entrepreneurs formed “informal cooperatives among relatives and friends engaged in small-scale industry”, allowing and attenuating the exposure to discrimination and other limitations on private investment.⁸⁸ This generated business groups (*qiye jituan* 企业集团) which contained substantial capital although each member firm remained small.⁸⁹ Efficiency when applied to Guanxi thus has a broader meaning. It is less rationalistic and “extends beyond a strictly economic consideration”.⁹⁰ This promotes "organizationally diffuse" groups of collaborating firms “connected by particularistic ties of kinship" and gives more security to the entrepreneur to reinvest.⁹¹ The reciprocal and mutual supporting relations of the co-operating businesses allow resorting to “considerable economies of scale, and the networks of both large and small firms can be extended”.⁹²

This mode of production prevents the drain of capital and enables (but also forces) the entrepreneur to be extremely flexible. As supplies cannot always be secured on usual ways (meaning, without personal connections) this adds to the importance of investing in as many different products as possible to achieve the maximum profit. To achieve this, not only a certain organization of the enterprise

⁸⁶ (Whiting 2001, 147).

⁸⁷ (Wank 1999, 254).

⁸⁸ (Whiting 2001, 147).

⁸⁹ (Wank 1996, 837).

⁹⁰ (Kiong and Kee 1998, 93).

⁹¹ (Wank 1999, 267).

⁹² (McNally 2006, 41).

is necessary, but even more so personal connections. As a consequence, the notion of core competence, one of the most important features of the Western understanding of conducting business is not really applicable to many privately-owned firms as it is not a relevant factor when considering further investments. “For the most part, a firm is known, not by what it produces, but by who stands behind it, and that individual will seize on any profitable [...] opportunity which presents itself, with scant regard for any core competence the firm may, or may not, have”.⁹³

This again reinforced the strengths of personal ties which not only are needed but are also the most helpful tool in such an economic environment.⁹⁴ Having no formalized bureaucratic system, these firms connected over networks are highly flexible, low-cost producers. More than that, they thrive in a market that requires fast reactions to changes in demand. Additionally, the emergence of niche markets and the need of flexible specialisation favoured the small-sized Chinese family enterprises. Multinational corporations increasingly subcontracted to small and medium enterprises, therefore Chinese firms could gain market shares for low-end, labour-intensive products, trading across borders with the help of networks.⁹⁵ Instead of ‘putting all eggs in one basket’, Chinese entrepreneurs invest in diverse branches and products, thus, in times of crises they can move resources to activities and locations promising the most profit, being able to leverage gains and losses, thereby also discovering new markets and investments.⁹⁶

All in all, Guanxi “is a connection between people, not firms. Even if an individual is running a number of separate companies, the counter-party considers itself as still trading with the same entity, the person with whom he has Guanxi. He could not have different relationships with each company”.⁹⁷

As can be seen, this is the complete opposite to the Western notion of doing business. Even considered the relatively large amount of transaction or sunk costs does not prevent this system to be extremely successful. Also, “entrepreneurs [...] concentrate their investment on transferable assets. And the single most transferable asset which entrepreneurs have is themselves and their social capital in the form of the ability to mobilize allegiances”. These assets cannot be confiscated by

⁹³ (Krug and Mehta 2004, 58f.).

⁹⁴ Cf. (Jinchuan 2004, 51ff.)

⁹⁵ (Lever-Tracy 2002, 512).

⁹⁶ (Lever-Tracy 2002, 519).

⁹⁷ (So and Walker 2006, 7).

local cadres and can be applied to as many different business opportunities as necessary to be successful. “It is the ability of the entrepreneur to form alliances, and the subsequent rents from co-operation, which are crucial to the establishment and on-going profitability of firms”.⁹⁸

Useful in times of prosperity and growth, the flexibility to move quickly from one sector or location to another derived from the small units of production turns out to be also a valuable asset during economic crises. Having relations to people with command over financial assets or supplies and distribution possibilities saves not only ‘transaction costs’ but can secure survival in economically difficult times. As Barbara Krug writes, there are four aspects networks provide: first, facilitating access to insider information; second, social and political sanctioning to make up for a missing or inadequate legal system, thereby providing contractual security; third, ensuring “that an entrepreneur can fail once yet return for a second attempt, but also forming a buffer against failure in the first instance”; fourth, acting “as a form of collective memory, ensuring that a single failure need not be constituted simply as one individual’s loss of investment but as an experience which others can learn from”.⁹⁹

Also, concluding transactions is more flexible when done with the help of Guanxi. It is more flexible than contracts because when doing business with people in one’s network it is easier to find compromises or giving new chances, especially if otherwise one of the business partners would have to default. “When there are problems, we can always talk it through. With Europeans, it’s quite different. We work with many multinational companies... They are not flexible. They won’t compromise and let you go [if you need to make adjustments]. They don’t share our mutual understanding. The Europeans go according to the books and rules”.¹⁰⁰

In other words, “risks are borne by the individuals and not absorbed by an external agency like a bank; neither is the contract between them bound by an external body, as in a legal institution”.¹⁰¹ Still, the advantages of Guanxi in contrast to formal contracts, which in the West are considered as mandatory prerequisites for

⁹⁸ (Krug and Mehta 2004, 59).

⁹⁹ (Krug and Mehta 2004, 60f.).

¹⁰⁰ (Kiong and Kee 1998, 82, 86).

¹⁰¹ (Kiong and Kee 1998, 88).

doing business because only those that can be enforced through law, are not recognized by “the West”.¹⁰²

5. Case Study: Wenzhou and the Global Financial Crisis

5.1. Wenzhou’s Rise after 1978

“Moonlight reaches the waterfront pavilion first, 近水楼台先得月”.¹⁰³

Wenzhou¹⁰⁴, the “quintessential capital of China’s network Capitalism”¹⁰⁵, was one of the first municipalities to heavily privatize and industrialize after 1978, after being impoverished and endowed with only few SOEs during the Mao era. However, it has a long tradition as a commercial city, a high population density, and a lack of arable land in the region, and thus has always attracted tradesman and merchants. The population of Wenzhou also resisted the collectivization during the 1950s and the collective sector remained weak throughout the communist era. In contrast, “private petty commerce and handicraft production” prevailed underground and were “quick to emerge ‘above ground’ in the more permissive atmosphere of the reform era”.¹⁰⁶ The decision of the Chinese central government to give a high degree of autonomy to impoverished areas such as Wenzhou after 1978 contributed to this development. Peasants quickly established small family-run enterprises, thereby going back to pre-communist practises. Entrepreneurship has a long tradition in Wenzhou and together with the lack of state investment in communist times due to its proximity to Taiwan and weak government control due to Wenzhou's geographic isolation, this led to a the creation of a “plethora of enterprises...coalescing into vast business networks”.¹⁰⁷

This generated an economic growth that earned a nationwide reputation and was named *Wenzhou model*.¹⁰⁸ Wenzhou will therefore be used as illustration for a Guanxi-based economy proper. It will be analysed how successful this environment can react to crises in general and to the current crisis in particular.

¹⁰² (So and Walker 2006, 17).

¹⁰³ (Whiting 2001, 215, fn. 83).

¹⁰⁴ For more information on Wenzhou’s location and history, see Appendix I and (Liu 1992b), as well as (Whiting 2001).

¹⁰⁵ (McNally 2006, 42).

¹⁰⁶ (Whiting 2001, 31f.).

¹⁰⁷ (McNally 2006, 42; Herrmann-Pillath 2002, 161, 165).

¹⁰⁸ (Encyclopædia Britannica 2009).

From 1980 to 1988, the growth of industrial output of Wenzhou increased from 1 to 41% and in 2002 was with 366.7 RMB (or 47.1% of total provincial output) higher than in most other provinces. From 2002 to 2007 the average yearly growth of GDP in Wenzhou was 13.8%. Its tax revenue put it among the top 5 percent of counties during the late 1980s and early 1990s.¹⁰⁹ During the same time, the number of private firms increased from 28,430 to 50,317 and the individually-owned units from 202,458 to 559,400, not including the private firms disguised as collective enterprises. Major industrial products include: footwear, clothing, metal cigarette lighters, razors, locks and plastic products. Pens produced in Wenzhou are estimated to be 30%, footwear 20% of China's market.¹¹⁰ In addition, the media proudly claims, there are "about 500 factories that make almost two-thirds of the cigarette lighters on the planet".¹¹¹

Reasons for the immediate success of Wenzhou's private sector was also that private rural households as primary productive unit produced goods that at the same time could be easily assembled and were commodities disregarded by the SOEs, such as plastic shoes and polyacrylic-fiber clothing. Those products could be manufactured in small-scale production and with simple labour-intensive technology, which required only small start-up capital and gave small profits but a quick turnover. Thus, Wenzhou firms used voids in the Chinese economic structures, exploiting niches for selling these products, which was supported by "benign neglect" from the state.¹¹²

FDI has not been very important for Wenzhou because of the difficult transportation situation and firms being small in size in lower-end production.¹¹³ In contrast, entrepreneurs in Wenzhou reactivated commercial contacts and soon marketing agents and labourers spread all over the country, creating country-wide distribution and information networks and sending back remittances that helped to kick-start many private enterprises.¹¹⁴ These transnational networks stemmed from the old Wenzhou tradition of migration. Migrants thus served as important source of financing and creators of stable social networks over great distances. After 1978, "lively smuggling trade arose between Wenzhou and Taiwan fisher-

¹⁰⁹ (Whiting 2001, 35).

¹¹⁰ (Kanamori and Zhao 2004, 30f.).

¹¹¹ (Mavin 2009).

¹¹² (Zhu 2007, 1512).

¹¹³ In 2004, it was only \$209 million. This is very low even compared to other cities in Zhejiang with Ningbo having \$2.1 billion and Hangzhou \$1.4 billion. (Yehua, Li, and Wang 2007, 440).

¹¹⁴ (Whiting 2001, 35, 131).

men....Wenzhou traders profited by marketing transistor radios and tape recorders produced in Taiwan in exchange for antiques and other valuables; [...] networks provided private resources of raw material outside plan channels. [...] Both local government official and private entrepreneur identified [smuggling] as one important early source of capital”.¹¹⁵ These informal markets were complemented by private purchasing agents who organized scarce materials from state enterprises around the country.¹¹⁶ Moreover, networks on a local level enabled the cooperation between otherwise independent family enterprises, allowing for specialization and division of work and thus overcoming the limitations of a traditional family firm.¹¹⁷ As official loans were difficult to obtain, entrepreneurs relied on informal sources of finance and the result was “the rapid development of an underground financial market in which various forms of informal networks act as financial intermediaries...30% of all lending in 2003 was extended through such networks” (see also next section).¹¹⁸

Hence, the success of the *Wenzhou Model* can be attributed to the dynamics of private entrepreneurs and the distribution networks between producers and consumers. Private firms were able to flourish because of the “evolution of a symbiotic relationship between local officials and entrepreneurs. This created a “political subculture” and semi-formal collective institutions which took advantage of the gaps in the rapidly changing Chinese economy and society and lags in government control.¹¹⁹ However, this collaboration is part of an old tradition as well. Wenzhouese were known to be notoriously insubordinate: skilled in smuggling throughout their history and never willing to give up trade and household industries, even during communist times.¹²⁰ It is also said that the liberation by an independent local guerrilla force in 1949 created a structure of local cadres that are willing to protect local private initiatives against central government policies and discrimination. This pragmatism and the will to take risks enabled local deviation from state policies and made government control and also tax collection harder to realize. Apart from the fact that its geographical distance and thus its difficult ac-

¹¹⁵ (Whiting 2001, 131, fn. 14).

¹¹⁶ (Peng 2004, 1059; Whiting 2001, 140f.).

¹¹⁷ (Herrmann-Pillath 2002, 166ff.).

¹¹⁸ (McNally 2006, 34).

¹¹⁹ (Herrmann-Pillath 2002, 168; Liu 1992b, 700ff.).

¹²⁰ The contempt towards authorities was often also expressed with the common saying, “the mountains are high and the emperor is far away” (shan gao huangdi yuan, 山高皇帝远). (Forster 1990, 56).

cessibility added to the autonomy given to the private sector already, the cooperation with local authorities facilitated the rise of the private sector long before it was officially sanctioned. For example, as early as in 1986 the Wenzhou industrial and commercial bureau proposed the relaxation of policies toward the private sector, also including the limit of employees (until then a maximum of 8) allowed for individual enterprises.¹²¹ Many of the laws concerning the private sector were also formulated with the Wenzhou model in mind. The passing of those laws was thus “a rather belated attempt to enshrine in statute practises which had been in operation for several years”.¹²² The predatory practises of local cadres described in the section above were met by giving many leading positions of the local government to natives. Hence, they were embedded into the social structure of Wenzhou through personal ties to family, friends and neighbours and were more likely to take local interests into account when implementing - or deviating from – state policies.¹²³ Officials helped enterprises to obtain land and bank loans and reduced taxes and states fees for them.

Enterprises in Wenzhou work in a nexus of dense social networks centred on family firms and historically rooted trust and culture. Even today it is shaped by the traditional labour-intensive industries with their low level of processing and low added value as it has been from its beginning in the 1970s.¹²⁴ Its economy is reconstituted of “local kinship relations and structures, in contrast to most understandings of Capitalism as the destruction of kinship by the mobility and fragmentation of wage labour”.¹²⁵ This obviously contradicts Weber’s prediction that industrialization and thus rationalization will supplant traditional feudal institutions to be successful.

Wenzhou is besides its impressive growth also known for its extravagant consumption and spending on weddings, funerals and similar occasions instead of reinvesting in their enterprises. Beside the fact that the shifting from investment to savings and consumption was a result of the high risk connected with investment over one million yuan due to tax regulations and other legislation concerning the private sector. Entrepreneurs “preferred to dismiss workers while spending their

¹²¹ (Whiting 2001, 135).

¹²² (Forster 1990, 59).

¹²³ (Liu 1992b, 294, 298ff.; Parris 1993).

¹²⁴ (Jinchuan 2004, 48).

¹²⁵ (Yang 2000, 484).

money on extravagant homes or even ancestral tombs”.¹²⁶ Excessive consumption like that also displayed wealth and demonstrated the generosity towards their networks, earning prestige and ‘face’. Especially local cadres who are rooted in local networks are expected to show their status by spending a lot at festive occasions in order to share and redistribute their wealth and to maintain their influence.¹²⁷ Contrary to Western capitalistic thinking, there is a gain of giving away. The more generous businessmen prove to be, the more symbolic capital - social status and face - they gain. This can also be a means to channel monetary means to protect them from being confiscated.¹²⁸

Although Wenzhouese networks form an “untouched net” and thus impede the intrusion of people from outside Wenzhou and contacts to the “outside world”, this is at the same time a protection in times of crises. They share the knowledge of the local business culture and of joint distribution and sale channels. These patterns had helped them to start privatization without the support and even against directives from the government, forcing them to invest in labour-intensive industries that only required little capital. They are able to quickly adapt products and designs and thus succeeded to become suppliers for major European brands.¹²⁹

5.2. Wenzhou in the Current Crisis

Since 1978, Wenzhou underwent several restructuring processes to be able to keep up its pace of growth and productivity. However, most enterprises are still family-controlled, small and low tech and are involved in a nexus of “local networks and gift culture”.¹³⁰ Even though there were slowdowns in its development, the consistent growth of Wenzhou is often seen in its success to face economic challenges.

The current global financial crisis turned into a serious crisis for the Chinese real economy and specifically the export sector. The Chinese government reacted to that with implementing massive stimulus packages.¹³¹ Thus, economic growth did only decrease from 9.6% in 2008 to 8.7% in 2009 (exceeding the goal of the

¹²⁶ “The Privately run enterprises, China News Analysis No 1382 (April 1, 1989), p.5, cited in (Whiting 2001, 148).

¹²⁷ (Yang 2000, 476ff.).

¹²⁸ (Parris 1993, 259).

¹²⁹ (Zeng and Williamson 2003, 98).

¹³⁰ (Yehua, Li, and Wang 2007, 440).

¹³¹ Recently, these policies have been criticized as reinforcing the dominance of state-owned enterprises and to crowd out the private sector (China Stakes, Aug. 7, 2009, accessed June 8, 2010), <http://www.chinastakes.com/2009/6/chinas-economy-in-turmoil-bubbles-in-a-downturn.html>. See also (Schüller and Schüler-Zhou 2009).

Chinese government of 8%) and (estimated) 9.9% in 2010, again declining in 2011 to 8.2%, reflecting the gradual impact of tightening economic policy.¹³² Still, this information visibly contrasts the fact that the growth rate of 2007 has been revised upward to 13%, from 11.9% previously. (In contrast, the world’s GDP is assumed to be 4.1% in 2010 and EU27 0.8%).¹³³ After an average annual growth of 27% between 2003 and 2008, exports contracted by 8.8% in 2009, but are expected to recover to around 8% in real terms in 2010-11 due to recovery of global demand.¹³⁴

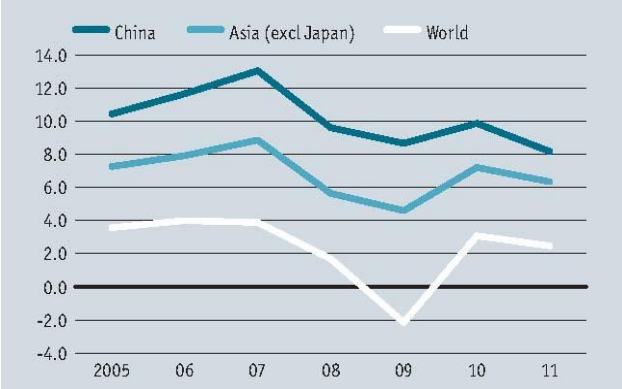


Figure 1: Real GDP growth (% change)
 Source: Economist Intelligence Unit 2010a, 23.

Credit quotas were widely used which disadvantaged small and medium-sized companies compared to SOEs. Small businesses were severely affected by the slowdown and approximately at least 20% went bankrupt, another 20% immensely affected by the lack of access to credit.¹³⁵

To complement this data, a look into newspapers gives an impression on how the crisis impacts the Chinese economy and more specifically, the Wenzhou private sector. In (Yin and Ng 2008) the authors state:

“About 67,000 SMEs have gone belly up in the first half of this year alone, many located in southern China where many industries churned out goods for the US and the European Union. Many complain that they are starved of credit as even the cash-rich local banks turned cautious about lending”.

It gives the example of Mingda Luggage, an SME based in Zhejiang province. Mingda produces Swiss Army knife bags, for example for Walmart and Kmart,

¹³² (Economist Intelligence Unit 2010a, 8, 11).
¹³³ (Economist Intelligence Unit 2010a, 7).
¹³⁴ (Economist Intelligence Unit 2010a, 19).
¹³⁵ (Economist Intelligence Unit 2010b, 6ff.).

with 80 per cent of its customers being from the US. Orders from the US started to decline in 2008, and instead of the planned increase of staff to 800, 200 were laid off. The owner was unable to get a loan from two local banks but had to sell a new factory building that he had built for 'a few tens of millions Yuan'.¹³⁶ Other articles give similar information:

*“Feiyue Group used to be the sewing machine manufacturing leader in China, and the model of township-enterprise in Taizhou, Zhejiang province.[...]Feiyue's export value in the first quarter of this year was only \$18.48 million, down 44 percent over the same period last year[...]. The reduced loans to SMEs from banks have made the situation even worse: Feiyue had to turn to underground private lenders to maintain its cash flow, but the higher interest rates left Feiyue struggling to pay the debts. [...] In Wenzhou, China's largest manufacturer of small goods, about 20 percent the enterprises have stopped production”.*¹³⁷

Well connected entrepreneurs turn to informal, underground private funding channels which will provide them with the necessary credits to bridge the time until the economy will recover. Especially small enterprises have strong difficulties in receiving loans over official sources which in a crisis situation is a particularly severe disadvantage.

*“According to an investigation by the SME bureau of Zhejiang province, during the first quarter of this year, new loans from four State-owned banks, namely the Industrial and Commercial Bank of China (ICBC), the Agricultural Bank of China, Bank of China, and the China Construction Bank, were reduced by 25 percent compared to the same period last year. During the same period, the ICBC alone reduced loans to SMEs by 87.5 percent, down from 9.8 billion yuan last year to 1.3 billion this year”.*¹³⁸

¹³⁶ (Yin and Ng 2008).

¹³⁷ (Business daily update 2008), similar example (Zhang 2008): “In Zhejiang province, Wenzhou is the bank. [...] A prominent politician of one city in Zhejiang [...] stressed that there was no way they could clamp down because businesses had to survive and that locals had to remain employed”.

¹³⁸ (Business daily update 2008).

Still, Wenzhou recovered much faster than other regions in China: “In the first half [of 2008], Zhejiang's economy expanded 11.4 percent from a year earlier, much higher than the nation's average of 10.5 percent”.¹³⁹

One reason might be the routine of ex-post sanctioning of practises already in use: “What's more encouraging for Zhejiang Province is that the CBRC [China Banking Regulatory Commission] is considering legitimizing its underground private lending, and setting up a limited amount of micro-credit companies to connect private capital with SMEs”.¹⁴⁰

“In Wenzhou, where some of the country's biggest underground lenders operate, a similar trend is being seen. Zhou Dewen, chairman of the Wenzhou SME Development Promotion Federation, estimates that 5 billion yuan entered the underground system as investors divested plants, property and other projects recently, making about 25 billion yuan available for loans to small and medium-sized enterprises.

*Though yet to be legitimised, underground lenders have become more integral to the operations of cash-strapped SMEs, which used to absorb 85 per cent of the 20 million people entering the job market each year”.*¹⁴¹

These unofficial bankers describe themselves not as underground or private bankers because unlike normal bankers they do not make money from interest payments, losing money in times of financial crisis, instead they make their “biggest profits when borrowers go bust”.¹⁴² This sector “remains the lifeblood of entrepreneurial China”. State-controlled banks tend to confine their lending to SOEs, informal bankers take great risks to supply credit to small businesses. In Wenzhou, which is said to have China's largest underground banking network, private bankers consider themselves not at risk.¹⁴³

“Wenzhou's webs of private lending are held together by a gentleman's code. Borrowers are introduced and implicitly guaranteed by friends and relatives. Huang Weijin [...] explains why local business people would rather lose their lives than default on a private loan. “I can fly to Europe or Africa with only 300 yuan because other Wenzhou business-

¹³⁹ (Business daily update 2008).

¹⁴⁰ (Business daily update 2008).

¹⁴¹ (Cai 2008a).

¹⁴² (Garnaut 2008a).

¹⁴³ (Garnaut 2008a).

men will look after me. They drive to Germany from Italy to pick me up, and I would do the same. It doesn't matter if you lose money. But if you lose trust, you lose everything."

Those bonds of business kinship, extending across China and the global Wenzhou diaspora, are far stronger than the contracts that bind borrowers to faceless state-owned banks. 'It's more secure than a state-controlled bank because if someone doesn't repay they have no place to play in Wenzhou any more'".¹⁴⁴

There is also evidence for alliances of Wenzhouese entrepreneurs with local officials:

"Juyi is a well-run enterprise, but no successful Chinese entrepreneur can display such confidence without earning the patronage of the gatekeepers of China's land, finance, labour and government largesse. These patrons are prominently exhibited throughout the elaborate corridors of Juyi's corporate headquarters. Some photos show Ms Li and her son with local government officials. [...] the company has a luxurious Communist Party Members Room, which is lined with portraits of [...] Joseph Stalin, Mao Zedong and Deng Xiaoping...The room...is a shrine of corporate loyalty to the party rather than any indication of ideological bent".¹⁴⁵

Also, there is proof for the diversification strategy of Wenzhou entrepreneurs:

"Wenzhou people don't give up easily. The business climate isn't good this year and many manufacturers are struggling to survive. Some have halted operations, but they are actively seeking chances to make a change - to enter other fields".¹⁴⁶

"Wenzhou is suffering less [than other export-oriented cities] as businesspeople are very flexible and have shifted to other industries'. [...] 'If I had stayed in machinery, I would be in difficulty because of

¹⁴⁴ (Garnaut 2008a).

¹⁴⁵ (Garnaut 2008b).

¹⁴⁶ (Cai 2008b).

the overall environment' [...]. "But our children's clothes business is making a significant profit now''".¹⁴⁷

Wenzhou's entrepreneurs seem to have survived the crises without substantial losses. Not least, because they "prefer being head of a cock than tail of a phoenix", as a Chinese saying describing a preference for decision-making power goes. One article even claims that only about 2 per cent of businesses failed. "The figure is not significant. It would be similar at normal times."¹⁴⁸

Many companies made decisions before the most difficult time. The widely travelled Wenzhou people smelled the downtown early and the message spread quickly through their network of family, friends and business acquaintances, enabling those at home to prepare for the worst. "Because we noticed the crisis early, there was no panic or bewilderment when it really landed," says Xu. "We were very clear about what we should do. We had a strategic plan and took countermeasures.[...]At the forefront of China's development of small private enterprises, Wenzhou's economy was affected early and deeply by the global turmoil. But the city maintained growth of 8.1 per cent in gross industrial product value last year. In January, bank loans to businesses rose markedly, electricity demand rose, and employment, especially of technical skilled workers, was high. For most companies, it was business as usual.[...]"They are signs of an upcoming economic revival. Wenzhou has stood the test. It is likely to walk out of the economic difficulty ahead of other cities in this country".¹⁴⁹

Firms can survive economically difficult times because "family and close friends were willing to work without salary and benefits for months, in some cases even putting up money to prevent cash flow problems".¹⁵⁰ On the other hand, extensive political Guanxi networks are a key element for success. As one entrepreneur argues: "Guanxi are more important than capital. If you have Guanxi, you will have access to capital. However, if an entrepreneur has capital

¹⁴⁷ (Ma 2008).

¹⁴⁸ (Asia Pulse 2009).

¹⁴⁹ (Asia Pulse 2009).

¹⁵⁰ (McNally, Guo, and Hu 2007, 14).

but no Guanxi, his/her business cannot survive”. He adds that he spends approximately half of his time cultivating Guanxi ties, particularly with government officials.¹⁵¹

All in all, there is evidence that all features of Guanxi Capitalism described before, which can help to survive economic crises, are being actually used in Wenzhou. This shows that Guanxi Capitalism can be as stable and sustainable as Western Capitalism.

6. Conclusion

“The difference between Chinese and westerners is not that one is relational and the other rational. Both are rational and relational. The difference is that western rationality is more based on universalistic principles and individual rights (jurisdiction) the Chinese rationality is based on particularistic principles and obligations and patron-clientelism (the opposite of clearly defined individual rights).”¹⁵²

This paper gives evidence for the stable character of Chinese Capitalism. Assuming that a permanent type of Capitalism should be able to overcome crises, it has been shown that certain features of Guanxi help entrepreneurs to survive. Taking Wenzhou as example, it was demonstrated that entrepreneurs not only employ their contacts to local officials but also that their embeddedness in dense networks facilitates maintaining their business or starting new if failing in one specific sector. Due to their extreme flexibility, the forgiveness and experiences of their networks, investing in a whole portfolio of products and the usage of underground banking facilities together help entrepreneurs survive. This is not equal to the survival of a specific enterprise, which might be forgone, because the failure of one business is not considered as failure as person. It is rather the existence of networks that gives the necessary stability and security, especially in times of economic turmoil. The connections to politicians proved to be extremely helpful. People utilized their ties to local cadres, which in turn due to their local embeddedness were compliant to support private enterprises.

¹⁵¹ (McNally, Guo, and Hu 2007, 14).

¹⁵² (Peng 2003, 3).

Although Wenzhou serves as an illuminating example and similar ones can be found throughout China, it is very important to keep in mind that „China is a continental system which contains a large number of different social and cultural practices. Its 34 provincial-level jurisdictions are most usually country-sized by the standards of the rest of the world.”¹⁵³ Still, industrial clusters in rural China developed spontaneously in various places depending on local traditional culture, local resources and also “local capable persons”.¹⁵⁴ Thus, within China there surely are different strategies at work to cope with the impact of the crisis, especially in regions with a large collective sector. However, although mainstream macro policies, such as the stimulus package, is of significance for the recovery of the Chinese economy (even if more directed towards the state sector), this paper stresses the importance of the private sector and hence the influence of informal connections and Guanxi of entrepreneurs as indispensable and vital factors for the successful restoration and stabilization of the Chinese economy.

Nevertheless, the reality of an increasingly flexible global economy favours not only mass production, but even more so subcontracting and small-business production, which is most effectively done in cities that create clusters of production for certain products, like for example in Wenzhou for shoes or lighters.¹⁵⁵ Small Chinese private firms are able to respond to rapidly changing market conditions which especially in difficult conditions is a comparative advantage compared to large-scale multi-national corporations. This fits to the Chinese tendency to only do business with people they know or have relations to. If entrepreneurs in the same business are in a dense network together, rather than competing each other they will support each other, exchanging resources and know-how. Networks not only serve as shelter to protect private property, but through that also increasing security and reducing transaction costs, additionally providing information on supplies or business opportunities. All in all, networks “lower entry barriers and raise the survival and success rates of private entrepreneurs”, which is especially important during crises.¹⁵⁶

¹⁵³ (Goodman 2007, 176f.).

¹⁵⁴ (Li and Li 2007, 49).

¹⁵⁵ Of course, this is also the case in some locations in Europe, which also developed cluster of small-scale businesses connected over networks. However, the relevance and quality of these networks differ from their Chinese counterparts, not least because they are also based on more formal, contractual relations. Unfortunately, it is beyond the scope of this paper to elaborate on this point more in-depth.

¹⁵⁶ (Yang 2002, 466ff.; Peng 2004, 1059).

In contrast to Weber's and Sombart's expectations on the growing rationalisation and bureaucratisation, instead of entrepreneurs losing significance in the Chinese economic system, they are still essential for the economic success of an enterprise. Entrepreneurs possess the necessary flexibility, the right instinct for profitable investments and the ability to mobilize connections and create alliances - valuable assets for the global production environment. Personal relations are not separated into a private and a business sphere or exchanged by other, in Western thinking more rational, means of doing business because it includes factors like reputation and long-term benefits for their family. Personal relations expose comparative efficiency as they are chosen as the most capable instrument for the private sector in China. Guanxi is a permanent part of the Chinese society and thus also its economy system. It will complement and coexist with Western institutions and thus form a specific type of Capitalism based on Guanxi.

Appendix I: Some Details on Wenzhou

Wenzhou is located in Zhejiang province, almost at the midpoint of China's eastern coast. It is situated on the south bank of the Ou River, about 30 km from its mouth. The Ou long provided the main transport route for this south-eastern section of Zhejiang as 78% of the territory is mountainous, isolating the municipality from the rest of Chinese mainland. Wenzhou consists today of an urbanized area (488 square kilometres, 4% of the municipalities 11500 square kilometres) and a large rural region, divided into eight counties.

In 999, the Song dynasty sanctioned Wenzhou to be a foreign-trade port and the Wenzhou people became very skilled in long-distance trade (but also smuggling). Rural household industries thrived and local markets were developed. At that time it had a flourishing shipbuilding industry, and its papermaking and lacquerware craft were well known. Many people migrated out of Wenzhou. After several closings, the Wenzhou's port was again opened to foreign trade as a treaty port in 1876, and for a while there was a considerable tea trade; however, the port never played a large part in China's foreign trade, and there was no foreign settlement. Wenzhou's trade flourished again during the early part of the Sino-Japanese War, as from 1937 to 1942 it was one of the few ports left in Chinese hands; trade subsequently declined toward the end of the war, however. The Mao administration invested little in Wenzhou's economic development. Not until 1955 was sea transport along the Zhejiang coast fully restored, after which Wenzhou rapidly recovered.

The Wenzhou people never totally abandoned their way of specialized production and long-distance trade under Mao's rule. Its citizens started their own household businesses and workshops in the early 1970s, and their efforts redoubled later in the decade as China officially began to liberalize economic policy and to move toward more of a market system. By the end of Mao's era, rural Wenzhou had, by and large, gone back to pre-communist practises. This became known as the *Wenzhou model*; there are now tens of thousands of Wenzhou merchants doing business around the country and abroad.

In 1984 Wenzhou was designated one of China's "open" cities in the new policy of inviting foreign investment, and there was considerable economic growth. Local products now include ceramics, machinery, chemicals, electronics, proc-

essed foods, and wearing apparel; shipbuilding is also important. The total product of society (sum of gross output value of industry, agriculture and commerce) increased from 3 billion yuan in 1980 to 13 billion in 1988. From 1978 to 1989, the industrial output rose from 1 to 8.9 billion yuan. The average income of Wenzhou peasants, which before 1980 was among the lowest in China, was 50% above the national average in 1989 (924 compared to 601 yuan).

The region's transportation infrastructure has been greatly improved. A branch rail line, completed in the late 1990s, links the city with the Zhejiang-Jiangxi trunk line at Jinhua. Expressways northeast to Ningbo and northwest to Jinhua opened for traffic in the early 21st century. Newer and larger port facilities also have been constructed, including docks near the mouth of the Ou River with berths capable of accommodating 10,000-ton ships. The city's airport, on the sea-coast, provides scheduled flights to many cities in the country.

Sources: (Encyclopaedia Britannica 2009; Liu 1992b).

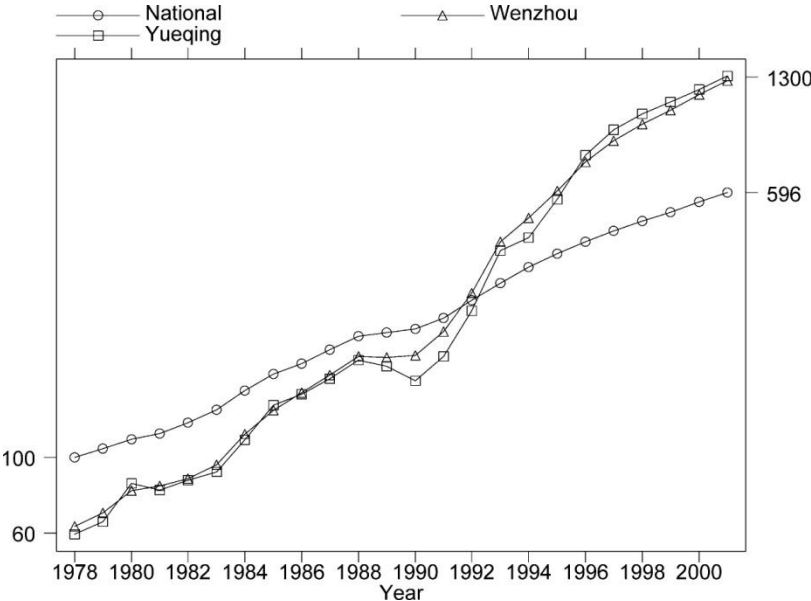


Figure 2: Index of real GDP per capita in the Yueqing Cluster, Wenzhou City, and China, 1978 to 2001 (China in 1978 = 100). Sources: China Statistical Yearbook 2002, Comprehensive Statistical Data and Materials on 50 Years of New Zhejiang, Statistical Bureau of Zhejiang Province, 2000, and various years of Zhejiang Statistical Yearbook. In: (Sonobe, Hu, and Otsuka 2004, 547).

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