


1-1-2017

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### Recommended Citation

Andrew Key & Jingchen Zhao, *Accountability in Corporate Governance in China and The Impact of Guanxi as A Double-Edged Sword*, 11 Brook. J. Corp. Fin. & Com. L. 377 (2017).  
Available at: <http://brooklynworks.brooklaw.edu/bjcfcl/vol11/iss2/5>

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# ACCOUNTABILITY IN CORPORATE GOVERNANCE IN CHINA AND THE IMPACT OF GUANXI AS A DOUBLE-EDGED SWORD

Andrew Keay\* and Jingchen Zhao\*\*

## ABSTRACT

*Accountability is an essential aspect of corporate governance and it has been argued that the “wenze” system of accountability in China comes very close to the accountability systems developed in Anglo-American corporate governance. This Article examines the role of cultural factors, namely guanxi and its derivatives, in corporate governance in China to determine what effect, if any, these cultural factors have on the operation and development of the “wenze” system in large listed companies. The Article specifically considers whether the cultural elements affect accountability, and if so, how and to what extent. It also explores whether these cultural factors are good, bad, or neutral as far as the development of accountability in fostering good corporate governance is concerned. The Article advocates a realistic, functional, and culturally sensitive corporate governance accountability system in China, under which guanxi and its derivatives will not be regarded as a substitute for accountability, but will work within the “wenze” system of accountability. Meanwhile, the Article’s analysis also demonstrates that guanxi is a double-edge sword, for while it can be an impediment to accountability, it is not totally inimical to ensuring that there is accountability.*

## INTRODUCTION

Accountability operates overtly and implicitly as a factor in the field of corporate governance.<sup>1</sup> In fact, the United Kingdom’s Department for Business Innovation and Skills<sup>2</sup> puts this concept more strongly, and has stated: “Transparency and *accountability* are the most important elements of good corporate governance.”<sup>3</sup> Along similar lines, the International Federation of Accountants has defined corporate governance as “the

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1. See Edward Rubin, *The Myth of Accountability and the Anti-Administrative Impulse*, 103 MICH. L. REV. 2073, 2073 (2005); see also Alice Belcher, *Codes of Conduct and Accountability for NHS Boards*, 288 PUB. L. 291 (1995).

2. The name of the department was changed to the Department for Business, Energy & Industrial Strategy in July 2016.

3. *Corporate Governance*, DEP’T BUS. INNOVATION & SKILL, <http://webarchive.nationalarchives.gov.uk/20090902193559/berr.gov.uk/whatwedo/businesslaw/corp-governance/page15267.html> (last visited Jan. 12, 2015) (emphasis added).

processes by which organizations are directed, controlled, and held to account . . . [it is] concerned with structures and processes for decision-making, accountability, control and behaviour at the top of organizations.”<sup>4</sup> The G20/OECD’s *Principles of Corporate Governance* also makes it plain<sup>5</sup> that accountability is a critical element in corporate governance. In like manner, the Pan-African Consultative Forum on Corporate Governance in 2001 indicated that accountability was one of the key elements of corporate governance.<sup>6</sup> Shortly after that, South Africa’s King Report (King II) on corporate governance identified accountability as one of seven characteristics of good corporate governance.<sup>7</sup>

It has been suggested that good corporate governance can best be achieved by holding directors accountable for their behavior and decisions,<sup>8</sup> and this means that the accountability of the board of directors in a company is the most important aspect of accountability. The *Report of the Committee on the Financial Aspects of Corporate Governance* (commonly known as the Cadbury Report) stated many years ago: “The issue for corporate governance is how to strengthen the accountability of boards of directors to shareholders.”<sup>9</sup> It has been argued that accountability of directors is the basis for the success of all other principles of corporate governance,<sup>10</sup> and such directorial accountability has been said to be at the heart of good corporate governance.<sup>11</sup> It follows that the enhancement of accountability should lead to better corporate governance.

According to an influential report in China, accountability is regarded as one of the basic principles of corporate governance that needs to be

4. INT’L FED’N OF ACCOUNTANTS, GOVERNANCE IN THE PUBLIC SECTOR: A GOVERNING BODY PERSPECTIVE 1 (2001).

5. ORG. FOR ECON. CO-OPERATION AND DEV., PRINCIPLES OF CORPORATE GOVERNANCE 51 (2015), <http://www.oecd.org/daf/ca/Corporate-Governance-Principles-ENG.pdf> [hereinafter PRINCIPLES OF CORPORATE GOVERNANCE].

6. Simeon Wanyama, Bruce Burton & Christine Helliari, *Stakeholders, Accountability and the Theory-practice Gap in Developing Nations’ Corporate Governance Systems: Evidence from Uganda*, 13 CORP. GOVERNANCE: INT’L J. BUS. SOC’Y 18, 22 (2013).

7. INST. OF DIR., KING COMMITTEE ON CORPORATE GOVERNANCE, EXECUTIVE SUMMARY OF THE KING REPORT 2002 10–11 (2002), [http://www.ecgi.org/codes/documents/executive\\_summary.pdf](http://www.ecgi.org/codes/documents/executive_summary.pdf). The other ingredients of good corporate governance were said to be discipline, transparency, independence, responsibility, fairness, and social responsibility. *Id.*

8. See JILL SOLOMON & ARIS SOLOMON, CORPORATE GOVERNANCE AND ACCOUNTABILITY 14 (2004); see also Emily Makuta, *Towards Good Corporate Governance in State-Owned Industries: The Accountability of Directors*, 3 MALAWI L.J. 55, 56 (2009).

9. REPORT OF THE COMMITTEE ON THE FINANCIAL ASPECTS OF CORPORATE GOVERNANCE ¶ 6.1 (2015).

10. See Makuta, *supra* note 8, at 56; see generally ANDREW KEAY, BOARD ACCOUNTABILITY IN CORPORATE GOVERNANCE (2015).

11. See ALICE BELCHER, DIRECTORS’ DECISIONS AND THE LAW 183 (2014); see also Angus Young, *Frameworks in Regulating Company Directors: Rethinking the Philosophical Foundations to Enhance Accountability*, 30 COMPANY LAW 355, 356 (2009).

consistently enforced.<sup>12</sup> A problem that exists is that “accountability” is an English word that is not easily translated into other languages. It has been translated in China using different Chinese words, since the Chinese language does not have a word that singularly encapsulates the English word, especially as used in relation to corporate governance.<sup>13</sup> The Chinese word that has been used most often as a translation for accountability is “*wenze*,”<sup>14</sup> but this is not completely equivalent to what the English word means, and does not appear to embrace all of the nuances of the concept of accountability as determined in Anglo-American corporate governance systems. The use of *wenze* in China is either too narrow, because it is focused on the process of undertaking enquiries only,<sup>15</sup> or it is misinterpreted as meaning responsibility.<sup>16</sup>

Administrative law in China employs an accountability system that bears some similarities to Anglo-American corporate governance systems, and this Chinese approach has been referred to as a *wenze* system.<sup>17</sup> It is envisaged that eventually accountability in the English sense will become more applicable in China as the country develops a system of corporate governance that is not completely founded on administrative governance, but is based more on economic governance, as is the case in Anglo-American systems. At present, China has a hybrid system combining elements of both administrative and economic governance.<sup>18</sup> This hybrid corporate governance does not have its goal focused solely on economic return and wealth maximization. Corporations, especially those that are State-Owned Enterprises (SOEs), have other missions with administrative goals such as: the maintenance of urban employment; the improvement of employment conditions; support for small businesses; the direct control of key industries such as banking, energy, and telecommunications; and politically motivated job placement.<sup>19</sup> SOEs’ corporate strategy and profit distributions are closely related to the needs of government, and their board

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12. See PROTIVITI & CHINESE ACAD. OF SOC. SCI., CORPORATE GOVERNANCE ASSESSMENT SUMMARY REPORT ON THE TOP 100 CHINESE LISTED COMPANIES FOR 2012 1 (2013).

13. Andrew Keay & Jingchen Zhao, *Ascertaining the Notion of Board Accountability in Chinese Listed Companies*, 46 H.K. L.J. 671, 687 (2016).

14. *Id.* at 689–92.

15. Yunfeng Li, *Accountability and Effectiveness of Corporate Governance* (问责动了真格公司治理才有效), <http://www.cnstock.com/08yaowen/sdfox/201112/1753422.htm> (last visited July 8, 2015).

16. YIKUN ZHU, INSTITUTIONAL STRUCTURE AND EFFICIENCY: BOARD OF DIRECTORS (董事问责: 制度结构与效率) 18 (2012).

17. Keay & Zhao, *supra* note 13, 696–702.

18. See generally Fuxiu Jiang & Kenneth A. Kim, *Corporate Governance in China: A Modern Perspective*, 32 J. CORP. FIN. 190 (2015); Jingchen Zhao, *Modernising Corporate Objective Debate Towards a Hybrid Model*, 62 N. IR. LEGAL Q. 361 (2011); QIAO LIU, CORPORATE CHINA 2.0: THE GREAT SHAKEUP ch. 5 (2016).

19. Qiao Liu & Zhou Lu, *Corporate Governance and Earnings Management in the Chinese Listed Companies: A Tunnelling Perspective*, 13 J. CORP. FIN. 881, 884 (2007).

members always have a close relation with the government or civil servants.<sup>20</sup>

This system relied on decentralized administrative governance as a key feature of market management in China prior to and during the transition period from 1979 to the present day, as the result of government reforms aimed at enhancing economic efficiency.<sup>21</sup> The government, when it intervenes in the business decision-making process, always does so by employing administrative action or imposing administrative sanctions. This approach has been subject to criticism because it produces an inefficient system of operations.<sup>22</sup> This administrative corporate governance has less impact on non-SOE listed companies, because their shareholders and directors usually do not have such a strong relationship with the government. This Article submits that the *wenze* system that presently applies in relation to administrative law can be modified to apply to the hybrid corporate governance model, one that involves greater economic governance.

In examining what any country should embrace in relation to its corporate governance system, consideration must be given to the fact that each will have different historical and social underpinnings. There is a clear suggestion that “the lesson of history . . . is that while markets have always been there, they have always operated in the context of geography, religion, language, folk ways, families, armies, and government, never in a vacuum.”<sup>23</sup> This is consistent with what is known as path dependence theory, which provides “that an outcome or decision is shaped in specific and systematic ways by the historical path leading to it,” as well as by other factors within the socio-economic context.<sup>24</sup> As part of the domestic legal and financial framework, a corporate law system has significant sources of path dependence, which include historical accidents as well as economic and political issues and elements that are particular to the domestic system.<sup>25</sup> The corporate governance system in China, and particularly aspects of its enforcement and ambit, are likely to be very different than they are elsewhere due to a number of factors, such as the country’s

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20. See generally John P. Burns, *Civil Service Reform in China*, ORG. ECON. CO-OPERATION DEV. J. BUDGETING, July 2007, at 17.

21. Especially under the Xi–Li Administration in 2012. See WILLY WO-LAP LAM, CHINESE POLITICS IN THE ERA OF XI JINPING: RENAISSANCE, REFORM, OR RETROGRESSION? ch. 4 (2015).

22. Victor Nee, Sonja Opper & Sonia Wong, *Developmental State and Corporate Governance in China*, 3 MGMT. ORG. REV. 19, 19–24 (2007); Cindy A. Schipani & Junhai Liu, *Corporate Governance in China: Then and Now*, 2002 COLUM. BUS. L. REV. 1, 28–31 (2002).

23. KARL MOORE & DAVID LEWIS, FOUNDATIONS OF CORPORATE EMPIRE: IS HISTORY REPEATING ITSELF 219 (2000).

24. Oona A. Hathaway, *The Course and Pattern of Legal Change in a Common Law System*, 86 IOWA L. REV. 601, 604 (2001).

25. See generally Lucian Arye Bebchuk & Mark J. Roe, *A Theory of Path Dependence in Corporate Governance and Ownership*, 52 STAN. L. REV. 127 (2000).

political evolution, its socialist underpinnings, and its rich and unique culture, the latter having developed over thousands of years.

Cultural issues<sup>26</sup> have been a crucial element for determining the nature of corporate governance in China and it is one of the factors that has had a favorable impact on both the effectiveness and efficiency of business operations. One critical aspect of Chinese culture is encompassed by the term “*guanxi*,” and its related derivatives, which are the subject of this Article. The roles of *guanxi*, which means “personal connections/relationships,” and other cultural derivatives related to *guanxi*, such as “*renqing*” (reciprocity), gift giving, “*mianzi*” (face), and “*xinren*” (trust) in Chinese business culture provide dramatic examples of entrenched cultural norms that are under pressure from the evolution of international business trends. The relationship between Chinese culture and the Chinese business model is complex and multidimensional.<sup>27</sup> *Guanxi* is examined here because of its strong impact on and in the business world and in the governance environment. It is an influential component of governance culture.<sup>28</sup> *Guanxi* is regarded as “the durable social connections and networks a firm uses to exchange favors for organizational purposes.”<sup>29</sup> Furthermore, it is argued that *guanxi* is de facto based on Confucian ideology,<sup>30</sup> a central life philosophy for many aspects of Chinese life. It teaches filial piety, loyalty, harmony, and reciprocity as the basis for maintaining good *guanxi*,<sup>31</sup> and the foundation to enable Chinese people to get through life. *Guanxi* remains rooted in Confucianism that connects social order and virtue. The Chinese have turned the art of personal relationships into a carefully calculated science, and there are people whose lives rely heavily upon *guanxi*.<sup>32</sup> It is generally recognized that *guanxi* can have both positive and negative effects in society and in business specifically.

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26. For general discussions on corporate governance and culture, see generally Amir N. Licht, *Culture and Law in Corporate Governance* (European Corp. Governance Inst., Working Paper No. 247/2014, Mar. 2014).

27. Ying Fan, *A Classification of Chinese Culture*, 7 CROSS CULTURAL MGMT. 3, 3 (2000). It is worth mentioning that Chinese Confucian culture and corporate governance have been discussed widely. See generally Charles A. Rarick, *Confucius on Management: Understanding Chinese Cultural Values and Managerial Practices*, 2 J. INT'L MGMT. STUD. 22 (2007); Irene Y.M. Yeung & Rosalie L. Tung, *Achieving Business Success in Confucian Societies: The Importance of Guanxi (Connections)*, 25 ORG. DYNAMICS 54 (1996); Tong Chee Kiong & Yong Pit Kee, *Guanxi Bases, Xinyong and Chinese Business Network*, 49 BRIT. J. SOC. 75 (1998).

28. Liang Guo, Clive Smallman & Jack Radford, *A Critique of Corporate Governance in China*, 55 INT'L J.L. & MGMT. 257, 267–68 (2013).

29. Flora F. Gu, Kineta Hung & David K. Tse, *When Does Guanxi Matter? Issues of Capitalization and Its Dark Sides*, 72 J. MARKETING 12, 12 (2008).

30. FOX BUTTERFIELD, CHINA: ALIVE IN BITTER SEA 80 (1983).

31. See generally Xuezhi Guo, *Dimensions of Guanxi in Chinese Elite Politics*, 46 CHINA J. 69 (2001).

32. BUTTERFIELD, *supra* note 30, at 80.

Despite the fact that the relationships between Chinese culture, history, and traditions have been discussed widely, the research that has been done has focused on how culture affects doing business in China in general terms. The current literature tends to focus on *guanxi* and business, cultivating sustainable *guanxi* in order to perform successfully in China or in the context of dealing with Chinese business partners. The literature on corporate governance and *guanxi* is very limited and dated.<sup>33</sup> This Article explores and analyzes the relationship that exists between *guanxi* and its cultural derivatives on the one hand and accountability in corporate governance on the other. To our knowledge there has not been any study of this relationship. The Article will contribute to the very limited literature on both corporate governance and culture, and the notion of accountability in the domain of Chinese corporate governance. The significance of the Article lies in the fact that accountability is critical to corporate governance, and *guanxi* and its derivatives will necessarily impact corporate governance in some way because they are essential elements of Chinese business. We seek to examine how and in what ways they affect accountability.

The research should be relevant not only to Chinese companies and those concerned with the development of corporate governance in China, but also to foreign companies that wish to engage in business relationships with Chinese companies, so that they can understand and, possibly, accommodate cultural issues. To understand *guanxi* and its cultural derivatives in a more rounded fashion, rather than just in a one-sided way, will enable Western readers to acquire a real picture of these cultural issues in a “unique Chinese way,” rather than seeking to find equivalent Westernized relations such as friendship, kinship, or social network to equate to *guanxi*. In detail, the research will be beneficial and important for company board members, including those who are not familiar with Chinese culture and traditions, to use *guanxi* and its cultural derivatives in a positive and sustainable manner in order to enhance board accountability. It is also significant for company board members to learn from the research so that they are aware of the challenges and risks in the process of promoting board excellence, especially in relation to accountability, while dealing with Chinese companies and these cultural issues. Therefore, *guanxi* and its derivatives are important components of cultural factors that could not only be employed by the board internally while making decisions, but also studied and investigated so that corrupt and illegal *guanxi* can be avoided on the journey towards more accountable companies.

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33. Through various popular search engines including: SSRN, Google Scholar, Westlaw, and Heinonline, we found two articles directly on *guanxi* and corporate governance. See generally Udo C. Braendle, Tanja Gasser & Juergen Noll, *Corporate Governance in China – Is Economic Growth Potential Hindered by Guanxi?*, 16 BUS. & SOC’Y REV. 389 (2005); David Smith, *Guanxi, Mianzi, and Business: The Impact of Culture on Corporate Governance in China*, 26 PRIV. SECTOR OPINION 1 (2012). They did not thoroughly address accountability.

Since *guanxi* has been a pervasive part of the Chinese business and political worlds for the last few centuries, we believe that it binds thousands of Chinese companies and Chinese board members. The market is not able to oust the old value; truly successful businesses are always well connected. This Article advocates a realistic, functional, and culturally sensitive corporate governance accountability system in China, under which *guanxi* and its derivatives will not be regarded as a substitute for accountability, but will work within the *wenze* system of accountability.

The first aim of this Article is to critically examine the role of cultural factors, namely *guanxi* and its derivatives, in corporate governance in China, in order to set the scene for our discussion of the relationship between *guanxi* and the notion of accountability. The second and main aim of the Article is to determine what effect, if any, these cultural factors have on the operation and development of a *wenze* system in Chinese corporate governance. The Article specifically considers whether the cultural elements affect accountability, and if so, how and to what extent. It also examines whether any such effects are good, bad, or neutral as far as the development of accountability in fostering good corporate governance is concerned. We should add that our concern is with large companies in China, whose shares are listed on a stock exchange.<sup>34</sup>

The Article is structured as follows. First, Part I provides a brief discussion of accountability and the Anglo-American development of this concept in corporate governance, the reason being that the Anglo-American model is pervasive and is embraced by the G20/OECD's *Principles of Corporate Governance*, which have been influential in the development of Chinese corporate governance. Part II explains the *wenze* system of accountability. Part III follows with an explanation of *guanxi* and other related cultural derivatives in the context of a hybrid corporate governance model in China. Part IV analyzes whether, and to what effect, these cultural and sociological issues have an impact on accountability in corporate governance. Part V endeavors to assess whether these cultural concepts provide obstacles to the development of accountability mechanisms as well as assessing the possibility of employing *guanxi* as a factor in the promotion of accountability in China. The Article will address these cultural issues from critical, functional and instrumental perspectives.

## **I. DEVELOPMENT OF THE CONCEPT OF ACCOUNTABILITY IN THE ANGLO-AMERICAN CORPORATE GOVERNANCE SYSTEM**

As discussed at the outset, accountability is something that is seen as an essential element to Anglo-American corporate governance. This concept

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34. Primarily this will be on one of China's two stock exchanges, which are situated at Shenzhen and Shanghai.



has been embraced by the G20/OECD in their *Principles of Corporate Governance*: “The corporate governance framework should ensure the strategic guidance of the company, the effective monitoring of management by the board, and the board’s accountability to the company and the shareholders.”<sup>35</sup> This envisages that the accountability of boards of directors is the most important element of accountability. Nevertheless, there are others who need to account within the corporate governance framework, such as the executives and managers of the company. Notwithstanding the importance of accountability, there has been a failure to articulate what it actually means in the context of corporate governance. The concept is mentioned on many occasions, but is rarely explained and developed.<sup>36</sup> This is likely due to several factors, the leading one perhaps being that accountability is notoriously difficult to articulate, as it is a complicated and elusive concept.<sup>37</sup>

A recent study has argued that accountability in relation to corporate governance, certainly as far as Anglo-American corporate governance is concerned, entails a process involving four stages.<sup>38</sup> The first stage is that the “accountor” (i.e., the one who is accountable) needs to provide accurate information concerning its decisions and actions, so that “accountees” (i.e., the ones to whom the accountor is accountable) are informed as to what has been done by the accountor in relation to the company. A part of this process encompasses transparency, which involves disclosure and furnishing reports concerning the work of the accountor.<sup>39</sup> The second stage involves an accountor explaining and justifying the things for which it is responsible, including what it has done and what it has failed to do.<sup>40</sup> Often this is seen as the predominant aspect of accountability, involving the accountor being answerable for what it has done, and it is this stage that is often focused on by elements of the accountability literature dealing with other areas of society and law. The third stage constitutes the questioning and evaluating of the accountor’s reasons for what has been done.<sup>41</sup> The fourth and final stage is that there is the possibility, but not the requirement,

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35. PRINCIPLES OF CORPORATE GOVERNANCE, *supra* note 5, at 51.

36. KEAY, *supra* note 10, at 36.

37. ROBERT D. BEHN, RETHINKING DEMOCRATIC ACCOUNTABILITY 221 (2001); Amanda Sinclair, *The Chameleon of Accountability: Forms and Discourses*, 20 ACCT. ORG. SOC’Y 219, 221 (1995); Istemi Demirag, Melvin J. Dubnick & M. Iqbal Khadaroo, *Exploring the Relationship Between Accountability and Performance in the UK’s Private Financial Initiative (PFI)*, 7, 20–21 (Sept. 2004) (paper presented at the Conference on Governing the Corporation: Mapping the Loci of Power in Corporate Governance Design, Queen’s University, Belfast); Mark Bovens, *Analysing and Assessing Accountability: A Conceptual Framework*, 13 EUR. L.J. 447, 448–49 (2007).

38. See Andrew Keay & Joan Loughrey, *The Framework for Board Accountability in Corporate Governance*, 35 LEGAL STUD. 252, 266–67 (2015).

39. Amir N. Licht, *Accountability and Corporate Governance*, 10, 23 (Sept. 2002), <http://ssrn.com/abstract=328401>.

40. ACCOUNTABILITY, AA1000 8 (Nov. 1999).

41. Keay & Loughrey, *supra* note 38, at 267.

of the imposition of consequences.<sup>42</sup> This might simply entail the provision of feedback to the accountant. It might, but it need not, constitute negative consequences that could involve some sort of sanction, perhaps involving the removal of one or more directors or managers, or the decision not to re-elect a director when his or her term comes to an end.

## II. THE *WENZE* SYSTEM AND CORPORATE GOVERNANCE IN CHINA

As mentioned earlier, the English word “accountability” is not easily translated into different languages, and over time there have been several Chinese words used to translate accountability.<sup>43</sup> One word that is frequently used is “*wenze*.” It has been argued that *wenze* is the most used and appropriate Chinese word to encompass the meaning of accountability.<sup>44</sup> It is translated as accountability in many English language documents, especially in relation to corporate governance. We have noted in prior work that, when combined with “*zhi*,” it provides a term that can be translated as “accountability system.”<sup>45</sup> Chen has argued that “*wenze zhi*” is a system implementing balanced rights and responsibility mechanisms via an institutionalized questioning process.<sup>46</sup> He described the *wenze* system as one that clarifies and balances rights and responsibilities through a systematic enquiry process in order to minimize risks from the actions of internal management.<sup>47</sup> It is commonly agreed that *wenze* is critical to promoting the development of the corporate governance system in China after the financial crisis of 2008.<sup>48</sup> *Wenze* does not exactly reflect all aspects of accountability that were identified earlier, but it is the Chinese term that comes closest to the understanding of accountability as it applies in Anglo-American systems and in international documents such as the G20/OECD’s *Principles of Corporate Governance*.

It has been suggested that the content and procedure of a *wenze* system in the context of corporate governance is able to facilitate an effective accountability mechanism as far as China is concerned, providing, for example, investors with the means to make enquiries and assess the actions of the board of directors and senior managers in order to make them accountable for their decisions and actions. However, while this *wenze*

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42. *Id.*

43. See Keay & Zhao, *supra* note 13, at 689–95.

44. *Id.*

45. *Id.*

46. Zhibin Chen, *Effective Enforcement of Accountability and Internal Control*, 7 ACCT. RES. 9 (2004).

47. *Id.*

48. Xinrong Gong, *Perplexity and Countermeasures of Judicial Intervention in Corporate Governance in China – New Thinking Under the Background of Financial Crisis of Wall Street* (我国司法介入公司治理的迷惑及对策——华尔街金融危机背景下的新思考), 27 TR. POL. SCI. & L. 8 (2009).

system has not been introduced in either legislation or the corporate governance code thus far,<sup>49</sup> it has been argued that it could be introduced into either or both to good effect.<sup>50</sup>

Accountability is clearly not something that is limited to corporate governance. In China, political reforms involving the introduction of an accountability system were introduced to make government officials more responsive to societal demands and more accountable for their performance as civil servants.<sup>51</sup> Government institutions have been established for this purpose, including legislative oversight committees, supervision committees, Communist Party discipline committees, and internal administration reconsideration procedures. An accountability system for government officials (“*ganbu wenze zhi*”, 干部问责制) is regarded as the most important of these.<sup>52</sup> The importance placed on the enquiry process within the *wenze* system is regarded as the result of government officials not being accountable for their decisions. The development of the market economy makes the government accountability reforms particularly important as China becomes increasingly open and diverse.

In relation to corporate governance, it is recognized that in Chinese listed companies, directors’ rights and responsibilities need to be clarified in order to make their enforceability more credible. The professionalism and competitiveness of Chinese directors have been questioned, and reforms through corporate governance mechanisms and corporate law changes have been recommended.<sup>53</sup> These problems are widely recognized in China, especially for directors in SOEs. It is equally important for the enhancement of greater transparency and accountability in companies generally.

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49. CHINA SECURITIES REGULATORY COMMISSION, CODE OF CORPORATE GOVERNANCE FOR LISTED COMPANIES IN CHINA (2001).

50. See Keay & Zhao, *supra* note 13.

51. See Dong Chen, *On Construction of Effective Law System of Administrative Accountability*, HEBEI L. REV. (HEBEI FAXUE 河北法学) (2007); Bill K. P. Chou, *Does “Good Governance” Matter? Civil Service Reform in China*, 31 INT’L J. PUB. ADMIN. 54 (2007).

52. Suisheng Zhao, *The China Model of Development: Can it Replace Western Model of Modernization?*, in IN SEARCH OF CHINA’S DEVELOPMENT MODEL: BEYOND THE BEIJING CONSENSUS 52 (S. Philip. Hsu, Yushan Wu & Suisheng Zhao eds., 2011).

53. See LIAO CHUN, THE GOVERNANCE STRUCTURE OF CHINESE FIRMS (2009); Jingjing Yang, Jing Chi & Martin Young, *A Review of Corporate Governance in China*, 25 ASIAN-PAC. ECON. LITERATURE 15, 25 (2011); Nandini Rajagopalan & Yan Zhang, *Corporate Governance Reform in China and India: Challenges and Opportunities*, 51 BUS. HORIZONS 55, 55–56 (2008); Yan-Leung Cheung, Ping Jiang, Piman Limpaphayom & Tong Lu, *Does Corporate Governance Matter in China*, 19 CHINA ECON. REV. 460, 460–61 (2008); Heibatollah Sami, Justin Wang & Haiyan Zhou, *Corporate Governance and Operating Performance of Chinese Listed Firms*, 20 J. INT’L ACCT. AUDITING & TAX’N 106 (2011); Lilian Miles & Zhong Zhang, *Improving Corporate Governance in State-Owned Corporations in China: Which Way Forward?*, 6 J. CORP. L. STUD. 213, 232 (2006); Shaomin Li, *China’s (Painful) Transition from Relation-based to Rule-based Governance: When and How, Not If and Why*, 21 CORP. GOVERNANCE: INT’L REV. 567, 574 (2013); Guangdong Xu, Tianshu Zhou, Bin Zeng & Jin Shi, *Directors’ Duties in China*, 14 EUR. BUS. ORG. L. REV. 57, 87 (2013).

The concept of a *wenze* accountability system provides opportunities to develop *wenze* in companies in a manner that is in line with the Anglo-American understanding of accountability, and which will benefit the development of the Chinese corporate governance system as an economic model. Unlike the essence of *wenze* itself, the *wenze* system could include dimensions with a rather wide scope relating to a process of balancing rights and responsibilities through enquiry and disclosure. The system requires directors and managers to be accountable and it includes, in a logical order, the following four dimensions<sup>54</sup> as far as the directors and managers are concerned: being responsible and exercising due diligence (“*jinze*,” 尽责 or “*lüze*,” 履责); clarifying and providing information concerning directorial and managerial responsibility, setting standards, and explaining, analyzing and justifying the responsibility the directors and managers have been given (“*mingze*,” 明责); and *wenze* in a narrow sense, focusing on an enquiry into the actions of the accountant (“*wenze*,” 问责).<sup>55</sup> It is highlighted that, in order to enforce and implement the accountability system, *mingze* (明责) is the foundation, *lüze* (履责) is the key to ensure the achievement of assigned tasks, and *wenze* (问责) can be regarded as the safeguard.<sup>56</sup> The logical flow of the four dimensions of a *wenze* system described above is important to bridge the gap, for example, between the expectations of the roles played by the board of directors and the reality of actual board performance.

As suggested above, the broad scope of the *wenze* system seems to come close to covering the four stages of accountability discussed in the previous section, and arguably extant in many Anglo-American systems, including providing accurate information concerning decisions and actions (“*xize*,” 析责), explaining and justifying that for which there is responsibility (“*mingze*,” 明责), questioning and evaluating the reasons provided by the accountant (“*zhize*,” 质责), and the imposition of consequences (“*chengze*,” 惩责 or “*baoze*,” 褒责). The *wenze* system mirrors many elements of accountability, including *xize*, *mingze*, *zhize*, and *chengze/baoze*, as it applies in Anglo-American systems, and these elements could provide a scheme of accountability in China that will enable substantial accountability to take place and this should foster good corporate governance.

This *wenze* system can be regarded as a trend that should be adopted in relation to Chinese corporate governance to enable China to develop its

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54. The *wenze* system is able to accommodate a number of dimensions. ‘Ze’ is the noun and ‘wen’, ‘ming’, ‘bao’, ‘cheng’ and ‘xi’ are verbs; this is an accurate way to compose a word in Chinese grammar. These four phrases can be regarded as four dimensions of the *wenze* system.

55. Keay & Zhao, *supra* note 13, at 697–98.

56. Yin Jiayu emphasises in the Discipline Inspection Group Company 2014 Training Session: “Discipline should focus on fulfilling its oversight responsibilities (尹家绪在集团公司 2014 年纪委书记培训班上强调: 纪委要聚焦主业 履行好监督责任)”, <http://www.norincogroup.com.cn/newsdetail.aspx?id=34423&type=1> (last visited Mar. 24, 2016).

own unique accountability system, based on a constantly changing and unique corporate governance model, and reflecting the fact that the development of its corporate governance is affected by path dependence. Due to the existence of a number of factors it is necessary for China's corporate governance to be unique. These factors include the deeply rooted Confucian philosophy, government interference and participation in companies (especially SOEs), and the distinctive shareholder structure that resulted from privatization, as well as the unique *guanxi* tradition that is the subject of this Article and which we now come to consider in detail.

### III. GUANXI AND RELATED CULTURAL ISSUES WITHIN THE HYBRID CHINESE CORPORATE GOVERNANCE MODEL

Political institutions determine the characteristics of corporate governance and the culture practiced in a jurisdiction. This is particularly true in China. China's feudal history has had a strong impact on the Chinese legal system due to path dependence. Chinese society has been traditionally and heavily influenced by values related to Confucianism, which are keen to promote a strict system of norms and propriety directing and guiding human behavior. It is recognized that cultural heritage may have a direct impact on the development and efficiency of corporate governance.<sup>57</sup> Networks form an important aspect of doing business in China, and one often hears of *guanxi*, *mianzi*, and *renqing*.<sup>58</sup> They are forms of social capital that we need to investigate in a critical manner as they create and enhance value, but they also might well hinder free market competition and the functioning market forces.

Over the past few decades a great deal of literature has been produced regarding the importance of *guanxi*, which is "variously translated as social relations, personal connection or particularistic ties."<sup>59</sup> As noted already, it plays an important role in Chinese culture, and it has long been established

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57. See Charles Kwan Nam Lam & Say Hak Goo, *Confucianism: A Fundamental Cure to the Corporate Governance Problems in China*, 35 COMPANY LAW 52, 55–57 (2014); Jingchen Zhao & Shuangge Wen, *Gift Giving, Guanxi and Confucianism in a Harmonious Society: What Chinese Law Could Learn from English Law on Aspects of Directors' Duties*, 34 COMPANY LAW 381, 382–84 (2013); Wen Qu & Philomena Leung, *Culture Impact on Chinese Corporate Disclosure – A Corporate Governance Perspective*, 21 MANAGERIAL AUDITING J. 241, 243–44 (2006); Lei Wang & Heikki Juslin, *The Impact of Chinese Culture on Corporate Social Responsibility: The Harmony Approach*, 88 J. BUS. ETHICS 433, 439–40 (2009); David Smith, *Guanxi, Mianzi and Business: The Impact of Culture on Corporate Governance in China*, 26 PRIV. SECTOR OPINION 1, 6–8 (2012).

58. YUNXIANG YAN, *THE FLOW OF GIFTS: RECIPROCITY AND SOCIAL NETWORKS IN A CHINESE VILLAGE* 74–122 (1996).

59. Andrew B. Kipins, *The Language of Gift: Managing Guanxi in a North China Village*, 22 MOD. CHINA 285, 285 (1996). For more discussion on the importance of *guanxi* in contemporary Chinese society see Dennis B.K. Hwang & A Blair Staley, *An Analysis of Recent Accounting and Auditing Failures in the United States on US Accounting and Auditing in China*, 20 MANAGERIAL AUDITING J. 227, 230–31 (2005).

that national culture is a deeply rooted causal factor shaping corporations' forms, customs, and performance.<sup>60</sup> *Guanxi*, a system of tight, close-knit networks among people,<sup>61</sup> has played a significant role in the Confucian-dominated Chinese society for almost two thousand years. With the impact of Chinese history and culture, the concept of *guanxi* and other closely related cultural issues make the Chinese definition of social capital unique. These cultural issues have a direct relationship with what occurs in the business world and they impact corporate profits,<sup>62</sup> efficiency in reaching agreement about sales contracts,<sup>63</sup> companies' accounting and market performance,<sup>64</sup> and, of course, the area that we are considering: corporate governance.

### A. GUANXI

*Guanxi* is, in essence, a coalition-based network of stakeholders sharing resources for survival, and it plays an important role in achieving business success in China. It has been defined in various ways and the literature contains no consensus as to its definition or translation.<sup>65</sup> It has been described as tight, close-knit networks,<sup>66</sup> interpersonal connections,<sup>67</sup> or a "gate/pass."<sup>68</sup> Etymologically, *guan* is a derivative word for "door" or "pass" and *xi* is a rather old word with the connotation of hierarchy. *Guanxi* literally means door into a hierarchy or group.<sup>69</sup> Westerners have always regarded it as a "mysterious, yet vital, ingredient in successful Chinese business activities."<sup>70</sup> A mechanism can be established through *guanxi* that enables companies to seek and develop working partnerships in an

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60. See, e.g., Amir N. Licht, *The Mother of All Path Dependencies: Towards a Cross-Cultural Theory of Corporate Governance Systems*, 26 DEL. J. CORP. L. 147 (2001); Amir N. Licht, *The Maximands of Corporate Governance: A Theory of Values of Cognitive Style*, 29 DEL. J. CORP. L. 649, 677–79 (2004).

61. Yeung & Tung, *supra* note 27, at 54.

62. Jin Ai, *Guanxi Networks in China: Its Importance and Future Trends*, 14 CHINA & WORLD ECON. 105, 115–16 (2006).

63. Yadong Luo, *Guanxi and Performance of Foreign-Invested Enterprises in China: An Empirical Inquiry*, 37 MGMT. INT'L REV. 51, 63–67 (1997).

64. Yadong Lou & Min Chen, *Does Guanxi Influence Firm Performance?*, 14 ASIA PAC. J. MANAG. 1, 14 (1997).

65. Anne S. Tsui & Jing-Lih Larry Farh, *Where Guanxi Matters: Relational Demography and Guanxi in the Chinese Context*, 24 WORK & OCCUPATIONS 56, 59–61 (1997).

66. Yeung & Tung, *supra* note 27, at 54.

67. Katherine R. Xin & Jone L. Pearce, *Guanxi: Connections as Substitutes for Formal Institutional Support*, 39 ACAD. MGMT. J. 1641, 1642 (1996).

68. Yeung & Tung, *supra* note 27, at 55.

69. HAROLD CHEE & CHRISTOPHER WEST, MYTHS ABOUT DOING BUSINESS IN CHINA 63 (2004).

70. YING LUN SO & ANTHONY WALKER, EXPLAINING GUANXI: THE CHINESE BUSINESS NETWORK, 1 (2006).

environment characterized by uncertainty and a relatively weak legal framework.<sup>71</sup>

Guanxi is a double-edged sword.<sup>72</sup> There are arguable benefits of building an extensive *guanxi* network,<sup>73</sup> such as reducing transaction costs, operational uncertainty, information costs, contextual hazards, and competitive threats. Other benefits include enhancing institutional support, better economic returns, business effectiveness, organizational legitimacy, and strategic capability, in order to provide more efficient mechanisms for transactions by acting as the catalyst for the development of new market channels and investment opportunities.<sup>74</sup> Nevertheless, it can also be argued that *guanxi* is closely related to corruption, bribery, reciprocal favors, and gift giving targeted at illicit transactions.<sup>75</sup> Notwithstanding this, it has been asserted that *guanxi* differs from bribery and corruption, as the former focuses on long-term relationships, rather than just the material interests that might be exchanged, while the latter is focused on what is actually exchanged, with the relationship simply being a means to an end.<sup>76</sup> Moreover, in *guanxi* there is an emotional element, but this is not the case in bribery or corruption.<sup>77</sup> Maintaining *guanxi* is normally related to an indirect, ultimate purpose of establishing long-term relationships with individuals or organizations, and doing this might be regarded in some contexts as leading to improper actions. Also, *guanxi* has the potential on the one hand to engender trust, but on the other hand it can also threaten trust, particularly in organizations such as companies.<sup>78</sup>

Chinese businesspersons have spent a significant amount of time, money, and energy to cultivate close *guanxi* with people who have political and economic bargaining power. “*La*” (“establishing”) *guanxi* is regarded as the most common strategy applied by the Chinese in order to establish

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71. See generally Yadong Luo, *Industrial Dynamics and Managerial Networking in an Emerging Market: the Case of China*, 24 STRATEGIC MGMT. J. 1315 (2003).

72. Braendle, Gasser & Noll, *supra* note 33, at 390.

73. Dong-Jin Lee, Jae H. Pae & Y.H. Wong, *A Model of Close Business Relationship in China (guanxi)*, 35 EURO. J. MARKETING 51, 53 (2001); see also Steve Lovett, Lee C. Simmons & Raja Kali, *Guanxi Versus the Market: Ethics and Efficiency*, 30 J. INT'L BUS. STUD. 231, 231–32 (1999).

74. YADONG LUO, *GUANXI AND BUSINESS* 48–49 (2000).

75. Philip Wright, W.F. Szeto & Louis T.W. Cheng, *Guanxi and Professional Conduct in China: A Management Development Perspective*, 13 INT'L J. HUM. RESOURCE MGMT. 156, 168–70 (2002); Dan Nile & Anna-Maija Lamsa, *The Leader-Member Exchange Theory in the Chinese Context and the Ethical Challenge of Guanxi*, 128 J. BUS. ETHICS 851, 857 (2015).

76. Mayfair Mei-Hui Yang, *The Resilience of Guanxi and its New Deployment: A Critique of Some New Guanxi Scholarship*, 170 CHINA Q. 459, 465 (2002).

77. Lovett, Simmons & Kali, *supra* note 73, at 234.

78. Chao C. Chen & Xiao-ping Chen, *Negative Externalities of Close Guanxi Within Organizations*, 26 ASIA PAC. J. MGMT. 37, 39 (2009).

networks.<sup>79</sup> The effects are to build up relationships with others where there was no pre-existing relationship between them, or where an existing relationship is not close enough to be useful. The impact of *guanxi xue* (“relationology”) percolates through the political, economic, social, cultural, and other spheres of life.<sup>80</sup> *Guanxi* has been identified as one of the most uniquely crucial factors in business relationships and networks in China; these relationships are successful and sustainable where entrepreneurs have extensive networks of connections with senior government officials. At its essence, it involves building, maintaining, and expanding deep, private, and complicated interpersonal relationships and bonds between individuals based on mutual trust, respect, and sometimes mutual interests.

One study of *guanxi* in the late 1990s found that managers in China were divided as to whether they felt that *guanxi* was decreasing in importance.<sup>81</sup> As for the relationship between corporate performance and *guanxi*, Law, Tse, and Zhou argue that the role of *guanxi* declined in relationship to Chinese companies’ increased performance.<sup>82</sup> With globalization of the Chinese economy and the country’s accession to the World Trade Organization, it is questionable whether *guanxi* still matters in relation to doing business in China. But, looking at the historical development and recent social and economic transformation in China, it appears that *guanxi* is still deeply rooted there, just as is Confucian philosophy, and it will likely remain so indefinitely.<sup>83</sup>

## B. OTHER RELATED CULTURAL DERIVATIVES

Other cultural derivatives from *guanxi* include factors such as *renqing*, which means gaining advantages from a relationship. If we look at “*ren*” and “*qing*” as two separate words, we find that *ren* means “people/humans” and *qing* means “feelings.” Therefore, the direct translation of *renqing* is human feelings. Related to these human feelings, the concept of *renqing* is about reciprocity in established relationships, and it is obviously closely related to the gift giving and *guanxi* culture in China. This means that *renqing* constitutes the favors that are offered through well-regarded

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79. See generally Ricky Szeto, Philip C. Wright & Edward Cheng, *Business Networking in the Chinese Context: Its Role in the Formation of Guanxi, Social Capital and Ethical Foundations*, 29 MGMT. RES. NEWS 425 (2006).

80. MIN CHEN, *ASIAN MANAGEMENT SYSTEMS* 45 (2d ed. 2004).

81. Douglas Guthrie, *The Declining Significance of Guanxi in China’s Economic Transition*, 154 CHINA Q. 254, 264–65 (1998).

82. See generally Kenneth S. Law, David K. Tse & Nan Zhou, *Does Human Resource Management Matter in an Emerging Economy? The Example of the PRC*, 34 J. INT’L BUS. STUD. 255 (2003).

83. See John H. Dunning & Changsu Kim, *The Cultural Roots of Guanxi: An Exploratory Study*, 30 WORLD ECON. 329 (2007); Chao C. Chen, Xiao-Ping Chen & Shengsheng Huang, *Chinese Guanxi: An Integrative Review and New Directions for Future Research*, 9 MGMT. & ORG. REV. 167, 199 (2013).



*guanxi*. *Renqing* is regarded as investment for social capital, with the expectation that the beneficiary will remember it and pay it back when the benefactor is in need. There are unspoken assumptions that both parties have based a relationship on mutual trust and common understanding,<sup>84</sup> and this recognition provides credentials that entitle people to various kinds of credit. In terms of *renqing* as unpaid obligations resulting from invoking a *guanxi* relationship, reciprocity obligations are also formed by the hierarchically structured *guanxi*.<sup>85</sup> Therefore, “the personal investment required to develop and maintain good social relations is accepted as an unavoidable fact of life,”<sup>86</sup> achieved through interpersonal accommodation and negotiation. *Renqing* is regarded as a key form of social capital that obliges people and companies to reciprocate through *guanxi* networks.

The concept of *guanxi* is also closely related to the gift giving culture in China, since giving and receiving gifts appropriately is vital in building and sustaining *guanxi*. Knowing how to give and how to receive gifts is critical in building and sustaining relationships, while each gift carries a piece of *renqing* and all “accounts” are kept carefully and strictly. Favors and obligations are weighed prudently and accordingly.<sup>87</sup> Through interacting and exchanging favors, individuals and business organizations build credibility and establish trust, gradually creating more useful *guanxi* that will normally be mutually beneficial for both parties.

The balance owed via the reciprocity principle by way of *renqing* is normally silently recorded on both sides, and may be discharged in various ways. Parties who do not fulfil their obligations are considered disloyal and dishonest, and will suffer loss of moral and social face (*mianzi*).<sup>88</sup> *Renqing* can be interpreted as feelings that are found within friendship, family, and kin relationships with regard to favors, etiquette, and customs.<sup>89</sup> Furthermore, *mianzi* provides the leverage one needs to successfully expand and manipulate a *guanxi* network.<sup>90</sup> Not losing face and the saving of others are key components for cultivating a sustainable *guanxi* network. *Xinren*

84. Wenshan Jia, *The Wei (Positioning) – Ming (Naming) – Lianmian (Face) – Guanxi (Relationship) – Renqing (Humanized Feelings) Complex in Contemporary Chinese Culture*, in CONFUCIAN CULTURES OF AUTHORITY 49 (Peter D. Hershock & Roger T. Ames eds., 2006).

85. KWANG-KUO HWANG & XIANJIN HU, *MIANZI POWER GAME OF CHINESE PEOPLE* 2–3 (2004).

86. Jilong Zhang & Nattavud Pimpa, *Embracing Guanxi: The Literature Review*, 1 INT’L J. ASIAN BUS. & INFO. MGMT. 23, 25 (2010).

87. Heidi von Weltzien Hoivik, *East Meets West: Tacit Message About Business Ethics in Stories Told by Chinese Managers*, 74 J. BUS. ETHICS 457, 460–64 (2007).

88. For discussion of *mianzi* and its relationship with *guanxi* and *renqing* see generally Kwang-Kuo Hwang, *Face and Favor: The Chinese Power Game*, 92 AM. J. SOC. 944 (1987); WENSHAN JIA, *THE REMAKING OF THE CHINESE CHARACTER AND IDENTITY IN THE 21ST CENTURY: THE CHINESE FACE PRACTICES* (2001).

89. Susanne Ruehle, *Guanxi as Competitive Advantages During Economic Crises: Evidence from China during the Recent Financial Crisis*, in CHINA’S ROLE IN GLOBAL ECONOMIC RECOVERY 60 (Xiaolan Fu ed., 2012).

90. LUO, *supra* note 74, at 29.

(trust) is regarded as an important element in dynamic *guanxi* because it limits the possibilities of opportunistic behavior in a business environment that lacks established rules of law or sound law enforcement. In China, these elements are generally important in life and they are major aspects of Chinese commercial life.<sup>91</sup>

One of the positive aspects of *guanxi* is conceivably that it will engender greater trust in the corporate governance system, in that relationships have been developed and individuals and groups might feel that they can trust others more.

### C. CORPORATE GOVERNANCE IN CHINA: AN IMMATURE MODEL ENRICHED AND SUPPORTED BY *GUANXI* AND ITS DERIVATIVES

It is important to discuss the board structure and characteristics of corporate governance in China before we can critically address the relationship between corporate governance, accountability, and cultural factors such as *guanxi*. Besides having a management board of directors, a limited liability company in China is required by the Company Law 2005 to have a supervisory board composed of no less than three members,<sup>92</sup> who are to supervise “the acts of the directors and senior executives performing their functions.”<sup>93</sup> The composition of the supervisory board should include shareholders’ representatives, who are elected by the shareholders at the general meeting, and by an appropriate percentage of employee representatives, so that the employees of the company democratically elect at least one third of the supervisory board.<sup>94</sup>

Thus, China has adopted a two-tier board system that is similar to the German insider model.<sup>95</sup> The membership of the supervisory board must include representatives of the staff and workers of the company.<sup>96</sup> For SOEs, the Communist Party (the Party) normally appoints the top executives.<sup>97</sup> Apart from their directorship position, the top executives normally have an official title within and endorsed by government, at a level that matches their company’s position. Many of them return to government positions after a stint as executives. In SOEs, members of the supervisory board are civil servants, and despite the fact that there has been

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91. John H. Dunning & Changsu Kim, *The Cultural Roots of Guanxi: An Exploratory Study*, 30 *WORLD ECON.* 329, 329 (2007).

92. COMPANY LAW OF THE PEOPLE’S REPUBLIC OF CHINA art. 52 (2005) [hereinafter COMPANY LAW].

93. *Id.* art. 54(2) (The supervisory board, as an independent board, offers independent opinions on corporate decisions and monitors the directors’ executive management, while the board of directors makes the main decisions on the day-to-day operations of the company).

94. *Id.* art. 52.

95. CTR. FOR FIN. MKT. INTEGRITY, CHINA CORPORATE GOVERNANCE SURVEY 8 (2007).

96. COMPANY LAW, *supra* note 92, arts. 45, 109.

97. See Andrew G. Walder, *From Control to Ownership: China’s Managerial Revolution*, 7 *MGMT. & ORG. REV.* 19, 31 (2009).

improvement since 2010<sup>98</sup> in their education levels and qualifications, they are normally lower than those of the directors on the management board.<sup>99</sup> They also tend to have limited knowledge about the company itself.<sup>100</sup>

While the two-tier system is representative of the corporate governance of many civil law systems,<sup>101</sup> China has also adopted an element that is found in most common law systems, which embrace a one-tier board model—namely the appointment of independent directors.<sup>102</sup> Independent directors are to be independent from the listed company that employs them and the company's major shareholders. These are non-executive directors who are there to hold the executive directors more accountable and to undertake the supervisory aspect of the function of non-executive directors. They are not able to hold any other position in the company apart from independent director.<sup>103</sup> The Corporate Governance Code provides that all listed companies should have at least three independent directors.<sup>104</sup> An

98. WEIAN LI, CHINA'S CORPORATE GOVERNANCE AND DEVELOPMENT REPORT 2014 178–79 (2014).

99. CORPORATE GOVERNANCE RESEARCH GROUP OF NAN-KAI UNIVERSITY, THE RESEARCH REPORT OF CORPORATE GOVERNANCE EVALUATION OF CHINESE LISTED COMPANIES (中国上市公司治理评价报告) (2005); see also Jay Dahya, Yusuf Karbhari, Jason Zezhong Xiao & Mei Yang, *The Usefulness of the Supervisory Board Report in China*, 11 CORP. GOVERNANCE: INT'L REV. 308, 308 (2003).

100. Li Guo, *Revisiting the Chinese Styled Board of Supervisors: How It Gets Failed?—An International Comparative Perspective*, 29 RES. COMP. L. (比较法研究) 74 (2016).

101. It is typically regarded as a characteristic of the German system. See generally John Kay, *Corporate Governance (with Aubrey Silberston)*, JOHN KAY (Aug. 31, 1996), <https://www.johnkay.com/1996/08/31/corporate-governance-with-aubrey-silberston/>. The *Aktiengesetz* mandates a two-tier board with supervisory board (Aufsichtsrat) and management board (Vorstand). See AUFSICHTSRAT §§ 76, 100 (2010); see also MITBESTIMMUNGSGESETZ §§ 1, 7, 27, 31. Three co-determination regimes are currently enforced under current German Law including co-determination pursuant to the Montan Co-Determination Act, co-determination pursuant to the DrittelbG 2004 and co-determination under the Co-Determination Act 1976, historically, voluntary formation of labour councils at the factory level by an amendment to Business Practice Act in 1890 (*Gewerbeordnung* or GewO); Article 165 of the Weimar Constitution of 1919 which guaranteed employees the right to cooperate with employers on an equal basis in the regulation of wages and working conditions; and the Labour Management Relationship Act 1952 (*Betriebsverfassungsgesetz* 1952 or BetrVG 1952) which introduced the principle of one third representation of the management board for all other industries. See Gerhard Cromme, *Corporate Governance in German and the German Corporate Governance Code*, 13 CORP. GOVERNANCE: INT'L REV. 362, 365 (2005); Marc Goergen, Miguel C. Manjoin Antolin & Luc Renneboog, *Corporate Governance in Germany*, in CORP. GOVERNANCE: ACCOUNTABILITY, ENTERPRISE AND INTERNATIONAL COMPARISONS 285 (Kevin Keasey, Steve Thompson & Michael Wright eds., 2005).

102. Jeffery N. Gordon, *The Rise of Independent Directors in the United States, 1950-2005: Of Shareholder Value and Stock Market Price*, 59 STAN. L. REV. 1465, 1468 (2007); for the discussion on Chinese independent directors regime see generally Donald C. Clarke, *The Independent Directors in Chinese Corporate Governance*, 31 DEL. J. CORP. L. 125 (2006).

103. CHINA SEC. REG. COMM'N, CODE OF CORPORATE GOVERNANCE FOR LISTED COMPANIES IN CHINA art. 49 (2001) [hereinafter CODE OF CORPORATE GOVERNANCE].

104. *Id.* art. 52.

independent director should chair the audit committee, the nomination committee, and the remuneration and appraisal committee.<sup>105</sup>

Just like other corporate governance models with a two-tier board, the management board is accountable to the supervisory board in China.<sup>106</sup> The supervisory board of a listed company is accountable to all shareholders.<sup>107</sup> Meanwhile, the board of directors is also accountable to the shareholders.<sup>108</sup> Therefore, management boards are accountable to both shareholders and the supervisory board, while the shareholders seem to be the parties that both boards are accountable to as far as the corporate governance code and company law is concerned.<sup>109</sup> Individual directors and managers of the corporation are accountable to the management board. These relationships will be taken into account in the next part of the Article.

*Guanxi* and other cultural derivatives are obviously closely related to the notions of reciprocity, obligation, indebtedness, and trust, and they are essential for personal relationships in China. The concentric *guanxi* circle is established through *renqing*, gift giving, and *xinren* by inventing and re-inventing relationships in an ongoing process of social engineering.<sup>110</sup> It has been argued that *guanxi* is a mixture of “*ganqing*” (sentiments) and *renqing*, while *renqing* is the precondition for establishing *guanxi* and provides a moral foundation for the reciprocity and equity that are implicit in all *guanxi* relationships.<sup>111</sup> The traditional Chinese social culture surrounding business practices, including the key roles of *guanxi* and *renqing*, still plays a significant role in the remarkable recent growth of the Chinese economy and in increasing cross-border business opportunities. Logically, *guanxi* and other cultural derivatives will also have an impact on the relationship between the two boards, independent directors, and the shareholders to whom they are all accountable.

Many scholars have viewed the interaction between *guanxi* and its derivatives, as in other collectivist cultures, as an idiosyncratic cultural phenomenon within which Confucianism is the major life philosophy.<sup>112</sup> Personal relationships have always played a key role in the process of business transactions in China in initiating, negotiating, and closing a deal. It is a matter of trust and reliance on networking opportunities, and the

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105. *Id.* art. 52.

106. Alice Belcher & Till Naruisch, *The Evolution of Business Knowledge in the Context of Unitary and Two-Tier Board Systems*, J. BUS. L. 443, 451 (2005).

107. CODE OF CORPORATE GOVERNANCE, *supra* note 103, art. 59.

108. *Id.* art. 42.

109. *See* COMPANY LAW, *supra* note 92, art. 47.

110. *See generally* Ambrose Yeo-chi King, *Kuan-his and Network Building*, 120 DAEDALUS 69 (1991); *see also* Jar-Der Luo & Yung-Ch. Yeh, *Neither Collectivism nor Individualism: Trust in the Chinese Guanxi Circle*, 2 J. TR. RES. 53 (2012).

111. LUO, *supra* note 74, at 15.

112. Dong-Jin, Pae & Wong, *supra* note 73, at 53; *see generally* MAYFAIR MEI-HUI YANG, GIFT FAVORS AND BANQUETS: THE ART OF SOCIAL RELATIONSHIPS IN CHINA (1994).

maintenance of well-established relationships.<sup>113</sup> One interesting feature of *guanxi* is that the exchange of favors tends to benefit the weaker side, which usually expects to receive more help than he or she can reciprocate.<sup>114</sup> This unequal exchange “reflects the Confucian principle of family loyalty, in which family ties demand the exchange of aid.”<sup>115</sup> Therefore, it may be worth considering the parties that are comparatively weaker in the scenario of accountability within the corporate governance framework. These parties could be at a disadvantage or in positions of vulnerability, especially when we are discussing *guanxi* in the context of accountability.

It is our task in this section to determine whether China’s social and cultural traditions, including *guanxi*, will continue to influence the development of Chinese corporate governance, in particular, where they fit in relation to the *wenze* system of accountability. The Chinese corporate governance system currently in place owes a lot to the longstanding and deeply held Chinese value of upholding the importance of flexibility, which allows for a certain amount of freedom for directors in the course of their decision-making.<sup>116</sup> Within corporate governance this is described as “low structure, high ambiguity,” in which the ambiguity allows for culture, traditions, and values to decide what is fair and what is right for corporations.<sup>117</sup> The higher degree of autonomy and ambiguity allow culture to play a greater role. Preferences and interpretations of culture are permitted to interfere with corporate governance.

It is also argued that culture is an amorphous concept, which is “difficult to define, [and yet] absolutely fundamental.”<sup>118</sup> In many places in China the government and the Party still play an important role in governing and interfering in corporate decisions, so that the existing culture may need to play a greater role in corporate governance. For example, the *guanxi* between the civil servants who represent the state or a state agency and shareholders and stakeholders are particularly important in a society that exhibits high levels of collectivism and the avoidance of uncertainty.<sup>119</sup>

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113. Angus Young, *Conceptualising a Chinese Corporate Governance Framework: Tension between Tradition, Ideologies and Modernity*, 20 INT’L COMPANY & COM. L. REV. 235, 237 (2009).

114. CHEN, *supra* note 80, at 44.

115. John P. Alston, *Wa, Guanxi, and Inhwa: Managerial Principle in Japan, China, and Korea*, 32 BUS. HORIZON 26, 28 (1989).

116. S.H. Goo & Anne Carve, *Low Structure, High Ambiguity: Selective Adaptation of International Norms of Corporate Governance Mechanisms in China*, in CHANGING CORPORATE GOVERNANCE IN CHINA AND JAPAN: ADAPTATIONS OF ANGLO-AMERICAN PRACTICES 206, 207 (Masao Nakamura ed., 2008).

117. *Id.*

118. Michel Lebas & Jane Weigenstein, *Management Control: The Roles of Rules, Markets and Culture*, 23 J. MGMT. STUD. 259, 264 (1986).

119. David Hay, Shayuti Mohamed Adnan & Chris van Staden, *Do Culture and Governance Structure Influence CSR Reporting Quality: Evidence from China, India, Malaysia and the United Kingdom* (Paper presented at the 2010 Asia Pacific Interdisciplinary Research in Accounting

It is crucial to point out that the essence of *guanxi* must be cultivated over time, and the process of establishing *guanxi* is the process of exchanging *renqing*, gift giving, and establishing *xinren*. While contracts are regarded as the core legal documents in the Western business world, cultural elements play a rudimentary role in China in the process of reaching business agreements. Discussions of these cultural issues are particularly important in corporate governance since these issues serve as a form of insurance in a relatively risky business environment.<sup>120</sup> While the enforcement of law is relatively weak and the involvement of government is comparatively strong in China, having *guanxi* with suppliers, banks, government supervisory agencies, retailers, and customers could help tremendously by offering them a number of benefits.

#### IV. DO *GUANXI* AND OTHER CULTURAL DERIVATIVES HINDER OR ENHANCE ACCOUNTABILITY IN CORPORATE GOVERNANCE IN CHINA?

##### A. NECESSITY AND THE ETHICS OF *GUANXI*

Before discussing the impact of *guanxi* and other cultural issues on accountability in Chinese corporate governance, it is necessary to discuss the ethical aspects of the terms themselves. A consensus has not yet been reached regarding certain ethical aspects of *guanxi*. Some commentators hold the opinion that it is an ethical concept, generating trust between, and dependence on, individuals in commercial transactions, allowing mutual understanding to facilitate the exchange of favors and product adaptation.<sup>121</sup> *Guanxi* provides boards of directors with access to scarce information, resources, and influence.<sup>122</sup> It is argued by McNally et al., that informal networks still act as a key component in companies' success, despite the stronger formalization of private sector institutions.<sup>123</sup> While the market depends on an elaborate legal system to enforce contracts in Western society, the Chinese system depends on reputation and trust, and transactions take place within flexible but permanent networks

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Conference, Sydney, Australia), [http://apira2010.econ.usyd.edu.au/conference\\_proceedings/APIR-A-2010-271-Adnan-Do-culture-and-governance-structure-influence-CSR-reporting-quality.pdf](http://apira2010.econ.usyd.edu.au/conference_proceedings/APIR-A-2010-271-Adnan-Do-culture-and-governance-structure-influence-CSR-reporting-quality.pdf).

120. Roy Yong-Joo Chua & Michael W. Morris, *Dynamics of Trust in Guanxi Networks*, in NATIONAL CULTURE AND GROUPS 95, 98 (Yaru Chen ed., 2006).

121. See generally James A. Brunner, Jiwei Chen, Chao Sun & Nanping Zhou, *The Role of Guanxi in Negotiation in the Pacific Basin*, 32 J. GLOBAL MARKETING 374, 382–86 (1989); E. Alan Buttery & Y.H. Wong, *The Difference between Chinese and Western Negotiations*, 17 MARKETING INTELLIGENCE & PLAN. 147 (1999).

122. Anne S. Tsui, Jiing-Lih Farh & Katherine R. Xin, *Guanxi in the Chinese Context*, in MANAGEMENT AND ORGANIZATIONS IN THE CHINESE CONTEXT 225 (J.T. Li, Anne S. Tsui & Elizabeth Weldon eds., 2000).

123. Christopher A. McNally, Hong Guo & Guangwei Hu, *Entrepreneurship and Political Guanxi Network in China's Private Sector* 15–17 (East-West Centre Working Papers, Paper No. 19, 2007).

characterized by long-term relationships, especially for small and medium-sized enterprises.<sup>124</sup> *Guanxi* assumes some of the functions of a legal system and is regarded as a code of conduct that is a substitute for the rule of law.<sup>125</sup> It is claimed that in an era of financial crisis, more credit should be given to *guanxi* capitalism due to the importance and effectiveness of the persona of the entrepreneur embedded in his or her network. *Guanxi* is not only a powerful instrument to overcome the challenges of a transformative economy, but also allows the entrepreneur to be adaptable and powerful in times of financial crisis, when networks are often more sustainable and reliable than actual enterprises.<sup>126</sup>

While the Western model assumes predictability with explicit remedies, clear exceptions to the rule, and a reliance on common law to complement the inadequacies of statutes, a *guanxi*-based business strategy has a profound and favorable impact on market performance through the positive function of good and functional *guanxi*. The logic of relationships and business performance differs in China when compared with Western countries, since the Chinese build relationships, and transactions and projects will benefit and develop based on good relationships, whereas Westerners believe that relationships will grow from building successful transactions. *Guanxi* and other cultural issues have helped corporations and business people within this close network to overcome institutional barriers and instability in order to confront regulatory changes in countries with emerging markets. However, others suggest that negotiators cultivate *guanxi* as an unnecessary and unethical transaction cost.<sup>127</sup>

There is an apparent contradiction between the openness of Chinese corporate governance and the strong culture of behavior among Chinese directors and strategic management policies in practice. These cultural aspects of Chinese society are arguably more focused on informal relations, such as non-normative agreements. These informal networks facilitate business relationships, but do sometimes limit the system's capacity to grow. They facilitate business transactions particularly within an uncertain business environment and an inadequate legal system. Therefore, cultivating *guanxi* may circumscribe entrepreneurs' objectives of maximizing profits. These foci may cause these informal factors to prevail in the face of systematic changes. Flexibility and swift reactions in a network based on trust and reciprocity may also limit the efficient

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124. Susanne Ruehle, *Guanxi as Competitive Advantages During Economic Crises: Evidence from China during the Recent Financial Crisis*, in CHINA'S ROLE IN GLOBAL ECONOMIC RECOVERY 60, 64 (Xiaolan Fu ed., 2012).

125. HAROLD CHEE & CHRIS WEST, MYTHS ABOUT DOING BUSINESS IN CHINA 63 (2004).

126. Ruehle, *supra* note 89, 60–61.

127. See generally T.K.P. Leung & Y.H. Wong, *The Ethics and Positioning of Guanxi in China*, 19 *MARKETING INTELLIGENCE & PLAN.* 55 (2001).

functioning of the legal system, because there will be fewer flexible rules and principles to be applied.

## B. TYPES OF *GUANXI*

Before looking at the impact that cultural issues have, in detail, it is important to identify the different *guanxi* that could be cultivated. *Guanxi* is embedded in most functions of everyday life, such as political alliances, recreation, and economic activity.<sup>128</sup> It is argued by Fan that there are normally three types of *guanxi*, defined as: PtP *guanxi* (people to people), BtB *guanxi* (business to business), and BtG *guanxi* (business to government).<sup>129</sup> Various types of *guanxi* within the Chinese corporate governance regime could also fit into these three types of *guanxi*. In detail, the most commonly considered types include *guanxi* between shareholders (PtP), especially affecting institutional shareholders and individual shareholders), between corporations and government or government agencies and bureaucrats (BtG), between corporations and suppliers (BtB), between corporations and their competitors (BtB), between boards of directors and shareholders (PtP), and between boards of directors, independent directors, executives, managers, and supervisory boards (PtP).

## C. *GUANXI* AND THE *WENZE* SYSTEM

*Guanxi* and other cultural issues are pertinent to many aspects of corporate governance and they will be closely related to every stage of the *wenze* system, including information discourse, explanation, justification, and the enquiry process. In the following discussion, we reference the stages that we identified in Part II for accountability in corporate governance and try to clarify the impact of *guanxi* on accountability at each of these stages. While we accept that accountability as defined in relation to Anglo-American systems does not map completely onto the Chinese position, we argue that the *wenze* system, as we have envisaged it, is close to the Anglo-American systems, and might well become even closer as Chinese corporate governance moves from having an administrative/economic hybrid model to something that is nearer to a full economic model. Based on discussions of the nature and scope of the *wenze* system, both positive and negative aspects of these cultural issues will be critically discussed in the following section. We use the stages of accountability identified earlier in relation to Anglo-American corporate governance as the basis for the discussion.

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128. MARCEL MAUSS, *THE GIFT: THE FORM AND REASON FOR EXCHANGE IN ARCHAIC SOCIETIES* 1–3 (1966).

129. Ying Fan, *Questioning Guanxi: Definition, Classification and Implications*, 11 INT'L BUS. REV. 543, 550–51 (2002).



### 1. First Stage: The Provision of Accurate Information Concerning Decisions Made and Actions Taken (Stage of *Mingze*)

The first stage of accountability requires the provision of accurate information concerning decisions and actions, and the nature of *guanxi* may hinder the accuracy of the information provided. Where this information comes from the management board, supervisory boards might not be able to detect this information or may not wish to do so. However, there is also the possibility of a positive impact of *guanxi* in terms of disclosing accurate or useful information if there is *guanxi* between the management and supervisory boards, because the members of the former will not want to withhold anything that might potentially place the latter in a position of embarrassment.

There is the possibility that because of *guanxi* the management board might be willing to accept reports and details from individual directors and managers that are not as comprehensive or as rigorous as would be normally expected. The same might be said about the supervisory board's acceptance of reports from the management board. In such a case, the accounting may be compromised to some degree.

*Guanxi* could enhance accountability at this stage by enabling companies to gain access to more diverse and highly valued information, and it is likely to be at a relatively lower cost.<sup>130</sup> Furthermore, if *guanxi* can be regarded as a substitute for formal institutional support, as it often is,<sup>131</sup> it might be used to provide access to resources that are normally not directly available to the shareholders and to the public;<sup>132</sup> it can be regarded as a semi-formal way of getting the information needed instead of requiring the fulfilment of legal obligations.<sup>133</sup> *Guanxi* might be regarded as a rational response to the lack of strong, formal institutions in China.<sup>134</sup> This might in fact provide management boards and supervisory boards with more

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130. Ronald S. Burt, *The Contingent Value of Social Capital*, 42 ADMIN. SCI. Q. 339, 340 (1997).

131. See e.g., Nancy Yi-feng Chen & Dean Tjosvold, *Guanxi and Leader-member Relationships between American Managers and Chinese Employees: Open-minded Dialogue as Mediator*, 24 ASIA PAC. J. MGMT. 171, 181–82 (2007); John H. Dunning & Changsu Kim, *The Cultural Roots of Guanxi: An Exploratory Study*, 30 WORLD ECON. 329, 333–34 (2007); Xin & Pearce, *supra* note 67, at 1641–42.

132. See Mike W. Peng, *Firm Growth in Transitional Economies: Three Longitudinal Cases from China, 1989–96*, 18 ORG. STUD. 385, 398–400 (1997); Xin & Pearce, *supra* note 67, at 1641–42.

133. It is said that this can occur at the expense of the interests and rights of others not covered by the *guanxi*. See Ying Fan, *Guanxi's Consequences: Personal Gains at Social Cost*, 38 J. BUS. ETHICS 371, 377–78 (2002).

134. Nolan Sharkey, *The Economic Benefits of the Use of Guanxi and Business Networks in a Jurisdiction with Strong Formal Institutions: Minimisation of Taxation*, 6 J. TAX RES. 45, 49 (2008); Douglas Guthrie, *The Declining Significance of Guanxi in China's Economic Transition*, 154 CHINA Q. 254, 257 (1998).

information than would normally be available through formal processes, which reduces the vulnerability of company stakeholders. Interpersonal and inter-organizational dynamics will enable shareholders, institutional shareholders, and other constituencies to access the information more quickly and efficiently, and in a customized form. Access to information is not only essential for companies, but also for stakeholders, particularly those in a disadvantaged position, such as minority shareholders or foreign investors, provided that the scattered information can be decoded in a more organized manner as far as it relates to the company's profile and performance. Therefore, the board of directors will have the ability to anticipate and prepare for responding to queries that are based on the information disclosed.

For SOEs, the concentrated ownership that exists could impede the development of high quality information disclosure because of BtG *guanxi* and the way that government and its agencies are able to directly obtain information from entities, partly because of *guanxi*. The information benefit to individuals that is provided by *guanxi* could be critical for shareholders and other stakeholders as a strategic element in gaining an edge over their competitors. However, the advantages brought by *guanxi* might place minority shareholders, who already suffer from high levels of information asymmetry,<sup>135</sup> in a disadvantageous position. This is due to the complicated social relationships between controlling shareholders and local government, and the *guanxi* between controlling shareholders and boards. It might not be fair for minority shareholders, who may not have effective access to the information; they are likely, for the most part, to be limited to the information already available to the public.<sup>136</sup>

The fundamental logic behind the voting system is the principle that the parties that have a claim to the residual benefit of the company and who also assume the greatest risk should be offered rights to enable them to exact some control.<sup>137</sup> This is normally achieved through voting rights for shareholders. Due to the fact that minority shareholders' rights to information and inspection are limited, partly due to the negative impact of *guanxi* and other related cultural factors, this may logically have a negative impact on the voting system in China. Decision-making in the shareholders' general meeting is dominated by capital rather than by heads/hands and the default rule is that the amount of voting rights exercisable by shareholders

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135. See Sun Liu, *Corporate Governance and Forward-Looking Disclosure: Evidence from China*, 25 J. INT'L ACCT. AUDITING & TAX'N 16, 17–18 (2015).

136. We are not envisaging information that could be used by parties to engage in insider dealing.

137. See generally Stephen M. Bainbridge, *The Case for Limited Shareholder Voting Right*, 53 UCLA L. REV. 601 (2006); Daniel Attenborough, *The Vacuous Concept of Shareholder Voting Rights*, 14 EUR. BUS. ORG. L. REV. 147 (2013)

at a meeting is based on the percentage of capital contribution.<sup>138</sup> Those shareholders without *guanxi* are disadvantaged due to lack of information and knowledge concerning the company's performance and strategy.

The existence of *guanxi* might lead to less questioning of the validity and reliability of information provided. The reason is that it is necessary for a person to show respect for the feelings of seniors or give face (*mianzi*) to people with seniority, those who have established friendships or *guanxi* with him or her, or people to whom one owes *renqing*, and it may mean the board fails to quiz a director or a manager sufficiently about what he or she has been doing. These cultural issues have a huge impact on various interactions between people, groups of people, and organizations.<sup>139</sup> It is inevitable that members of supervisory boards and independent directors will not enquire about information that might put the chief executive officer (CEO) or the chairman of the board of directors in an embarrassing or awkward position.

Apart from *guanxi* between independent directors and members of the executive board, *guanxi* between the members of the supervisory board and the management board also has the potential to limit the scope and nature of information disclosed to the members of the supervisory board. The *guanxi* between members of the management board and the controlling shareholders and employees on the supervisory board could restrict the disclosure of useful or controversial information in the context of further enquiries. Just as the management board might not quiz individual directors (or managers) adequately about what they have done or not done, so the supervisory board might not make sufficient enquiry of the management board as to what it has reported. The shareholders' representatives on the supervisory board may want to establish better *guanxi* with members of the management board and therefore choose not to challenge them or require additional information beyond what either has been provided or is available to the public. They may also think that leaving these "prohibited" or sensitive areas unexplored may win some *renqing* from the members of the management board, so that they will benefit in the long run.

A possible drawback is the fact that a person who owes *guanxi* to another would not normally disclose information that would cause the other to be shamed, and thus lose face. Therefore, in a corporate context a board might refrain from conveying information that would in some actual or potential way harm the position of a person to whom *guanxi* is owed. Also, as collectivism is, arguably, an element of *guanxi*, a Confucian concept that

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138. COMPANY LAW, *supra* note 92, art. 42. Also, Limited Liability Companies can change voting rules in the company's constitutional document. *Id.* art. 41.

139. CAO BIN XIE, A STUDY OF THE INDEPENDENT DIRECTOR SYSTEM (独立董事法律制度研究) 319-320 (2004).

involves the group being paramount to the individual,<sup>140</sup> members of the board might be persuaded, out of loyalty to the group, not to disclose certain details that might cause embarrassment for the board as a whole.

From an instrumental point of view, *guanxi*, *mianzi*, and *renqing* may entitle accountees to “resort to *guanxi* networks to bridge the gaps [that exist] in the formal institutions to obtain crucial information and valuable resources.”<sup>141</sup> It is argued that *guanxi* networks provide “secret, exclusive, and safe channels of communication for officials to disclose crucial information,”<sup>142</sup> but the accountees may need to offer significant *renqing* in the form of economic or non-economic benefits in exchange.<sup>143</sup> Therefore, accountees could get the necessary, useful, and tailored information in an informal and efficient manner through *guanxi* networks, although this may contradict principles of transparency and fairness, which are, along with accountability, described as fundamental corporate governance principles by the G20/OECD.<sup>144</sup> This may also lead to corruption.

## **2. Second and Third Stages: Justification and Explanation Followed by Questioning and Evaluation (Stage of *Jinze* and Narrow *Wenze*)**

Within the *wenze* system,<sup>145</sup> the second and third stages involve accountors explaining and justifying their decisions, followed by the questioning and evaluation of the reasons for what has been done or not done. It is indeed very likely that cultural issues including those centered on *guanxi* will also have an impact on these two processes. Consideration of these issues is reliant on information disclosure, for without valid, accurate, and comprehensible information, as discussed, the entire process of enquiry would be useless and pointless, and “monitoring could be extremely ineffective.”<sup>146</sup>

Like information disclosure, the explaining, questioning, and evaluating process is also limited by *guanxi*-centered cultural factors. The explanation of what individual directors and managers, as well as the respective boards of directors, have done could be limited by the amount of information that has been disclosed, so that if little information were disclosed then that would require less explanation. But on the other side of the coin, if there were *guanxi* between the managers and the management board and between

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140. John H. Dunning & Changsu Kim, *The Cultural Roots of Guanxi: An Exploratory Study*, 30 *WORLD ECON.* 329, 332 (2007).

141. Jing Vivian Zhan, *Filling the Gap of Formal Institutions: The Effects of Guanxi Network on Corruption in Reform-era China*, 58 *CRIME L. & SOC. CHANGE* 93, 94 (2012).

142. *Id.* at 106.

143. Szeto, Wright & Cheng, *supra* note 79, at 426.

144. Zhan, *supra* note 141, at 106.

145. Keay & Zhao, *supra* note 13, at 698–99.

146. Enrichetta Ravina & Paola Sapienza, *What Do Independent Directors Know: Evidence from Their Trading*, 23 *REV. FIN. STUD.* 962, 963 (2010).

the two boards, and more information were disclosed than might ordinarily be expected, then any explanations would, normally, be greater and that would enhance accountability. In other words, because *guanxi* could affect disclosure of material, there might be a knock-on effect as far as these second and third stages are concerned. That is, if *guanxi* causes the management board to fail to disclose particular information to the supervisory board or the shareholders, it will mean that the directors will not justify their decisions relating to matters covered by that information and, perhaps more importantly, the accountees will not have a chance to question what the directors have done. This chain reaction effect from *guanxi* could produce negative effects as far as accountability in corporate governance is concerned.

It is possible that at times management boards, for example, might be caught between two competing obligations, namely to honor *guanxi* on the one hand and to account fully to the supervisory board and shareholders on the other. Perhaps it can be said that as boards may be subject to consequences if they fail to account appropriately, board members are not going to let *guanxi* get in the way of providing information to the supervisory board and the shareholders. That might be too simplistic a view, however, for if everyone keeps quiet the issue that might be embarrassing does not get aired, and this may hamper the accountability process.

Independent outsiders and supervising insiders look at corporate decisions subject to the predetermined direction of the CEO.<sup>147</sup> It is often the case in China that the dominant CEO may tap into a *guanxi* network when selecting directors. The *guanxi* between selected members of the board, independent directors, and the CEO, and consideration of the *mianzi* of the CEO, are likely to make the questioning and evaluation processes less robust. Furthermore, independent directors on a board, who are employed independently by a corporation, may not in fact be independent, and investors need to undertake due diligence in evaluating individuals' current directorships and directors' historical ties, including former board members' links and overlaps in terms of schools and universities attended, and places of birth (so-called *laoxiang* culture, which is related to *guanxi*).<sup>148</sup>

As a result of this *guanxi*, many independent directors do not use the regulatory tools granted by the law, such as proxy contests, employing

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147. Shaopin Yin, *Some Thoughts on Independent Directors* (关于独立董事制度的思考), CHINA SECURITIES DAILY (中国证券报) 16 (2001).

148. Smith, *supra* note 57, at 6–7; see generally Jane Nolan, *Good Guanxi, Bad Guanxi: Western Bankers and the Role of Network Practices in Institutional Change in China*, 22 INT'L J. HUMAN RESOURCE MGMT. 3357 (2011). For discussions on *laoxiang* (native ethnic group identity) culture, see Haizhong Zhang & Yongzhi Jiang, *A Cross-Cultural Psychological Analysis of the Chinese Concept of Laoxiang*, 3 TRIB. EDUC. CULTURE 8 (2010).

external independent auditors, or direct communication with employees in order to supervise the board of directors more effectively and to promote accountability.<sup>149</sup> While employees' representatives within supervisory boards are fully aware that managerial ties may not always guarantee their career success, their absence usually leads to failure and independent directors are clear about the massive influence that the management board has on appointment to, and removal from, their positions.<sup>150</sup> The *guanxi* between the members of the board of directors who are required to explain and justify their decisions can make accountability less meaningful and effective.

A major issue that is likely to exist while accountees are enquiring and questioning is that the accountees may consider and be concerned about maintaining *guanxi* with, and *mianzi* for, the accountant. For instance, out of respect and to avoid any shame that might result from publicly disclosing the flaws or failures of Chinese CEOs, who have super-sensitive radars for *mianzi*, the accountees may not engage in detailed or extensive questioning about what the accountant has done. Wang has argued that independent directors in China are more accurately defined as "vase directors" (appointed for show only), "*guanxi* directors," or "*renqing* directors" when it comes to having to explain and justify their actions and decisions.<sup>151</sup> The appointment of directors and the relative influence of independent directors are closely related to the *guanxi* network of the executive directors and controlling shareholders. Their independence and ability to resist undue influence from other parties is seriously limited by these cultural issues, and hence their ability and/or willingness to engage in the evaluation process is likely to be seriously limited.

However, looking at the positive and instrumental effects of *guanxi*, it is also undeniable that independent directors who know with whom, when, and how to create ties with the government, suppliers, and competitors add considerable value to corporations, and the appointment of independent directors with good *guanxi* networks is more likely to lead to better corporate performance. *Guanxi* between the accountee and the accountant may also make informal enquiries and the questioning process more useful and efficient. Discussions and developments could be accomplished around the dinner table in a harmonious manner and without conflict. It is easier, in this atmosphere, to reach agreement and maintain a more sustainable relationship between directors, independent directors, and representatives of

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149. See Yonghui You, *Coordination and Perfection Between Independent Directors and Supervisor's Council*, 1 J. POL. & L. 61, 64 (2008).

150. Jinsong Tan, *A Study on Independence of Independent Directors*, 10 CHINA INDUS. ECON. (中国工业经济) 64 (2003); Wei Cai, *The Dilemmas of Independent Directors in China: An Empirical and Comparative Study*, EUR. BUS. ORG. L. REV. (forthcoming 2017), [http://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=2758519](http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2758519).

151. TIANXI WANG, RESEARCH HANDBOOK ON CORPORATE GOVERNANCE AND INDEPENDENT DIRECTORS (公司治理与独立董事研究) 129 (2005).

the shareholders and employees. The complementary relationships that emanate from the *guanxi* network compared with stricter practice in law are regarded as positive aspects of *guanxi*. This involves taking advantage of the flexibility offered by *guanxi* to promote more harmonious and sustainable business relationships.<sup>152</sup> Furthermore, by engaging in a united, personalized, and reciprocal *guanxi* network, the decision makers could respond to queries in a more timely and effective manner, and *guanxi* could improve the efficacy of the justification stage.

### 3. Fourth Stage: Imposition of Consequences (Stage of *Baoze* or *Chengze*)

While the consequences of accounting are not necessarily negative, as accountees might praise and affirm the work of the accountors or provide feedback that will enrich the personal and working lives of the accountors,<sup>153</sup> the consequences of accounting are often seen as negative. Examples are the censuring or removal of directors. Despite the fact that consequences may have a negative flavor and involve formal or informal sanctions<sup>154</sup> or a requirement to make reparations,<sup>155</sup> this process is closely related to law enforcement. It is argued that the position of *guanxi* is always regarded as operating in juxtaposition to the role of law and legal institutions,<sup>156</sup> and *guanxi* may undermine and distort China's legal framework and make the judicial system in China ineffective. For example, the legitimate positions of foreign investors have been questioned due to the lack of *guanxi*, the lack of capacity to establish *guanxi*, or the failure to understand the significance of *guanxi*. *Guanxi* also facilitates the continuing dominant role of the state and the government in Chinese corporate governance and corporate law, which may hinder their functioning efficiently.

Furthermore, *guanxi* may also make aspects of the imported legal system of Europe or North America difficult to enforce fully without adaption.<sup>157</sup> As a result, it may facilitate the rise of extra-legal protections,

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152. See generally Xin & Pearce, *supra* note 67.

153. KEAY, *supra* note 10, at 104–07.

154. Carol Harlow & Richard Rawlings, *Promoting Accountability in Multilevel Governance: A Network Approach* 4 (European Governance Papers, Paper No. C-06-02, 2007), [http://edoc.vifapop.de/opus/volltexte/2011/2461/pdf/egp\\_connex\\_C\\_06\\_02.pdf](http://edoc.vifapop.de/opus/volltexte/2011/2461/pdf/egp_connex_C_06_02.pdf).

155. *Id.*

156. See generally Jose Tomas Gomez Arias, *A Relationship Marketing Approach to Guanxi*, 32 EUR. J. MARKETING 145 (1998).

157. See Pitman B. Potter, *The Chinese Legal System: Continuing Commitment to the Primacy of State Power*, 159 CHINA Q. 673, 673–74 (1999); see also Jianfu Chen, *Modernisation, Westernisation, and Globalisation: Legal Transplant in China*, in ONE COUNTRY, TWO SYSTEMS, THREE LEGAL ORDERS - PERSPECTIVES OF EVOLUTION 91 (Jorge Oliveira & Paulo Cardinal eds., 2009).

including private protection or quasi-law enforcement.<sup>158</sup> Therefore, the consequences that flow from not being accountable may be softened or may even be non-existent due to *guanxi* between the accountant, the accountee, and government officials. This lack of, or softened, enforcement will make the accountee question whether enquiries and explanation processes are necessary or worthless due to a lack of recognition of what the directors have done or should not have done and a lack of consequences. It is also argued that *guanxi* is a factor that facilitates the bribery of public officers and promotes the formation of networks of corruption.<sup>159</sup> Connections between corruption and *guanxi* have been broadly observed,<sup>160</sup> and the absence of a reliable set of rules of law means that private companies are subject to threatened interference and arbitrary extortion by Party and government officials.<sup>161</sup>

It is argued that the dominance of state power in Chinese society and the relative absence of formal institutional limits on state power continue to militate in favor of *guanxi* relations.<sup>162</sup> Less strict enforcement of law in terms of the consequences resulting from the accountability process could be beneficial, since more flexible enforcement allows the coexistence of opposing viewpoints, especially when decisions made by a board of directors are subjective, strategic, and normally difficult to challenge. The existence of *guanxi* in China is attributed to the weakness in law enforcement and can be regarded as a coping mechanism to promote better accountability within the framework of corporate governance. It is employed as a substitute for formal enforcement of accountability through corporate law. Instead of sanctions, informal negotiation, discussion, or consultation could be employed to avoid conflict between accountants and accountees in order to create a more harmonious relationship. *Guanxi* and

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158. Peng Wang, *Extra-Legal Protection in China: How Guanxi Distorts China's Legal System and Facilitates the Rise of Unlawful Protectors*, 54 BRITISH J. CRIMINOLOGY 809, 813 (2014); see also AVINASH K. DIXIT, LAWLESSNESS AND ECONOMICS: ALTERNATIVE MODES OF GOVERNANCE (2004).

159. See Thomas W. Dunfee & Danielle E. Warren, *Is Guanxi Ethical? A Normative Analysis of Doing Business in China*, 32 J. BUS. ETHICS 191, 198, 200 (2001); see generally Yadong Luo, *The Changing Chinese Culture and Business Behavior: The Perspective of Intertwinement between Guanxi and Corruption*, 17 INT'L BUS. REV. 188 (2008).

160. See Ling Li, *Performing Bribery in China: Guanxi-Practice, Corruption with a Human Face*, 20 J. CONTEMP. CHINA 1 (2011); Zhan, *supra* note 141, at 93; Alan Smart & Carolyn L. Hsu, *Corruption or Social Capital? Tact and the Performance of Guanxi in Market Socialist China*, in CORRUPTION AND THE SECRET OF LAW: A LEGAL ANTHROPOLOGICAL PERSPECTIVE 167 (Monique Nuijten & Gerhard Anders eds., 2007).

161. Xin & Pearce, *supra* note 67, at 1644-46; see also Xingqiao Du, Jianhua Guo & Yu Lei, *Political Connections and Corporate Performance of Private Listed Companies: Government Intervention or Guanxi?*, 353 J. FIN. RES. 158 (2009).

162. See generally Paul Bohannon, *The Differing Realms of Law*, 67 AM. ANTHROPOLOGIST 33 (1965); P.B. Potter, *Guanxi and the PRC Legal System: From Contradiction to Complementarity*, in SOCIAL CONNECTIONS IN CHINA: INSTITUTIONS, CULTURE AND THE CHANGING NATURE OF GUANXI 180 (Thomas Gold, Doug Guthrie & David Wank eds., 2002).



the consequent respect for others could ensure that there is a constructive and positive discussion of corporate issues.

From the discussions of *guanxi* and the four stages of accountability, we identified that *guanxi* could have either a positive or negative impact on the promotion of accountability. Positive values and negative problems include the following aspects:

Positive Values	Negative Problems
Diverse & comprehensible information	Compromised degree of rigorousness
Lower costs	Discrimination to vulnerable parties
Informal/Semi-formal support	Concerns of participants' superiors
Long-term coalitions	Independence of boards and directors
Draws on cultural ethics of cooperation	Possibility of generating bribery
Feasibility, substitute for regulation, and compensates for poor enforcement	Undermines and distorts China's legal framework

In the next section, the positive aspects of *guanxi* will be discussed in detail in order to demonstrate the relationship between those cultural issues centered on *guanxi* on the one hand, and accountability on the other, in order to identify the potential of applying *guanxi* so as to promote accountability in corporate governance.

#### V. *GUANXI* AS A COMPETITIVE ADVANTAGE: LEGITIMATE, CLEAN, AND SUSTAINABLE *GUANXI* WITHIN A *WENZE* SYSTEM

The core of our initial question was: what are some of the culturally specific and value-related barriers that make accountability in the context of corporate governance challenging, and what can be done about it? We are aware that Western approaches to corporate governance and accountability do not necessarily function equally well in other cultures, unless those approaches are reassessed and adapted. With the rapid economic development of large-scale Westernized movements, such as culture, intellectual property products, and systematic changes in developing nations, including corporate governance model transformation and, increasingly, globalization of the trade and financial markets in China, the adoption of the notion of accountability in China should be effected in a

unique manner, with cultural factors taken into account in order to assist the development and enforcement of a *wenze* system.

*Guanxi* is a value based on Eastern principles, however it can be as ethical as any Western system.<sup>163</sup> *Guanxi* and other related cultural derivatives are increasingly being identified as complementary, rather than as alternatives to formal institutions.<sup>164</sup> Such core cultural issues still have a massive impact on doing business in China and they have become even more entrenched.<sup>165</sup> The West needs to consider the implicit cultural values that hinder Chinese directors in appreciating the function of rule-based systems, and their lack of historical importance in building and sustaining relationships in China. But Chinese directors also must appreciate the need to reconcile the values that both sides have to offer.<sup>166</sup> It is argued that one of the main concerns that investors have, especially international investors who do not have a clear understanding of the Chinese culture and legal system, is the lack of stable legal and regulatory systems and reliance on trust-based personal relationships as a means of obtaining resources and doing business in China.<sup>167</sup> Therefore, awareness and understanding of *guanxi* and cultivation of legitimate, clean, and sustainable *guanxi* (including BtB, BtG, and PtP) matter in very significant ways, not only for Chinese companies and their participants, but also for foreign companies and their stakeholders. Within the domain of corporate governance, *guanxi* primarily facilitates transactions between companies and their stakeholders, leads to the furnishing of information, and provides creditable social resources for companies.

#### A. PRECONDITION IN PROMOTING ACCOUNTABILITY: *GUANXI* AND THE HARMONIOUS BUSINESS ENVIRONMENT

In this section, we will discuss the function of *guanxi* in creating a harmonious and strategic business environment, which could be regarded as a precondition and key virtue for more effective accountability. The connections between accountability and *guanxi*-centric cultural factors is relevant, dynamic, and of contemporary concern. These cultural factors have had a major effect on history, values, and social and economic transformation in China. It also applies to corporate governance and the *wenze* system. An overview of the jurisdictions that are economically advanced or developed and that are also Confucian societies, such as Japan,

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163. Lovett, Simmons & Kali, *supra* note 73, at 236.

164. See Dunning & Kim, *supra* note 91; see generally Jianjun Zhang & Hean Tat Keh, *Interorganizational Exchanges in China: Organizational Forms and Governance Mechanism*, 6 *MGMT. & ORG. REV.* 123 (2009).

165. Seung Ho Park & Yadong Luo, *Guanxi and Organizational Dynamics: Organizational Networking in Chinese Firms*, 22 *STRATEGIC MGMT. J.* 455, 466 (2001).

166. Weltzien Hoivik, *supra* note 87, at 467.

167. Fan, *supra* note 129, at 555–56.

South Korea, Hong Kong, Singapore, and Taiwan, demonstrates that economic development and the establishment of an institutional legal system does not necessarily displace reliance on personal connections; in fact, *guanxi* remains the core value of these societies.<sup>168</sup> It is clear that *guanxi* will continue to influence the development of Chinese corporate governance and Chinese people's understanding of business relationships, as it is continuously transformed as part of its adaptation to new social institutions and structures, unless new legal and commercial regimes are introduced in China.<sup>169</sup>

Positive forms of *guanxi* include those between the company and their internal and external stakeholders, such as *guanxi* between boards, among directors, with government agents, with shareholders, and among shareholders themselves and other stakeholders. *Guanxi* provides a valuable entrepreneurial means to bridge gaps in information flows between companies, and also between companies and primary external stakeholders who are originally unrelated.<sup>170</sup> Fitting in with Chinese traditions, corporate governance participants rely on personal connections and loyalty, which could be more effective than relying purely on organizational affiliations or legal standards. These personal connections generate a smoother and more harmonious business environment that is important for promoting accountability in the various stages discussed in Part IV.C. In this way, *guanxi* could help to build core competences and social harmony in the business environment that lay a solid basis for a functional *wenze* system, with involvement and contribution from corporate constituencies and other external stakeholders, including government.

With the rapid economic growth, development of the legal and regulatory institutions, and the continuing important role of the government and the Party in the economy in China, *guanxi* is still relevant. Besides being relevant, *guanxi* is sustainable and sometimes more reliable for creating harmonious business environments for promoting accountability. It is argued that strengthening pre-existing social connections is a much more reliable strategy than bribing unconnected officials.<sup>171</sup> Positive aspects of *guanxi* may give the opportunity to promote accountability in countries like China, where these cultural issues play a critical role in daily life and *guanxi* becomes a common preoccupation.

Therefore, within a transitional corporate governance regime, unique in China and which has administrative and economic characteristics as well as government control and interference, *guanxi* serves as a means of signaling trust and integrity in a system that lacks a strong background of institutions

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168. LUO, *supra* note 74, at 31.

169. *See generally* Yang, *supra* note 76.

170. Seung Kyoong Shin, Michael Isham & G. Lawrence Sanders, *An Empirical Investigation of Socio-Cultural Factors of Information Sharing in China*, 44 INFO. & MGMT. 165, 168 (2007).

171. LUO, *supra* note 74, at 29.

and legal systems.<sup>172</sup> Even with the progressive legislative reform evidenced by the implementation of new laws in the form of the 2005 Company Law, the 2006 Securities Law, and the 2005 Insolvency Law, doing business in China is still personal and *guanxi* has not lost its legitimacy.<sup>173</sup> Cultivating and maintaining clean and sustainable *guanxi* between board members and administrative superiors is an effective way to mitigate the negative effect of arbitrary intervention from the government and the absence of a stable legal and regulatory environment, and it may facilitate government support. Respectable *guanxi* with government does facilitate business dealings and establishes a balance by complementing ambiguous bureaucratic rules and principles with the flexibility of *guanxi* and its cultural derivatives, which provide a more sustainable basis and environment for accountability to take place.

#### B. THE CRITERIA OF “GOOD” *GUANXI* AND A MORE EFFECTIVE *WENZE* SYSTEM

If *guanxi* is going, in a dynamic manner,<sup>174</sup> to have an impact on the understanding and enforcement of accountability in corporate governance in China, it may be worth, based on earlier discussion, promoting *guanxi* in a way that leads to more accountability in corporations. A significant contribution to achieving this could be made by the shareholders and directors accommodating and cultivating a form of *guanxi* that does not precipitate breaches of directors’ duties or involve bribery, corruption, favoritism, or nepotism. In this respect, *guanxi* could help in the promotion of accountability in corporate governance in general. Clean *guanxi* could compensate for the fact that there is a lack of a formal and contractual *wenze* system, due to weak law enforcement and ineffective corporate governance mechanisms. It could also mitigate the negative impact on accountability that results from other cultural factors, such as the practice of *mianzi*. With the administrative rank of board members of SOEs and agents of shareholders who hold SOE shares, *guanxi* could be viewed as an informal, non-institutional and under-regulated mechanism that lubricates the necessary link between various constituencies within the *wenze* system.

*Guanxi* and resources obtained from sustainable *guanxi* open an alternative route for companies to be more actively engaged with government and their stakeholders, which is key for the Chinese corporate governance model in which the state plays a controlling role and where

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172. Lovett, Simmons & Kali, *supra* note 73, at 240–42.

173. TIM AMBLER, MORGEN WITZEL & CHAO XI, DOING BUSINESS IN CHINA 95–127 (2009); see generally Jonathan Wilson & Ross Brennan, *Doing Business in China: is the Importance of Guanxi Diminishing?*, 22 EUR. BUS. REV. 652 (2010).

174. It is argued by Su et al. that “[e]ffective *guanxi* is dynamic.” Chenting Su, Ronald K. Mitchell & M. Joseph Sirgy, *Enabling Guanxi Management in China: A Hierarchical Stakeholder Model of Effective Guanxi*, 71 J. BUS. ETHICS 301, 305 (2007).

government interferes with boards' decisions and corporate objectives. In this hybrid model, the *wenze* system needs to be enhanced with informal, flexible, and socio-cultural oriented factors, since companies cannot rely only on the market or institutional instruments. Building and maintaining sustainable *guanxi* could provide flexibility, efficiency, informal support, and a harmonious business environment, which all could promote accountability in the domain of corporate governance. Instead of rejecting *guanxi* as illegitimate and corrupt on moral and political grounds, the process of accountability could embrace the *guanxi* practice and view the employment of *guanxi* as an integral part of developing sound corporate governance.

This becomes possible and feasible with the development of the legal system in China, especially with the far-reaching, highly publicized anti-corruption campaign that was introduced since the 18th National Congress of the Communist Party of China in 2012.<sup>175</sup> In a jurisdiction with weak formal law enforcement and strong bureaucratic institutions, a model of "informal accountability" can be enabled and brought to maturity by applying functional and sustainable *guanxi*. This informal accountability model can help to overcome institutional barriers in three aspects: the involvement and interference from the state and government; instability in terms of regulatory changes, such as multiple legislative levels of central government, stock exchanges, government authorities, and local governments; and the difficulties in accessing market resources, especially for companies that have weak government links, such as non-SOE listed companies, which are growing in number,<sup>176</sup> and listed companies in the Growth Enterprise Market (GEM).<sup>177</sup>

Since all directors have a strong incentive to cultivate *guanxi* with government officials while the boundaries between the state and the firm remain blurred, it is normal that directors' ties with government are regarded as the most effective and direct ways to achieve corporate success. The obvious way of promoting accountability through the BtG *guanxi* network would be the provision of more efficient and accurate information disclosure that is not normally available from the market.<sup>178</sup> Sustainable and

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175. See Shaomin Li, *Assessment of and Outlook on China's Corruption and Anticorruption Campaigns: Stagnation in the Authoritarian Trap*, 25 MOD. CHINA STUD. 139 (2017).

176. See generally Yuan Ding, Hua Zhang & Junxi Zhang, *Private vs State Ownership and Earnings Management: Evidence from Chinese Listed Companies*, 15 CORP. GOVERNANCE: INT'L REV. 223 (2007).

177. The first 28 companies were listed on the Shenzhen stock exchange on 30 October 2009 as listed companies in the Growth Enterprise Market that was designed for accommodating vigorous scientific and technological and innovation. See Chao Xu & Renyong Chi, *Entrepreneur's Social Capital, Personal Characteristics and Firm Performance—An Empirical Analysis Based on Chinese Listed Companies in Growth Enterprise Market*, 28 SOFT SCIENCE 57 (2014).

178. Park & Luo, *supra* note 165, at 459 (recognizing that the significant role of *guanxi* in information sharing with the business community and the government authorities in China, where market information is greatly distorted like other transition economies).

clean PtP *guanxi*<sup>179</sup> should also facilitate good means of access to what is often limited information that is only available to insiders.<sup>180</sup> PtP *guanxi* becomes a reliable source of necessary information for the disclosure exercise from the board of directors in a more engaging, trustworthy, and efficient manner to promote accountability. *Guanxi* that satisfies the criteria also will reduce uncertainties and equivocality in decision-making through more coherent information processing mechanisms.<sup>181</sup> These mechanisms may have the potential to greatly encourage accountability in stages 1 to 3 of the *wenze* system.<sup>182</sup>

Apart from information benefits, the board of directors may also want to rely on *guanxi* and its cultural derivatives to establish a more harmonious environment for the enquiry and explanation process. Huang argues that *guanxi* is helpful in creating a more holistic, sincere, and heartfelt harmonious relationship.<sup>183</sup> *Guanxi* will be helpful in generating a cooperative spirit between constituencies in the enquiry and explanation stages of accountability, and the outcome can be generated in a genuinely harmonious environment. This is particularly important for a society that relies heavily on *mianzi* and the benefits emanating from smooth enquiry and explanation processes, and *guanxi* makes the fulfilment of the accountability stages easier and more efficient.<sup>184</sup> *Guanxi* and other cultural derivatives could therefore be regarded as a way of resolving conflicts in Chinese corporate management.<sup>185</sup> Smooth and harmonious interpersonal relationships due to social norms such as *guanxi* and *renqing* will ease the conflict element of the enquiry and explanation process in order to ensure that the relationship between the accountors and accountees is healthy and sustainable.

## CONCLUSION

Accountability is an essential aspect of corporate governance and, while the Western notion of accountability is not encapsulated in any single Chinese word, it has been argued that the *wenze* system of accountability as considered in this Article comes very close to it in the context of corporate governance. In light of this, the Article has examined the role of cultural

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179. These PtP *guanxi* including those between members of management boards, supervisory boards, independent directors, shareholders, and managers of institutional shareholders.

180. See Xin & Pearce, *supra* note 67, at 1643–64.

181. James B. Thomas & Linda Klebe Trevino, *Information Processing in Strategic Alliance Building: A Multiple-Case Approach*, 30 J. MGMT. STUD. 779, 780–81 (1993).

182. See *supra* Part II.

183. See generally LI-LI HUANG, INTERPERSONAL HARMONY AND CONFLICT: INDIGENOUS THEORIES AND RESEARCH (人际和谐与冲突——本土化的理论与研究) (1999).

184. Hwang provides a theoretical model to explain the Chinese way of conflict management and resolution. Using the concept of “harmony” as the axis while *mianzi* and *guanxi* are regarded as “two wings” of harmony. See Hwang, *supra* note 88, at 954–55.

185. See generally Kwang Kuo Hwang, *Guanxi and Mientze: Conflict Resolution in Chinese Society*, 7 INTERCULTURAL COMM. STUD. 17 (1997).

factors, namely *guanxi* and its derivatives, in corporate governance in China to determine what effect, if any, these cultural factors have on the operation and development of the *wenze* system in large listed companies. The Article has found that cultural elements do affect accountability in corporate governance, and in some situations significantly so. With the growth in importance of the economic and political influence of China within the global trading community, the management implications of *guanxi* also grow in importance.<sup>186</sup> *Guanxi* and its cultural derivatives have to be factored into any reform considerations and any changes to law or practice have to be sensitive to these cultural pillars.

This Article's analysis demonstrates that *guanxi* is a double-edge sword, for while it can be an impediment it is not totally inimical to accountability. Indeed, it might enhance accountability if it and its derivatives are utilized in a positive way in promoting a more sustainable and harmonious business environment. We identified three criteria on which *guanxi* could exhibit positive impact, namely legitimacy, reduction of transaction costs, and promotion of flexibility. In this sense, *guanxi* will be likely to mature as a traditional cultural value and become less visible and more sophisticated and instrumental, with more emphasis on strategic management policies and business outcomes than on politics and corruption. It could become a unique but effective code of ethics that helps to promote accountability in corporate governance in China, as well as fostering corporate governance in general. Within this positive and functional *guanxi* circle, shareholders and other stakeholders will work towards forming a "*guanxi qun*" (nexus or group of *guanxi*) based on their interests or need to achieve a common objective or goal, which is promoting greater accountability and ultimately the success of the company. The cultural factors will help companies with more diverse and comprehensible information, obtained at lower cost and operating in a more harmonious environment, to establish accountability in the long term.

This Article also argues that cultural factors in general, and *guanxi* in particular, could certainly enhance accountability in being able to compensate for the lack of law and enforcement in the Chinese corporate sector. In Chinese business there are two kinds of laws; on the one hand there is formal law (including legislation) and on the other hand there is "deeply rooted cultural 'law.'"<sup>187</sup> With the latter, which includes the positive values of *guanxi*, it should be consistent with key elements of the *wenze* system. Enhanced information access, cooperation, and informal support will make the *wenze* system smoother, more harmonious, and effective, all of which are positive for the long-term development of corporations.

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186. Su, Mitchell & Sirgy, *supra* note 174, at 305.

187. Braendle, Gasser & Noll, *supra* note 33, at 402.

However, we do not deny that *guanxi* and other cultural factors can have a negative impact as far as accountability is concerned. Nevertheless, we contend that there are enough indications that it is possible to employ legitimate, clean, and sustainable *guanxi* within a *wenze* system in order to ultimately promote better accountability in corporate governance, and at the same time recognizing that in certain cases *guanxi* will, as employed by some, fail to do so. It is acknowledged that *guanxi* can make the processes of corporate governance vulnerable, but on the other hand it has the potential to fulfil an important role in fostering accountability, especially in the absence of effective law and enforcement. Certainly, to provide a positive impact *guanxi* and its derivatives need to be carefully applied when promoting accountability, since they may be exploited for personal interests instead of mutual benefit with corporate participants, considering that BtB and BtG *guanxi* always start from PtP *guanxi*.

Finally, it is interesting to note that many in the West are calling for greater trust in corporate governance, and yet *guanxi* is essentially built on trust,<sup>188</sup> so one might assert that there is greater trust evident in Chinese companies. Perhaps a problem with *guanxi* is that it is misunderstood by non-Chinese people and this might cause concern over whether those involved in corporate governance are truly accountable, which might stymie attempts by the Chinese government to ensure the adoption of international benchmarks and for Chinese corporate governance to be accepted by international markets.

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188. See Lovett, Simmons & Kali, *supra* note 73, at 232; Guthrie, *supra* note 81, at 261; see also Stephen S. Standifird & R. Scott Marshall, *The Transaction Cost Advantage of Guanxi-Based Business Practices*, 35 J. WORLD BUS. 21, 24 (2000).