

The prevalence of networking or *guanxi* in Indonesian [family] business¹

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Abstract

This conceptual paper examines the ethical dimension of using gifts to establish social networks, applying the concept of ‘*guanxi*’ or social capital in Indonesia - a practice which may lead to personal and/or corporate gain. *Guanxi* refers to a network of personal and social relations. *Guanxi* is characterized by specific ethical and instrumental dimensions that embedded in social and moral norms and originally founded on a traditional Confucian philosophy. Social contextuality seems to be more relevant for its ethical acceptability than a precise moral individual threshold. To what extent can possible gain or profit from *guanxi* be considered as 'ethical'? The answer lies in understanding the fine line between socially appropriate and a-social networks. Social networks such as *guanxi* could transgress as they take the form of nepotism wherein emotional and moral obligations in interpersonal relations are ignored in favor of pure instrumental [calculating] exploitation of networks for personal gain. When the cultural ritual of *guanxi* degenerates into a rent-seeking *guanxi*, an appropriate network loses its ethical edge as it turns into inappropriate behaviour, and allows itself to be corrupted. Networks then transgress in ‘nepotistic’ or corrupt practices. Only appropriate governance mechanisms and visionary leadership can curb such destructive behaviour.

Key Words: *guanxi or relationships, gifts turning into bribes, relationship-based governance versus rules-based governance, transgression of networks into nepotistic clietelism*

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The majority of Indonesian businesses are family based. Even those corporations “publicly” listed on the Jakarta Stock Exchange are predominantly still controlled by either some family patriarch or the state. These family-controlled business groups can bring considerable risk to their own company and to the economy when they operate with minimal external oversight and when their objectives are focused to extract rents at the expense of minority shareholders or relevant stakeholders. It can be argued that weak governance structures as in poor accounting disclosure and weak oversight enabled family-controlled business groups in Korea, Thailand, Indonesia, Malaysia and the Philippines to mask operating problems or to hide inflated investment structures fuelled by short term USD loans exposed in local currency. These hidden governance weaknesses were at the roots of the Asian crisis in 1997. Research suggests that foreigners invest less money in companies that insiders control and that reside in countries with a reputation of weak investor protection and relatively low transparency (Leuz *et al* 2009).

Elsewhere I have argued that any company’s overall risk can be brought back to (1) the firm specific risk attributable to execute a strategy that supposedly creates some cash flow for the company, (2) the risk that is related to the industry in which one is operational, (3) particular risk measurements that are related to intermediaries that might mitigate or reduce specific company’s risks through insurance, hedging or specific investment vehicles, and finally (4) institutional voids and cultural norms that may contribute to risks not related to any of the three above (Verhezen 2011; chapter 5: 92). This essay will focus on the latter risk, institutional voids and specific cultural norms that may contribute to enduring weak governance structures and mechanisms in Indonesia.

If corporate governance aims to prevent or dissuade potentially self-interested managers and main equity blockholders from engaging in activities detrimental to the welfare of all shareholders and stakeholders, then it should be obvious that governance systems are also dependent on its broader environment. Indeed, efficiency of local capital markets, the extent to which the legal system provides protection to all shareholders, the reliability of accounting standards, the enforcement of regulations and societal and cultural values all affect governance mechanisms that are required to monitor and control managerial self-interested behaviour (Larcker *et al* 2011). Minority shareholders – both local and definitely foreign – would be concerned with how the legal system protects their minority ownership rights at the hands of potential abusive controlling owners. If the legal system is corrupt or cannot be relied upon to provide reliable and consistent appropriate protection as is the case in Indonesia, interested minority investors may back off to invest in Indonesia. In addition, a

civic legal system – as practiced in Indonesia - may give less legal protection than the common law system as functioning in Malaysia or Singapore (La Porta *et al* 1999 & 2000). Moreover, companies operating in countries whose legal system protect minority interests have higher stock market valuations than companies operating in countries with lesser protections (La Porta *et al* 2002).

If the legal system is ineffective or corrupt, and if the capital market is relatively weak, alternative mechanisms are necessary to finance growth and to monitor appropriate business behaviour in a closed business society: (1) higher demanded returns on capital to compensate for the greater risk of investing their money, and or the use of retained earning without paying dividends over an extended period, and (2) the extensive use of networking or *guanxi* to get access to resources and different sorts of capital. This essay will focus on the importance and prevalence of *networks in Indonesian business*, analysing both its initial positive effects as well as a much darker side.

Dimension of networks or guanxi³

Quite a number of ‘overseas’ Chinese, and indigenous pribumi businessmen and entrepreneurs, use the strategy of utilizing or constructing social ties with individuals who can facilitate the process of investment or help secure favorable contracts. While such strategies relying primarily on social guarantees and relationships can dramatically speed up a process and may increase the odds of securing contract, such relationship-dependent tactics usually occur at the cost to traditionally negotiated legal guarantees or judicial boundaries. It has been argued that such ‘bamboo network’ strategies have, no doubt, led to amazingly quick economic growth in these countries, but have also proven to sow the seeds of their downfall as in the Asian financial crisis of 1997 (Pye, 2000).

Because of the ambivalence of networking, I intend to examine its subtle differences in order to draw a fine line where network turns into nepotism, or why it might nurture some type of ‘nepotism’. Networking and bonding refer to a natural human tendency to relate to

³ An earlier published paper - Verhezen, P., (2008), “Guanxi: Networks or Nepotism?”, in Zsolnai, Laszlo (Ed), *Europe-Asia Dialogue on Business Spirituality*, Antwerp; Apeldoorn, Garant, pp.89-106 – has been the basis for this reviewed essay, where I relate the importance of guanxi and networking in family business with governance mechanisms in Indonesia.

one another. Hence, giving gifts, as a form of establishing alliances, bonds and networks, is a prevalent practice in most traditional cultures. Likewise, the jostling for an advantageous position in social relationships and networks is a predominant way for Asians to survive in their communities (Verhezen, 2002 & 2009) aside from gaining a competitive advantage in business. Lately, no issue incites such heated debates as nepotism, collusion and bribery (Noonan, 1984) in the Asian media and business courses. Many seem to suggest that gifts, networks and their less benevolent expressions are indeed cultural phenomena and are therefore acceptable. On the contrary, despite specific differences, gifts and networks can certainly be found in most cultures where they are clearly distinguished from practices such as bribery⁴ and nepotism⁵ respectively. Gifts may not necessarily be considered bribes if they are understood as non-secret and integral to the relationship, unless it is a means to attain immediate instrumental goals. As bribery connotes a wrongful transfer of resources between parties (Johnston, 1989), then nepotism implies a misuse of relationships between parties. The core of this analysis focuses on distinguishing socially and morally acceptable networks from unethical but prevalent nepotism in the realm of Asian business, despite an inherent ambiguity that will continuously shift the meaning and moral relevance of gift practices in business.

Gift giving, while “interested”, must appear not to be so if it is to have the intended effect. Gifts complying with unwritten rules of reciprocity can be perceived as an expression of acknowledgment of membership in a network of personal relationships, known in Chinese as ‘*guanxi*’. That the use of gifts could and would lead to personal (or corporate) advantages is well understood, and accepted as long as it is contained within (social and ethical) boundaries. As expressions of recognition and even (sought-after) gratitude, gifts reflect a form of ‘social contract dynamic’. Usually expressed as respect for another person such gift

⁴ Because of the ambiguity of the gift, aiming at sharing and/or superiority, and either/or characterized by an element of disinterest and self-interest, I believe that gifts can transgress into bribery. Bribery is here then defined as ‘the result or the misuse of a monopolistic position of a certain agent, without clear accountability for his/her actions and under the banner of discretion/secret, where the agent does benefit from his position to illegally and personally gain at the expense of the principal’.

⁵ Nepotism is defined as the practice among people with power or influence of favouring their own relatives and extended family members, especially by giving them jobs; achieve promotion through nepotism. Clietelism is slightly broader interpreted and include non family members in the network of loyal members who are bound by valuable gifts and job opportunities in return for complete loyalty.

practices are bound by specific public rituals ('li'⁶) or socially proper conduct - forms of courtesy and rules of moral legitimacy, while strengthening the relationship.

Social connections and personal relationships – or *guanxi*⁷ as they are known within the Chinese community – are established and enhanced by gift exchanges that conform to what can be observed in the logic of the gift (Verhezen, 2009). Deeply rooted in the Confucian Chinese tradition, *guanxi* involves relationships between or among individuals, creating obligations for continued momentum of exchange and established trust and credibility. Revealing is the fact that quite a number of scholars agree that *guanxi* cannot be founded merely through the one-time payment of a coarse bribe.

Although gifts in traditional *guanxi* indeed reflect the relative wealth of the parties involved, they are one of the ways to nurture relationships and to strengthen trust, commitment and reciprocity. In a situation where there is a pervasive distrust of the legal and political system, the consolidation of social interaction and relationships built on gift exchanges serve to provide a “substitute form of trust that can improve the profitability of investment and reduces the risk of arbitrary bureaucratic interferences that is not in the interest of the investors” (Smart, 1993: 398).

Guanxi is built through the exchange of gifts, favors and banquets, and as such its art lies in the skilful mobilization of moral and cultural imperatives where the pursuit of social ends and calculated instrumental ends will be diffused by obligation and reciprocity (Yang, 1994). Sometimes one clearly distinguishes “expressive ties” from “instrumental ties” as where the former is related to families and kinship and the latter to business *guanxi*. Although a relationship may be cultivated with some instrumental goals in mind, some culturally specified forms must be conformed to if these goals are to be achieved (Fan, 2002). Thus, it is predominant that the relationship is presented as primary and that the exchanges, useful though they may be, are treated as secondary. If, instead, it becomes apparent that the relationship involves only material interest and is characterized by direct and immediate payment, the exchange is classified as one of bribery, or possibly even a mere commercial

⁶ The Chinese mandarin notion 'li' rests upon a broad normative ethic of 'right relations' which express the heart of ethical concern and respect in the Confucian tradition. Indeed, both relationship networks, i.e. *guanxi*, and the social stature of face –as well as respect for others, expressed through the 'face' that is paramount in Asian culture – are enshrouded in public rituals (li) which express status within the group, respect and bonding in formal terms.

⁷ Yang, 1994. *Guanxi* is defined as relationships of social connections built on pre-existing relationships of classmates, people from the same native-place, relatives, superior and subordinate in the same workplace, and so forth.

exchange. Manipulative and exploitative use of gift exchange is inevitably made possible by deviating the existence of genuine gift exchanges that attach priority to the social or personal relationship to the immediate instrumental objectives of the corrupted gift.

Guanxixue, the practice of building such networks, is morally neutral but in everyday life, it implies both high moral principles and petty calculations with ethics and tactics coexisting in tension and in harmony - a coexistence expressed in the choreography of *guanxi* etiquette. *Guanxixue* connotes 'human sentiments' – *renqing*⁸ – referring to friendships and long-lasting personal relationships, and customarily of people helping one another. Indeed, *guanxi* (networks) and *renqing* (ethics) are characterized by moral obligations and emotional attachments in interpersonal relations, and by a stable mutuality of cooperation between people within these networks. Hence, the power of *renqing* or the pressure of its moral force is such that it is very difficult for a community member to decline a request for help or to fail to repay a (social and or moral) debt of *renqing*. The discourse of *guanxi* and *renqing* obligations may be situated in the cultural unconsciousness of a community through which norms and values are expressed. But, other less benevolent forces may be at play behind the accepted cultural expressed features of *guanxi* and *renqing*.

The informal network of *guanxi* or networking among Indonesians⁹ may be seen as a substitute for the rule of law, which was its initial *raison d'être*, or it became an effective alternative in environments where the rules of law are rarely implemented or enforced. Even Lee Kuan Yew, the founding father of Singapore, would have admitted that the Chinese use of *guanxi* is “to make up for the lack of the rule of law and transparency in rules and regulations” (Dunfee *et al* 2001: 198). Networking is still very relevant in the context of Asian and thus Indonesian [family] businesses because it mitigates external political and socio-economic risk: it navigates opaque bureaucracies; it copes with the absence of a rule of

⁸ Yang, 1994. The Mandarin notion *Renqing* can be found in ancient Confucian discourse, such as in Han dynasty (206 BCE – 220 CE) text of The Book of Rites, where *renqing* refers to the natural human feelings and emotions found in father – son relationships, and as well within family and kin relationships and friendships. The following three main features are cited: 1) human nature is defined, not as an individual quality, but in terms of social relationships and interaction; 2) there is a proper way of conducting oneself in social relationships; and 3) any bond is characterized by reciprocity.

⁹ Networks as in Chinese '*guanxi*', or its comparable equivalent is the notion '*arisan*' among the indigenous pribumi in Indonesia, serve as a means to signal trust and credibility in societies with weak formal rules of accountability and where social and economic exchanges are barely embedded in strong institutions. The Indonesian '*arisan*' is a typical cultural expression of social bonding through the formation of extended family membership credits. Those trusted members participate in a revolving and rotating credit system, informally but nevertheless very strictly-ruled, according to specified procedures where social exclusion is the ultimate sanction.

law; it accesses reliable information, resources and infrastructure, and it recruits trustworthy, i.e. well connected, employees.

Networks could provide a competitive advantage vis-à-vis foreigners in the absence of well-developed financial markets and unknown markets (where one could scarcely count on the support of any other reliable institution). However, while networks may provide a certain degree of access, they also may pose a peril of non-merit and consequently of inefficiency in terms of micro-economic analysis. *Guanxi* could easily become inconsistent with the idea of efficiency or performance merit: many people are hired for jobs, not on the basis of their individual merit, but rather on the basis of their lineage or connections.

Although the fine line between gift and bribery is often blurred, one clearly can distinguish a gift¹⁰ from a bribe taking into account a specific cultural and moral context (Verhezen, 2003 & 2009). Similarly, it is logical (despite the notion's inherent ambiguity) that is possible to distinguish networks from nepotism, although in reality reading the real intentions of the actors and making this judgment is far more difficult.

A simple acid test to judge whether a *guanxi* network is in fact ethical is to determine if there are victims resulting from *guanxi* relations. In other words, a *guanxi* practice is ethical only if it causes no harm to a third party or to society as a whole. Examples of victims would include competitors or customers, or even undetermined stakeholders. If a network action adversely affects a third party while the network transaction produces gains for individual agents (or even firms-principals) while inflicting loss on society as a whole by overriding the fairness of competitive rules, one cannot ethically justify such a network transaction. When *guanxi* or a network becomes a pure exchange, a degradation process of displacement and a process of commodification enter the relationship. When *guanxi* commoditizes into a shadow of money exchange only, the network degenerates into its corrupted form of nepotism and clientelism. Through a process of displacement, the direct

¹⁰ One should bear in mind that a 'gift' when translated in Chinese Mandarin is '*liwu*', where *wu* refers to the ritual gift object and *li* equals reciprocity in social intercourse. The Chinese term indicates that a gift is more than a material present; it carries cultural rules and properties and involves some strict rituals. So, a *wu* without *li* is merely a thing or item, not a gift. Hence, a gift object that is handed over and that fails to enhance a relationship of reciprocity is degraded, becoming a pure instrumental bribery exchange, and accordingly does not function as part of the *guanxi* rituals in se. Under Confucian rules and in the absence of a rational-legal framework, officials - assumed to be of good, i.e. virtuous, character - judged each case on its special merits. Confucius repeatedly stresses the pivotal role of exemplary persons whose behavior can have an impact on the whole of society. He seems to emphasize relations where its individual is subordinated to the 'li'. This ritual propriety for Confucius dictates to an individual how he/she should behave toward his/her family, friends, superior, and others in society. The focus is not on an individual per se, but on the social relations. Confucius goes so far as to assert that playing one's role (in society) will bring an effective government. In traditional Confucian China, moral learning through role modelling was preferred to penal law. Moreover, the notion of a civil society characterized by institutional checks, balances, and accountability remains underdeveloped.

payment of money trivialises and degrades the practice of *guanxixue* to monetary compensation in certain contexts. This is why business *guanxi* has gained such a notorious reputation, inside Indonesia, China and abroad.

Networks or 'guanxi' as Social Capital

If the notion of 'Social Capital'¹¹ is indeed a form of capital – a set of actually usable resources and power – then it may be equated with a form of power that can either be used to influence others' behavior, or to aid in achieving desired goals. Social Capital is almost always a potentiality: once cashed in, it becomes something else, e.g. economic capital or profit. In this context, I define 'social capital' as referring to a network of individuals – as in '*guanxi*' – that may result in certain forms of capital and profit. Social capital, then, includes obligations of reciprocity (though not in its legal nor even in its economically enforceable sense), with the advantages derived from connections or social hierarchy, and the presence of a presumed trust. These obligations and connections in business are the result of investment strategies by businessmen and entrepreneurs, who consciously or unconsciously aim at establishing or reproducing social relationships that are directly usable in the short or long term.

By its own definition, *guanxi* is a form of 'social capital' that aims to amass symbolic capital, a phenomenon which takes the form of 'face' in Indonesia, China and for that matter throughout most of the Asian world. Someone who has a reputation for having a great deal of face and thus influence in networks – i.e. social and symbolic capital often resulting in economic capital – can use it to accomplish a great deal. The more social, symbolic or economic capital is at his disposal, the more powerful is his socio-economic or influential standing. It is here that the reputation of the family plays a very important role. For decades now, the stellar reputation of the family shipping magnate Samudra group and the diversified Tahija family business group have allowed them to grow in spite of or because of their independency of the Suharto clan (which has a connotation of corruption and nepotism).

Interesting is the fact that the emphasis on the instrumental ends of a relationship rather than the cultivation of a relationship itself does not affect either social or symbolic

¹¹ Particularly the groundwork on social capital as explicated by social scientists Robert Putnam, Pierre Bourdieu, James Coleman and Francis Fukuyama are of great relevance to understand the notion of 'social capital' more accurately. For a good overview on the current debate on 'social capital' I refer to Hooghe, M. & D. Stolle, (2003), "Conflicting approaches to the Study of Social Capital. Competing explanations for Causes and Effects of Social Capital", *Ethical Perspectives*, Leuven, Vol.10: 21-44, and Portes, A. (1998), "Social Capital: its origins and applications in modern sociology", *Annual Review of Sociology*, Vol.24: 1-24.

capital. Indeed, it is the manipulation of proper relationships and networks that can cause “loss of face”, and thus, decreased symbolic capital.

However, an emphasis on the instrumental ends rather than the cultivation of relationships does not support the increase of either social or symbolic capital. Nevertheless, businessmen are advised to subordinate immediate interests for the cultivation of a relationship to create a resource that can be repeatedly utilized over the long term, yet does not cause the donor to lose face despite the lack of subtlety of his blatant manipulation. Although the gift – ambiguous as it is – attaches priority to the relationship, it can be easily manipulated or exploited, and end up as a bribe (Noonan, 1984; Verhezen, 2009). The reciprocal social obligation created by a gift must be and is implicit; although it no longer holds true when the gift drifts towards been a bribe or results in a failed gift performance, which then made it explicit. The political introduction of an institutionalized monopoly has been a contributing factor to induce gift exchanges to become predominantly instrumental. Monopolists have the power to extract rents from their position in (official) office, inducing to get engaged in such “corrupting” behavior undermining the neutral objectives of “office” [to serve all citizens in an equal and fair manner] itself.

Networks or positive social capital can usually be distinguished from nepotism or negative social capital structures, by focusing on their results or outcome. Networks of *guanxi* are usually characterized by ‘general’ or ‘positive’ reciprocity, whereas nepotism could well be characterized by inappropriate pure mutuality or instrumental reciprocity, or even by ‘negative’ reciprocity. A notorious example of negative social capital is the inclusive network of the mafia where the instrumental rather than the social value of relationships is made obvious. The mafia network springs from trust built through giving favors to individuals – in an environment that lacks credible and effective systems of justice and law enforcement. The violent side of the Mafioso is a logical consequence of the effort to enforce the monopoly of otherwise legal goods (Gambetta, 1988).

If *guanxi* now is permeated by instrumentality, self-seeking opportunism, and dishonorable attitudes and behaviour rather than by trust relationships based on mutual warmth, loyalty and respect, then an ethically justifiable *guanxi* network easily transgresses into a corrupted nepotistic *guanxi*. Given the lack of strong effective legal institutions and civic traditions, and the overwhelmingly networked nature of Asian society, based on family networks. Moreover, if a weak judicial system does not provide any constraining deterring signal to curb the excesses of corrupt behaviour, then “manipulative” relationships or *guanxi* will thrive, undermining the glue of normal social exchanges.

The Transgression of Networks in Nepotism

As mentioned above, *guanxi* involves not only instrumentality and rational calculation, but also sociability, morality, intentions and personal affections. In other words, ambiguity and subtlety are the very essence of *guanxi* relationships, making it sometimes difficult to distinguish their differences. However, when the instrumental value becomes predominant, or when rituals aiming at social and personal relationships are no longer strictly applied, one falls back into the pure instrumentality of a relationship. At that point in time a network assumes the character of a nepotistic relationship, as it veers from its initial intentions of preserving harmonious reciprocity and social structure within a community.

How could networks and alliances be ‘negatively’ (from a certain normative point of view) used and be turned into clientelism and nepotism? The question is not whether one is allowed to instrumentally use personal or social relationships, *guanxi*, for personal gain, but when *guanxi* becomes purely instrumental and then nepotistic.

Guanxi has several characteristics that differentiate it from nepotistic or patronage corruption, and thus allowing for a threshold between inappropriate nepotism *sensu stricto* and appropriate network to be demarcated. One distinguishes five major possible demarcation criteria differentiating ‘legitimate’ networks from ‘inappropriate’ nepotistic corruption: (1) the presence of moral and social norms, (2) the time horizon, (3) the ‘cultural’ interpretation of legitimacy of a gift, (4) the nature of the transaction and relationship – i.e. the use of Social Capital – and (5) the transferability of *guanxi* relationships.

1) Embeddedness in norms:

A certain level of embeddedness in a network of community strings will enhance trust between persons. It is precisely the notion of reciprocity within such community network which adds a flavor of impartiality (beyond pure personal rationality or interest) to particularized trust (Uslaner, 2002). When the impartiality of networks in which shared common norms and values are transformed into a specific alliance with particular and pure instrumental (self-) interests that are detrimental to the public interest then the network fades into a corrupted and often nepotistic alliance. It is well understood that power, influence and self-interest is at work within most networks, yet a certain level of impartiality of common nature, norms and values can be expected in appropriate networks or nepotistic systems. Networks are part of an organization’s capital making for easier access to information and knowledge, or for a better understanding of influences or for ascertaining power. Contracts or favours obtained are gained through purely Machiavellistic exploitation of networks and

connections, and of denying competitive fairness to other players in the market instead of through competitive merit or superior quality of products or services. In a more negative perspective, and owing to the unique character of its relationship combining trust, dependence and favors, *guanxi* often leads to insider-based decision making as it runs counter to the idea of transparency and openness; hence, its unethical or unacceptable reputation. Because *guanxi* is based on trust and implicit reciprocity, a *guanxi* ‘gift’ can hardly be refused. Obviously, if networks or ‘*guanxi*’ transgress into nepotism, one faces an ethical dilemma: either one engages in long-term business relationships with a certain minimum level of ‘common good’ in mind, or one colludes in bribery (usually shorter term) which usually is associated with close relationship with bureaucratic power.

2) *Time horizon:*

Nepotism is usually based on transaction-based exchange, whereas genuine *guanxi* networks refer to long-term relationship. Admittedly, the time horizon between nepotism and network is sometimes very vague and non-deterministic. Hence why, other variables such as legality, transferability and the nature of transaction need to be regarded as additional yardsticks to distinguish nepotism and patronage from genuine *guanxi* relations.

3) *The nature of the relationship:*

The moral threshold, i.e. ‘reasons to value’, of the possible transgression resides in the fact that the relationship becomes purely instrumental. Under some description all relationships (even intimate ones) have instrumental aspects and the threshold of this unspecified moral theory itself consequently becomes blurred. Moreover, most relationships are not one-dimensional and virtue and vice merge in personalities as well as in relationships. In other words, the nature of any relationship is mostly intentional and very hard to detect or to analyse, making *guanxi* networks so complex and often ambiguous.

4) *Cultural legitimacy:*

When the cultural ritual of *guanxi* turns into a rent-seeking *guanxi*, the network may become a form of instrumental nepotism. Obligations and the notion of reciprocity as well as some favor seeking - which are all quite predominant in Indonesian rural areas among villagers and among kinfolk - are obvious and respected, whereas the rent seeker or recipient is usually a powerful bureaucrat - reflecting an authoritarian state’s organizational hierarchy - with some monopolistic powers. In the place of social and personal relationships, power becomes the driving engine in nepotism which undermines the moral value of empathy or *renqing*. This form of negative social capital then turns into symbolic or economic profit, accrued from a position of power and no longer driven by social rites and rules of courtesy.

The social relationship is turned into an instrument to enrich the agent instead of the principal. Hence, why *guanxi* or networks are an acceptable practice among Indonesian and or Chinese communities despite the fact that pure nepotistic patronage or clietelism has been widely condemned. Although *guanxi* involves an exchange of favors characterized by genuine feelings of empathy, it is inherently a social transaction and not a pure monetary exchange as the cost of noncompliance is a loss of face. On the contrary, nepotism and patronage refer to an economic transaction between known – or even kin and friends – parties, and often has legal consequences.

5) *Transferability*:

Long-term *guanxi* ties and obligations can be transferred to other members of the network, whereas those of corruptive nepotism can hardly be transferred unless by or to other close family members as they reflect the transaction-based covert relationships between two (often known) parties that are usually ‘blood’-related. The role of network in Indonesian Chinese business culture provides a dramatic example of an entrenched cultural norm that has come under pressure from international business trends.

Could this pressure to abandon *guanxi* be partially explained by the globalization and the “Westernization” of rules of law in Indonesia and Asia in general? *Guanxi* – expressed through the means of gift practices and favors yet emphasizing good faith, respecting another’s face - inherently contains the ambiguous criteria of passing the threshold of proper courtesy and *renqing* that makes it possible to turn this cultural ritual into a useful instrument for competitive advantage garnered by an agent for its illegitimate personal gain. Although *guanxi* is firmly entrenched in some cultural rituals, it does not excuse it from being turned to ends far from its original ethical and social objectives. In entering a personal or social relationship, the corporation or the executive is always faced with a certain ethical dilemma when at a particular point in time this relationship evolves and develops an instrumental and useful value.

Perhaps *guanxi* could be seen as an entry barrier in an Indonesian business context since a lack of *guanxi* may constitute a comparative disadvantage. That was very obvious during the Soeharto regime, but still prevails today, though maybe to slightly lesser extent. In that sense, *guanxi* can be compared to the Western concept of relationship marketing which is related to trust and involves taking actions to create tightly linked connections between business parties for an enduring long-term business relationship (Dunfee & Warren, 2001). These relationships are based on the assumption that humans are social creatures and that social bonding underpins many other forms of social and personal interactions.

Any governance mechanism should aim to balance the arm's length principle that emphasizes the importance of neutral objectivity in managerial decisions and some form of relationship that binds people. *Guanxi*, unfortunately, quite often results in personal gain for the agent [and executives] as individual beneficiaries of the nepotistic relationship which makes this relationship from an efficiency, effectiveness and merit point of view, *highly* problematic. Moreover, the Western concept of network marketing is structured to benefit the organization, whereas *guanxi* often benefits the agent [at the expense of the principal] in an inappropriate manner. Because of the subtlety, discreteness and ambiguity of networks in *guanxi*, one can hardly figure out if those *guanxi* connections are used for personal or for organizational gain.

One should not forget that the cost of establishing and maintaining *guanxi* can be quite costly – ranging between 5-15% of the total cost in doing business in China (Fan, 2002) which could be quite similar for Indonesia - nor does it necessarily decrease uncertainty since there is a non-specified time gap between the initial and the counter gift. A survey indicated that most business people in China (both foreign and local ones) named branding, quality and distribution channels rather than *guanxi* as the most important factors in achieving marketing or financial goals (Fan, 2002). It also argues that highly personalized social relations and exchanges may increase personal or 'particularized' trust between *guanxi* parties, but they run the risk of lowering the procedural justice of perceived impartial neutrality and can therefore negatively affect 'generalized' trust and trust at the institutional level. In the complex Indonesian business context, one should acknowledge that relationships are usually a combination of emotional feelings and reasons of instrumental usefulness. However, when the instrumental intentions become predominant, unethical behaviour may result, especially in the absence of or lack of functioning social norms, moral values and weak judicial and legal mechanisms to enforce the law in an equitable manner.

The competitiveness of an operating environment is correlated with executives' attitudes towards *guanxi* and toward its ethical grounding. Ethics may not immediately pay off, but it definitely wields influence in any relationship. With growing globalization and intertwined international economies, the (international) "rules of the game" will at least to a certain extent likely converge in the respective business environments. Meanwhile, the availability of information flows and knowledge easily accessed through the use of the Internet, and combined with the rapidly escalating worldwide condemnation of corruption as a powerful and destructive disease for any institution or nation will not only definitely influence the nature but also decrease the business usefulness of *guanxi*. However, despite the

internationalization of the Indonesian economy, quite a huge number of Indonesian family business executives still rely on *guanxi* networks, i.e. preferring to do business within the *guanxi* network, exploiting legal loopholes or smoothing out favorable business decisions from government officials. That also explains Indonesian executives' strong resistance to official governance and supervision, and this is understandable given that they could not rely on an impartial legal system to guarantee fairness and neutrality in applying the law. Sometimes, those Indonesian businessmen have no real "choice" but to comply to pressures from officials to "help out", especially if these businessmen have become very visible. They are often "requested" to pay back some of their wealth "for the sake of the community". It often becomes a subtle form of extortion.

How will *guanxi* evolve in the future? Will it decline or does it remain entrenched in Indonesian (and Asian) culture? With globalization, the outcome on *guanxi* in Indonesia is unclear. There are basically two schools of thought with respect to the future evolution of *guanxi* in Indonesia's fast-paced business environment. Some believe that the role of *guanxi* may decline in the face of market forces and expect that business in and beyond Indonesian borders will compete on a level playing field based on arm's length-transactions. The other school of thought maintains that despite economic advances *guanxi* will remain entrenched and deeply embedded in the Indonesian hierarchical culture and will, and will likely continue to influence business conduct in the future.

Expanding a minimum of procedural neutrality in terms of unbiased procedures and some policies structured towards impartiality will help increase 'generalized' trust in management and benefit merit based efficiency in companies. In short, if they occur in public domains of life when there is a high potential for conflicts of interest and if they are examined through the lens of justice or those of procedural justice, *guanxi* practices are more likely to be viewed as problematic. But then again, changing the underlying values of 'particularity' towards a more 'impartial' market system may take time. Any hasty transition may be questioned. And we should not ignore the important fact that *guanxi* – or any (business) relationship for that matter – remains a potent strategic or tactic weapon in the form of social and symbolic capital, which obviously can be turned into economic capital and gain.

Conclusion

Since Indonesia is still characterized by certain institutional weaknesses and institutional voids, businessmen have used networks to fill in for the lack of impartial

mechanisms to survive or thrive. Since most businesses in Indonesia are still dominated by families, or the state, relationship building has been deeply engrained in the way businesses are conducted in Indonesia.

Any network or *guanxi* can be either legitimate and therefore ethically appropriate, or it can turn into a nepotistic and inappropriate relationship. We have attempted to provide some useful critical factors which could demarcate the threshold between ‘legitimate’ networks and ‘inappropriate’ nepotism, patronage or clientelism. The nature of the relationship of *guanxi* is very much determined by a tendency as to which side one is leaning to.

Although most Asian countries are slowly moving from a person-based to a rule-based society where the importance of relational and procedural neutrality in managerial decisions is acknowledged, powerful networks with government officials and bankers remain a very important ingredient in the success of Indonesian family business. The personal use of *guanxi* may be elevated to an organizational level and is often interpreted as part of the social and customer capital of the organization, despite the ascending value of the rule of laws, merit-based reward, and global competitiveness. In a growing “capitalistic” oriented economy based on merit and competition, accountability, transparency and formal rules, the influence of *guanxi* as an instrument to gain personal advantage may decrease over time while its social meaning may remain entrenched in cultural life.

Nonetheless, Indonesian family and especially state companies which are more keen to be competitive and thus more-profit oriented tend to be more concerned not with ethics but with *guanxi* and its instrumental use. Hence, completely avoiding the less socially benevolent or even pure instrumental and negative side of *guanxi* will prove to be extremely difficult and even naive. Blindly accepting *guanxi* as a cultural Indonesian practice without questioning its intentions and the possible consequences for a company would also be a grave mistake. It would be wise to understand the opportunities and pitfalls of networks or *guanxi*, allowing it to play its social role in the Indonesian society and business context by advocating appropriate networks while acknowledging its intrinsic ambiguities and temptations. That is what integrity is all about. Without legitimate leadership that has proven to show integrity, corporate governance mechanisms will remain nothing but window-dressing at best. Indonesian family businesses deserve better. Nothing wrong with networks, as long as the leadership or patriarch is guided by principles that are in line with “best practices”, instead of short term opportunism.

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