

# Can *Guanxi* Influence Firms' Dynamic Capabilities? Evidence from Triadic Relationships in East Asia's Automobile Industry

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Received: December 30, 2024    Accepted: January 20, 2025    Published: February 7, 2025

doi:10.5296/csbn.v11i1.22519    URL: <https://doi.org/10.5296/csbn.v11i1.22519>

## Abstract

This study advances the discourse on strategic management by integrating resource-based and capability-based frameworks with an informal social network perspective, specifically examining the role of *guanxi* in shaping dynamic capabilities within firms in East Asia's Automobile Industry. This study explores two key dimensions: (1) the impact of *guanxi* on the development of dynamic capabilities and (2) the interaction between *guanxi* and formal institutional structures. This research employs a longitudinal case study approach to analyze the experiences of an automobile manufacturer in Taiwan during its business collaborations with Japanese and mainland Chinese partners. This study elucidates how specific attributes of *guanxi*-sentimentality, reciprocity, functionality, and openness-enhance the firm's ability to develop dynamic capabilities and effectively navigate the volatile market conditions prevalent in East Asia. This research underscores the strategic importance of *guanxi* in corporate management and offers critical insights into leveraging relational networks to achieve a sustainable competitive advantage in East Asian markets. Furthermore, this study provides implications for multinational automobile manufacturers aiming to develop new capabilities to address operational challenges in this region.

**Keywords:** *Guanxi*, Dynamic capabilities, Informal social networks, East Asia, Automobile industry

## 1. Introduction

*Guanxi*, as a complex relational network, carries significant implications for firms in East Asia. Research on *guanxi*, viewed through the lens of social capital, has increasingly focused on its role in establishing and sustaining competitive advantage, especially within rapidly evolving economies such as China. The importance of the social capital embodied in managerial ties with top executives from other firms and government officials is well recognized, particularly during periods of economic turbulence (Chen & Wu, 2011).

*Guanxi*, encompassing social ties at both interpersonal and inter-organizational levels, plays a critical role in organizational dynamics. At the interpersonal level, managers' *guanxi* networks are pivotal in shaping various organizational processes, such as social capital accumulation, knowledge absorption, and organizational learning (Huning et al., 2015). By

fostering individual integration and cultivating a network environment conducive to dialogue and constructive dissent, managers can significantly enhance their firm's adaptive capacity. High-quality relationships within firms enable the development of dynamic capabilities, which are essential for navigating organizational change and unlocking innovative potential (Salvato & Vassolo, 2018). Therefore, it is imperative to investigate the impact of managers' *guanxi* at the personal level on inter-organizational relationships and the development of dynamic capabilities within firms.

At the inter-organizational level, *guanxi* functions as an informal institution critical to business operations in East Asia (Horak & Restel, 2016; Wang, 2000). Consistent with previous studies, Chen and Wu (2011) classify *guanxi* networks into two primary categories: connections with the business community and connections with governmental authorities. These networks are cultivated through managers' horizontal ties with task environments and vertical relationships with government officials. Business ties, encompassing relationships with suppliers, distributors, and other stakeholders within a firm's industrial community, are instrumental in fostering cooperation and facilitating business development through the alignment of shared objectives (Adler & Kwon, 2002; Peng & Luo, 2000). Such connections not only enhance the exchange of information and business opportunities (McEvily & Zaheer, 1999; Uzzi, 1996), but also serve as a mechanism for mitigating conflicts (Graca & Barry, 2018). Moreover, given the power asymmetries between governmental and business entities (Chen & Wu, 2011; Peng & Luo, 2000), a positive relationship between managers and government officials can provide firms with access to valuable non-industrial resources, such as bank loans (Li et al., 2008), regulatory advantages through political engagement (Burt et al., 2018), connections to new social and business capital (Hou & Zhu, 2020), and a broader array of business development opportunities (Putnam, 2000).

Although numerous studies have investigated the pivotal role of *guanxi* in organizational contexts, the influence of *guanxi* on dynamic capabilities, particularly within the framework of sustainable enterprise performance or sustainable development goals (Yipeng Liu, 2024), remains inadequately explored. In times of economic turbulence, firms must anticipate how current decisions will impact their future capabilities, including managing risks associated with climate change, resource scarcity, and social instability. Existing research has primarily concentrated on specific dynamic capabilities, such as logistics capacity (Fearon et al., 2013) and adaptive and resource-bridging capabilities (Chen & Wu, 2011), while incorporating the *guanxi* construct in a limited scope. Other studies have predominantly highlighted the adverse effects of *guanxi* on corporate dynamic capabilities, often using quantitative approaches (Abosag et al., 2021). However, there has been a notable gap in addressing a comprehensive view of corporate dynamic capabilities through the lens of informal institutional elements within *guanxi* dyads. This study aims to fill this gap by applying a dynamic, longitudinal approach, underpinned by substantial historical evidence, to explore the relationship between *guanxi* and corporate dynamic capabilities within the East Asian cultural context. By conducting detailed case studies, this research seeks to advance the literature by providing empirical support for a theoretical framework that integrates informal institutional perspectives into the study of dynamic capabilities and sustainable performance.

Our study delineates sentimentality, functionality, reciprocity, and openness as the defining characteristics of *guanxi*, in alignment with the strength of relational ties. Building on the refined conceptualization of *guan* and *xi* (Li et al., 2019), we identify three distinct scenarios-inception, restructuring, and expansion-in which *xi* networks can enhance *guan* dyads throughout a firm's development. Additionally, we demonstrate how *guanxi* supports the development of dynamic capabilities within a continuously evolving environment.

The next section synthesizes the literature on social network theory, *guanxi*, informal institutions, and dynamic capabilities, exploring the links between these elements. Following this, the paper offers a detailed description of the longitudinal research method employed. Section Four presents the qualitative findings, and Section Five concludes with recommendations for future research.

## 2. Theoretical Background

### 2.1. Social Network Theory and Guanxi

*Guanxi* has long been a pivotal construct within the study of social network theory, particularly in the Chinese cultural context (Burt et al., 2018; Lu et al., 2018; Zhang & Gill, 2019). The theoretical underpinnings of this research are deeply rooted in the core principles of social network theory. Simmel (1950) initially introduced the concept of social networks, highlighting the dualistic nature of individuals and groups within social structures. Building on this foundation, Granovetter (1985) underscored the significance of “weak ties” in social networks, arguing that such ties facilitate the acquisition of superior information through interactions with acquaintances rather than close connections. Furthermore, Coleman and James (1990) further developed this perspective by exploring social networks as arenas of competition for social resources, suggesting that the formation of social relationships is driven by deliberate and rational decision-making. Central to social network theory is the premise that individuals strategically engage with these networks to secure essential resources for their activities.

Building on this foundation, Burt (1992) introduced the structural holes theory, highlighting non-redundant information sources constituting the most efficient network structure. He emphasized that the more autonomous an individual's position within a network, the more independent, efficient, and well-informed they become, thereby enhancing their ability to mobilize resources (Burt, 1992), foster creativity (Burt, 2004), and adapt supervision management modes (Burt & Wang, 2022). Bian (1997) conducted a series of studies examining the role of social networks in job-seeking, promotion, and enterprise development. Lin (2001) further explored how individuals can acquire social resources and elevate their status through social networks, thereby reinforcing the importance of *guanxi* within the broader framework of social network theory.

Building on the aforementioned research, there is a compelling indication that *guanxi* may function as a pivotal driving force within social networks, manifesting as the “freedom source for individuals and organizations,” a “bridge in structural holes,” a form of “social capital for organizations,” or as “weak/strong ties” in both social and inter-organizational interactions.

These observations prompt critical inquiries, such as “What is *guanxi*?”, “What is the nature of *guanxi*’s impact?”, and “What is the mechanism through which *guanxi* influences corporate dynamic capabilities?”

## 2.2. *Guanxi as an Informal Institution*

*Guanxi*, as a form of informal institution, refers to informal access to others’ resources due to dyadic and particular social ties (Opper et al., 2017). While formal institutions are characterized by codified regulations and laws, informal institutions are often governed by “unwritten rules” that encompass values, trust, and *guanxi* (Horak & Restel, 2016). Barbalet (2023) posits that *guanxi*, as an informal relationship, is deeply embedded in the fabric of modern Chinese society and functions as a significant informal institution. Li et al. (2019) also conceptualize *guanxi* into two dimensions: *guan* and *xi*. *Guan*, meaning “related,” pertains to direct dyadic relationships between social actors. *Xi*, in contrast, meaning “tied together,” refers to the formation of factional groups where a focal individual and other connected persons establish a differentiated network, often involving triadic or more complex relational structures.

The literature identifies four fundamental characteristics of *guanxi*: sentimentality, reciprocity, functionality, and openness. Sentimentality, often rooted in familial or quasi-familial relationships, manifests among individuals who share deep emotional connections, fostering loyalty and a willingness to offer special favors (Hwang, 1987). At the organizational level, sentimentality may lead one organization to favorably allocate resources to another, thereby strengthening relational bonds (Kaynak, 2013). Reciprocity involves the expectation that favors exchanged within *guanxi* will be reciprocated in the future, with the timing and nature of the reciprocation often unspecified (Horak & Restel, 2016). This implicit obligation sustains interpersonal and organizational generosity and cooperation (Song et al., 2012). Functionality pertains to the exchange of resources facilitated by mutual trust and closeness between managers, allowing individual *guanxi* to serve as a conduit for broader organizational benefits (Chen & Chen, 2004). Peng and Luo (2000) suggest that managerial *guanxi* can bridge organizations, transforming personal *guanxi* into collective advantages for a wider array of stakeholders, thereby enhancing firm competitiveness. Openness reflects the potential for establishing new *guanxi* through intermediaries, highlighting the dynamic and transferable nature of *guanxi* (Horak & Taube, 2016). These characteristics of *guanxi* are evident within the dimensions of *guan* and *xi*. However, the interaction between *guan* dyads and *xi* networks across these four characteristics and their impact on a firm’s development of dynamic capabilities remains underexplored (Horak & Restel, 2016; Wang, 2000). *Guanxi* is frequently conceptualized as a form of social capital, with the potential to enhance corporate capabilities through both internal and external avenues (Burt & Burzynska, 2017). Empirical studies have demonstrated that *guanxi* positively influences relationship quality, interdependence, and sales growth, though its effect on profit growth appears limited (Park & Luo, 2010).

*Guanxi* has been studied across various levels of social networks. While some researchers, such as Adler and Kwon (2002), focus on the corporate networks of depersonalized ties,

others, including Li (2007) and Wellman and Frank (2017), emphasize personalized ties as a more appropriate level of analysis. The personalized level is particularly relevant in the Chinese context, where managerial behavior is shaped by shared cultural values and behavioral norms (Horak & Restel, 2016; Wang, 2000). *Guanxi* is frequently conceptualized as a form of social capital, with the potential to enhance corporate capabilities through both internal and external avenues (Burt & Burzynska, 2017). Empirical studies have demonstrated that *guanxi* positively influences relationship quality, interdependence, and sales growth, though its effect on profit growth appears to be limited (Park & Luo, 2010).

Conversely, another group of researchers questions the uniformly positive effects of *guanxi*, despite its recognition as a form of social capital. They contend that the efficacy of *guanxi* is contingent upon various contextual factors. For example, in environments with underdeveloped legal frameworks, executives of private companies are more dependent on *guanxi* compared to their counterparts in state-owned or collective-hybrid firms (Xin & Pearce, 1996). While *guanxi* networks can facilitate market access and business growth, it is crucial for managers to effectively leverage these networks from the personal to the corporate level (Gu et al., 2008). Furthermore, research distinguishes between business and political *guanxi* ties, with findings suggesting that business ties generally lead to economic benefits, whereas the outcomes associated with political ties are more inconsistent (Chen et al., 2013).

The primary disadvantages of *guanxi* are often associated with the additional time and costs it incurs (Lee & Humphreys, 2007). First, businesses must adopt a *guanxi*-oriented approach when interacting with Chinese partners. Second, they should recognize that *guanxi* does not always guarantee commitment. Finally, sustained efforts are required to cultivate and maintain *guanxi*, which, while potentially offering a competitive advantage in securing an insider position within the Chinese business environment, cannot completely mitigate threats and competition (Abosag et al., 2021; Henry et al., 1998; Hung, 2021; Ren & Chadee, 2020).

Building on previous research that has explored both the positive and negative impact of *guanxi*, this study posits that *guanxi* can positively influence corporate dynamic capabilities when strategically managed and cultivated. This effect is particularly pronounced within the cultural context of East Asia and for multinational corporations that have effectively offset the initial costs associated with *guanxi* cultivation and operation (Horak & Taube, 2016; Horak et al., 2019; Murray & Fu, 2016; Wang & Woods, 2013). Moreover, established firms derive substantial benefits from both internal and external *guanxi*, especially when navigating similar external or internal environmental changes and challenges (Cao & Quazi, 2017; Su et al., 2017; Tang & Ke, 2013).

### 2.3. *Guanxi and Corporate Dynamic Capabilities*

The concept of dynamic capabilities, as proposed by Teece (2007), emphasizes a firm's capabilities to capitalize on market opportunities and manage risks in an uncertain business environment. This involves three fundamental processes: sensing opportunities and risks (sensing), seizing identified opportunities (seizing), and reconfiguring resources to sustain competitive advantages (reconfiguring). This framework extends the resource-based view (RBV) of the firm proposed by Barney (1991), which asserts that a firm's competitive



advantage stems from its possession of heterogeneous resources that are valuable, rare, inimitable, and non-substitutable.

The RBV and dynamic capabilities perspectives assume that firms can independently deploy their resources to sustain competitive advantage (Kindström et al., 2013). However, these frameworks often overlook how firms acquire and leverage “relational” resources through the establishment, development, and maintenance of relationships with business partners (Madhavaram & Hunt, 2008). This oversight is particularly significant in transitional economies like China, where formal institutions, such as legal contracts, may be weak, and informal institutions, such as shared history and ethnic ties, are robust (Pinkham & Peng, 2017). Consequently, analyzing dynamic capabilities in isolation from informal institutions can be problematic, as these institutions can significantly influence inter-organizational relationships and the roles of other entities (Giuliani, 2013). For instance, the embeddedness of relationships within the home country network, encompassing both domestic and foreign enterprises, can impact the dynamic capabilities of Chinese multinational corporations (Du et al., 2021).

Numerous researchers have explored the relationship between social networks and corporate dynamic capabilities. Some scholars argue that strengthening relationships with government entities through *guanxi* can enhance overall logistics capacity (Fearon et al., 2013). Additionally, the nature of *guanxi*-whether with government agencies or business partners-significantly influences the development of adaptive and resource-bridging capabilities (Chen & Wu, 2011). Business *guanxi* has been shown to positively affect key components of dynamic capabilities, such as environmental perception, learning, integration, and coordination, all of which are essential for sustaining competitive advantage. In business partnerships, *guanxi* reduces competition and fosters stability (Wong & Tjosvold, 2010). Furthermore, the concept of relationship management, while varying in form, demonstrates similarities across cultures, reflecting its importance in managing relationships in different cultural contexts (Mukhtar et al., 2022). Several studies have also highlighted the relational perspective of dynamic capabilities. For example, Kim et al. (2013) discussed how relationship-enabled responsiveness contributes to customer value creation, while Alinaghian and Razmdoost (2018) focused on the role of network resources in developing network-oriented dynamic capabilities. Furthermore, network capability has been incorporated into the framework of corporate dynamic capabilities from a resource-based view perspective (Mcgrath et al., 2019).

*Guanxi* continues to be a fundamental managerial framework, deeply ingrained in the mindset of managers rather than being merely a reactive cultural norm. It is increasingly recognized as a proactive mechanism through which Chinese firms can achieve sustainable strategic objectives and economic success in the highly competitive modern business environment of China (Cao & Quazi, 2017). Despite the significant role of *guanxi* in East Asia, existing research on the relational perspective of dynamic capabilities has largely neglected the potential applications of the *guanxi* approach. Specifically, the interaction between *guan* dyads and *xi* networks, and their combined impact on a firm’s dynamic capabilities, remains underexplored.

### 3. Research Objective, Methodology and Data

#### 3.1. Research Objective

This study seeks to explore the impact of managers' *guanxi* on the evolution of firms' dynamic capabilities. By synthesizing insights from dynamic capabilities theory and informal institutions, this research addresses the following key questions (R.Q.s):

R.Q. 1: How do managers cultivate *guanxi* with stakeholders?

R.Q. 2: How does *guanxi* shape the development of firms' dynamic capabilities?

#### 3.2. Methodology

We employ a longitudinal case study to explore the causal relationship within a complex context characterized by multiple influencing factors and limited observations (Yin & Thousand, 2009). The existing literature does not clearly delineate how each of the four *guanxi* characteristics impacts firms' dynamic capabilities. By adopting a longitudinal case study approach, we aim to uncover the detailed processes and mechanisms through which firms engage with actors in the same business environment, as well as the contingent circumstances under which these mechanisms operate (Huber, 1995).

The longitudinal case study centers on Yulon Motor Co. Ltd. ("Yulon"), which developed dynamic capabilities through its interactions with network actors across East Asia, including Japan's Nissan Motor Corporation ("Nissan"), mainland China's Dongfeng Motor Corporation ("Dongfeng"), as well as government officials and customers from both Taiwan and mainland China. Yulon was selected as the focal case for two primary reasons: (1) it exemplifies the perception and application of *guanxi* in Taiwan and mainland China, regions characterized by varying degrees of government intervention; and (2) Yulon's extensive development history, spanning over 70 years, provides a comprehensive perspective on the dynamics of *guanxi* interactions and the evolution of dynamic capabilities. Table 2 presents the key events in Yulon's development.

#### 3.3. Data Collection and Analysis

To collect primary data, we conducted open-ended, in-depth interviews with Yulon's senior managers and performed site visits. Additionally, we interviewed key informants from Yulon, Dongfeng and Nissan to gain insights into the Yulon-Nissan and Yulon-Dongfeng collaborations, ensuring the reliability of primary data from multiple perspectives. Throughout this process, we continuously supplemented and updated our data as needed. Data collection spanned from 2023 to 2024.

The transcripts and secondary data were imported into NVivo 11 (QSR International) for analysis. We used NVivo 11 to identify themes related to *guanxi* characteristics and dynamic capabilities. Initially, the case data were coded by source to delineate the main stages and key events in Yulon's development. Subsequently, using a priori codes derived from the literature, we coded three key aspects: situational contexts, the evolution of *guanxi*, and dynamic



capabilities, thereby forming second-order codes. In instances of differing opinions, the research team engaged in discussions to reach a consensus.

#### 4. Results and Discussion

Since its establishment, Yulon has navigated dynamic and turbulent business environments. Its founder and chairman actively cultivated *guanxi* with government officials, business partners, and customers across the Taiwan Straits. The following sections outline the three stages of Yulon's dynamic capabilities: (1) the inception stage in Taiwan (1953-1994), (2) the restructuring stage (1995-2004), and (3) the expansion stage (2005-present). This three-stage approach illustrates the institutional context during each period, the causal relationship between managers' personal *guanxi* and the firm's dynamic capabilities development, the influence of *guanxi* on relationships between firms from Taiwan, mainland China, and Japan, and the interaction between *guanxi* and formal institutions in both Taiwan and mainland China.

##### 4.1. The Inception Stage (1953-1994)

###### 4.1.1. Business Environment

After World War II, Taiwan's economy experienced significant growth (Gee, 1992), yet its automobile industry remained underdeveloped. In response to political leader Chiang Kai-shek's call for entrepreneurs to "produce domestic engines to save the country," Ching-Ling Yen, the founder of Yulon, established the company in 1953. Concurrently, Japanese automakers, including Nissan, were seeking international business partners. As a result, Yulon entered into a collaboration with Nissan to receive technological support.

During this period, Taiwan experienced a shortage of technical talent and spare parts essential for automobile manufacturing. Recognizing Yulon's potential significance to the local military industry, the government enacted several laws and regulations between 1961 and 1965 to protect this nascent sector. These included measures to develop the domestic automobile industry, regulations on automobile transportation management, and laws ensuring transaction security. Such regulations deterred foreign brands and established Yulon as a strategic institutional asset.

However, despite these protections, Yulon remained reliant on foreign technologies and failed to achieve technological independence for producing a "civic car." This ongoing reliance led to disappointment within the Taiwan's government, which then shifted its strategy towards establishing joint ventures between state-owned and foreign automakers to facilitate automobile exports. As a result, the government withdrew its support from Yulon, leading the company into a temporary predicament.

###### 4.1.2. *Guanxi* Development

During the inception stage, the founder's *guanxi* was primarily characterized by sentimentality. He secured policy and financial support from his townsmen, originally from Jiangsu and Zhejiang provinces in mainland China, who held government positions in Taiwan. This sentimentality also extended to his non-biological relationships with

government officials who shared similar educational backgrounds and national ambitions. For instance, leveraging his engineering background, the founder developed a close relationship with General Lin Zhu of the Air Force Aviation Technology Bureau, who provided Yulon with continuous technological support.

The founder's dedication to the automotive industry gained international recognition. Publications like *Newsweek*, *Fortune magazine*, and the *New York Times* praised him as the man who "assembled wheels to free." Consequently, Taiwan's political leader Chiang Kai-shek expressed hope that Yulon could "develop the domestic automobile industry for the urgent need of people's wellbeing." Chiang even pledged to "give priority to Yulon's automotive products, even if the initial products are not as good as foreign cars."

#### 4.1.3. Dynamic Capabilities Development

Yulon sensed Taiwan's need for a robust automobile industry and the Western auto manufacturers' need for market collaboration. This insight was informed by the founder's educational background and his shared sentiments with government officials, citizens, and relatives. Taiwan authorities supported Yulon with the expectation that the company would achieve technological independence and contribute to their administration. This reciprocity exerted coercive pressure on Yulon to repay the support it had received (Dinh & Calabrò, 2019).

The partnership with Nissan enabled Yulon to start producing sedans and commercial vehicles in 1960, allowing the company to leverage technological advancements. The relationship between Yulon and Nissan was characterized by a functional benefits exchange, with Nissan viewing Yulon as both a supplier and a subsidiary (Nie et al., 2011). In response to this partnership, Yulon invested in the co-construction of the Automobile Engineering Center (AEC) with National Central University in 1981. The AEC was crucial in designing Yulon's first major passenger car model, the "Feeling 101," which significantly enhanced pride and quickly became popular. However, the model faced persistent technical issues, resulting in numerous customer complaints. To address these problems, Yulon modified the headlights, upgraded the front disc brakes, and added a four-wheel disc braking system, culminating in the introduction of the "Feeling 102" model.

Despite Yulon's efforts to achieve technological autonomy, the company's market position did not recover. The failure of the "Feeling" models severely impacted Yulon's brand image, resulting in consecutive financial losses from 1990 to 1994. This crisis compelled Yulon to "surrender" to Nissan as an offshore supplier, repair business relations with Nissan, and focus on developing technological capabilities for automobile bodywork. Figure 1 illustrates the business environment during Yulon's inception stage, including the institutional and market contexts and *guanxi*-dynamic capability development.

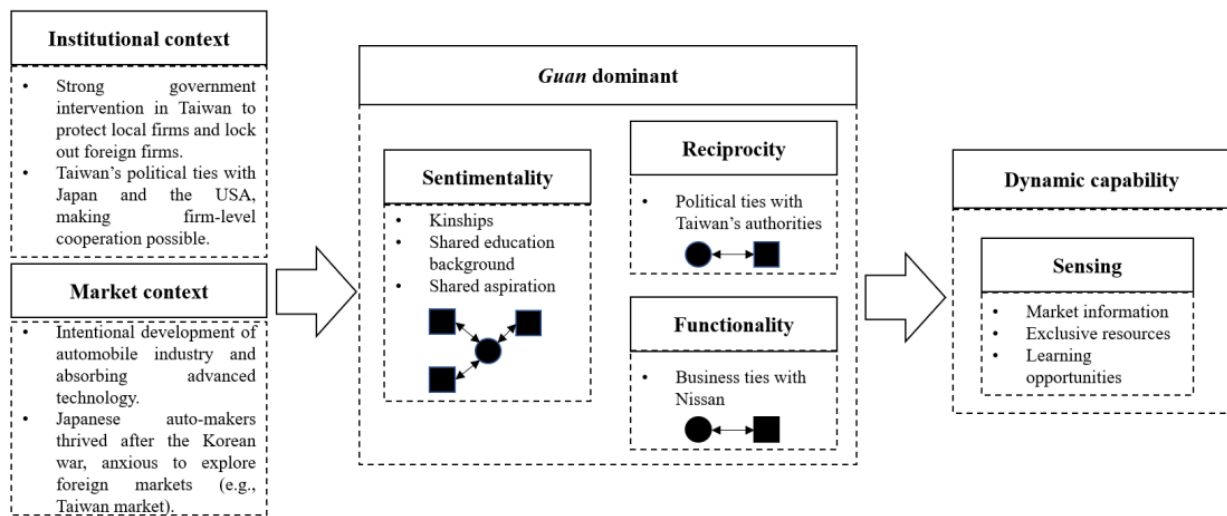


Figure 1. Yulon's business environment, *guanxi* and dynamic capability development during the inception stage. (Source: Author's creation)

## 4.2. The Restructuring Stage (1995-2004)

### 4.2.1. Business Environment

The burst of Japan's economic bubble had a profound impact on automobile sales, significantly affecting Nissan. Faced with declining sales and increasing debt, Nissan formed an alliance with Renault, and Carlos Ghosn, a Renault executive, was appointed as Nissan's CEO. Ghosn's management approach emphasized "doing whatever is necessary to make money." He implemented cost-reduction measures, including closing inefficient factories and reducing the number of production platforms and models. This strategic shift allowed Yulon to enhance its capabilities with reduced interference from Nissan.

During this stage, automakers' relationships with customers and government authorities in Taiwan were dominated by functionality. The Taiwan government recognized that developing the automobile industry required advanced technologies and large production scales, which were predominantly controlled by a few foreign giants. As a result, the government implemented more tariff reductions. The accession of Taiwan to the WTO in 2002 introduced cheaper foreign-made cars into the market, leading to a decline in local automobile sales from 462,000 units in 1996 to 347,000 units in 2001.

Simultaneously, the mainland Chinese government relied on state-owned automobile manufacturers to produce heavy vehicles, while these manufacturers were relatively weak in producing sedans. To foster technological innovation, they sought partnerships with advanced automakers.

### 4.2.2. *Guanxi* Development

Yulon's managers leveraged personal *guanxi* with government officials across Taiwan and mainland China. The newly developed *guanxi*, characterized by functionality, enabled Yulon to secure resources such as favorable industrial policies and regulatory advantages (Chen & Wu, 2011). Kenneth Yen, son of Yulon's founder, inherited his parents' deep-rooted *guanxi* with political leaders. These inherited biological ties were unconditional and sentimental, allowing the firm to access privileged information and accurately gauge market needs through a process of sensing. Kenneth Yen proactively strengthened *guanxi* with Taiwan's political leaders, securing a preferential stance that facilitated exclusive access to critical information and scarce resources.

Moreover, Kenneth Yen's established *guanxi* with Taiwan's political leaders served as a conduit for developing personal ties with mainland Chinese government officials. His strategic lobbying efforts aimed at ensuring stable political relations and favorable cross-strait trade policies, though these ties were more functional in nature. Mainland authorities regarded him as an investor, while business leaders viewed him as a partner, allowing Yulon to secure external resources, including special favors and industrial insights(sensing), which significantly advanced the firm's capability development.

#### 4.2.3. Dynamic Capabilities Development

The development of Yulon's dynamic capabilities was further catalyzed by Nissan's crisis, which provided Yulon with opportunities to enhance its R&D capabilities, thereby differentiating its product offerings and strengthening its position within Nissan's global network. Yulon assumed control of Nissan's underperforming operations, exploiting opportunities across Nissan's value chain and evolving from an OEM division into a strategic partner. In 1999, Yulon was invited to take over Nissan Philippines and develop the new Sentra HV model, aiding Nissan's penetration into the Southeast Asian market.

Yulon's success extended to its collaboration with Dongfeng, a mainland Chinese automaker, where it redesigned the Altima model on behalf of Nissan. The model's commercial success not only demonstrated Yulon's design capabilities but also solidified its strategic partnership with Dongfeng, leading to the joint establishment of Fengshen Automobile Company. Yulon strategically reconfigured its capabilities in car model differentiation, manufacturing, and marketing, achieving a competitive edge in the Chinese mainland market, a space where many non-local brands struggled to integrate with local manufacturing resources.

The renewed partnership with Nissan allowed Yulon to internalize motor frame design capabilities and adapt Nissan's engine and chassis systems to meet East Asian market preferences. Kenneth Yen's *guanxi* was instrumental in Yulon's acquisition of technological capabilities and the reconfiguration of assets, transforming Nissan's Cefiro Model into a top seller in Taiwan. Yulon's resource reconfiguration was facilitated by its functional ties with Nissan, characterized by formal transactions, and its dynamic relationship with Dongfeng, which was also marked by functionality. Figure 2 illustrates the business environment, institutional and market contexts, and the role of *guanxi* in the development of dynamic capabilities during Yulon's restructuring phase.

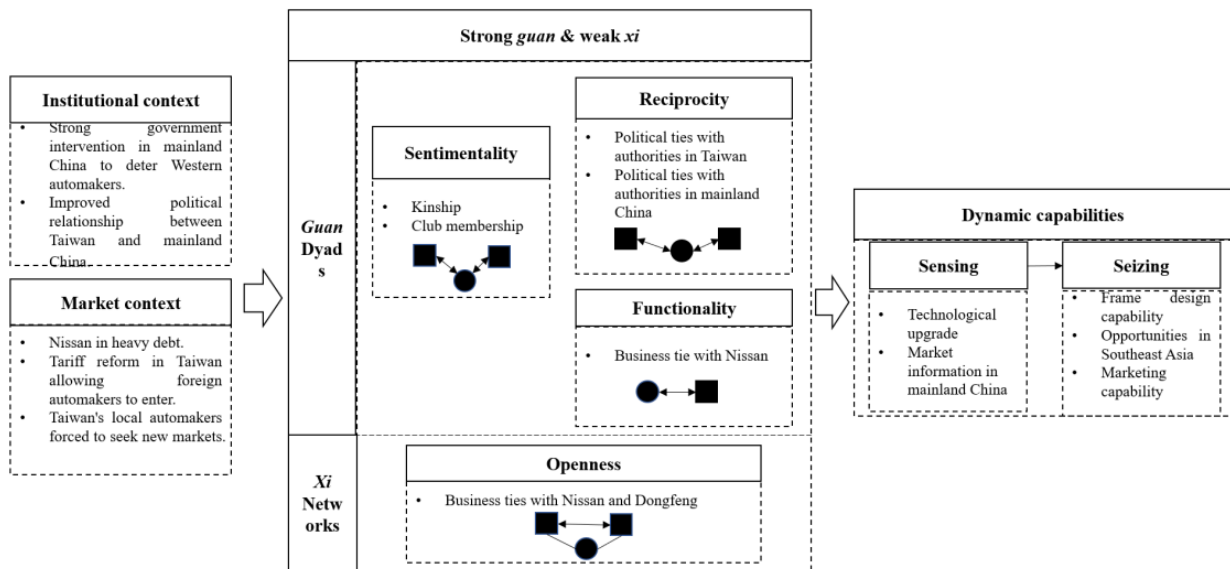


Figure 2. Yulon's business environment, *guanxi* and dynamic capabilities development during the restructuring stage (Source: Author's creation)

### 4.3. The Expansion Stage (2005-present)

#### 4.3.1. Business Environment

The mainland Chinese government restricted non-mainland capitals from independently registering automobile manufacturers. Instead, non-local firms were required to establish joint ventures with local partners to gain market access, thereby potentially facilitating technological spillovers. During this period, the relationship between mainland China and Taiwan was showing signs of improvement. In March 2005, Lien Chan, the political leader of Taiwan's Kuomintang (KMT), led a historic delegation to mainland China. This meeting, the highest-level interaction between the KMT and the Chinese Communist Party (CPC) since 1945, marked a significant thaw in cross-strait relations, easing some regulatory hurdles for businesses operating across the Taiwan Strait. The 2010 Economic Cooperation Framework Agreement (ECFA) between the mainland and Taiwan further reinforced this trend by reducing tariffs and business barriers. These developments illustrate how shared historical and ethnic ties-informal social networks-can influence the shaping of formal institutions and the removal of legal obstacles for businesses.

#### 4.3.2. *Guanxi* Development

Yulon's chairman strategically extended his *guanxi* with mainland government officials through existing connections with Taiwan's political leaders. Nonetheless, his *guanxi* with mainland authorities remained largely functional rather than deeply embedded. As a delegate on Lien Chan's political visit to mainland China, he signed cooperative agreements with the Hangzhou municipal government, which was keen on transforming and upgrading its local automobile industry by attracting prominent automakers. During this visit, Ping Xu, president of Dongfeng, warmly welcomed Yulon's chairman and formalized a joint venture agreement

with Yulon for automobile manufacturing. The interpersonal *guanxi* between the leaders of the two organizations, characterized by Chinese reciprocity, provided Yulon with legitimacy in the business relationship and seize market opportunities.

In a parallel development, Yulon's senior management cultivated *guanxi* with Mizuno Kazutoshi, a former chief engineer, project manager, and sales manager for Nissan's GT-R model. Upon retirement, Kazutoshi was invited by Yulon's chairman to lead Yulon's technology center in Japan, overseeing R&D projects aimed at producing new models that could compete with German counterparts in terms of performance and price. Kazutoshi's role also extended to recruiting top automobile R&D talent from Japan, facilitating collaboration between Yulon's Taiwan and Japan divisions. This collaboration was instrumental in developing globally competitive automobile models, demonstrating how managers' functional *guanxi* can help firms acquire technological and human resources and transform these resources into innovative products and services.

#### 4.3.3. Dynamic Capabilities Development

In its bid to expand into the global market, Yulon registered the "Luxgen" brand for its sedan cars. However, to manufacture and market Luxgen in mainland China, Yulon needed to secure a manufacturing license, which was initially declined as Zhejiang Zhongyu Automobile Co., Ltd. lacked the necessary authorization. Leveraging his *guanxi*, Yulon's chairman sought assistance from his political allies in Taiwan. In December 2008, Yulon held the opening ceremony for Luxgen in Xiaoshan Industrial Park, Zhejiang, with the support of Lien Chan and Li Bingcai, the vice-president of the Association for Relations Across the Taiwan Straits, signaling official backing from mainland China (sensing and seizing).

Subsequently, Yulon integrated IT technologies into its Luxgen models, enhancing the cars' added value. In 2010, Yulon launched electric rental cars and established battery exchange and maintenance platforms in Taiwan. This reflects Yulon's ability to reconfigure assets to adapt to evolving market and technological conditions, a process significantly facilitated by its robust *guanxi* network. Figure 3 illustrates the institutional context and *guanxi*-dynamic capability development during Yulon's restructuring phase, emphasizing the pivotal role of *guanxi* in developing the company's dynamic capabilities.



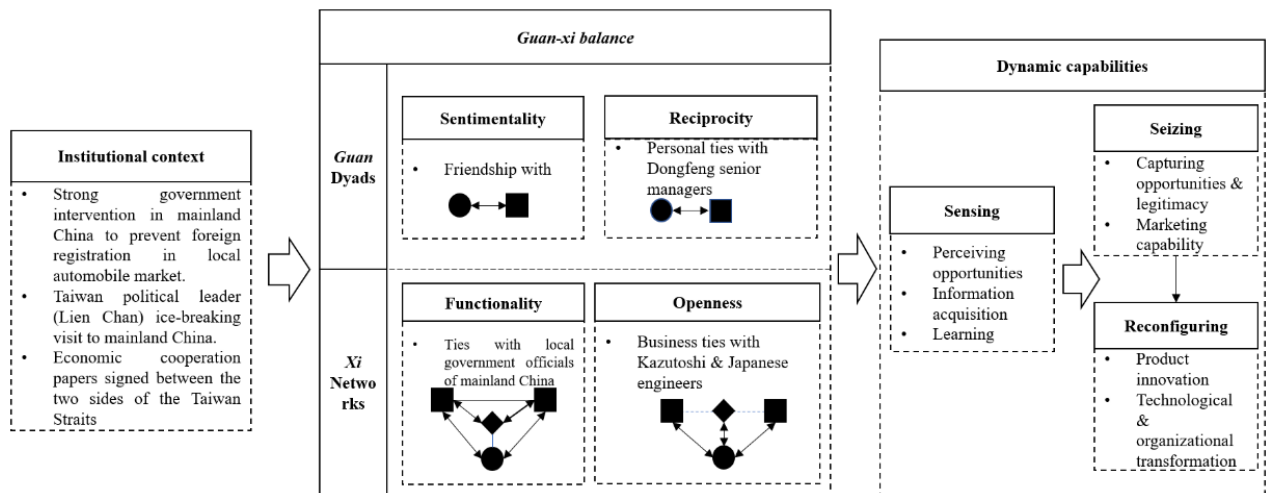


Figure 3. Yulon's business environment, *guanxi* and dynamic capabilities development during the expansion stage (Source: Author's creation)

However, the passing of former CEO Kenneth Yen and the subsequent bankruptcy of Yulon's traditional fuel energy division in Hangzhou presented the company with significant challenges. Following Yen's death, his wife, Yan Chen Li Lian, assumed leadership of the company, inheriting his extensive *guanxi* (Chen & Wu, 2011; Luo, 2014). This assures the stability of Yulon while sensing the risk caused by the change. Together with Yulon's established management team, she transformed these challenges into opportunities for operational reform by implementing a New Energy Vehicle (NEV) strategy and phasing out the traditional Luxgen brand (seizing).

In alignment with this strategic pivot, Zuozisheng, the former General Manager of Yulon Motors, leveraged his personal *guanxi* with Liu Weiyang, the former General Manager of Hon Hai Precision Industry (Foxconn's subsidiary), to initiate collaboration on next-generation NEVs. Foxconn, the world's largest electronics manufacturer, which had been exploring entry into the NEV market since 2005, found a synergistic partner in Yulon (sensing). In 2020, Yulon and Hon Hai formalized their collaboration by signing an agreement to establish a joint venture company, Foxtron. The leadership of this new venture comprised senior managers from both Yulon and Hon Hai, combining their respective strengths to achieve success in the NEV market (configuring).

By October 2023, the market reception of Luxgen's first pure electric vehicle, the "Luxgen n7," was overwhelmingly positive, with pre-orders exceeding 8,000 units in Taiwan, highlighting the vehicle's popularity. The chairman's *guanxi* with Yulon and Hon Hai facilitated mutual growth, driving both companies' progress. This strategic alliance was further exemplified by the cooperative agreement forged between Yulon, Hon Hai, and Fiat Chrysler Automobiles.

#### 4.4. Discussion

##### 4.4.1. The connections between *guanxi* and social network theory

*Guanxi*, often conceptualized as a form of social capital within the context of Chinese culture, has also been interpreted as a product of Confucian traditions (Hwang et al., 2009; Shin et al., 2007; Tan & Snell, 2002; Wu, 2022; Zhu et al., 2022). Subsequently, Burt and Burzynska (2017) and Park and Luo (2010) have further validated this perspective and explored its implications for corporate dynamic capabilities. Our research adopts this understanding of *guanxi* as an informal institution, distinct from formalized systems or laws, to analyze how *guanxi* influences dynamic capabilities through its four characteristics, as demonstrated in the Yulon case.

Burt's analysis of Chinese business leaders' social networks highlights how *guanxi*, within the framework of social network theory, impacts both individual and organizational performance (Burt, 2004). Prior research by Bian (2002) corroborates the influence of CEOs' social capital on company performance, noting that the diversity of a CEO's network correlates with higher status and more resource channels (Lin, 2005). Additionally, Burt and Burzynska's (2017) analysis of 700 Chinese entrepreneurs' social networks reveals that those with large, open networks achieve greater business success.

This study leverages the informal institutional framework to construct a model connecting *guanxi* with dynamic capabilities. Through the case of Yulon, we demonstrate how *guanxi* acts as an initial catalyst for dynamic capabilities and as an intermediary in responding to external and internal changes, leading to further development of both personal and organizational *guanxi*, and thereby enhancing corporate dynamic capabilities.

#### 4.4.2. From inter-personal Guanxi to Inter-organizational *Guanxi*

Our case study of Yulon also elucidates the distinctions between strong and weak forms of *guanxi*, based on individuals' positions within social network structures. Granovetter's (1973) "weak ties" theory has long categorized *guanxi* into strong and weak ties, a classification further refined by Chinese scholars into family ties, acquaintances, and weak ties (Luo, 2014). Yulon's development across different stages illustrates the influence of these *guanxi* levels, encompassing family kinships, senior management connections, and weak ties with external partners like Nissan and Foxconn.

The evolution of Yulon underscores the significance of personal *guanxi* in Eastern cultures, which often extends to organizational levels. Prior studies, highlight that personal *guanxi* forms the foundation of social networks, with the second layer of relationships within institutional structures being crucial for sustaining the first layer (Liu, 1998). This phenomenon is evident in Yulon's development, where the founder's *guanxi* provided critical resources and support during the company's early stages.

As Yulon transitioned through leadership changes, *guanxi* continued to play a pivotal role. The successor managed to maintain and extend internal and external *guanxi*, facilitating collaborations with Foxconn and ensuring the company's survival in the new energy vehicle sector. These examples demonstrate how *guanxi* can evolve from personal to organizational levels, fostering the development of dynamic capabilities in response to changing environments.

In summary, the interconnectedness and convertibility of *guanxi* between personal and organizational levels are crucial in East Asian cultural contexts (DiTomaso & Bian,

2018). This interplay contributes to the formation of organizational capabilities through various actions, such as investments and strategic alliances, which reflect dynamic capabilities indicators and reinforce the connection between *guanxi* and corporate dynamic capabilities.

#### 4.4.3. The Impact on Dynamic Capabilities Based on Yulon's Case

Yulon's case illustrates how *guanxi* influences dynamic capabilities at different stages, guided by the four characteristics of *guanxi*: sentimentality, functionality, reciprocity, and openness.

During the inception stage, kinship and shared educational backgrounds (sentimentality), combined with support from Taiwan authorities (reciprocity) and collaboration with Nissan, enhanced dynamic capabilities by providing market information, additional resources, and opportunities for technological learning (sensing). In the restructuring stage, Yulon leveraged its partnership with Nissan to upgrade technology and design capabilities, extending ties to mainland China (openness) and reinforcing its sensing and seizing capabilities.

In the expansion stage, Yulon further developed its reconfiguring capability, adapting internal resources to enter the new energy vehicle sector with support from the Zhejiang provincial government and Foxconn. This progression demonstrates how *guanxi*, through its evolving characteristics, contributes to dynamic capabilities development in a rapidly changing business environment.

## 5. Conclusion

This study elucidates how *guanxi* facilitates firms' interactions with external stakeholders, enabling them to navigate environmental turbulence and achieve differentiation in response to local business dynamics. Our research contributes to the understanding of *guanxi* in three key ways:

First, we propose that the four characteristics of *guanxi*—sentimentality, functionality, reciprocity, and openness—follow a specific sequence. Sentimentality typically emerges first, rooted in biological ties, reflecting a cultural norm in China where family members inherit family businesses (Chen et al., 2013). As *guanxi* extends beyond familial ties, functionality and reciprocity become more prominent, leading to openness as *guanxi* networks expand through shared connections.

Second, we identify three scenarios where *guan* dyads are enhanced by *xi* networks during a firm's development. Initially, *guan* dyads embed favorable resources, evolving through restructuring and expansion stages, where managers balance strong *guan* dyads with expanding *xi* networks. This balance is crucial when *guan* dyads alone cannot provide the necessary resources and capabilities.

Third, we demonstrate how *guanxi* contributes to dynamic capabilities development across different business stages. In the inception stage, *guanxi* enhances sensing capability; in the restructuring stage, it supports both sensing and seizing capabilities; and in the expansion stage, it facilitates reconfiguring capability, enabling firms to adapt and innovate in response to environmental changes.

Yulon's experience offers valuable insights for other automobile manufacturers in East Asia. Chinese firms can strategically deploy *guanxi* to access industrial information, resources, and market opportunities, ensuring their adaptability in dynamic markets. Multinational firms must recognize the four dimensions of *guanxi* and the associated differences when building personal ties and business relationships in East Asia.

Despite these contributions, this study has limitations that warrant further research. Our longitudinal approach, driven by incomplete quantitative data, suggests that future studies could employ mixed methods to enhance generalizability. Additionally, alternative theoretical approaches could further explore the influence of informal institutions on firms like Yulon, particularly in the context of crisis management and “co-opetition” among firms with diverse institutional backgrounds.

### **Acknowledgments**

We greatly appreciate the valuable contributions of Zhuang Ma (Lecturer, Huddersfield University), Tang Wanxin (Consulting Advisor, Accenture Japan), Fei Zheng (Dongfeng Yulon), Jianhao Chen (Manager, Taiwan), and other interviewees from Yulon Taiwan for their support and assistance in data collection and manuscript writing.

### **Authors contributions**

First author Hancheng Huang was responsible for drafting the initial manuscript, as well as revising and polishing the final version. Qiu X., Associate Professor at NTNU Business School, guided the first author in the design and analysis of qualitative research. Jun H., from City University of Macau, provided assistance with big data text analysis using NVivo 11 (QSR International) software, as well as support in text analysis. Other authors were responsible for data collection and manuscript editing. All authors read and approved the final manuscript.

### **Funding**

This work was supported by the Faculty of Business, City University of Macau, through general academic support.

### **Competing interests**

The authors declare that they have no known competing financial interests or personal relationships that could have appeared to influence the work reported in this paper.

### **Informed consent**

Obtained.

### **Ethics approval**

The Publication Ethics Committee of the Macrothink Institute.

The journal's policies adhere to the Core Practices established by the Committee on Publication Ethics (COPE).

### **Provenance and peer review**

Not commissioned; externally double-blind peer reviewed.

### **Data availability statement**

The data that support the findings of this study are available on request from the corresponding author. The data are not publicly available due to privacy or ethical restrictions.

### **Data sharing statement**

No additional data are available.

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