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A Transaction Governance Perspective on Business Entertainment: A General Model and Evidence From China

Yonglin Sun
The University of Western Ontario

Supervisor
Shih-Fen Chen
The University of Western Ontario

Graduate Program in Business

A thesis submitted in partial fulfillment of the requirements for the degree in Doctor of Philosophy

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A TRANSACTION GOVERNANCE PERSPECTIVE ON BUSINESS ENTERTAINMENT: A GENERAL MODEL AND EVIDENCE FROM CHINA

(Spine Title: Business Entertainment and Transaction Governance)
(Thesis Format: Monograph)

by

Francis Yonglin Sun

Graduate Program in Business Administration

A thesis submitted in partial fulfillment
of the requirements for the degree of
Doctor of Philosophy

School of Graduate and Postdoctoral Studies
Richard Ivey School of Business
The University of Western Ontario
London, Ontario, CANADA

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THE UNIVERSITY OF WESTERN ONTARIO
School of Graduate and Postdoctoral Studies

CERTIFICATE OF EXAMINATION

Supervisor	Examiners
Dr. Shih-Fen Chen	Dr. Glenn Rowe
Supervisory Committee	Dr. Paul Beamish
Dr. Jean-Louis Schaan	Dr. Shahbaz Sheikh
	Dr. You-Ta Chuang

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A Transaction Governance Perspective on Business Entertainment: A General Model and Evidence from China

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Abstract

Despite the prevalence of business entertainment in economic life, nearly all studies on the phenomenon have explored it from a social perspective by labeling it as a social vice. Although a few scholarly works have identified the role of business entertainment in facilitating exchange relationships; none of them has offered a systematic explanation of how business entertainment plays such a role. Meanwhile, despite some scholars' recognition of the role of social sanctions in regulating economic activities, virtually none of them has explored the relationship between social sanctions and business entertainment. This dissertation aims to bridge these gaps by arguing that business entertainment plays a governance role by reinforcing social sanctions to regulate economic transactions.

Drawing on theories from the literatures on economics, business management, anthropology, sociology, and psychology, I start with the proposition that each society during its evolution forms a transaction governance structure (TGS) featuring a unique combination of market, social, and legal sanctions in regulating economic relationships. Depending on their social and cultural heritages, some societies rely more on social sanctions, and others more on legal sanctions, to compensate for the failure of market sanctions. I further argue that underdeveloped market and legal infrastructures are associated with prevalent practice of business entertainment because the latter plays a role in reinforcing social sanctions that supplement market sanctions. These arguments set up a theoretical framework for systematically explaining the social practice of entertainment in business settings from a perspective of economic transaction governance.

To verify the above arguments, I derived two sets of hypotheses and conducted two empirical tests within the Chinese context: one to predict the pervasiveness of business entertainment at the firm level, using secondary data collected from firms listed on the Shanghai Stock Exchange in China; the other to test the effectiveness of business entertainment at the transaction level, with primary survey data collected from a sample of Chinese corporate client sales managers. Statistical results from both tests provide support for my transaction governance approach to business entertainment.

Keywords

Business entertainment, social sanctions, transaction governance, transaction governance structure (TGS), market sanctions, market failure, legal sanctions, governance mechanisms, China, business ethics, relationship marketing, gifts, bribery, bribes, *guanxi*, international business, anthropology, economics, sociology, psychology, relativity, social norms, evolution, transaction costs economics (TCE).

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Table of Contents

List of Tables

List of Figures

List of Appendices

Societies in their evolution have developed implicit agreements to certain kinds of regard for others, agreements which are essential to the survival of the society or at least contribute greatly to the efficiency of its working.

— Arrow, 1974: 26

…(In) all economic systems known to us up to the end of feudalism in Western Europe,…the orderly production and distribution of goods was secured through a great variety of individual motives disciplined by general principles of behavior. Among these motives gain was not prominent. Custom and law, magic and religion co-operated in inducing the individual to comply with rules of behavior which, eventually, ensured his functioning in the economic system.

— Polanyi, 2001:57

In societies which have no 'self-regulating market' (in Karl Polanyi's sense), no educational system, no juridical apparatus, and no State, relations of domination can be set up and maintained only at the cost of strategies which must be endlessly renewed, because the conditions required for a mediated lasting appropriation of other agents' labor, services, or homage have not been brought together.

— Bourdieu, 1977: 183

Chapter 1

1. Introduction

1.1. The Phenomenon

Business entertainment, defined as entertainment activities in business settings, such as eating at restaurants, drinking at bars and teahouses, golfing, singing at Karaoke clubs, traveling, sightseeing, and watching ball games with business partners, has been a popular practice among managers worldwide.

Business entertainment is particularly rampant in China, where most business transactions are carried out with the facilitation of entertainment activities (see Zhang, 2001). Data from the 2007 annual reports of more than 220 companies listed on the Shanghai Stock Exchange indicate that these companies on average spent 10 percent or more of their annual profits (1.17 million yuan on average, ranging from 325,000 *yuan* to 617 million *yuan*) on business entertainment. In the public sector, which mainly consists of the state-owned enterprises (SOE), the official statistics show that in 2004 alone, entertainment expenses exceeded 360 billion *yuan*, which is more than twice the total expenditures (170 billion *yuan*) on building the Three Gorges Dam (*Outlook Weekly*, 2006). These figures indicate the pervasiveness of business entertainment in China.

Business entertainment, nonetheless, is not a phenomenon limited to China. In the United States, for instance, business entertainment was once so pervasive between the medical profession and the pharmaceutical industry that, in April 2003, the Office of Inspector General (OIG) of the U.S. Department of Health and Human Services issued a compliance guide to curb such practices (*The New York Times*, 2003; Dresser, 2006).

In Australia and Canada, business entertainment is the most frequently practiced activity in conducting commercial transactions (Armstrong, 1992; Chan & Armstrong, 1999). In Greece, likewise, lavish and extravagant entertainment is considered a necessary “custom” in business transactions (Kavali, Tzokas & Saren, 2001). In Japan, managers are often engaged in after-hours entertainment activities at nightclubs with their business partners at the company’s expense (Allison, 1994; Alston, 1989). Organizations like the International Olympic Committee (IOC), whose most famous motto is “fair play,” were also rocked with allegations of largesse and munificence. During the voting process to choose the next site for holding the Olympic Games, according to Booth (1999), it is a widespread practice that the bidding cities arrange extravagant travel and sightseeing programs for IOC officials and their families at resorts.

1.2. Previous Research

Scholars have not left the phenomenon of business entertainment unexamined. Rather, numerous studies have addressed the issue. In the Chinese context, for instance, a unique stream of literature on *guanxi* has developed to give an extensive treatment on business entertainment (i.e., in the context of social networks and connections built through business entertainment, see Yang [1994] for details about the “art of *guanxi*”; also see Gold, Guthrie & Wank [2002] for a review).

Based on their arguments for the good or bad nature of business entertainment-related *guanxi* practices, these studies can be roughly classified into two camps. The proponents of *guanxi* practices argue that social connections built through business entertainment can substitute for formal institutional support (Xin & Pearce, 1996), create organizational dynamics (Park & Luo, 2001), reduce transaction costs (Standifird & Marshall, 2000), sustain competitive advantages (Tsang, 1998), and therefore lead to efficiency and business success (Davies, Leung, Luk & Wong, 1995; Lovett, Simmons & Kali, 1999; Yeung & Tung, 1996). The opponents claim that, on the contrary, business entertainment in *guanxi* practices triggers ethical problems (Fan, 2002a), causes corruption (Manion, 1996; Steidlmeier, 1999), and will “harm the weak Chinese corporate governance system and hamper its further economic development and growth” (Braendle, Gasser & Noll, 2005).

Previous studies on business entertainment in the general management literature follow a similar dichotomist approach, focusing mainly on the good or bad nature of the practice and often putting a negative label on it. Based on the criterion that bribes are bad but gifts are good, virtually all studies on business entertainment are polarized at either the bribe or the gift end, addressing ethics-vs.-efficiency issues with either a normative or an instrumental approach. Those business entertainment practices that are perceived as bad are labeled as bribes—the synonym of corruption—or at least are treated as being ethically problematic (e.g., Cooper, Frank & Kemp, 1997; Fritzsche, 2005; Kitson & Campbell, 1996; Mellahi & Wood, 2003; Turner, Taylor & Hartley, 1994). The literature explores, in a normative manner, what the nature and consequences of these practices are (e.g., Pacini, Swingen & Rogers, 2002), what motivates managers to entertain or "bribe" others (Powpaka, 2002), why those practices are bad (e.g., D'Andrade, 1985), and how to combat them (e.g., Gordon & Miyake, 2001).

On the other hand, when certain business entertainment practices are perceived as good, they are then treated as gifts. With an instrumental approach, the literature focuses on how effective gifts work as marketing wares (e.g., Beltramini, 1992, 2002; Bruhn, 1996; Dorsch & Kelley, 1994; D'Souza, 2003), or how they can improve productivity (e.g., Flynn, 2003) and strengthen affective organizational commitment (e.g., Grant, Dutton & Rosso, 2008).

Both the pro and con camps of studies have made valuable contributions to our understanding of the roles played by business entertainment in our society. Nonetheless, there are still major gaps in the literature, which hinder the field from generating better explanations for the phenomenon.

Despite the prevalence of business entertainment in economic life, virtually no previous study has given it a systematic explanation from an economic perspective. Instead, nearly all studies have made their analyses from a social perspective (e.g., Beck & Maher, 1986; Beltramini, 1992; Dorsch & Kelley, 1994; Flynn, 2003; Fritzsche, 2005; Grant et al., 2008; Mellahi & Wood, 2003). Meanwhile, although some neo-classical economists and economic sociologists have acknowledged the role of social sanctions in governing economic transactions (e.g., Arrow, 1974, Bradach & Eccles, 1989; Granovetter, 1985), few studies have further investigated the positive role that such business practices as entertainment play in reinforcing social sanctions to facilitate economic transactions. These literature gaps pose three questions on the business entertainment phenomenon, which I specify below.

1) **If business entertainment is truly corruptive, why is it widely practiced at the population level in some societies?** Business entertainment involves both a giver and a taker (e.g., the seller and the buyer in a business deal). Whereas the motive of the business entertainment giver is obvious (e.g., to secure a contract), the taker's willingness to be "corrupted" in private settings has remained unexplained. For instance, when business entertainment is perceived as bribery, economists identified the major factors

that influence the willingness of giving and taking as the probability of being convicted, the severity of punishment, and the relative salary levels of givers and takers (Goel & Rich, 1989). In private business settings, however, we often find that even when we might assume, based on these determinants, that an individual will not take business entertainment, he or she takes it anyway. This puzzle remains unsolved.

2) **Why is business entertainment widely adopted in some societies but limited in others?** The pervasiveness of business entertainment varies substantially from society to society. Treating business entertainment either as bribes (e.g., Martin, Cullen, Johnson & Parboteeah, 2007; Sanyal, 2005) or as gifts (e.g., Arunthanes, Tansuhaj & Lemak, 1994), prior studies have used cultural, economic, human, and other factors to investigate the variations in the popularity of business entertainment across countries. The empirical results have been mixed, however. For example, the cultural factor of collectivism vs. individualism in these studies generated different or even opposite results (e.g., Davis & Ruhe, 2003; Sanyal & Samanta, 2004a). The question of why business entertainment is pervasive in some societies but limited in others is still waiting for a systematic theoretical account.

3) **If business entertainment indeed plays a positive role in economic life, what are the mechanisms that underlie such a role?** The aforementioned *guanxi* studies have identified a number of positive functions which business entertainment serves in economic life (e.g., Park & Luo, 2001; Xin & Pearce, 1996). When it is perceived as a gift, business entertainment is also regarded as a powerful marketing tool (e.g., Beltramini, 1992, 2002; Bruhn, 1996; Dorsch & Kelley, 1994). When it is labelled bribery, business entertainment has been found to be a common alternative to competitive bidding (Beck & Maher, 1986) and an efficient auction mechanism (Leff, 1979). However, these studies did not provide a systematic explanation as to how business entertainment plays such a role. The mechanisms underlying the positive roles of business entertainment in economic activities remain unexplored (see Luo, 1997).

1.3. Research Objective

Against the background described above, the objective in this dissertation is to bridge the literature gaps, address the above unanswered questions, and thereby advance our understanding of business entertainment. This objective will be accomplished by setting up a theoretical framework upon which business entertainment plays an economic transactions governance role through a social behavioral process.

To pursue that end, I begin by delineating the boundaries of this study. First, this study focuses only on the secular components of social sanctions, without exploring the role of religious social sanctions, religion being one of the principal social institutions regulating human behavior (see Iannaccone [1998] for an introduction). Second, instead of debating the good or bad nature of business entertainment, this study aims to identify the function of this social practice. Third, rather than taking the perspective of either the giver or the taker, this study treats business entertainment as an integrated, interactive process of giving and taking (Hodgson, 1992) embedded in social relations (Zelizer, 1998). Fourth, instead of assuming that there is a clear way to distinguish bribes from gifts, the study sees business entertainment as a general construct, based on the understanding that defining a business entertainment practice as either bribe or gift is relevant to cultural and other contexts (e.g., Salbu, 1997; Noonan, 1986; Philips, 1984). Finally, without limiting the takers of business entertainment to public officials, the study covers *all* economic transactors in business settings, including private agents (e.g., Dunfee, Smith, & Ross, 1999), principals (Fort & Noone, 2000), and any ordinary persons (Smart, 1993).

Within the above boundaries, I provide an explanation for business entertainment from the perspective of economic transaction governance. Drawing on economics theories on transaction governance, I begin my conceptualization by proposing that each society coordinates economic activities by developing a transaction governance structure (TGS) featuring a unique combination of market, social, and legal sanctions in regulating the behavior of economic agents. Depending on its cultural and historical heritages, a society may rely more on social sanctions, while others may depend more on legal sanctions, and still others equally on social and legal sanctions, to supplement market sanctions in regulating exchange relationships. I call this pattern the relativity of TGS across societies.

Based on insights from theories in anthropology, sociology, and social psychology, I further argue that business entertainment serves as a significant amplifier of social sanctions in regulating the behavior of economic agents, especially in societies where market and legal infrastructures are underdeveloped. This approach maps social theories onto the literature of economic transaction governance and sets up a theoretical framework that enables a systematic explanation for the social practice of business entertainment from a perspective of economic transaction governance.

The above theoretical framework allows me to carry out empirical tests in a more accurate and proper way than has been done in previous studies. First, to predict why business entertainment is more pervasive in some cases than in others, I draw hypotheses that use society-level characteristics to predict business entertainment expenses at the firm level. Second, to address the issue of why business entertainment is more effective in some situations than in others in facilitating business transactions, I also develop hypotheses that use the social behavioral features of business entertainment to predict its effectiveness in smoothing transactional relationships.

To the best of my knowledge, this dissertation is the first study that offers a systematic explanation for the practice of business entertainment from a transaction governance perspective. It draws on theories from multiple disciplines to trace the social and behavioral origins of the business entertainment phenomenon and to find the underlying reasons for its resilience and pervasiveness. The study bridges the gaps between anthropology, economics, management, sociology, and social psychology to offer a better understanding of a widely practiced and commonly observed but understudied and often misunderstood phenomenon. More specifically, my dissertation treats the business entertainment practice as an interactive social behavioral process that is embedded in human relations and that represents an inseparable part of the transaction governance structure with which a society as a whole coordinates economic interactions. My empirical method is also the first to operationalize and test the social practice of business entertainment with both economic and perceptual data at multiple levels. The study is meaningful to both policy makers and practitioners in business, as well as to academic researchers in multiple fields.

1.4. Dissertation Structure

This dissertation is composed of six chapters. Following this introductory chapter, Chapter 2 provides a general literature background on business entertainment, economic transaction governance, and social sanctions. Literatures under review cover research on business entertainment in the context of business ethics, marketing, international business, and business *guanxi* studies, economics studies on transaction governance, and sociological studies on social sanctions. At the end, a research agenda is outlined against this general literature background.

In Chapter 3, I present the model of transaction governance structure (TGS), which consists of market, social, and legal sanctions, and propose the relativity of TGS across societies. I also elaborate on how business entertainment enhances the power of social sanctions to regulate economic transactions. I focus on business entertainment's role in promoting reciprocal behavior at the individual level, establishing and maintaining long-term relationships in dyadic interactions, and enhancing group dynamics within communal settings, all of which are conducive to effective working of social sanctions, effective regulation of individual behavior, and, hence, effective governance of transactions.

In Chapter 4, I use China as an empirical context to develop a set of hypotheses to explore how society-specific characteristics shape different TGS and affect business entertainment spending at the firm level. These hypotheses are tested on secondary data collected from annual reports of manufacturing firms listed on the Shanghai Stock Exchange (SSE).

Chapter 5 again uses China as a context to test why business entertainment is more effective in some situations than in others at the transaction level. I develop a theory to build a link between business entertainment's effectiveness and its social behavioral features. These arguments are tested on a set of survey data collected from client sales managers working for a sample of companies affiliated with a business association in China.

I conclude the dissertation with Chapter 6, summarizing its major contributions to the literature; presenting its implications to policy makers and business practitioners; and acknowledging its limitations, which also point out promising directions for future academic research.

Chapter 2

2. Literature Background

This section first reviews the literatures on business entertainment in the context of business ethics, marketing, and international business. Following that, the economics literature on transaction governance and sociological literature on social sanctions are surveyed. These seemingly disparate literatures are then summarized and synthesized to introduce a new agenda that aims to offer a transaction governance account for business entertainment.

2.1. The Current Literature on Business Entertainment

2.1.1. Business entertainment in the general management literature

The management literature in general covers the business entertainment phenomenon in the context of business ethics, marketing, and international business. Business ethics studies often focus on the nature of the phenomenon (good or bad); the marketing literature emphasizes business entertainment's positive role in facilitating business transactions; and the international business research analyzes the business entertainment phenomenon from a cross-cultural perspective. Overall, these studies can be classified into two opposing camps on which I will elaborate below.

2.1.1.1. The negative view: Business entertainment perceived as a social vice

Management studies that take a negative view of business entertainment often use a normative approach to focus on business entertainment's ethics issues, social effects, and pervasiveness relative to different cultural, institutional, and organizational contexts. Such studies perceive business entertainment either as bribery, which is often a synonym for corruption, or at the least, ethically problematic practices. Empirical tests on the factors that lead to the pervasiveness of business entertainment across societies have produced mixed results.

2.1.1.1.1. Business entertainment as bribery and ethically problematic practices

Generally, the studies that perceive business entertainment as a bad practice often explore what the nature and consequences of business entertainment practices are (e.g., Pacini et al., 2002), what motivates managers to entertain others (Powpaka, 2002), why such practices are bad (e.g., D'Andrade, 1985), and how to combat business entertainment (e.g., Gordon & Miyake, 2001). Some studies have also recommend best-practice prescriptions to cope with business entertainment (e.g., Doh, Rodriguez, Uhlenbruck, Collins & Eden, 2003; Johnson, 1985; Weismann, 2008).

The fundamental argument in this body of literature is that business entertainment practices should be labeled as bribery or at least as ethically problematic or undesirable activities (e.g., Baumhart, 1961; Brenner & Molander, 1977; Lewis, 1985; Tsalikis & Fritzsche, 1989). More specifically, for instance, in Gordon and Miyake's (2001) survey on 246 corporate codes of conduct, the majority of these standards clearly categorize entertainment activities as bribes. In another study, Fisher (2007) identified the major unethical practices in business settings as offering clients drinks, meals, entertainment, and tickets to sporting or cultural events. To maintain consistency with the original terminology in prior studies, I will sometimes call business entertainment activities "bribery" or "unethical business practices" when I review these studies.

When business entertainment is perceived as bribery, it often refers to transactions within which the giver offers something of value in exchange for a benefit conferred through abuse of the taker's job duty (Mauro, 1995; Nichols, 1999; Rasmusen & Ramseyer, 1994). In many studies, bribery is usually considered synonymous and interchangeable with the term *corruption* and condemned as an evil in economic life (D'Andrade, 1985; Getz & Volkema, 2001; Treisman, 2000). For example, Nichols (1999) labeled business entertainment and related activities as a corrupt practice and argued that such activities could corrode governments, distort economies, undermine democratic institutions, and degrade transnational relationships.

Regarding the relationship between the nature and the intensity of business entertainment practices, most studies believe that no matter how small the scale of such practices, they are nonetheless intolerable. For instance, Argandona (2005) argued that even if disguised as small facilitating favors, business entertainment practices still have a pernicious effect on the working of public and private organizations because most of the time they serve as the slippery slope to more serious forms of corruption.

In the Chinese context, some of the studies of *guanxi* (i.e., the social networks and connections built through business entertainment) hold negative views on the business entertainment phenomenon. They claim that business entertainment in *guanxi* practices leads to ethical problems that are not conducive to economic development (see Fan, 2002b; Millington, Eberhardt & Wilkinson, 2005). They believe that such practices are the major causes of corruption in China (see Dunfee & Warren, 2001; Manion, 1996; Steidlmeier, 1999).

Viewing business entertainment through negative lenses, international business scholars have a broad coverage on business entertainment. They try to establish certain types of relationships between the pervasiveness of the perceived bad practice of business entertainment and cultural, economic, and other factors across societies. Regarding cultural influence on this practice, most studies used either the cultural dimensions index (Hofstede, 1980; Hofstede & Bond, 1988) or the Project GLOBE's cultural measures (House, Hanges, Javidan, Dorfman & Gupta, 2004; House, Javidan, Hanges & Dorfman, 2002) in their models to test correlations between cultural factors and business entertainment activities. Nevertheless, none of these studies has developed a theory that can systematically explain the business entertainment phenomenon across societies.

2.1.1.1.2. Empirical evidence

Those scholars doing empirical research on business entertainment who perceived the practice as bribery have found that factors at both the firm level and the individual level affect the pervasiveness of those practices (e.g., Hamra, 2000; Powpaka, 2002; Sanyal, 2005). Empirical studies at the firm level have produced mixed results regarding firms' use of business entertainment or bribery in their daily operations. In a survey among 3,769 firms, Martin et al. (2007) found that firm-level factors such as financial constraints and intensity of competition have a major impact on a firm's business entertainment and bribery activities. In a different study, it was found that a firm's ethics policy and human resources practices are major factors affecting such practices within a firm (Hamra, 2000).

Like the studies at the firm level, empirical research on the motives for receiving entertainment or taking bribes at the individual level have produced mixed results too. Here the different results regarding individual motives for bribe-taking were mainly due to different research emphasis. For example, with a research focus on economic factors and formal external sanctions, Goel and Rich (1989) found that the major factors influencing bribe-taking are the probability of being convicted, the severity of punishment, and the giver's and taker's relative salary levels. Elsewhere, with research emphasis focused on cognitive and behavioral factors, Powpaka's (2002) survey among 188 Thai business managers found that these individuals' willingness to take a bribe was affected by attitude towards bribes-taking, subjective norms, and necessity of the bribe.

Empirical studies in international business have produced mixed results as well. For example, when business entertainment is perceived as bribery, Martin et al.'s (2007) study found that the cultural characteristic of collectivism has a significant negative relationship with the prevalence of business entertainment or bribery practices. Similar research by Davis and Ruhe (2003), however, produced the opposite results. Elsewhere, Sanyal (2005) and Getz and Volkema (2001) tested the determinants of business entertainment or bribery practices in international business and found that the collectivism factor was not significant. The only consistent result produced by many studies is that the economic factor has a significant negative relationship with bribery activities, that is, the more developed a society is, the less prevalent business entertainment or bribery is within it (e.g., Husted, 1999; Martin et al., 2007; Sanyal & Samanta, 2004a, 2004b).

2.1.1.1.3. Comments

The negative studies on business entertainment built their arguments on the premise that business entertainment is bad and equivalent to bribery, which in turn is often considered to be the synonym of *corruption* (e.g., Brademas & Heimann, 1998; Davis & Ruhe, 2003; Getz, 2006). *Corruption*, in fact, refers to a larger scope of misconducts beyond bribery, including kickbacks, embezzlement, cronyism, nepotism, favoritism, fraud, and political corruption (e.g., Khatri, Tsang & Begley, 2006; Oldenburg, 1987). Some have questioned the use of Transparency

International's Corruption Perception Index (CPI) to measure the pervasiveness of bribery or business entertainment across nations (Lambsdorff, 1998). Furthermore, virtually all of the studies limit business entertainment takers to public officials, focusing on entertainment activities between business and government. Few of them explore business entertainment at a business-to-business level (Dunfee et al., 1999; Fort & Noone, 2000; Lambsdorff, 1998).

In addition, the negative studies often limit business entertainment takers to public officials, focusing on business entertainment between business and government only, without really looking into such relationships between businesses, or other parties. In real business settings, however, business entertainment takers include private agents (e.g., Dunfee et al., 1999; Lambsdorff, 1998) and principals (Fort & Noone, 2000), or any ordinary person (Smart, 1993). Sometimes, it is hard to tell who is a public official, who is a private agent, or who is a principal in business settings. For example, in emerging markets where business entertainment is more prevalent, the same business entertainment taker can be both a corporate executive at a state-owned enterprise and a governmental official holding a public position (McCubbins, 2001). In transitional economies that are in the process of privatization, a business entertainment taker can also have the dual status of being a governmental official and a private entrepreneur (Salbu, 1997).

Another drawback of this stream of study is that the researchers try to distinguish between bribes and gifts by overlooking the fact that defining business entertainment as either bribes or gifts is context specific. A bribe in one circumstance might be a gift in another , and it is very hard to apply a general principle to all situations (Oldenburg, 1987; Noonan, 1986; Pitman & Sanford, 2006). Furthermore, as *bribe* is a legal term and the law stipulates what constitutes a bribe (Noonan, 1984; Rose-Ackerman, 1998), different legislatures may have different legislations about what is a bribe (Nadler & Schulman, 2008), and different firms may have different codes of conducts defining what practices are permitted and what are unacceptable and unethical (Kaikati & Label, 1980; *Online Ethics Center*, 2009). In addition, at the individual level, one man's medicine is another's poison; one man's gift is another's bribe (Carvey, 1986; Weismann, 2008). It is problematic to treat business entertainment in all situations alike and to use a single standard to define them as either bribe or gift.

The international business scholarly publications suffer from the same pitfall of attempting to isolate each business entertainment activity and label those activities as either bribes or gifts, which is particularly hard to do in an international context, where culture plays a key role in evaluating the nature of a business entertainment transaction (Duncan, 2000; Fatehi, 2008; Getz & Volkema, 2001). Literally, the terms *gift* and *bribe* were used in an interchangeable manner in the ancient Jewish bible (Berlin, Brettler & Fishbane, 2004: 1474–1479). As human society evolved, however, a difference emerged between the two, in that a *gift* is now perceived as being good and a *bribe* as bad (Husted, 1999; Kim & Kim, 1997; Krever, 2007). Yet, the judgment on being good or bad involves moral standards that depend on the ethics and moral relativism across cultures. Therefore, a bribe in one culture might be a gift in another culture (Moran & Harris, 2007; Philips, 1984; Salbu, 1997). It is questionable to lump together business entertainment activities in all societies to evaluate their nature with a single standard without taking into account the relativism of ethics and moral standards across different cultures.

The negative mark on business entertainment also affects empirical results in the testing of its pervasiveness. The previous studies' labeling of business entertainment as being corruptive and unethical makes it difficult to collect reliable data, as few people are willing to reveal their "corrupt" or "unethical" records in detail. In addition, all of these studies are based on isolated factors, such as collectivism or intensity of competition, without applying a systematic approach under a unified theoretical framework. As such, it is predictable that previous empirical studies would not find consistent results, neither at the organizational level nor at the individual level.

Given their limitations, the negative studies on business entertainment have left an intriguing question that continues to puzzle us: if business entertainment is truly corruptive, why is the taker willing to be corrupted? In addition, business entertainment involves both a giver and a taker (e.g., the seller and buyer in a business deal), but whereas the motive of the business entertainment giver is obvious (e.g., to secure a contract), the taker's willingness to be "corrupted" remains unexplained. Furthermore, if business entertainment is truly corruptive, why is it widely practiced at the population level in some societies?

2.1.1.2. The positive view on business entertainment

Contrary to those negative studies that label business entertainment as a social vice, a few management studies, particularly in the marketing literature, have assigned a positive role to business entertainment, applying an instrumental approach to examine its effectiveness as a marketing tool. In the Chinese context, some of the *guanxi* studies also view entertainment-related practices in business settings as a substitute for formal institutions. Still other studies even recommended the best practices for delivering business entertainment to facilitate sales more effectively.

2.1.1.2.1. Business entertainment as gifts and a marketing ware

The positive studies perceive business entertainment as a normal business practice and treat its activities as gifts and favors that can facilitate marketing and sales (e.g., Fan, 2006; Bruhn, 1996). For example, Dorsch and Kelley (1994) defined entertainment activities in a business setting, such as drinking and eating, attending sports or entertainment events, an evening out on the town, or hunting and fishing trips, as gifts. Again, to be consistent with the original terminologies in former studies, I define business entertainment on some occasions as “gifts” in the review of this literature stream.

When business entertainment activities are perceived as gifts, they are considered an effective means of facilitating marketing and sales. Beltramini (2002) argued that organizations could use business entertainment and gift-giving along with other marketing and communications programs to retain existing clients and pitch potential clients. D’Souza (2003) identified a similar positive role for entertainment and gift-giving practices in business contexts, arguing that such activities have the benefits of building ties, cultivating relationships, enthusing loyalty and goodwill, and serving as an integral part of relationship marketing. Elsewhere, Fan (2002a) posited that business entertainment and gifts can help to reinforce other elements in a firm’s marketing communications mix such as advertising and sales promotion.

Some of the studies in the marketing literature also focus on how to deliver entertainment and gifts effectively to get better results. For example, Bruhn (1996) identified the factors that should be taken into consideration when delivering business entertainment and gifts. These factors include the type of business relationship, the recipient’s personal attributes, the objective or purpose of the giving itself, the occasion of giving, the type of entertainment or gift, the need for special types of entertainment or gifts, and the form of handling or presentation of the entertainment or gifts. Similarly, Fan (2006) suggested that the delivery of business entertainment or gift should incorporate factors like the purpose, budget, timing, types, and ethical considerations. Also, Greaves (2001) observed that to better promote business with a message of quality, lasting appreciation, and perceivable value delivered through entertainment activities and business gifts, such activities and gifts had to suit the age, gender, and lifestyle of the intended recipient.

Even when business entertainment is perceived as a bribe, Beck and Maher (1986) still found a positive role for it to play. They argued that entertainment-related practices in business settings are a common alternative to competitive bidding on the purchasing side of the transaction, in that the buyers are indifferent between bidding institutions (sellers) because the net purchase price is the same. Leff (1979) made a similar argument comparing similar practices with auction mechanisms in sales and marketing.

Again, in the Chinese context, some *guanxi* studies believe that entertainment-related *guanxi* practices can help firms to achieve efficiency and business success (e.g., Davies et al., 1995; Lovett et al., 1999; Yeung & Tung, 1996). With an instrumental approach, these studies propose that business entertainment in a *guanxi* context is not a moral issue (Su & Littlefield, 2001; Su, Sirgy & Littlefield, 2003; Tian, 2008); instead, it plays a key role in economic life by serving a surrogate market system due to ill-defined property rights, economic roles, and a restricted flow of information (Johnston, 1997). Based on their arguments and empirical results, social connections arising from entertainment-related *guanxi* practices can substitute for formal institutional support (Xin & Pearce, 1996), create organizational dynamics (Park & Luo, 2001), and provide a complement to contract law (Luo, 2002; Potter, 2002). More specific to business operations, some studies have also found entertainment-related *guanxi* practices to be able to help establish business networks (Hammond & Glenn, 2004), reduce transaction costs (Standifird & Marshall, 2000; Yi & Ellis, 2000), and sustain competitive advantage (Carlisle & Flynn, 2005; Tsang, 1998).

In a cross-cultural context, when business entertainment is regarded as gift-giving, Kumayama's (1990) study emphasized the important role of business entertainment and gift-giving in Japanese business life, while D'Souza (2003) suggested that business entertainment and gift-giving are an integral part of business culture in Asia. Arunthanes et al. (1994) even did a cross-cultural analysis on business entertainment and gift-giving, arguing that business entertainment and gift-giving are more prevalent in high context cultures than in low context ones.

2.1.1.2.2. Empirical evidence

Most positive studies on business entertainment and gift-giving explored the effectiveness issue empirically from the giver's side, examining how similar practices initiated by the seller would affect the buyer's decision-making process (Wazana, 2000). Nevertheless, the results on the effectiveness of business entertainment as a marketing ware are mixed. In addition, similar to other studies in the marketing literature, empirical studies on the positive role of business entertainment have failed to offer any theoretical explanations to support their findings (e.g., Burton, 2005; Deshpande, 1983).

For, example, Beltramini (1992) found that although business entertainment and gift-giving are generally effective in increasing positive customer perceptions toward key product attitudes, they are somewhat less so in increasing the buyer's reported likelihood of actually contracting the seller (i.e., the entertainment or gift giver). Furthermore, such activities are more effective in facilitating sales when combined with other marketing communications tools. In a follow-up study, Beltramini (2000) added more variables into her above-mentioned (Beltramini, 1992) tests and found that more expensive business entertainment and gifts are relatively more effective in generating an immediate and sustained increase in customer overall satisfaction and therefore have greater potential to raise their intent to repurchase. In a different study, Dorsch and Kelley (1994) found similar results. Despite these findings, no theoretical explanation has been offered by any of those studies.

Contrary to the above findings, however, some other scholars found that gift value does not really matter: both small and big gifts serve the same purpose and have the same effect (e.g., Friedman & Friedman, 1996; Katz, Caplan & Merz, 2003; Trawick, Swan & Rink, 1989). Like the others, these studies did not build any theory.

Among the studies of business *guanxi* in China, a number of empirical papers have produced results that support the argument that entertainment-related *guanxi* practices can create institutional support for firms and are beneficial to asset efficiency and overall firm performance. For instance, in Xin and Pearce's (1996) study, they found that private entrepreneurs in China rely on more entertainment-related *guanxi* practices in doing business than their state-owned rivals do, suggesting that business entertainment is an important alternative for formal institutional support. Elsewhere, Park and Luo (2001) found that Chinese firms practice business entertainment as a strategic mechanism to overcome competitive and resource disadvantages by cultivating relationships and exchanging favors with business partners and regulators.

2.1.2. Summary: Limitations of the current literature on business entertainment

In general, there are three limitations that have affected the perceptions on business entertainment and blurred relevant empirical measures, and, therefore, led to contradictory theoretical arguments and mixed empirical results.

First, it remains unclear whether business entertainment plays a constructive or destructive role in economic life. Within the extant literature, most of the analyses on business entertainment are from a social perspective, labeling it as bribery or corruption, with a few of them exploring the efficacy issue of business entertainment by treating it as gift-giving. According to the common moral principles followed by former studies, bribes are bad, gifts are good; “bad” entertainment activities are bribes that are corruptive and could cause ethical (or even criminal) consequences, and “good” entertainment practices are gift-giving that could facilitate market transactions. Building on these two conflicting views, two branches of study have developed: one examines business entertainment’s nature and pervasiveness across countries, addressing the ethics issue (i.e., perceiving business entertainment as bribery); the other explores business entertainment’s effectiveness as a marketing ware in business settings, tackling the efficiency issue (i.e., perceiving business entertainment practices as gifts). An integrated approach is therefore needed to accommodate the two perspectives.

Second, regardless of its positive or negative views on business entertainment, the previous literature lacks a systematic theoretical framework for explaining business entertainment practices as a social phenomenon in business settings. Particularly, business entertainment is a prevalent phenomenon in economic life and, while some studies have recognized its role in facilitating economic transactions, surprisingly, no study has applied an economic transaction governance approach to explain this phenomenon. The foremost shortcoming of the positive studies on business entertainment is that they have not applied a systematic approach to analyze the positive role that business entertainment plays in economic life; rather, they have simply based their analyses on some factors that are not backed up by a strong theory. Consequently, although they emphasize business entertainment's constructive role in marketing and sales, and even in enhancing firm performance, the question of how such a constructive role is carried out still remains unanswered. In international business studies, due to the lack of an integrated theoretical framework that might be used to reach an explanation of business entertainment that could accommodate different situations across all cultures, nearly all studies use only isolated factors, for example, "Protestant tradition, histories of British rule, higher imports, or federal states" (Treisman, 2000), or simply plug some cultural factors into their models (e.g., Sanyal, 2005) to test their correlations with business entertainment. Consequently, these studies fail to offer us a systematic explanation of why business entertainment is pervasive in some societies but limited in others.

Finally, the lack of a systematic theoretical model has also caused the previous literature to fall short in empirically interpreting the functions and underlying mechanisms of business entertainment practices with an integrated approach. In addition, in the absence of a proper definition and operationalization of the business entertainment phenomenon, the previous studies also lack the proper empirical data necessary for systematic research. For example, in testing the variations of the pervasiveness of business entertainment in different situations, previous studies' labeling of business entertainment practices as being corruptive and unethical makes it difficult to collect hard data, as understandably few people are willing to admit and report their corrupt or unethical records in details. Consequently, previous studies have drawn their conclusions either by borrowing data from similar concepts (e.g., data on corruption in economics; see Brademas & Heimann, 1998; Davis & Ruhe, 2003) or from subjectively reported data based on individual perceptions (e.g., Park & Luo, 2001; Xin & Pearce, 1996). In the empirical tests on the effectiveness of business entertainment, virtually no study has been conducted from the business entertainment giver's side to verify its effectiveness as a facilitator in transactional relationships. Most former studies have also tended to treat business entertainment practices in all transactions alike without exploring what makes business entertainment in one transaction more (or less) effective than in another.

2.2. Economics literature on transaction governance

Transaction governance has been a prominent issue in economic life (see Alchian & Demsetz, 1972; Greif, 2000; Matthews, 1986). Orthodox economists believed that economic activities could be perfectly governed by the “invisible hand” of market forces (see Smith, 1981). Neo-classical economists recognized the imperfections of the market and acknowledged that additional governance schemes, e.g., legal arrangements, are required to govern the behaviors of economic agents (see Arrow, 1974; Barzel, 1982; Spence, 1976). Building upon these thoughts, the traditional transaction cost economics (TCE) theory framed transaction governance mechanisms along the market-contract-hierarchy continuum, arguing that market failure can be remedied by legal arrangements, including their extreme form, hierarchy (see Williamson, 1979). Economic historians, economic sociologists, and the current form of TCE further incorporated the social dimension of governance, e.g., social relationships and trust, into the governance framework (e.g., Granovetter, 1985; Greif, 1994; Williamson & Ouchi, 1981). This section first reviews the governance mechanisms along the market-contract-hierarchy continuum, which is the key component of the traditional TCE. It is followed by an introduction to the literature on the role of social sanctions in economic transactions governance.

2.2.1. Transaction governance along the market-contract-hierarchy continuum

The traditional transaction costs economics theory (TCE) holds that the failure of governance from pure market forces (i.e., the price system) can be compensated for by nonmarket institutions, which are conceptualized as legal contracting and, its extreme form, hierarchy (i.e., internalization of external transactions; see Williamson, 1979, 1985). Because firms can be treated as a composition of multiple contracts, hierarchy is also considered a form of legal arrangement (see Stinchcombe, 1985). For the sake of simplicity, here I conceptualize the market-contract-hierarchy continuum as pure market sanctions and its standard remedy of legal sanctions. Of course, pure market and pure hierarchy rarely exist in the real world, since most transactions are contractual in nature, where legal remedies are always needed to compensate for the weakness of market power in sanctioning economic transactions.

2.2.1.1. Market sanctions

Economic transactions are believed to be best governed under pure market sanctions, which refer to the price system in orthodox economics (see Smith, 1981). Under such a system, economic agents are believed to be able to influence each other's behavior solely by price and personal utility preference (Arrow, 1974). Each agent offers prices to solicit exchange from others and each agent makes her decision to accept or refuse those inducements. Sellers agree to trade with whoever offers the highest price, regardless of the buyer's personal identity. Here, prices play an important coercive role by discouraging inefficient behavior (see Ouchi, 1980). For instance, if a buyer feels the seller's price is acceptable, she will reward the seller with more transactions in the future; otherwise, the buyer will punish the seller by simply walking away to find a better seller.

Economic reality, however, often deviates from the classical assumptions of flexible market entry and exit and free and full access to accurate market information (Grossman & Stiglitz, 1976; Zelizer, 1988). For prices to guide individual actions efficiently in reaping the benefits of specialization, they must accurately reflect the value of goods and services. This in turn assumes that the value of output can be accurately measured beforehand by the transacting parties (Akerlof, 1970; Barzel, 1982; Spence, 1976), which is actually impossible due to bounded human rationality and uncertain environments (Williamson, 1985). Besides, the actual transaction group is not large enough as assumed which renders free market entry and exit unrealistic (Caves & Porter, 1977). In addition, asset specificity also increases the costs of free entry or exit, even if the transaction group is large. These factors reduce the price-based self-enforcing power in voluntary arm's-length transactions and thus make market sanctions inadequate in governing transactions (Arrow, 1971).

2.2.1.2. Legal sanctions

When market sanctions alone fail to regulate transactions, the TCE theory suggests that formal legal arrangements (including the extreme form, hierarchy) can be used to compensate for market imperfections and provide additional governance (Williamson, 1985). Legal sanctions use formal contracts to define transaction terms, but they rely on third-party enforcement to ensure compliance to the contractual terms. As a third-party enforcement mechanism, legal sanctions require costly investment in the setting up of an effective legal system, including the court, legal codes, and legal professionals. In addition, the costs of drafting contracts are usually high. Given bounded human rationality and environmental uncertainty, contracts are not always exhaustive, which makes opportunism a big problem in contract negotiation (Williamson, 1985). These factors indicate that contractual transactions upheld by legal sanctions may fail in governing transactions. Hence, like market sanctions, legal sanctions are not perfect either. The governance of economic transactions still requires additional mechanisms.

2.2.2. The role of social sanctions in transaction governance

Economists also recognize that social sanctions, along with legal sanctions, play a role in supplementing market sanctions to govern transactions. Economic historians believe that the development of nonmarket exchange governance mechanisms is a process of institutional evolution that supplements social sanctions with legal sanctions, and that under the circumstances where legal sanctions are not sufficient in supplementing market sanctions, social sanctions can provide additional governance to facilitate transactions (see Greif, 2004; Milgrom, North & Weingast, 1990; North, 1990, 1991, 1994).

In economic life, social sanctions can actually be very efficient in mediating transactions between interdependent individuals, because common values and beliefs harmonize mutual interests and eradicate opportunistic behavior (see Ouchi, 1980). Along with classial and neo-classical contractual laws, relational contracts, supported by social sanctions, help to adjust long-term economic relations (Macneil, 1978). They play that role through “encompassing such basic relational norms as role integrity, reciprocity, contractual solidarity, balancing power in acceptable ways, propriety of means (doing things the right way), and harmonizing the relations with the external social matrix in which they occur” (Macneil, 1985).

Given the existence of such a fact, some economists criticized the earlier versions of transaction cost economics for neglecting the role of social sanctions and delineating market transactions sharply between those governed by market sanctions and others by legal sanctions (e.g., Demsetz, 1988). In their later work, transaction cost economists began to recognize social sanctions as the third mechanism in governing market transactions. In his joint work with Ouchi, for instance, Williamson (1981) developed the concept of "soft contracting," where informal, uncodified, and trust-based relationships foster the context that provides additional governance support for market transactions.

Across the economics literature, numerous studies have recognized the role of social sanctions in economic life. For instance, Arrow (1974: 26) argued that "societies in their evolution have developed implicit agreements to certain kinds of regard for others, agreements which are essential to the survival of the society or at least contribute greatly to the efficiency of its working." Such "agreements" and "regards" are social sanctions that can coordinate the behavior of economic agents. Others have also argued that social sanctions contribute to efficiency and productivity by enhancing stability and certainty in exchange relationships (Biggart & Beamish, 2003) and by increasing cooperation among individuals (Cooter, 1998). According to Macaulay (1963), even in the United States where legal sanctions are the dominant means for regulating economic transactions, businesses sometimes still rely on "a man's word" or "common honesty and decency" (i.e., social sanctions) instead of on legal sanctions to adjust exchange relationships.

By conceptualizing economic relations as an always-embedded system, some scholars have further established the governance role of social sanctions in our economic life. They suggest that social sanctions constitute a favorable economic dynamic in human life that enables economic interactions to happen more smoothly (Block, 2003; Polanyi, 2001:57). Granovetter (1985) and Zelizer (1988) emphasized the function of social sanctions in economic life by arguing that market transactions are embedded in institutionalized social relations under a variety of cultural and structural settings where social sanctions play a major role in governing exchange relationships. Similar arguments can also be found in studies by Biggart and Delbridge (2004), Bradach and Eccles (1989), Li (2003), and Lindberg, Campbell, and Hollingsworth (1991), to name a few.

2.3. Sociological Studies on Social Sanctions

As noted above, economists have identified social sanctions as a key mechanism in regulating the behavior of economic agents. Social sanctions in fact are a social and psychological process through which social norms are enforced and infused with the power to influence human behavior (Cooter, 1998). Sociologists and social psychologists have developed core principles on how social sanctions work and how to boost the power of social sanctions.

2.3.1. How social sanctions work

According to sociologists, social sanctions coordinate human behavior through a set of rules called norms (see Bendor & Swistak, 2001; Opp, 2001). Individuals display a great degree of coordinated behavior in social interactions simply because of the existence of norms (Axelrod, 1986), which include formalized norms backed by state sanctions (i.e., laws) as well as informal rules backed by social sanctions (i.e., social norms; Cooter, 1998). Please note that this study on social sanctions focuses on secular social sanctions only. In reality, social sanctions also include religious social sanctions, religion being one of the principal social institutions regulating human behavior (see Iannaccone [1998] for an introduction).

Although there is no consensus on the definition of social norms, one generic point is that social norms are the collective evaluation and expectation of, and particular reactions (i.e., sanctions) to, certain behaviors (Gibbs, 1965). This common thread indicates that social norms express a consensus in a community regarding what people ought to say or do in social interactions and that deviation from such consensus will be sanctioned (Opp, 2001). Such sanctions are social in nature because they are imposed on the transgressor by those who are hurt as well as by third-party community members who, although not affected by the original transgression, are in a position to punish the deviant (Bendor & Swistak, 2001). Social sanctions include not only negative punishment for behavior that is nonconforming but also positive rewards for behavior that does conform to social norms (Gibbs, 1965).

Social sanctions work at two levels—individual and group—that involve both individual emotions and group interactions. First, at the individual level, when an individual internalizes a social norm, he or she makes a moral commitment that attaches a psychological penalty to the forbidden act (Cooter, 1998). When individuals in a community internalize social norms to achieve self-improvement, violating an established norm will bring them psychological pain even if the violation incurs no direct losses or even produces net gains. The efficacy of social sanctions thus depends on each individual's willingness to uphold social norms. Second, at the group level, because they have internalized the group's social norms or principles, individuals are willing to monitor others and punish defectors in social exchanges. In some circumstances, they are even willing to punish those who fail to punish norm violators (Opp, 2001; Posner, 1997).

2.3.2. How to boost the power of social sanctions?

The power of social sanctions is a combination of forces from individual behavioral and social structural dimensions within the context of social relations (Etzioni, 2000). Therefore, the power of social sanctions can be reinforced through changing individual behavior and enacting group dynamics (see Emerson, 1981; Homans, 1974: 58). In both processes, frequent social interactions can increase individuals' willingness to internalize norms and engage in enforcement activities and to create cohesive (i.e., interdependence) group structures, thereby boosting the power of social sanctions (Homans, 1974; Horne, 2001, 2004, 2007).

2.3.2.1. Individual behavioral level

Social sanctions are reflected in human emotions such as feelings of personal obligation, gratitude, and trust (Blau, 1964; Foa & Foa, 1980; Homans, 1958). Exerting influence on such personal emotions can induce reciprocal behavior and reinforce social sanctions at the individual level.

Numerous studies have elaborated on the ways to promote individuals' reciprocal behaviors. For example, Simmel (1950) described social exchanges like entertainment and gift interactions (giving and taking) as events during which the giver offers spiritual or intellectual values to the taker, and the taker shows gratitude by returning affective values or compensates the giver by injecting will power into her. In a similar way, Sherry (1983) theorized on the ritual and psychic power of gift-giving by suggesting that the gift-giver invests psychic energy into the gift and makes it "charged" with that energy. Consequently, according to Sherry, the gift becomes a container of the being of the giver. By accepting the gift, the taker receives not only the gift, but also a portion of the being of the giver, which can force the taker to reciprocate following the giver's expectations. Schwartz (1967) used a metaphor similar to those used by these two scholars, except that what Simmel called the "spirit" and Sherry the "psychic energy" of the gift-giver, Schwartz termed the "identity."

These metaphors also have solid grounding in psychological studies on social sanctions. According to Greenberg (1980), the receipt of a benefit places the taker in a psychological state of indebtedness, which is a state of the obligation to repay the giver: the greater the magnitude, the greater the resultant arousal and discomfort, and therefore the stronger the desire to reduce it through reciprocity. Similarly, Simmel (1950) argued that the act of giving and taking could trigger the emotion of gratitude from the taker, which serves as a psychic imperative that coerces the taker to reciprocate.

Having internalized such reciprocal behaviors, individuals would abide by exchange rules to avoid sanctions from self-imposed emotional penalties such as guilt and shame (see Cooter, 1998). Such individuals who did not conform would also be more sensitive to social punishments such as peer pressure, social disapproval, and community ostracism, and would be more willing to follow exchange rules in the future (see Noussair & Tucker, 2005). This would further enhance the power of social sanctions.

2.3.2.2. Social structural level

The reinforcement of the power of social sanctions also depends on the realignment of relationships and the enacting of group dynamics at the social structural level (Emerson, 1981). Empirical evidence supports this proposition, indicating that reformation of relationships and construction of cohesive group structures are all conducive to the effective working of social sanctions (e.g., Ruth, Brunnel & Otnes, 2004; Ruth, Otnes & Brunel, 1999).

Sociologists have developed various theories on how to mobilize structural factors to boost the power of social sanctions. This is in fact a process of extending the individual level mechanisms to the structural level dynamics. According to Gouldner (1960), social exchange such as entertainment can realign social structures by mobilizing egoistic motivations and channeling them into the maintenance of the social system. Following Gouldner's theory, egoism can motivate one party to satisfy the expectations of the other, since by doing so she induces the latter to reciprocate and satisfy her own expectations. Once a stable relation of mutual gratification has been established, the system is self-perpetuating through a beneficent cycle of mutual reinforcement. Here social exchange reinforces the norm of reciprocity, which serves as both a starting mechanism and a stabilizing function in interpersonal relations: it helps to initiate social exchanges and then to sustain and reinforce them. Consequently, within the reciprocal relationship, social sanctions become more powerful in regulating individual behavior (Homans, 1974; Horne, 2007).

From an interpersonal power and dominance perspective, Bourdieu (1977: 183) argued that

> In societies which have no 'self-regulating market' (in Karl Polanyi's sense), no educational system, no juridical apparatus, and no State, relations of domination can be set up and maintained only at the cost of strategies which must be endlessly renewed, because the conditions required for a mediated lasting appropriation of other agents' labor, services, or homage have not been brought together.

Repeated social interactions such as entertainment therefore become a major instrument for exercising influence on others in societies where the personal strategic mode of domination functions as the major power mechanism. For instance, in an entertainment activity like gift giving and taking interaction, once the taker accepts the entertainment, he or she loses power and status relative to the giver and becomes a social inferior and subordinate; the only way for the taker to pay back may be to also accept the orders of the giver (Blau, 1964; Burt, 1992; Homans, 1974). The imbalance of power and indebtedness between the giver and the taker will ensure continued relationships and therefore strengthen the power of social sanctions (see Schwartz, 1967; Simmel, 1950).

At the group level, these cohesive structures in turn can promote repeated interactions among the same individuals (Horne, 2007), which can generate a higher degree of social approval and promote cooperation (Homans, 1974). Here behavioral norms are more easily established and enforced (see Axelrod, 1984: 129). The physical proximity exposes individual activities to group surveillance, making it easier to impose social sanctions on those members who violate exchange rules (Ruth et al., 2004). In such occasions, individuals are even willing to monitor and punish those who fail to punish defectors in unrelated social and economic exchanges (see Opp, 2001; Posner, 1997). As such, frequent social exchanges can weave cohesive social structures that make social sanctions work more effectively.

In addition to the different levels of analyses, some scholars also incorporated the time factor into the analysis of the strength of social sanctions. They argue that time is a key factor in promoting reciprocal behavior and long-term and group orientation in relationship building (Sharma & Patterson, 1987), which in turn are critical conditions for social sanctions to work more effectively (see Altman & Taylor, 1973). Elsewhere, Knapp (1984) has classified the time factor in a relationship into five stages, from early to late—initiating, experiencing, intensifying, integrating, and bonding—and argues that the strength of social sanction increases as the relationship develops and moves through those five stages.

2.4. Summary of Literature Review

Despite the prevalence of business entertainment worldwide, most former studies have examined the phenomenon from a social perspective. Although some of them have recognized business entertainment's role in facilitating economic exchanges, they have not linked this facilitating function with the concept of economic transaction governance. Meanwhile, the traditional TCE framework does not consider the role of social sanctions in the traditional market-contract-hierarchy continuum, nor examine the function of business entertainment in facilitating exchange relationships.

Although TCE scholars have recently recognized the role of social sanctions in transaction governance, such a role has not been incorporated into the traditional transaction costs economics theory (TCE) with a systematical approach. In addition, despite their recognition of the role of social sanctions in economic transaction governance, few economists have gone further to explore the relationship between social sanctions and the omnipresent entertainment activities in business settings. At the same time, sociologists have developed core principles on how social sanctions work and how the power of social sanctions may be boosted. Consequently, such fragmentation has formed the major gaps in the current literature.

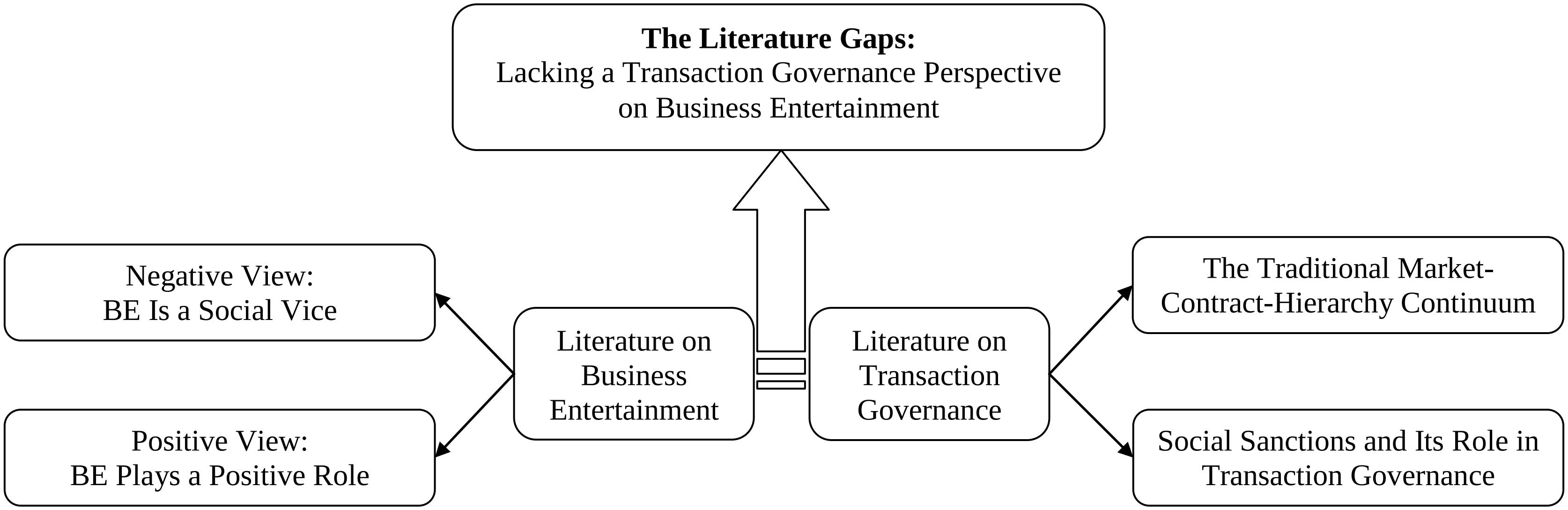

Figure 2.1. The Literature Gaps

Figure 2.1 illustrates these literature gaps. The left-hand side depicts the management literature that has somewhat addressed the business entertainment phenomenon through two conflicting views. The right-hand side shows the transaction governance literature that is conceptualized as a market-contract-hierarchy continuum plus the recognition of the role of social sanctions in transaction governance, and the sociological literature on social sanctions. These literature gaps pose a series of questions regarding why the business entertainment taker is willing to be "corrupted" (if it is truly corruptive), whether or not business entertainment plays a positive role, how it plays such a role, how to boost the power of social sanctions in transaction governance, and why the pervasiveness of business entertainment varies across societies. The new agenda in my dissertation, therefore, is to bridge these gaps and answer the questions by setting up an integrated framework upon which a systematic explanation for business entertainment can be constructed.

2.5. New Agenda: A Systematic and Multidisciplinary Approach

Based on the extant literature on business entertainment and transaction governance, my agenda is to provide an explanation for business entertainment from the perspective of economic transaction governance. I begin by proposing the relativity of transaction governance structures (TGS), that is, that each society, depending on its cultural and historical heritages, features a unique combination of market, social, and legal sanctions in regulating economic transactions. I further argue that business entertainment serves as a significant amplifier of social sanctions in alleviating market failure, especially in societies where market and legal infrastructures are underdeveloped. This two-step approach maps the business entertainment literature onto the economics literature on transaction governance and sets up an integrated theoretical framework for systematically explaining the business entertainment phenomenon from a transaction governance perspective.

Figure 2.2 provides an illustration of the integrated framework. In this figure, horizontally, the dotted rectangle represents a transaction governance structure, where each society features a relatively different combination of market, social, and legal sanctions in governing transactions. Vertically, the figure depicts the relationship that I theorize existing between business entertainment, social sanctions, and transaction governance, i.e., that business entertainment has the potential to reinforce social sanctions to supplement market sanctions in regulating the behaviors of economic agents to govern transactions. In particular, business entertainment will be more prevalent and effective in societies where social sanctions play a greater role in governing economic activities. I will develop this framework in the next chapter.

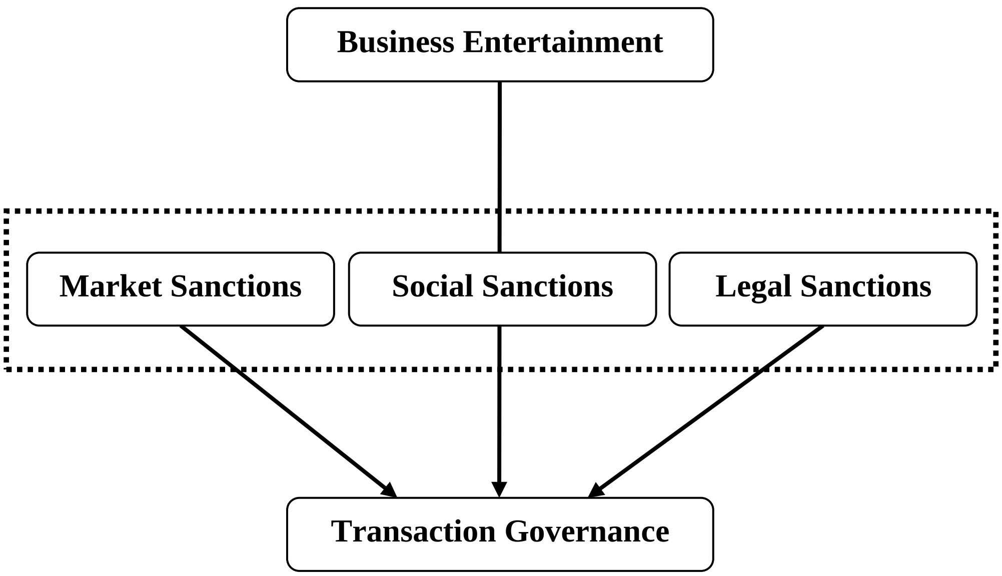

Figure 2.2. An Integrated Framework of Business Entertainment Reinforcing Social Sanctions to Facilitate Transaction Governance

Chapter 3

3. Relativity of Transaction Governance Structures and the Role of Business Entertainment

This chapter first presents the model of transaction governance structure (TGS), which consists of market, legal, and social sanctions, and proposes the relativity of TGS at the society, industry, and firm levels. Building upon this TGS framework, the chapter then establishes the association between social sanctions and business entertainment by arguing that business entertainment plays a role in reinforcing the power of social sanctions in regulating the behavior of economic agents, particularly when market and legal infrastructures are underdeveloped, and thereby social sanctions play a more important role in transaction governance.

3.1. Transaction Governance Structure

Transaction governance is a fundamental problem in all economic systems (see Coase, 1992; Williamson, 1985). Governance rules regulate exchanges that not only enable economic agents to complement one another with distinct material endowments but also allow them to split the gains from specialization and create the incentives to further maximize output (Alchian & Demsetz, 1972; Greif, 2000). The mechanisms for transaction governance include social, market, and legal sanctions (see Bradach & Eccles, 1989; Lindberg et al., 1991), which have evolved to form a unique TGS that is relatively different across societies or under different circumstances at the industry or firm level.

3.1.1. Evolution of Transaction Governance Structures

3.1.1.1. The governance of social interactions: Social sanctions

Human beings have the propensity to expand personal well-being or wealth to cope with the issue of scarcity (Commons, 1924; Hume, 1957). Wealth can be expanded through cooperative interactions such as team production, division of labor, and voluntary exchange. Group living makes such cooperative interactions possible and has played a key role in civilization. For example, in the hunting and gathering age, pooling the joint efforts of a group could maximize gains and increase survival chances, and sharing harvests by a group could motivate others to reciprocate, which in turn would insure oneself from bad harvest and therefore reduce uncertainty.

For team production and voluntary exchange to occur, group living requires coordination under behavioral rules that individuals expect each other to follow. Rules coordinate and motivate interdependent behaviors in team production and voluntary exchange, in that one individual's compliance or disobedience will influence the choice and reaction of the other. Over time behavioral rules or patterns have evolved into what we now know as norms of cooperation and reciprocity. Conforming to those norms generates social sanctions to guide human interactions (Ridley, 1996: 105–117).

Social sanctions are a social and psychological process through which behavioral norms are infused with the power to influence human behaviors and hence can be enforced to regulate social activities. Like the roles of cooperation and reciprocity, the roles of social norms are to provide a collective evaluation and expectation of, and particular reactions (i.e., sanctions) to, certain behaviors (Gibbs, 1965). Individuals display a great degree of coordinated behavior simply because of the existence of norms (Axelrod, 1986). Social norms express a consensus in a community regarding what people ought to say or do, and deviation from such consensus will be sanctioned (Opp, 2001). Such sanctions are social in nature because they are imposed on the transgressor by those who are hurt as well as by third-party community members who, although not affected by the original transgression, are in a position to punish the deviant (Bendor & Swistak, 2001). For instance, a bystander whose own interest is not affected by a transgression may choose, if he or she is armed with certain social norms, to punish the transgressor.

Social sanctions include not only negative punishment following nonconforming behavior but also positive rewards for compliance to social norms (Gibbs, 1965). Social sanctions mediate exchanges by harmonizing mutual interests and eradicating opportunistic behaviors with common values and beliefs (see Macneil, 1978; Ouchi, 1980). They contribute to efficiency and productivity by enhancing stability and certainty in exchange relationships (see Biggart & Beamish, 2003). Social sanctions served as the key mechanism governing the behavior of group members in facilitating cooperation and exchange in primitive societies and early human history (see Benson, 1999).

The functioning of social sanctions is limited to communal or intra-group settings, where social sanctions deter repeatedly interacting individuals from wrong-doing with the threat that misconduct will cause self-conscious emotional penalties such as embarrassment, shame, and guilt; result in public disproval and ostracism; and lead to a loss of reputation and/or future gains from exchange (Fiske, 2005; Noussair & Tucker, 2005). Effective social sanctions can reinforce the relationships within a group, and cohesive social structure within groups or communities can in turn generate stronger social sanctions (Homans, 1974; Horne, 2007). Those self-enforcing mechanisms enabled social sanctions to facilitate exchanges in primitive societies where both social and economic exchanges were conducted mostly within a communal group. When inter-group exchange became necessary and frequent, however, social sanctions became less effective in governing inter-group exchanges, and other forms of mechanisms had to develop to govern human interactions.

As human activities extended from intra- to inter-group interactions, social exchange became more objectified and started to acquire the features of economic exchange (Simmel, 1950). For example, when a hunting and gathering community evolved into specialized groups of hunters or gatherers, exchange of harvest (e.g., barter) between them became a necessity. Further specialization of labor, greater mobility, better information flow, better transportation means, the usage of money, and the emergence of marketplaces (e.g., bazaars) and professional merchants expanded exchanges to strangers outside the boundaries of communities. In such exchanges, community-based social sanctions could not function effectively. Furthermore, these developments required exchanges to have more accurate measurement and exact fairness (Seabright, 2004: 67–78). Market sanctions based on the price mechanism thus emerged as another governance device to facilitate transactions.

3.1.1.2. Market sanctions

In exchanges governed by market sanctions, economic agents influence each other's behavior by price and personal preference (Arrow, 1974). Each agent offers prices to solicit exchange from others and each agent makes the decision to accept or refuse those inducements based on the principle of maximizing his or her own profit. Unlike social sanctions that are effective only in communal groups, market sanctions can support exchange even with strangers from outside a group. In such transactions, sellers agree to trade with whoever is offering the highest price, regardless of the buyer's personal identity. Here prices play an important coercive role by discouraging inefficient behaviors (see Ouchi, 1980). For instance, if a buyer feels the seller's price is acceptable, the buyer would reward the seller with more transactions in the future; otherwise, the buyer would punish the seller by simply walking away to find a new seller.

Unlike transactions supported by social sanctions, which are often an ongoing process, price-enabled transactions are often one-shot and self-liquidating, as in spot-market exchanges, where sellers and buyers keep an arm's-length distance. Both sellers and buyers are assumed to have free entry into and free exit from a transactional relationship. It is the "invisible hand" that directs movements of commodities and coordinates activities of self-interested economic agents (Smith, 1981: 25). The impersonality and ephemerality (i.e., one-shot) of arm's-length transactions governed by market sanctions suggest that market sanctions are powerful cognitive simplifiers that radically reduce the complexity of human interactions and therefore turn out to be a more efficient means of governance (Bowles, Choi & Hopfensitz, 2003).

The essence of price-based arm's-length transactions is the rational calculation of costs and benefits based on the price mechanism (i.e., market sanctions) (Zelizer, 1988). Economic reality, however, often deviates from the classical assumptions of flexible market entry and exit and free and full access to accurate market information (Grossman & Stiglitz, 1976). For prices to guide individual actions efficiently in reaping the benefits of, for example, specialization, they must accurately reflect the value of goods and services. This in turn assumes that the value of output can be accurately measured beforehand by transacting parties (Barzel, 1982), which is actually impossible due to bounded human rationality (Williamson, 1985). Besides, the actual transaction group is not large enough as assumed which renders free market entry and exit unrealistic. These factors reduce the price-based self-enforcing power in voluntary arm's-length transactions and thus make market sanctions inadequate in governing transactions (Arrow, 1971).

Market failure becomes a prominent issue particularly when economic activities and market transactions become more complicated and more powerful, and effective governance thus means other than social and market sanctions are needed in transaction governance (North, 1990). Again, take the aforementioned hunting and gathering groups as examples. Over time, each of these groups evolved into larger societies consisting of numerous sub-groups. The development of long distance trade between groups made it harder for traders to monitor each other's behavior. Increased group size led to anonymity among group members, which encouraged opportunistic behavior and misrepresentation of trade information. These developments made social and market sanctions less efficient in regulating transactions. Therefore, formal legal institutions, which could support contractual transactions with impartial third-party sanctions (e.g., from the state), arose to fill the gap (Greif, 2004; Milgrom et al., 1990).

3.1.1.3. Rise of legal institutions

Legal sanctions support contractual transactions based on a third-party impartial enforcer with coercive power (Greif, 2000). Such contracts are drafted on the basis that they are fair, voluntary, conforming to society's contractual expectations, and without administrative difficulties (Macneil, 1985). The third-party enforcer is an effective system including the laws, the courts, and legal professionals backed up by the state. It regulates individual behavior with the threat of increasing their costs and with punishment based on law, if individuals cheat or fail to fulfill their contractual obligations.

Similar to market sanctions, but unlike social sanctions that support relational transactions, legal sanctions facilitate impersonal exchanges, where the decision to exchange is not conditioned on knowing a current partner's past conducts or on expecting future trading opportunities. Different from market sanctions, legal sanctions deter deviant behaviors with the threat of punishment based on third-party sanctions (i.e., laws) to force individuals to fulfill their contractual obligations.

Legal sanctions require costly investment to set up an effective legal system, including the court, legal codes, and legal professionals. As such, legal sanctions are marked by high fixed costs to set up the legal framework but low variable costs of establishing new exchange relationships (Li, 2003). Prohibiting the excessive gains or rewards that are possible under other modes, legal sanctions are effective in maximizing overall societal welfare (Glaeser & Shleifer, 2002). Yet legal sanctions are not the panacea for transaction governance. When the costs of drafting contracts are high or when contracts are not exhaustive, for instance, contractual transactions upheld by legal sanctions may fail as well (see Williamson, 1985).

Table 3.1. The Properties of Transaction Governance Mechanisms

	Market Sanctions	**Legal Sanctions**	**Social Sanctions**
Transaction type	Arm's length	Contractual	Relational
Instruments	Price	Legal institutions	Norms
Duration	One-shot-based	Definite term	Long term
Interaction	Impersonal	Impersonal	Personal
Nature	Voluntary	Drafted voluntarily & backed-up by State	Community pressure
Fairness	Assumed exact value	Agreed-on value	Approximate value
Context	Beyond groups	Beyond groups	Intra-group

3.1.1.4. Summary

The key properties of the three governance mechanisms described above are summarized in Table 3.1. Within the three mechanisms, social sanctions can facilitate relational transactions based on norms in a communal setting. In this type of transaction, the seller and buyer must know each other and the relationship must be oriented to the long term. Each transaction is conducted in approximate fairness in the hope that any deficiency may be reciprocated in future transactions. Social sanctions can only support intra-group exchanges in a communal setting that cannot be extended to strangers.

Market sanctions in turn often support one-shot transactions conducted at arm's length and based solely on the price system. In such transactions, the seller and buyer exchange voluntarily and without the need to know each other. The one-shot transaction also allows for intergroup exchanges without the need to restrain transactions within a community. The value of the trade is assumed fair enough to match the price exactly.

Finally, legal sanctions can support contractual transactions engaged in voluntarily but backed up by third-party coercion—the legal institutions. Like in market sanctions, the seller and buyer do not need to know each other before conducting a transaction. They can transact in a fixed term stipulated by a contract that is mutually agreed on. The fairness between price and value is also stipulated in the contract. Legal sanctions also enable strangers to trade with each other beyond groups.

3.1.2. The Transaction Governance Structure (TGS)

Regarding the three governance mechanisms, in reality, market, social, and legal sanctions are not mutually exclusive in governing economic transactions. Economic sociologists believe that economic relations are embedded in interactions among individual self-motivations (i.e., market sanctions), state actions (i.e., legal sanctions), and social norms (i.e., social sanctions) (see Polanyi, 2001). Accordingly, economic transactions are governed by a combination of market forces and institutionalized social relations (Granovetter, 1985; Zelizer, 1988), which are often classified as market, social, and legal sanctions (see, e.g., Biggart & Delbridge, 2004; Bradach & Eccles, 1989; Lindberg et al., 1991; Ouchi, 1980). I define such a combination as a transaction governance structure (TGS).

3.1.2.1. Evolution of TGS in a society

Like all institutions governing human interactions, a transaction governance structure (TGS) that regulates the behavior of economic agents is derived from the interactions among market, social, and legal sanctions (i.e., the co-evolution of individual behavior and social institutions; see Bowles et al., 2003). Market sanctions are ideal but not perfect; therefore, social and legal sanctions are needed to supplement market sanctions in governing transactions. For example, social and legal sanctions serve to guarantee property rights in order to conduct market transactions. On the other hand, social and legal sanctions may also affect the efficiency and effectiveness of market sanctions. That is why the market is not always clear: sometimes there are authoritative and sentimental elements such as fairness, esteem, reputation, and long-term considerations that are implicitly contained in prices. In addition, social and legal sanctions also provide protective countermoves to curb the insatiable “invisible hand” from immoral activities that make perfect economic sense, such as abusing child labor, destroying the natural environment, or trafficking drugs, weapons, and human beings (see Polanyi, 2001).

Market sanctions in turn can weaken the forces of social and legal sanctions. Market forces disrupt other social institutions by permeating all aspects of human life. Market operations may commodify politics, family life, friendship, education, arts, human settlement patterns, religion, and so on (Polanyi, 1977). For example, market forces reduce the need for compassion, patriotism, brotherly love, and cultural solidarity (Schultze, 1977). Market forces may thus undermine the basis of social sanctions, corrupt impartial legal institutions, and render both social and legal sanctions less effective in supplementing market sanctions to govern transactions.

As well, social sanctions and legal sanctions can influence each other—social sanctions are reinforced partly by legal sanctions, and laws are indeed legalized social norms (Cooter, 1998). Meanwhile, social fabrics that constitute the conditions for social sanctions to work make impartial enforcement of legal sanctions difficult. For instance, the practices of nepotism and cronyism could undermine the fairness of legal sanctions.

According to economic historians, an institutional structure that facilitates exchange and fosters economic efficiency is cultivated in a broader social, political, and cultural process; once a particular institutional structure has developed in a society, it can propel itself to evolve along a particular path (Greif, 2000; North, 1981). As for the evolution of TGS in a society, during the interplay among market, legal, and social sanctions, a more efficient form emerges to govern economic transactions through an evolutionary process of natural selection; and the form that is best suited to prevailing in a particular environment is most likely to survive in that environment (see Hannan & Freeman, 1977; Nelson & Winter, 1982). As such, TGS in a society will evolve over time to form an optimal combination of market, social, and legal sanctions that best fits the environmental contexts of the society.

3.1.2.2. The relativity of TGS

During the institutional evolution process described above, the ecological, cultural, and historical context of each society shapes its unique TGS that regulates the behaviors of economic agents in business transactions (see Berry, 1979). One mechanism's waxing and another's waning in the interaction process can lead to the formation of a particular TGS featuring more of one mechanism but less of others among social, market, and legal sanctions. Hence, in a certain developmental stage, each society tends to rely more on one mechanism but less on another in regulating market transactions. I call this pattern the relativity of TGS across societies, which is illustrated below through a comparison of China, the United States, and Japan.

3.1.2.2.1. Comparison among China, the U.S., and Japan

3.1.2.2.1.1. China

In most of its history, China has been an agrarian society where indigenous people live in a community-based life pattern. Originating from Confucian heritages, Chinese rulers advocated rule of norms instead of rule of law. Meanwhile, the official suppression of commerce and supporting of agriculture prevented the development of a market economy (see Balazs, 1965; Fei, 1939; Fried, 1969). These heritages led China to form its unique national characteristics as described in the following four dimensions.

Collectivist orientation. The Chinese civilization has been the main source of oriental culture. Following the tradition of Confucianism, each Chinese person identifies herself or himself by his or her relative position to others, and each person's conduct is required to be aligned with the collective well-being and natural harmony of the greater community (Hamilton, 2006b). Each person's reputation is therefore associated with the reputation of the whole community. People voluntarily monitor each other's behavior to make sure that no reputational damage is brought to the community.

The social fabrics in such a collectivist society make monitoring of deviant behaviors easier and therefore support social sanctions. At the same time, such a relationship-based social structure makes impartial enforcement of legal sanctions difficult. For example, litigation, spelled as "*daguansi*" in Chinese, is often in a play of words referred to as "*daguanxi*" in China, meaning "comparing which side between the plaintiff and defendant has the better *guanxi* network." This example indicates that social relationships in a collectivist society can interrupt legal sanctions in a great magnitude. As a result, social sanctions play a more important role than legal sanctions in regulating individual behavior and exchanges in China.

Rule of norms rather than rule of law. Under the influence of the Confucian heritage, Chinese rulers advocated rule of norms rather than rule of law. Confucius said that although governing by laws and punishment can make people obey, it cannot cultivate people's virtues; governing by moral forces and rituals can make people feel ashamed of wrong-doing and become good (*The Analects of Confucius: Book 2—Chapter 3,* 2002).

These basic principles define the major function of the Chinese law as the punishment of those who have failed to conform to norms; the responsibility of enforcement and sanctions of the law are left to the society (Balazs, 1965). Conflicts between individuals are mediated and solved by members within the community. There are no formal codes governing commerce and merchants. Disputes arising from business transactions are settled within craft or merchant guilds (Hamilton, 2006b).

After the last imperial dynasty collapsed in 1911, neither the nationalists before 1949, nor the communists hereafter, made much progress in establishing an efficient legal system in mainland China (see Appelbaum, 1998; Balazs, 1965; Orts, 2001). As a result, China still has a weak legal system today, although it has continued the effort to build a modern legal system (Potter, 2002). Rather, social sanctions are heavily relied on in transaction governance.

Inefficient market. China provides a good case of an immature market. In Chinese history, the Confucian teachings ranked social hierarchy in an order that placed the literati on the top and the merchants at the bottom (Hamilton, 2006a). In the economic sphere, agriculture was supported and commerce was suppressed. These value propositions were reflected in official policies through dynasties and led China to the trajectory of an agrarian society with a natural economy of autarky.[*]

Throughout Chinese history, produces were consumed locally with little exchange; labor was bound to the land; and capital was largely consumed or reinvested into the land with little accumulation (Fei, 1939). The Chinese dynasties changed, but the institutions, including the orthodox Confucian principles, carried on. The social and economic structures in China have

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[*] The word *autarky* appeared in English in the 1610s from the Greek word *autarkeia*, meaning "self-sufficient, having enough, independent of others." In the late 1930s, it started to be used as a term in international economics, referring to an economically self-sufficient country that is not dependent on international trade.

never been challenged with social transformations like the Western Enlightenment. As a consequence, unlike the West, China has an economic sector that has not been separated from the rest of the social life (see Polanyi, 2001). Land, labor, and capital in China have all failed to become commodities, which is a necessary condition for capitalism to emerge and florish. This often becomes a popular explanation for the absence of a market economy in China (Hamilton, 2006b). An inefficient market naturally increases the chances of using more social sanctions.

Lower human mobility. Confucius taught that each individual should stay where he is without traveling far away, especially when his parents are still alive. When a person must leave his hometown, he must have another fixed place to stay (*The Analects of Confucius: Book 4—Chapter 20,* 2002). Economically, China has been an agrarian society throughout the nation's history, and labor has been fettered to the land with little mobility. Individuals in China interacted with one another only within a given social and economic group or community without much trade with, and few commercial connections with, long-distance strangers (see Fried, 1969). This is another important factor that led China to be a low mobility society.

In such a society with lower human mobility, it is easier for individuals to have frequent interactions, establish long-term relationships, foster trust, promote cooperation, and develop behavioral norms in a communal setting. Furthermore, social sanctions can facilitate exchanges only if the parties involved can monitor each other's behavior closely and if their interactions are observable to other members of the community (Bendor & Mookherjee, 1990; Kandori, 1992). The Chinese society has strongly satisfied these conditions of low human mobility and therefore social sanctions were more effective and used more often in regulating human behaviors.

3.1.2.2.1.2. The United States

Individualism. In sharp contrast to China, the United States has been an individualistic society featuring rule of law, an efficient market system, and higher human mobility. The individualist tradition, inherited from ascetic Protestantism and the liberal culture of the Enlightenment, has cast the most important influence over the U.S. culture from the days of its formative period (Parsons, 2007). Weber (1978) argued that starting from the Protestant Reformation, individual believers became responsible for their own salvation without authoritarian brokers like kings, popes, or religious judges. By the time of the Enlightenment, people logically became responsible for their own conduct and began to make their own rational calculations. This is the social origin of Western individualism, which has been persistent in U.S. society since early European immigrants brought the tradition to the new continent in colonial times (see Inglehart & Baker, 2000; Goldstein & Eichhorn, 1961).

In such an individualistic society, people treat all exchange partners the same way, regardless of whether they are inside or outside a group or community. Transactions are not based on long-term repeated patterns. People care more about a current transaction while future opportunities to transact are not a major concern. Transactions in such a society are characterized as price-based impersonal exchanges whereby sellers and buyers are driven by self-interest and less affected by social relations (Greif, 1994). Legal documents (i.e., contracts), instead of social relationships, become the key binding mechanism for economic relationships. While an individualist society lacks the social fabric to support social sanctions, impartial enforcement of the laws is relatively easy because the parties involved tend not to keep close personal relationships. As such, social sanctions are less effective and hence used less often in the United States (vs. China).

Rule of law. Unlike China, the United States has relied heavily on a well-developed legal system to regulate market transactions. A number of factors have led to this unique feature. First, the United States became a colony not by Europeans coming to govern a large indigenous population, such as was the case in Latin America or Africa. Instead, its core social structure was composed of settlers of European origin, who largely displaced the 'native' (Parsons, 2007). This unique social structure makes possible the selective appropriation of the European heritages and the creation of new institutions adapting to the frontier (Engerman & Sokoloff, 2008).

Second, more fundamentally, Weber (1978) believed that rationalism, which is based on the belief that the validity and legitimacy of power rest in rational rules, contributed to the configuration of legal-rational domination in Western societies. Inspired by such beliefs, the society set up legal institutions to guarantee the political and economic rights of individuals who owned properties and engaged in exchanges (Hirschman, 1982). These beliefs provide the foundations for the Western tradition of rule of law (Appelbaum, 1998). Originating from the same Enlightenment thoughts, the legal status of organizations is recognized in the U.S., and Western organizational logics are developed based on the principle that private citizens and individual firms are the key economic agents in society (Hamilton, 2006a).

Third, from its early years of independence, the country's rapid territorial and demographic expansion, industrialization, increasing trade with Europe and across the American continent, massive immigration, and the absorption of new arrivals all created strong demand for a new institutional framework. These developments complicated business transactions to the extent that they can be best supported only through an efficient legal system (see Lipset, 1993; Parsons, 2007).

These factors, to a larger degree, shaped the institutional structure of the new nation (Richter, 1969). The United States, from the very beginning, "favored the development of an efficient legal system to a particularly important place in the structure of the society" (Parsons, 2007). As a result, the Americans became a much more litigious people. They not only are more likely to sue the government, but also show greater propensity to sue each other (Lipset, 1993).

Efficient market. The United States boasts a highly efficient market system backed up by a highly efficient legal system. Since colonial times, cross-Atlantic trade with Europe has been the major feature of the American economy. After the Second World War, the United States as a single nation has continuously been the world's largest economy and market. It has been the largest trade partner to many countries in the world (*Bureau of Economic Analysis*, 2008).

The United States has the world's largest stock exchange—the New York Stock Exchange; it also has the world's largest commodities and futures exchange center—the Chicago Mercantile Exchange. The surging information industry since the 1990s has also enabled the United States to develop the largest online trading network in the world. Overall, the highly competitive business environment, liberal trade policies, highly fluent information flow, and huge market size indicate that the U.S. is an epitome of a mature market. Accordingly, market imperfections are less severe and social sanctions should be used less in compensating for market failure.

Higher human mobility. The United States is an immigrant society, where high mobility has been the most important symbol of individual rights and liberty. Early days' rapid industrialization, urbanization, and territorial expansion, and later days' development of railroad systems, highway networks, and civil aviation industry and networks, as well as the booming of the auto industry, have all helped Americans to realize the dream of mobility. Every day, millions of Americans are on the road. Travel and related industries have been an important part of the U.S. national economy (*The Travel Industry World Yearbook—The Big Picture*, 2003). Job change, relocation, moving, and business and leisure traveling…indeed, the restlessness of American life has been regarded as a source of freedom and opportunity (Kopf, 1977).

In such a society featuring higher human mobility, a high rate of residential turnover fosters institutional disruptions and weakens interpersonal ties (Coleman, 1990: 316). Residential instability ruptures social fabrics and renders social sanctions less popular and effective, compared to legal sanctions, delivered through sheriffs, guns, contracts, lawyers, and the court system, in regulating individual behavior and market transactions. Hence, social sanctions are less effective and more legal sanctions will be used in transaction governance in the United States (than in China).

3.1.2.2.1.3. Japan

Collectivist society. Historically, the Japanese society was heavily influenced by Confucianism, which was introduced into Japan and became popular in the seventh century. The Japanese society highly resembles that of China in most aspects, including the collectivist orientation. A more unique feature of Japanese society is that prior to the Meiji Restoration in 1868, in over two and a half centuries of peace time (Tokugawa era), Japan evolved into a collectivist value system featuring traditions of Confucianism, Buddhism, and Shinto ethics (Bellah, 1970; Ooms, 1996). That value system is believed to be the origin of today’s high trust and collectivism in the Japanese society (Fukuyama, 1995). These conditions foster the rich soil for social sanctions to work.

Rule of both norms and law. One major difference between the original Confucianism in China and the Confucianism in Japan is that the latter is a combination of ancient Chinese legalism and Confucianism traditions, or “Ritsuryo Confucianism,” which emphasizes both rule of law and rule of norms (Holcombe, 1997). Legalism, which is the ideal of the great ancient Chinese legalist Han Feizi (280 B.C.–233 B.C.), was one of the rivaling philosophical doctrines, along with Daoism and Confucianism, during the Warring States period (475 B.C.–221 B.C.) in ancient China. According to Han Feizi, “no country is permanently strong, nor is any country permanently weak. A country can be strong if the law administrators are strong; otherwise, the country is weak….Strict laws are means to forbid extra-judicial actions and exterminate selfishness; severe penalties are means to execute decrees….” (*Han Feizi: Chapter 6*, 2004).

The first emperor of China, *Yinzheng* (*shihuangdi*) of the *Qin* kingdom, unified China in 221 B.C. and established the *Qin* dynasty. He advocated legalism and rule of law in his newly established state (Balazs, 1965). Although later dynasties reverted to Confucianism as the major doctrine for ruling the country (e.g., *Han* Dynasty established in 202 B.C.), legalism still left a legacy in Chinese philosophical thoughts and political practices. This is the origin of the legalism element in “Ritsuryo Confucianism” that was transmitted into Japan along with other Chinese cultural heritages.

In addition to the above legalism origin from China, the Japanese legal system has also been strongly influenced by the West. The Western influence on Japan had a major effect in the 1860s and reached its peak in the postwar era. During the Meiji Restoration starting in 1868, Japan emulated the West as it established modern institutions, including a modern legal system (Hunter, 2005; Westney, 1982). Under the U.S.-led Allied occupation after World War II, Japan carried out a major constitutional reform and established a democratic political system that weakened the power of the monarch (Upham, 1987).

Those influences from both China and the West have helped Japan to form a unique governance system. On the one hand, the nation is governed by an efficient legal system, and on the other hand, it is still maintaining its traditional cultural values through rule by norms (see Fukutake, 1989; Harris, 1982). Thus, the Japanese society is featured as using both traditional norms and modern laws to regulate individual behavior and market transactions.

Efficient market. As one of the world’s major industrialized countries, Japan features a highly efficient market system. Japan’s raw material supplies and industrial outputs rely heavily on international trade (i.e., imports of natural resources and exports of finished goods), which requires an efficient market system to support and is also an indicator of market efficiency (North, 1991). Japan also has one of the world’s most efficient financial markets. Strong market forces render both legal and social remedies for market imperfections less eminent.

Lower human mobility. Like China, Japan was an agrarian society with aboriginal people living in communal life patterns (Smith, 1959). Compared to China’s geography, Japan’s mountainous island features further limit human mobility. In addition, Japanese companies' practice of lifetime employment discourages job mobility. As such, low mobility allows Japanese people to promote reciprocal behavior, build stable and long-term relationships, foster cooperation, and develop intricate norms in a strong communal setting. In such a social context, social sanctions work more effectively as a supplement to market sanctions in regulating the behavior of economic agents.

3.1.2.2.1.4. Summary

Those discrete cultural and historical origins depicted above have created the conditions for social sanctions to be the dominant mechanism in the TGS of China, but enabled a TGS dominated by legal sanctions in the U.S., and yet led to quite a unique TGS in Japan featuring both high legal and high social sanctions in regulating economic transactions.

Figure 3.1 helps to explain the different types of TGS in China, the U.S., and Japan. In this two-dimensional space, the *x*-axis represents a society's reliance on legal sanctions, while the *y*-axis represents its reliance on social sanctions. The oval close to the *y*-axis represents the TGS of China that is evolving along ray *R-China*, where more social but less legal sanctions are relied on, and the oval close to the *x*-axis represents the TGS of the U.S., which evolves along ray *R-US* where more legal but less social sanctions are applied in transaction governance. The oval in the middle represents the TGS of Japan, which develops along ray *R-Japan*, featuring both high legal and high social sanctions. In other words, in China, social sanctions are the primary remedy for market imperfections, whereas in the U.S., market imperfections are addressed mainly through legal sanctions imposed by specialized third-party institutions such as the court and legal professionals, and in Japan, economic activities are coordinated with both rule of law and social norms.

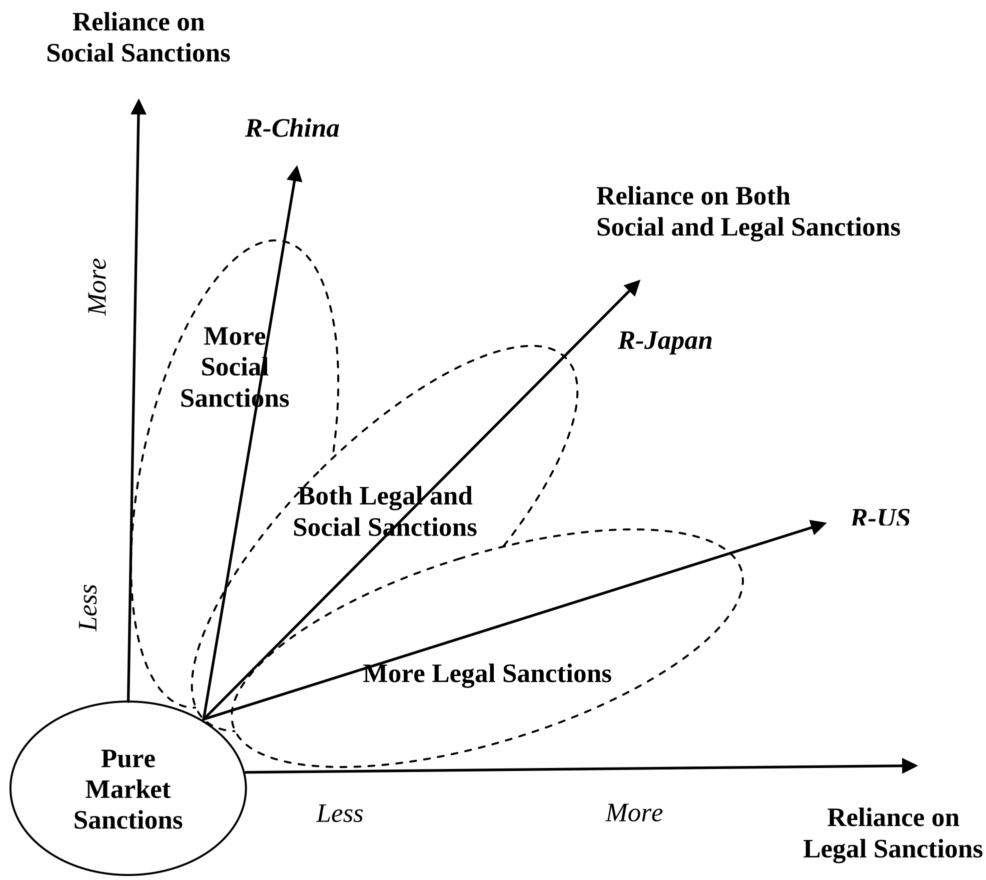

Figure 3.1. Comparison of Transaction Governance Structures (TGS) among China, the United States, and Japan

3.1.2.2.2. The relativity of TGS within a single country at multiple levels

Based on the model given above (Figure 3.1), all societies can find a distinctive position in the two-dimensional space that corresponds to the degree of their reliance on social vs. legal sanctions to supplement market sanctions in regulating economic transactions. We can narrow the model to a single country, where the relativity of TGS can be observed across regions, simply because regional disparity may lead some areas to rely more on legal sanctions, but others to depend more on social sanctions, to address market imperfections. For instance, such factors as human mobility, population density, market maturity, and availability of legal services may cause the correcting mechanism for market imperfections (i.e., social or legal sanctions) to vary across different regions of a country (see Bendor & Mookherjee, 1990; Kandori, 1992; Sampson, Morenoff, & Earls, 1999).

The model can also be further narrowed down to the industry level, where variations in TGS across industries can be found within a single society. For example, certain industries (e.g., those creating products with high technical complexity) are more likely to suffer from market imperfections and, as a result, social or legal sanctions, whichever are more immediately available or more efficient, are used more often as a supplement to market sanctions in governing business transactions.

Finally, this TGS model can be narrowed down to the firm level, in that each firm in a particular industry uses a unique combination of market, legal, and social sanctions to govern transactions. Expectedly, the ability of a firm to exercise its market power also depends on such attributes as size and age. Relative to their smaller and younger counterparts, thus, bigger and older firms tend to rely less on social or legal sanctions to supplement market sanctions in governing business transactions.

The concept of the multilevel relativity of TGS can be illustrated through the two-dimensional space in Figure 3.2. In this space, the *x*-axis captures the degree of reliance on legal sanctions, and the *y*-axis, the reliance on social sanctions, as a supplement to market sanctions to govern a particular transaction (at the society, region, industry, or firm level). Thus, the *origin* of the space represents a perfectly efficient market where *pure market sanctions* alone are enough to govern all economic activities (or, zero reliance on legal and social sanctions), a hypothetical case that can hardly be found in modern economies.

The distance between the origin and any point in the space measures the extent to which market sanctions have failed to govern economic transactions (i.e., the degree to which a society, a region, an industry, or a firm relies on legal and social sanctions to correct for market imperfections). This concept can be illustrated through *Ray R*, upon which any point captures a particular level of market inefficiency, where a certain combination of social and legal sanctions can be used as a supplement to market sanctions to regulate the behavior of economic agents.

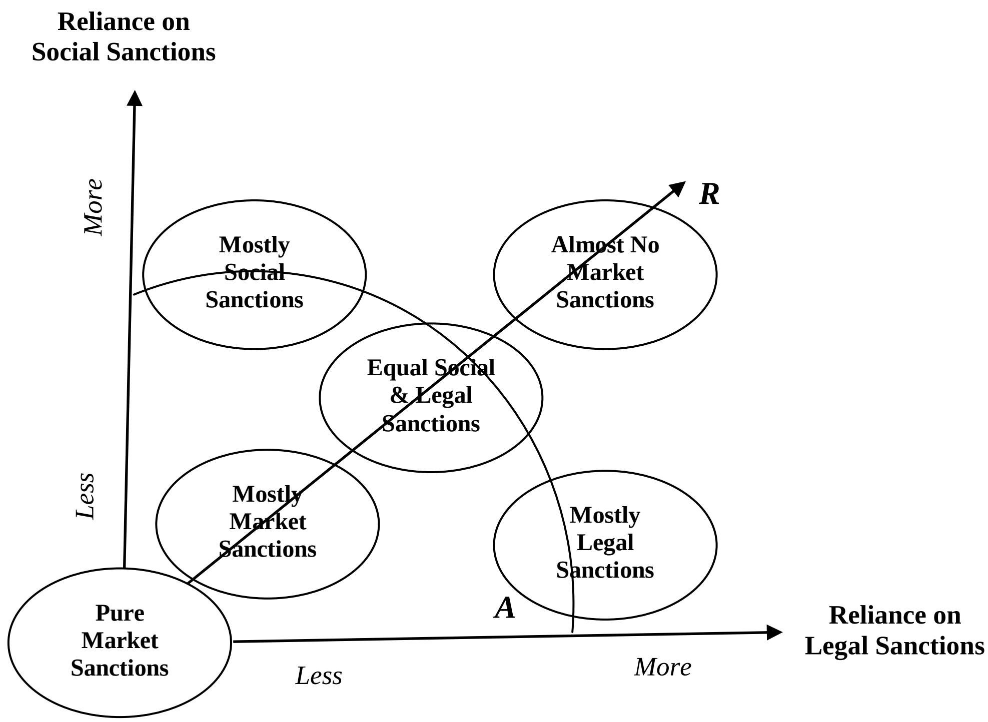

Figure 3.2. Relativity of Transaction Governance Structures (TGS)

Accordingly, the oval near the origin (at the lower-left corner of the space) represents those cases that use *mostly market sanctions* to govern economic transactions, where only a low level of reliance on both social and legal sanctions is needed to support a nearly perfect market. In contrast, the oval at the upper-right corner of the space represents those cases that use *almost no market sanctions* to govern economic activities, where extreme market inefficiency calls for a high level of reliance on both social and legal sanctions to regulate business transactions.

Under a constant level of market inefficiency, social and legal sanctions can be combined in an infinite number of ways to regulate economic activities. We can link all points that have an equal distance from the origin of the space to construct an arc (e.g., *Arc A*), which represents a given level of market inefficiency. Along *Arc A*, we have numerous combinations of social and legal sanctions as a mechanism to correct this level of market inefficiency.

The oval at the upper-left end of *Arc A*, for example, stands for the use of *mostly social sanctions* to correct for market imperfections, which means that legal sanctions are rarely used to deal with market inefficiency. The oval at the lower-right end of *Arc A*, in contrast, represents the use of *mostly legal sanctions* to address market imperfections, which means that social sanctions are barely used to supplement market sanctions. Finally, the oval in the middle of *Arc A* represents *equal social and legal sanctions*, which means that social and legal sanctions are used equally to alleviate market inefficiency. To construct a TGS space at the society level, therefore, we should put China at the upper-left corner (i.e., *mostly social sanctions*), the U.S. at the lower-right corner (i.e., *mostly legal sanctions*), and Japan right in the middle (i.e., *equal social and legal sanctions*) of the space.

3.1.3. Summary

The above arguments have established the first step of the general framework I proposed in Chapter 2 in the literature review (illustrated by the lower part in Chapter 2, Figure 2): transactions are governed by a combination of market, social, and legal sanctions and the degree of reliance on each of these three mechanisms depends on social and historical factors at the society, regional, industry, or firm level in each society. This step can be illustrated by Figure 3.3, where the dotted rectangle represents a transaction governance structure (TGS) that includes market, social, and legal sanctions.

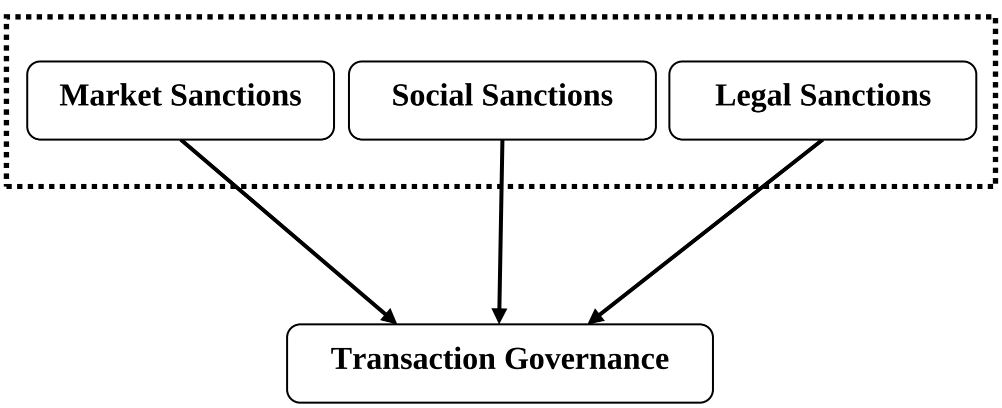

Figure 3.3. Transaction Governance (Step 1 of the General Model)

3.2. Social Sanctions and Business Entertainment

The model of TGS relativity depicted above suggests that under the conditions where market and legal sanctions are weak or ineffective, social sanctions have to play a bigger role to compensate for the imperfections of market sanctions in regulating economic transactions. Nevertheless, a key question that remains unanswered in the literature is: how can the power of social sanctions be reinforced in such cases? I propose below that business entertainment serves as a potential booster of social sanctions, another major pillar of my theoretical framework.

3.2.1. How social sanctions work

As argued above, social sanctions are one of the supplemental mechanisms used to correct for the imperfections of market sanctions in regulating transactions. Social sanctions are a social and psychological process through which social norms are enforced to regulate human behavior. They support long-term and repeated interpersonal exchanges within communal settings by deterring economic agents from cheating with the threat that misconduct will incur self-conscious emotional penalties, result in public disproval, and lead to a loss of reputation and/or profits from future exchanges (Cooter, 1998).

Social sanctions involve both individual emotions and group-level interactions in a community. The efficacy of social sanctions depends on each individual’s willingness to uphold social norms, which is featured as a dual-level process. At the individual level, people internalize social norms to achieve self-improvement, so that violating an established norm makes them feel psychologically pain (Cooter, 1998). At the group level, based on these internalized norms or principles, each individual is willing to monitor the behavior of other members in the community and punish defectors or even those who refuse to punish the violators (Opp, 2001; Posner, 1997).

Increasing the power of social sanctions, first, requires reinforcing personal emotions at the individual level. Emotions such as social disapproval, distrust, ostracism, peer pressure, feelings of anxiety, guilt, shame, and public embarrassment of offenders all play key social functions and the more reinforced these emotions are, the better regulated an individual’s social behavior will be (e.g., Baumeister & Leary, 1995; Fischer & Manstead, 2008; Fiske, 2005; Noussair & Tucker, 2005). Second, the power of social sanctions also depends on structural dynamics at the group level. Within the context of social relations, social interactions can change both human behavior (Homans, 1974: 58) and social structure (Emerson, 1981). As such, frequent interactions through communal settings or long-term relationships can build cohesive social structures within which individuals will be willing to engage in enforcement activities, and thereafter social sanctions become more powerful in regulating social behavior (Axelrod, 1986; Homans, 1958; Horne, 2007)

3.2.2. Business entertainment

Entertainment in general is an important form of social exchange that can entail feelings of personal obligations, gratitude, and trust, and create enduring social patterns or structures (Mauss, 1990; Lévi-Strauss, 1957). It has the features of particular and symbolic social exchanges that can influence individual behavior and social structure (e.g., Blau, 1964; Foa & Foa, 1980). As a unique type of social exchange, though taking various forms at different stages of history, entertainment has played important social roles in human life (e.g., Kipnis, 1996; Mauss, 1990). Since the hunting and gathering stage of human history when food was the most elementary human need, the functions of eating and drinking, which are typical forms of entertainment activities, have never been limited to their basics as a physical necessity for survival. Eating binds people to their faiths through powerful links between food and memory (Sutton, 2001). Individuals are more receptive to persuasion when eating enjoyable food (Janis, Kay & Kirshner, 1965). As part of the eating process, alcoholic drinking has also played an integrating role in maintaining social cohesion (Dietler, 2006).

As human society added more sophistication to everyday life, entertainment practices assumed more important social roles: they are now far removed from merely satisfying subsistence requirements. For instance, people are often able to exert control over appetite in favor of social relations during eating (Kipnis, 1996). Entertainment activities have thus started to be used as rituals and symbols to construct belief systems and to reaffirm and transform relationships (Mintz & Du Bois, 2002).

The social functions of entertainment can be found in primitive societies and in the history of a number of civilizations. An important ritual called potlatch (a ceremony accompanied with banqueting, dancing, and gift exchange) was found among Pacific Islanders, Northwestern

American Indians, and Asian Eskimos. Potlatch facilitated transactions that exchanged not only wealth but also actions of politeness; it served as a form of social contract in the absence of the State's assumption of that role (Mauss, 1990). For the Mayas, feasting events were used to "integrate and differentiate group members by providing the public backdrop for the construction and reproduction of social relations" (LeCount, 2001). For the New Irelanders in the Pacific, eating was a social institution for maintaining cohesion of the society and of groups within. Banquets among New Irelanders were used as an occasion for dispute resolution, gift exchange, sharing jokes and gossip, and arranging business transactions (Powdermaker, 1932). Similar ritual occasions were observable elsewhere as well. For instance, the Romans used public banquets to establish and maintain group identities (Donahue, 2003); inscriptions on archaic bronze vessels recorded details about banquets, rituals, and gift ceremony that were part of the State life in ancient China.

One common thread of the above observations in different societies is that the material flow in entertainment practices does not consist of merely concrete and tangible objects; the "items" flowing are "vehicles and instruments for realities of another order: influence, power, sympathy, status, and emotion" (Lévi-Strauss, 1957). Entertainment activities have been used as means of nurturing relationships and strengthening mutual trust, caring, reciprocity, and commitment (Carrier, 1991; Kipnis, 1996). In business settings, entertainment activities, as a form of social exchange, play an important role in reinforcing social sanctions to facilitate economic transactions.

3.2.3. Business entertainment reinforces social sanctions

Just like entertainment in general has played an important role in facilitating human interactions, business entertainment in particular can create favorable conditions for social sanctions to work in regulating the behavior of economic agents. Specifically, at the individual level, business entertainment can promote reciprocal behavior. At the group level, business entertainment helps to establish and maintain long-term relationships and enhance group dynamics that enable social sanctions to function more effectively.

3.2.3.1. Promoting reciprocal behavior

Reciprocity is one of those social norms that are often enforced to generate social sanctions to regulate interpersonal interactions, including transactional relationships in business settings (Chen, 2010; Gouldner, 1960). Individuals are often expected to observe the norm of reciprocity in social and economic exchanges. Failing to do so would engender social sanctions from both individual and group levels. At the individual level, failing to reciprocate would incur self-imposed emotional penalties like guilt and shame. At the group level, failing to conform to the principle of reciprocity would subject an individual to social punishments such as peer pressure, social disapproval, and community ostracism (see Noussair & Tucker, 2005). Those emotional penalties or social sanctions can force individuals to conform to exchange rules in business transactions, even if such conformation will result in material losses (Akerlof, 1980). Promoting reciprocal behavior among individuals, therefore, can boost the power of social sanctions.

Business entertainment serves to promote reciprocal behaviors among individuals. The process of a business entertainment event, like all other social exchanges, is often accompanied by a flow of goodwill from the giver to the taker (see Blau [1964], Foa & Foa [1980], and Mauss [1990] for a discussion on goodwill flow in social exchanges). By accepting entertainment, the taker also accepts the goodwill that makes him or her feel indebted to the giver. Failing to reciprocate the giver would force the taker to entail internal emotional penalties and external social sanctions. Consequently, frequent interactions through business entertainment will increase the taker's indebtedness to the giver. The greater the magnitude of indebtedness at the taker's side, the stronger the desire to reciprocate the giver by complying with the terms in an expected transaction (see Greenberg's [1980] theory on indebtedness and reciprocity). Further, from a social power perspective, which is about an individual's socially hierarchical position within a social stratum (see Burt, 1992), accepting business entertainment from the giver can put the recipient in a socially subordinated position where he or she is obliged to reciprocate the giver following the giver's expectations (see Blau, 1964; Homans, 1974). In addition, accepting business entertainment without reciprocity will subject the receiver to public reprimand, leaving him or her with a tainted reputation and hence fewer trading opportunities in the community. By upholding the norm of reciprocity at the individual and group levels, business entertainment can potentially boost the power of social sanctions in regulating transactional relationships.

3.2.3.2. Building long-term relationships

Long-term relationships are conducive for the social sanctions that facilitate transactions. On the one hand, long-term relationships enable repeated interactions, including repeated economic transactions, which can foster the cooperative behavior that enhances the power of social sanctions (see Axelrod, 1984). On the other hand, both the seller and buyer in long-term-based and repeated transactions expect that cheating and other opportunistic behaviors will be retaliated in follow-up transactions, which makes social sanctions more effective in deterring uncooperative behaviors. Establishing and maintaining long-term relationships, therefore, can create favorable conditions for social sanctions to regulate business transactions.

Business entertainment is an effective means for establishing and maintaining long-term relationships. First, business entertainment enhances long-term relationships by generating long-term orientations (see Gouldner's [1960] discussion on relationship building). For example, an initial treat from a business entertainment giver is often made in the expectation that the recipient will reciprocate, and in fact it can often induce a treat-back from the recipient. This treat-back in turn can trigger another reciprocal treat-back from the original giver. The cycle just keeps going on, in that business entertainment serves not only as a starter but also as a stabilizer in nourishing a long-term exchange relationship. Expressed differently, business entertainment helps to initiate, sustain, and reinforce long-term relationships that create a favorable condition for social sanctions to work in governing repeated transactions (Schwartz, 1967; Simmel, 1950).

Second, business entertainment is an exchange of approximate fairness, just like all other forms of social exchange (see Schwartz's [1967] discussion on approximate fairness in social exchanges). By accepting entertainment, the taker owes a favor to the giver, the quality and quantity of which is often an approximate amount. What the taker pays back is often believed to exceed what the giver originally offered, which again puts the original giver (who is now the taker) in an indebted position. Such imbalance of favor between entertainment giver and taker will ensure long-term relationships where social sanctions work more effectively in facilitating transactions.

3.2.3.3. Enacting group dynamics

Group dynamics is a necessary condition for social sanctions to work because it is only at the group level that behavioral norms can be established and enforced to generate social sanctions (see Axelrod, 1984: 129; Horne, 2007). Indeed, group dynamics makes the ritualization of ideas about proper behaviors more likely and renders deviant behaviors harder to hide (Festinger, Schachter & Back, 1948).

Group dynamics is the interaction process between an individual and the group he or she belongs to that can generate the power of social sanctions to regulate individual behaviors. Normally, individuals are expected to internalize norms autonomously so that sanctions can emerge from within the individual. However, more often than not individuals fail to observe norms voluntarily; therefore, external deterrence at the group level is needed to force individuals to internalize norms. In cases where such group-level deterrence fails to force an individual to internalize and comply with norms, third-party social pressure at the group level is also needed to force the individual to abide by norms. As such, group dynamics is a critical condition for social sanctions to work more effectively.

As a social activity that is often practiced at the group level, business entertainment can enact group dynamics to make social sanctions more effective in facilitating transactions. Business entertainment is usually attached to a business purpose. When a guest manager accepts an invitation and takes business entertainment from the host manager, she is expected to cooperate on, or at least be more receptive toward, the accompanied business transaction, based solely on the norm of reciprocity. On the one hand, the co-presence of multiple participants in the entertainment event would expose her to the deterrence of group-level sanctions that could force her to internalize norms and comply. On the other hand, when such deterrence still does not work, those participants would punish the defaulter by spreading her bad reputation in the business circle that could exert real collective sanctions upon the defaulter at the group level. As a result, the defaulter will be ostracized from the business circle and incur future economic losses. As such, business entertainment enacts group dynamics that makes social sanctions work more effectively in facilitating transactional relationships.

3.2.4. Summary

The above arguments have established the second step of the general framework I proposed in Chapter 2 (illustrated by the vertical part in Figure 2.2): business entertainment boosts the power of social sanctions in governing transactions, particularly under the conditions where social sanctions play a bigger role in a TGS (i.e., market and legal sanctions are weak). This step can be illustrated by Figure 3.4, where business entertainment contributes to transaction governance through boosting the power of social sanctions.

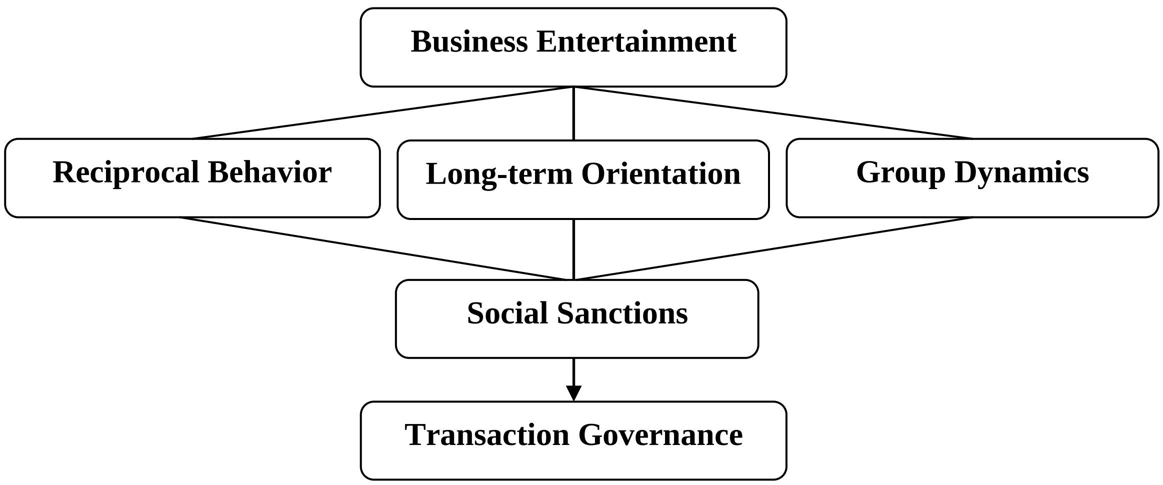

Figure 3.4. Business Entertainment, Social Sanctions, & Transaction Governance (Step 2 of the General Model)

3.3. An Integrated New Model

Up to now, I have set up an integrated model where business entertainment plays a role in boosting the power of social sanctions as a supplement to market and legal sanctions to govern economic transactions. Integrating Figure 3.3 and Figure 3.4, I portray this transaction governance model of business entertainment through Figure 3.5, where all transactions are governed through a combination of market, legal, and social sanctions. I have called such a combination the transaction governance structure (TGS), which is symbolized by the dotted rectangle.

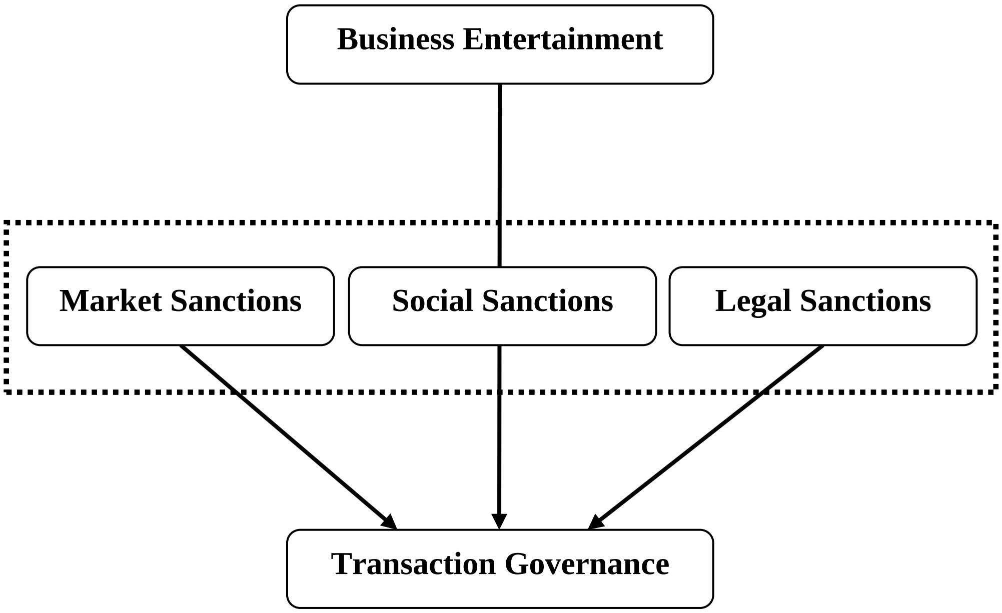

Figure 3.5. The Integrated General Model of Transaction Governance Structure & Business Entertainment

I have argued further that business entertainment serves as a significant amplifier of social sanctions in alleviating market imperfections, especially in societies where market and legal infrastructures are underdeveloped. More specifically, I have focused on business entertainment's role in promoting reciprocal behavior at the individual level, in establishing and maintaining long-term relationships in dyadic interactions, and in enhancing group dynamics within communal settings, which are all conducive to the effective working of social sanctions, and hence to the regulation of individual behavior and the governance of transactions. As such, an association between social sanctions and business entertainment has been established.

3.4. Summary

To sum up, economic transactions are governed through a TGS that features a combination of market, legal, and social sanctions. Cultural, social, and institutional factors shape relatively different transaction governance structures across societies. Such variations can also be observed at the regional, industry, and firm levels. Within a TGS, social sanctions play a bigger role in governing transactions when both market and legal sanctions are weak. Social sanctions play such a role through a social psychological process where social norms are enforced to regulate the behavior of individuals.

Business entertainment fits into the TGS by creating favorable conditions for social sanctions to work in regulating the behavior of economic agents. At the individual level, business entertainment can promote reciprocal behavior. At the group level, business entertainment helps to establish and maintain long-term relationships and to enact group dynamics that enable social sanctions to function more effectively.

Building upon the framework of the relativity of TGS and the proposition that business entertainment reinforces social sanctions to facilitate transactions, I make two predictions. First, under the conditions where social sanctions play a bigger role in transaction governance, business entertainment will be more intensively practiced; and second, business entertainment should be more effective when it induces stronger reciprocal behavior and long-term orientation and enacts stronger group dynamics. In the next two chapters, I use China as an empirical context to verify my general model. Chapter 4 tests the pervasiveness of business entertainment with a sample of Chinese manufacturers listed on the Shanghai Stock Exchange (SSE), and Chapter 5 tests the effectiveness of business entertainment with survey data collected among Chinese sales managers.

Chapter 4

4. Predicting the Pervasiveness of Business Entertainment at the Firm Level

Building upon the general framework of transaction governance structure (TGS) and the proposition that business entertainment has the potential to boost the power of social sanctions in regulating the behavior of economic agents, this chapter uses China as an empirical contest to develop hypotheses and runs empirical tests to verify the firm-level pervasiveness of business entertainment. The basic argument is that companies will spend more on business entertainment in situations where social sanctions play a greater role in governing economic transactions, namely, the situations where market and legal infrastructures are less developed. The empirical data needed for the tests were collected from a sample of manufacturers listed on the Shanghai Stock Exchange (SSE) in China.

4.1. Hypotheses

The general model I have proposed in this dissertation is that social and legal sanctions can be used as remedies for market imperfections and that business entertainment boosts the power of social sanctions for the sanctions to function more effectively. I use a set of society-level factors to predict firms' reliance on social sanctions (vs. legal sanctions) as remedies for market imperfections in governing transactional relationships, and hence to predict their spending on business entertainment.

4.1.1. Social sanction conduciveness

Social sanctions work more effectively as a remedy for market imperfections when the norm of reciprocity is well-established in a society, business transactions are long-term in nature, and the parties involved transact in a communal setting. Social sanction conduciveness denotes whether or not a society meets these conditions.

According to my base TGS model (see Chapter 3, Figure 3.5), market, social, and legal sanctions constitute a transaction governance structure in regulating exchange relationships. In a social context that is conducive to social sanctions, social sanctions must be more effective and will therefore be used more widely in regulating transactions. In such a case, as illustrated by Figure 4.1 (a), business entertainment will be practiced more intensively to boost the power of social sanctions in transaction governance (as compared to the base model shown in Figure 3.5).

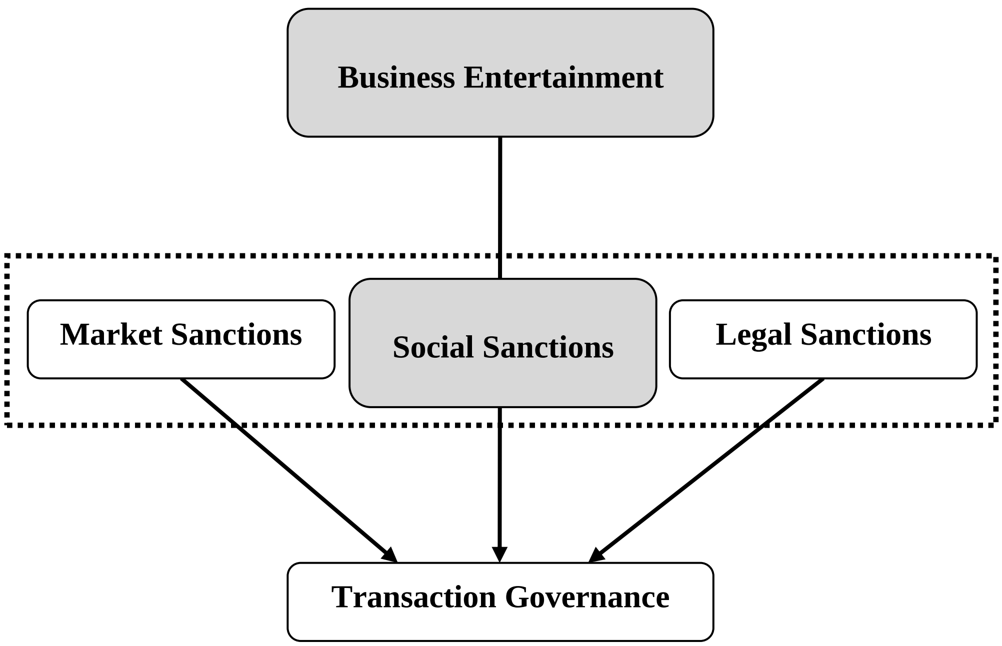

Figure 4.1. (a): Relativity of TGS & Pervasiveness of Business Entertainment: Social Sanction Conduciveness

Let me take China as an example of the model in Figure 4.1. China has been historically an agrarian society where indigenous people live in a community-based life pattern. The communal setting is conducive to norm development, which makes close monitoring and group sanctioning of individual behaviors possible. Given China's collectivist cultural heritages (see Hofstede, 1980), most interpersonal relationships are oriented to the long term, including business relationships. As well, the Chinese society has developed elaborate norms, particularly the norm of reciprocity, which is an important norm for governing interpersonal relationships (see Axelrod, 1984). Famous ritual principles in China include, for instance, "receiving without reciprocating is not ritually proper behavior" and "the receipt of a droplet of generosity should be repaid with a gushing spring." Such principles are all about the norm of reciprocity, which works better in governing transactional relationships that are long-term in nature. The above three conditions (communal setting, long-term orientation, and reciprocity) foster a conducive context for social sanctions to work in regulating the behavior of economic agents, which allows China to rely more on social sanctions to regulate exchange relationships. Under the three conditions, as shown in Figure 4.1, business entertainment is practiced more intensively to boost the power of social sanctions in transaction governance.

Economic reform in the past three decades, however, has brought about gigantic social changes in China. To begin with, urbanization and increased human mobility resulting from economic development have rent the traditional social fabrics that are necessary for effective functioning of social sanctions. Also, rapid development has generated economic systems that are too complicated for social sanctions to regulate. More important, frequent interactions with the outside world, particularly with the Western societies, have exposed some local communities to mimetic and normative pressures that have led to institutional assimilation with the West, such as the adoption of legal sanctions as a remedy to market imperfections (see DiMaggio & Powell, 1991).

Such changes, nonetheless, have happened unevenly across the country, given the nature of the gradual geographic commitment of the country's reform. For instance, the coastal areas have experienced intensive changes which distorted the social context needed for social sanctions to function effectively; the inland areas, in contrast, still feature a traditional social context that is more conducive to social sanctions, where business entertainment serves to boost the power of social sanctions in regulating transactional relationships. As such, I predict that:

> Hypothesis 1: Chinese firms operating in a context that is conducive for social sanctions to work will spend more on business entertainment to facilitate exchange relationships than others operating in a context that is not conducive to the working of social sanctions.

4.1.2. Legal infrastructure development

In addition to social sanctions, legal sanctions are another remedy for the failure of market sanctions. Given a certain level of market inefficiency, social and legal sanctions can be used in numerous combinations to supplement market sanctions in governing transactions. Thus, the reliance on social vs. legal sanctions to regulate the behavior of economic agents depends on the relative availability and effectiveness of the two substitute mechanisms. As illustrated by Figure 4.1 (b), social sanctions will be used more often if legal infrastructures are less developed (that is, legal sanctions are rarely used to support economic transactions). When social sanctions play a greater role in transaction governance, business entertainment will be more widely practiced to boost the power of social sanctions in playing this role (as compared to the base model shown in Chapter 3, Figure 3.5).

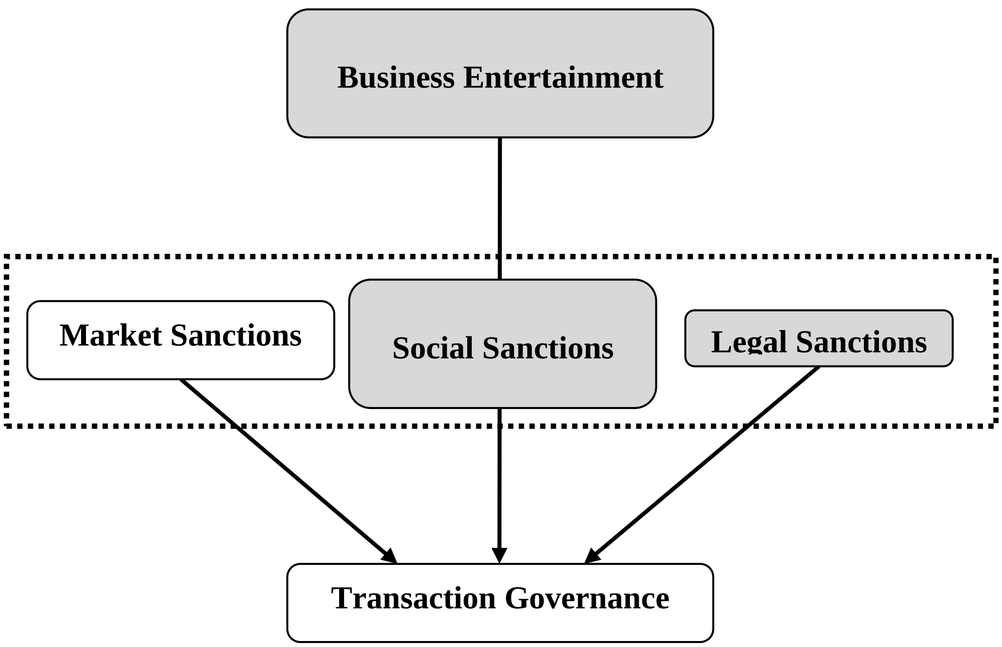

Figure 4.1. (b): Relativity of TGS & Pervasiveness of Business Entertainment: Under-Developed Legal Infrastructure

Let me use China as an example. The traditional Chinese economy has been characterized as a family-based business model that did not evolve into complex economic systems supported by formal legal institutions (see Portes & Haller, 2005). In addition, intertwined personal and business relationships in this collectivist society have made impartial enforcement of laws difficult, if possible at all. Throughout her history, China has been epitomized as having a weak legal system. This system can also be attributed to the Confucian values that advocate rule by norms and rituals instead of rule of law (Appelbaum, 1998; Balazs, 1965). After the last imperial dynasty fell in 1911, neither the nationalists nor the communists made much progress to replace this traditional rule by norms by establishing an efficient legal system (Potter, 2002). Although the country has continued its efforts to develop modern legal infrastructures, legal sanctions are still missing in many aspects of the economic life in China.

In the past thirty years, however, the reform policies in China have fostered institutional changes that are characterized as the adoption of legal sanctions in transaction governance. Nonetheless, such changes happened largely in selected areas, e.g., in big cities and the coastal regions. In many inland areas, however, legal services are not widely available and the traditional rule by norms has remained a key supplement for market sanctions in regulating the behavior of economic agents. Given the absence of well-developed legal infrastructures in such areas to address market inefficiency, social sanctions will serve as the main remedy for market inefficiency, and hence business entertainment will be used more intensively to boost the power of social sanctions in governing economic transactions.

As such, I predict that Chinese firms operating in those regions with less developed legal infrastructures will use business entertainment more often to facilitate exchange relationships (vs. their counterparts operating in regions with better developed legal infrastructures).

> Hypothesis 2: Under a given level of market inefficiency, Chinese firms in regions with less developed legal infrastructures will spend more on business entertainment to facilitate transactional relationships than others in regions with better-developed legal infrastructures.

4.1.3. Market efficiency

The above arguments are framed on the assumption that social and legal sanctions are used as remedies for a constant level of imperfections of market sanctions. In reality, however, the efficiency level of market sanctions varies under different situations, which may affect the extent to which social sanctions are needed for transaction governance, and thereby the extent to which business entertainment is used to boost the governance power of social sanctions.

When market sanctions are too weak to uphold transactions, more nonmarket institutions (i.e., legal and social sanctions) have to be used to regulate transactions. As illustrated in Figure 4.1 (c), with the development level of legal infrastructures being kept constant, social sanctions must play a bigger role to govern exchange relationships supported by weak market sanctions (or transactions conducted in a less efficient market). Accordingly, more business entertainment will be needed to boost the governance power of social sanctions in a less efficient market (as compared to the base model shown in Figure 3.5).

China is well-known as a society inflicted with market imperfections. In Chinese history, the Confucian teachings supported agriculture and suppressed commerce. This traditional cultural value was well reflected in official policies through dynasties and had led China to the trajectory of an agrarian society featuring a natural economy of autarky, where land, labor, and capital had all failed to become commodities. The Confucian tradition, indeed, is considered the main cause for the absence of a market economy in Chinese history (Hamilton, 2006a).

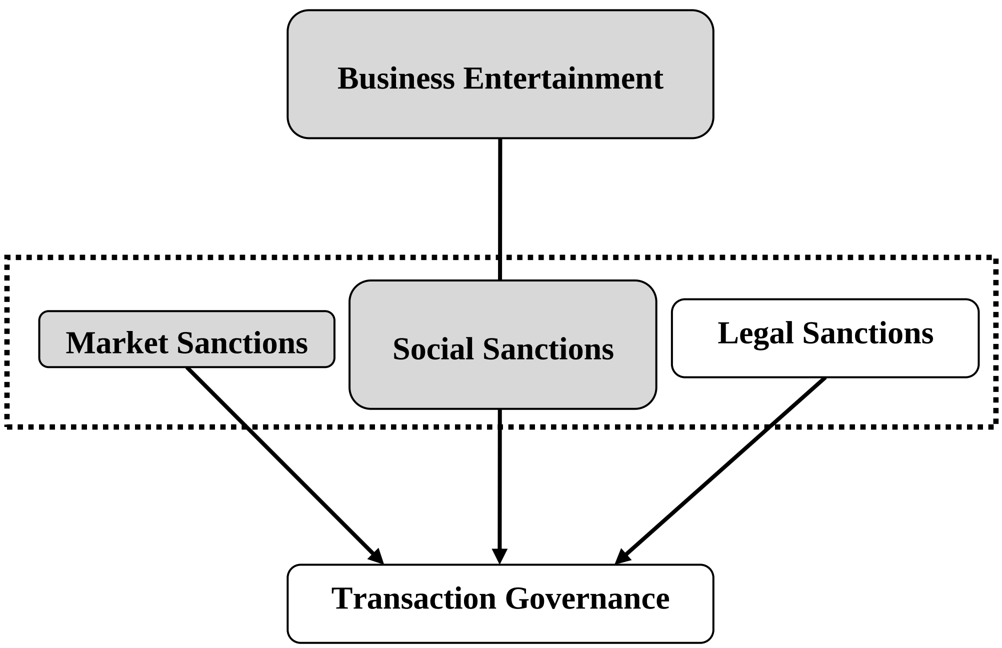

Figure 4.1. (c): Relativity of TGS & Pervasiveness of Business Entertainment: Inefficient Market

In the past thirty years, uneven economic development has changed the business landscape in China and made the picture more complicated. As a result of the "open-door" policy implemented in China, those coastal provinces hosting special economic zones, for instance, have been exposed to industrialized economies and urbanized societies in the West (e.g., Japan and the U.S.) and developed a modern economic system featuring stronger market sanctions. In contrast, many inland areas still maintain to a greater extent the traditional agrarian and less mature economic systems that rely heavily on social sanctions. For example, the coastal areas generate intensive exports and imports (e.g., long-distance trade) that are found in modern market economies, but the inland areas still run local or regional trade found mainly in less developed economies.

Hence, I propose that Chinese firms operating in regions where market infrastructures are less developed will use business entertainment more intensively to boost the power of social sanctions in regulating exchange relationships than their counterparts operating in regions where market infrastructures are better developed (and hence where social sanctions play a smaller role in regulating economic activities).

> Hypothesis 3: Chinese firms located in regions with inefficient market infrastructures will spend more on business entertainment to govern exchange relationships than firms located in regions with efficient market infrastructures.

4.2. Empirical Tests

4.2.1. Sample and data collection

I tested the above hypotheses on a sample of manufacturers listed on the Shanghai Stock Exchange in China (*Shanghai Stock Exchange Statistics Annual*, 2009). For three reasons I believe that this empirical setting is ideal for verifying the transaction governance approach to business entertainment. First, as pointed out earlier, China still has a relatively immature market system featuring the Confucian heritage of rule by norms rather than rule of law. Second, economic reforms in past decades have led to developmental disparities in China and variations in transaction governance mechanisms are evident across different regions of the country. Third, the sample provides perfect control for other country-level factors that also affect the prevalence of business entertainment (e.g., national cultures or political systems).

Among the firms listed on the Shanghai Stock Exchange I used only those manufacturing firms that included the accounting item “entertainment expenses” in their financial reports. I focus on the manufacturing sector to control for the idiosyncrasy of the service sector and reflect the dominant role of China as the production plant in the world. According to the general accounting principles in China, firms must record all entertainment expenses in their financial accounts and failing to do so will draw penalties from the taxation authorities (*State Administration of*

Taxation, 2006). In practice, however, not all firms include entertainment expenses in their annual reports, and I included in the sample only those that had chosen to do so. Previous studies have found that financial data reported by public firms in the Shanghai Stock Exchange are reasonably reliable (e.g., Allen, Qian & Qian, 2005; Chen, 2004).

A major possible concern was that the firms' decision to exclude or include the item of entertainment expenses in financial reports might cause selection bias to this study. To make sure that this selection bias does not exist in my sample, I compared sample means on key variables between the two groups of firms (one including and the other excluding entertainment expenses). The comparison yielded no significant differences between the two groups. Overall, the sample firms are highly representative of all SSE firms on the majority of the variables. For instance, these firms span 28 out of China's 31 regions at the province level, representing all 16 three-digit Standard Industry Classification (SIC) sub-sectors of manufacturers, with an average state ownership of 30.71 percent, which is close to the SSE average of 31.84 percent (*Shanghai Stock Exchange Factbook*, 2008).

I collected data backward from 2007 to 2003 (i.e., a five-year window). A number of reasons have convinced me that financial data collected in this period are particularly suitable for my analysis. In 2003, the Chinese economy had cooled down from an overheating in the 1990s with a successful soft-landing. Also, it had largely absorbed the shocks from the 1997 Asian financial crisis and the burst of the Internet bubble in the early 2000s. Further, this sampling period preceded the recent global recession that began in 2008. It is safe to say that during this five-year period, Chinese firms were experiencing relatively stable and smooth growth. In addition, the consumer price index in China was steady (around 1%) and thus adjustments to data due to inflation were not necessary.

This sampling procedure yielded a list of 139 firms and a panel of 695 firm-year observations over the period between 2003 and 2007.

4.2.2. The Model

I have argued that business entertainment serves to reinforce social sanctions to facilitate transactions, particularly under the conditions where social sanctions are more effective and play a bigger role (i.e., market and legal infrastructures are underdeveloped). Hence, Chinese manufacturers will spend more on business entertainment when they operate in environments that are more conducive for social sanctions to work, and where weak legal and market sanctions call for more social sanctions to govern transactions. These hypotheses were tested through a time-series, cross-section model as specified below:

$$Y_{it} = \alpha + \beta 1 X1_{it} + \beta 2 X2_{it} + E_{it}$$

where Y_{it} is the dependent variable (i.e., business entertainment spending); $X1_{it}$ a vector of independent variables; $X2_{it}$ a vector of control variables, α the intercept, $\beta 1$ *and* $\beta 2$ are vectors of parameters for the i^{th} firm in year t, and E_{it} is the error term.

As mentioned earlier, I used a firm's total annual spending on entertainment-related activities as the dependent variable. I used real spending, rather than an intensity ratio of business entertainment spending to sales, to avoid information loss. According to the general accounting principles in China, expenses on activities that take place in venues ranging from hotels, restaurants, golf courses, karaoke booths, and dance halls, to bowling lanes, sauna rooms, hair salons, and massage parlors are considered business entertainment spending.

In testing the governance role of business entertainment, I assume that the sample firms make rational decisions on entertainment spending that can help them facilitate business transactions. I also assume that they self-select the optimal form of entertainment activities to maximize the governance effect. Entertainment spending may be toward suppliers, buyers, or even government regulators, but all types and forms of entertainment activities play the same role of reinforcing social sanctions to facilitate transactional relationships that are weakly supported by legal and market sanctions. It is not necessary, or even empirically possible, to classify those entertainment activities. Overall, I believe that this accounting item is an accurate and reliable proxy for business entertainment spending at the firm level.

4.2.3. Independent Variables

On the right-hand side of the equation is a vector of independent variables that I used to predict Chinese firms' spending on business entertainment and thereby to test the hypotheses developed earlier.

4.2.3.1. Social sanction conduciveness

As defined earlier, social sanction conduciveness denotes whether in a particular region the norm of reciprocity is well-established, whether long-term orientation is featured in the social culture, and whether there exists a strong communal setting that enables frequent social interactions. There are two factors that can potentially change social sanction conduciveness of a particular region and hence serve as its measures. First, urbanization can rupture the traditional social fabrics that are necessary for the effective functioning of social sanctions. Second, frequent interactions with the developed societies, particularly international trade, can expose local communities to mimetic and normative pressures that could lead to institutional assimilation with the West (DiMaggio & Powell, 1991). Both factors can change the social context in a way that makes reciprocity and long-term orientation less of a binding behavioral norm and enables individuals to break out from their communal norms in dealing with strangers. Such changes could make the social setting less conducive to the working of social sanctions. As such, I used urbanization and international trade in the home province of the focal firm to measure *social sanction conduciveness*. As suggested by Hypothesis 1, I expected this variable to carry a negative coefficient.

4.2.3.2. Legal infrastructure development

The number of attorneys in a particular region in China was used in prior studies to measure the availability of legal services in the region (e.g., Gao, Murray, Kotabe & Lu, 2010). I used two factors to measure legal infrastructure development: one is the number of attorneys per 100,000 population, and the other is the number of filed lawsuits per 100,000 of population in the home province of a firm (*Chinese Yearbook of Lawyers 2004*). Because of the high correlation between these two measures, I used the factor analysis method to construct an index to evaluate the development level of *legal infrastructures*. I believe this index can reflect the availability of legal services and thus proxy for the legal infrastructures in a region. According to Hypothesis 2, I expected this legal index to carry a negative coefficient.

4.2.3.3. Market efficiency

A number of studies have used the index of free market mechanism development, which was compiled by the National Economic Research Institute (NERI) of China, to test the variation in market efficiency across Chinese provinces (e.g., Gao et al., 2010; Li, Meng & Zhang, 2006). I used the same index to measure *market efficiency* in this study. This index captures two sub-indices: the percentage of products with market-determined prices; and the reduction of local protectionism that affects a firm's ability to decide where and at what price to sell their products. As predicted in Hypothesis 3, I expected this measure to carry a negative sign.

4.2.4. Control Variables

My theory is focused on the social, legal, and market factors at the regional level. Therefore, there is the need to control for other regional factors, along with industry and firm level factors, to isolate out the main effects. Those factors are described as follows.

Firm annual sales. I used a firm's total annual sales to control for the scale effect, expecting this variable to carry a positive sign (i.e., firms that generate more sales also spend more on business entertainment).

Firm age. I controlled for firm age, expecting that older firms may have a larger business network to maintain and therefore must spend more on business entertainment, which indicates a positive impact of firm age on entertainment expenses.

Firm employee number. The number of employees in a firm may have two conflicting effects on business entertainment. On the one hand, firms with more employees often feature stronger bureaucratic control and corporate governance that can effectively prevent managers from using business entertainment excessively. On the other hand, agency problems (see Jensen & Meckling, 1976) may be more severe in firms with more employees, which means that managers in firms with more employees will spend more towards their private benefits in the name of business entertainment (e.g., Cai, Fang & Xu, 2005; Rajan & Wulf, 2004). Hence, the impact of *employee number* on business entertainment is an empirical question to be answered later by the results.

State ownership. State-owned enterprises (SOEs) in China may have more legal power and hence use less business entertainment to boost the governance power of social sanctions. I used the percentage of the stake controlled by the state in a firm to measure its ownership structure. I expected this variable to have a negative impact on a firm's spending on business entertainment.

GDP per capita. At the regional level, we used provincial GDP per capita to control for disparities of economic development that may affect firms' business entertainment spending. I expected this variable to carry a positive sign, based on the fact that the affluence level in different regions can affect the scale and varieties of entertainment activities and hence the amount of entertainment spending (i.e., a firm's entertainment spending tends to be larger if it is located in a more affluent region).

Industry control. Although the sample covers only manufacturing firms, it still spans 16 industries at the three-digit Standard Industry Classification (SIC) level (from 311 to 339). To control for any unaccounted industry effects, I also included 15 zero-vs.-one dummy variables in my model to represent the 16 three-digit SIC industries, using food products (SIC 311) as the base industry.

The statistics of all variables and the correlation matrix are given in Table 4.1. The variance inflation factors (VIFs) generated from ordinary least square (OLS) tests are well below the critical threshold of 10, indicating that multicollinearity is not a concern in the dataset (e.g., the largest VIF is 2.57). A test on distribution found that sample distribution is good.

4.3. Results

My analyses are based on a cross-section, time-series panel that has the advantages of increasing sample size and of capturing both the individual effects from each section and the dynamic effects from the sample (Kmenta, 1996). However, pooling repeated entries of the same observations may lead to within-unit autocorrelation and cross-sectional heteroskedasticity. As a result, using an OLS model may create biased variance estimates that hamper hypothesis testing (Greene, 2003). To correct for the potential autocorrelation and heteroskedasticity issues, I follow the advice of Sayrs (1989) by using a generalized least square (GLS) approach.

Through the Wooldridge Test (see Drukker, 2003), I found that autocorrelation is not a concern in my dataset ($F = 0.79$ and $p < .38$). Through the Breusch-Pagan Test introduced by Baltagi and Raj (1992), I found that heteroskedasticity is present in the panel (Chi-Square = 2,310 and $p < .001$). Thus, I applied a Feasible Generalized Least Square (FGLS) method that fits a dataset with heteroskedasticity but without autocorrelation (Greene, 2003).

The results of the FGLS regression are reported in Table 4.2. On top of industry controls (which I will report later), I entered into Model 1 only the five other control variables (i.e., *GDP per capita*, *total sales*, *firm age*, *total employees*, and *state ownership*) to capture the effects of regional economic and firm level variables on firms' entertainment spending. As predicted, both *GDP per capita* and *total sales* carry a positive coefficient that is significant at the 0.001 level; *firm age* is significant at the 0.05 level; and *state ownership* carries a negative sign that is significant at the 0.01 level. The coefficient of *total employees* is positive but not significant. One explanation for the insignificant effect of the employee number is that business entertainment is often used to facilitate exchange relationships, which is a marketing/sales function that cannot be fully reflected through the large number of assembly workers in a sample that covers only manufacturing firms.

In Model 2, I added another pair of variables, i.e., *international trade* and *urbanization*, to capture the effect of social sanction conduciveness on entertainment spending. As expected, the variable *international trade* carries a negative sign that is significant at the 0.001 level. To my surprise, the coefficient of *urbanization* is positive and statistically significant at the 0.01 level, contradicting my prediction. The combined results lend partial support for Hypothesis 1, which predicts that a social context that is more (less) conducive to the working of social sanctions will have a positive (negative) effect on the pervasiveness of business entertainment.

I have two explanations for the positive impact of *urbanization* on the prevalence of business entertainment. First, urbanization enables more varieties of modern entertainment formats that potentially increase the scale of entertainment spending. For instance, people in urban areas can consume lavishly in luxurious restaurants to which rural dwellers don't have immediate access. Second, urban life allows people to have closer physical proximity, which provides the convenience for entertainment activities. These two factors can potentially boost entertainment spending, and hence they are all positively correlated with the dependent variable, which is

Table 4.1. Minimums, Maximums, Means, Standard Deviations & Correlations [a]

	Minimum	Maximum	Mean	S. D.	1	2	3	4	5	6	7	8	9
1. Pervasiveness	.12	128.33	5.96	8.62									
2. GDP per capita	3,838	78,801	31,449	17,159	.13***								
3. Annual sales	19.68	76,180	2,530	5,395	.54***	.07*							
4. Firm age	3	24	8.56	3.53	.05	.16***	–.02						
5. Total employees	56	94,269	4,406	9,011	.31***	.08*	.64***	–.05					
6. State ownership	.44	.69	.31	.21	.02	.00	.17***	–.25***	.19***				
7. International trade	.00	1271	54.89	258	.00	.32***	–.01	.14***	–.02	–.06*			
8. Urbanization	.02	1.00	.38	.25	.13***	.58***	.06*	.03	.08*	–.00	.37***		
9. Legal index	13.15	504.55	151.88	134.61	.15***	.56***	.10**	.03	.15***	.14***	.30***	.52***	
10. Market index	3.84	10.40	7.49	1.79	.06*	.58***	–.01	.22***	–.05	–.06*	.34***	.15***	.54***

1. [a]n = 695.
2. * P < .05; ** P < .01; *** P < .001 (2 tailed p-value).

Table 4.2. FGLS Results for Pervasiveness of Business Entertainment

	Model 1	Model 2	Model 3	Model 4
Control variables				
GDP per capita	3.17E – 05*** (5.19E – 06)	9.42E – 06 (7.47E – 06)	7.53E – 06 (7.42E – 06)	1.65E – 05* (7.53E – 06)
Total sales	9.34E – 04*** (5.97E – 05)	9.19E – 04*** (6.03E – 05)	9.33E – 04*** (6.08E – 05)	9.38E – 04*** (6.18E – 05)
Firm age	.05* (.02)	.07** (.02)	. 06* (.02)	.08** (.02)
Total employees	1.62E – 05 (2.97E – 05)	6.60E – 06 (2.90E – 05)	–2.22E – 06 (2.98E – 05)	1.45E – 05 (3.59E – 05)
State ownership	–.02 ** (5.82E – 03)	–.02*** (5.18E – 03)	–.01** (5.20E – 03)	–.02 ** (5.80E – 03)
Industry control (see Table 4.3)				
Social sanctions conduciveness				
International trade		–2.31E – 03*** (4.68E – 04)	–2.61E – 03*** (4.62E – 04)	–2.63E – 03*** (4.77E – 04)
Urbanization		.04** (.01)	.08*** (.01)	.10*** (.02)
Legal infrastructure development				
Legal index			–5.99E – 03*** (2.18E – 03)	–8.17E – 03** (2.51E – 03)
Market efficiency				
Market index				–.23** (.08)

1. † P < .10; * P < .05; ** P < .01; *** P < .001 (2 tailed p-value).
2. n = 695.
3. Enclosed in parentheses are standard errors.

business entertainment spending. They help to explain why *urbanization* bears a positive coefficient, instead of a negative one as predicted in Hypothesis 1.

In Model 3, I added the variable *legal index* that captures the development level of legal infrastructures in each province to predict the pervasiveness of business entertainment. The variable bears a negative coefficient that is significant at the 0.01 level. The finding confirms Hypothesis 2, where I predicted that firms located in provinces with better developed legal infrastructures spend less on business entertainment than their counterparts located in provinces with less developed legal infrastructures.

Model 4 is the full analysis that also considers the impact of *market efficiency* on the pervasiveness of business entertainment. I used the *market index* to capture a firm's home province's level of market efficiency. This variable carries a negative coefficient that is significant at the 0.01 level, supporting Hypothesis 3 that firms located in regions with a less efficient market system spend more on entertainment activities than firms located in regions with a more efficient market system.

The results of all industry dummies are reported in Table 4.3. When the model covers only industry dummies (Column 1), it has a Wald Chi-Square of 391.66 that is significant at the 0.001 level, confirming the existence of unaccounted industry effects on the pervasiveness of business entertainment. In fact, my data revealed substantial variations in entertainment spending across sectors, ranging from RMB 8.06 million in beverages/tobacco to RMB 4.51 million in plastics/rubber products. In the full model that covers all independent variables (Column 6), the Wald Chi-Square is 981.00 ($p < .001$), which again indicates consistent model fit.

4.4. Summary

In this chapter, I developed a set of hypotheses to verify why the intensity of business entertainment practice varies between firms, based on the model of relativity of TGS across multiple levels. Empirical tests were conducted on a sample of manufacturers listed on the Shanghai Stock Exchange. The results indicate that entertainment spending among the firms in the sample is significantly related to those society-level factors that affect the use of social sanctions as a supplement for market and legal sanctions in governing transactional relationships. These results provide evidence supporting my transaction governance approach to business entertainment.

Table 4.3. FGLS Results from Industry Controls

	Industry control	**Model 1**	**Model 2**	**Model 3**	**Model 4**
Independent and other control variables (See Table 4.2)					
Beverage and tobacco products	–8.06*** (1.26)	–3.60** (1.34)	–5.51*** (1.19)	–5.43*** (1.17)	–5.27*** (1.15)
Textile mills	–8.05*** (1.29)	–3.56** (1.36)	–5.30*** (1.21)	–5.16*** (1.19)	–5.01*** (1.17)
Apparel	–6.61*** (1.31)	–3.58** (1.37)	–4.89*** (1.26)	–4.97*** (1.24)	–5.25*** (1.20)
Wood products	–6.46*** (1.43)	–1.50 (1.46)	–4.32** (1.35)	–4.76*** (1.34)	–4.24** (1.33)
Paper products	–6.33*** (1.33)	–1.90 (1.40)	–3.87** (1.24)	–3.73** (1.23)	–3.41** (1.21)
Basic chemicals	–5.67*** (1.28)	–1.24 (1.34)	–3.44** (1.18)	–3.37*** (1.17)	–3.40** (1.14)
Plastics and rubber	–4.51** (1.56)	–2.12 (1.43)	–3.42** (1.28)	–2.56 (1.31)	–2.26 (1.31)
Nonmetallic mineral	–7.62*** (1.28)	–3.20* (1.34)	–5.02*** (1.19)	–4.91*** (1.17)	–4.99*** (1.15)
Primary metals	–4.88*** (1.26)	–6.72*** (1.35)	–8.38*** (1.22)	–8.21*** (1.21)	–8.32*** (1.17)
Fabricated metals	–5.28*** (1.38)	–2.44 (1.35)	–3.96** (1.21)	–3.89** (1.19)	–3.55** (1.17)
Machinery	–6.23*** (1.36)	–2.72 (1.42)	–4.51*** (1.26)	–4.40*** (1.25)	–4.34*** (1.21)
Computers and electronic products	–6.26*** (1.28)	–3.00* (1.35)	–4.63*** (1.20)	–4.52*** (1.19)	–4.23** (1.16)
Electrical equipment	–4.94*** (1.31)	–2.09 (1.35)	–4.27** (1.23)	–4.07** (1.22)	–3.86** (1.19)
Transportation equipment	–5.03*** (1.27)	–1.34 (1.34)	–3.06** (1.17)	–3.12** (1.16)	–3.25* (1.13)
Miscellaneous products	–3.47 (1.96)	–.42 (2.00)	–3.18 (1.94)	–2.63 (1.95)	–2.47 (1.95)
Constant	10.85*** (1.25)	4.62** (1.39)	5.23*** (1.29)	3.74** (1.35)	4.10** (1.35)
Wald statistics	391.66***	927.92***	835.78***	899.33***	981.00***

1. *P < .05; ** P < .01; *** P < .001 (two tailed p-value).
2. n = 695.
3. Enclosed in parentheses are standard errors.

Chapter 5

5. Effectiveness of Business Entertainment: A Transaction-Level Test

Chapter 3 argues that business entertainment reinforces the power of social sanctions in regulating the behavior of economic agents when market sanctions and legal sanctions have both failed to do so effectively. In this chapter, I use China as an empirical context to examine the effectiveness of business entertainment in playing that role, using a set of survey data collected from a sample of Chinese sales managers.

5.1. Hypotheses Development

The previous chapters have argued that each society features a unique combination of market, legal, and social sanctions in transaction governance, and that business entertainment has the potential to reinforce the power of social sanctions, particularly under the conditions where market and legal sanctions are weak and social sanctions play a bigger role in transaction governance. Specifically, at the individual level, business entertainment can induce reciprocal behavior, which also fosters long-term and group orientation. At the group level, business entertainment helps to establish and maintain long-term relationships and to enact group dynamics that enable social sanctions to function more effectively. As such, the effectiveness of business entertainment in boosting the power of social sanctions to facilitate transactional relationships is determined by the magnitude of the reciprocal behavior it can trigger, the degree of the long-term orientation it can promote, and the strength of the group dynamics it can help to enact. In other words, increasing the magnitude of Chinese managers' reciprocal behavior, promoting long-term orientation, and enacting group dynamics should also increase the effectiveness of business entertainment in boosting the power of social sanctions to facilitate transactional relationships.

I identified a set of features of business entertainment and propose that they could potentially influence the effectiveness of business entertainment in reinforcing social sanctions to facilitate exchange relationships. Specifically, I hypothesize that the dollar amount of entertainment spending, the frequency of entertainment practice, and intimate and observable entertainment activities all have an impact on the effectiveness of business entertainment.

5.1.1. Amount of business entertainment expenses

I first argue that the dollar amount of business entertainment spending has an impact on its effectiveness in helping a Chinese manager to trigger, and increase the magnitude of, reciprocal behavior from his or her guest. In business settings, when a guest manager accepts entertainment from the host manager, the guest will feel indebted to the host and obliged to reciprocate the host with an expected transaction based solely on the rule of reciprocity. The larger the amount spent on business entertainment by the host, the stronger the guest's feelings of indebtedness and hence the desire to reciprocate the host.

The above argument can find support from both individual behavioral and social structural dimensions. First, from an individual behavioral perspective, which is pertinent to an individual's internal self-emotional reactions to external stimuli (see Homans, 1958), increasing the amount of business entertainment expenses can strengthen the guest manager's feelings of indebtedness to the host manager and therefore engender the obligation to reciprocate the host manager. In China, people rarely split expenses on eating, drinking, or entertainment activities. There is usually a clear distinction between the host and the guest in such events and the host often pays the entire bill. This is particularly true when one manager entertains another manager in business settings. In such a setting, the host manager pays the bill and therefore transfers a favor of both material value and goodwill to the guest. Based on the Chinese ritual principle that "receiving without reciprocating is not ritually proper behavior" (*The Book of Ritual*: *Qulishang*, 1970), in most cases the process can trigger feelings of indebtedness at the guest side and induce the guest to reciprocate. The larger the amount of entertainment expenses, the greater the magnitude of such a mood of indebtedness, and hence the higher degree of discomfort and the stronger desire to reduce it through reciprocity (see Greenberg [1980] for a discussion of indebtedness and reciprocity).

Second, from a social structural perspective, which is about an individual's socially hierarchical position within a social stratum he or she belongs in (see Burt, 1992), increasing the dollar amount of business entertainment expenses can put the guest manager in a more socially subordinated position where the guest manager is obliged to obey the host manager following her expectations (see Blau, 1964; Homans, 1974). Based on a traditional Chinese norm on the interaction mechanisms in personal relationships, once a guest manager receives a treat of entertainment from the host manager, the “mouth becomes soft” and the “hands become short,” which means that he or she becomes socially subordinated and sentimentally obliged to the host manager (see Yang, 1994: 197). Consequently, the relationship between the two becomes closer after each entertainment. A Chinese ritual principle also holds that the receipt of a droplet of generosity should be repaid with a gushing spring, which indicates that a guest manager who has received an entertainment treat from a host manager must pay back in excess of the original offer the guest received. Increasing the expenses of business entertainment thus triggers stronger reciprocal and cooperative behavior at the guest manager’s side and more effectively convinces the guest to reciprocate the host manager by abiding by exchange terms and maintaining a long-term orientation on the business relationship. As such, I propose that:

> Hypothesis 1: The dollar amount of business entertainment expenses is positively associated with business entertainment’s effectiveness in facilitating transactional relationships.

5.1.2. Frequency of business entertainment practices

The frequency of business entertainment practice can affect its effectiveness as well. Business entertainment is accompanied with an emotional flow (i.e., goodwill) from the giver to the taker that can trigger reciprocal goodwill or social approval from the taker. Increasing the frequency of business entertainment practices can thus engender a higher degree of social approval and build up a higher degree of trust, thus making it more effective in generating stronger social sanctions to facilitate business transactions (see Axelrod [1984] for the theory of social interaction and social approval). Such a rationale also helps explain why most business entertainment activities are practiced in a frequent and repeated pattern (see Yang, 1994), where the more frequently the guest manager accepts business entertainment from the host manager, the stronger the obligation she feels to reciprocate.

This argument can also be explained from both individual behavioral and social structural levels.

First, at the individual behavioral level, repeated interactions like business entertainment can renew an individual's feelings of indebtedness to refresh a relationship for a long-term orientation (see Bourdieu [1977] for a discussion on the role of social practices in renewal and maintenance of relationships). In Chinese business settings, normally, an initial business entertainment is between strangers where the host manager uses the event as a "foot-in-the-door" strategy to get connected with the guest manager and sow the seeds of indebtedness in the guest's heart. Repeated entertainment activities can continue to refresh the guest manager's waning feelings of indebtedness and bring the guest manager closer to the host manager step by step. The more frequently business entertainment is practiced, the closer and more stable and long-term-oriented the business relationship becomes (see Wilmot, 1994).

Second, from a social structural perspective, frequent entertainment activities can also increase the chances of exposing individual behaviors to group surveillance and make social sanctions work more effectively (see Rawlins, 1994). An occasional entertainment between a host manager and his or her guest may not be observable to others. However, when such activities are repeated frequently, there will be a greater chance that others will see it. In the event the guest manager defaults or fails to reciprocate the host manager, others would sanction the guest manager by spreading bad reputation or refusing to deal with the manager in the future. Indeed, the mere threat of such sanctions would usually deter the guest manager's deviating behaviors and induce the manager to comply with exchange terms. As such, I hypothesize that:

> Hypothesis 2: The frequency of business entertainment practices is positively related with its effectiveness.

5.1.3. Intimate business entertainment activities

Extending the above arguments further, I also propose that intimate business entertainment activities are positively associated with the overall effectiveness of business entertainment practice in facilitating transactional relationships.

Intimacy, which is denoted as the sentimental and physical closeness between individuals, is a critical variable that has an impact on promoting reciprocal behavior and building long-term interpersonal relationships (see Lowenthal & Haven, 1968). Some business entertainment activities, such as drinking in a bar, singing at a KTV club, or having a sauna together, are effective means and venues for Chinese managers to use to develop intimacy with business partners, so as to induce reciprocal behavior and to initiate, sustain, and reinforce long-term orientations that can make social sanctions work more effectively in regulating transactions. I define such entertainment activities as intimate entertainment.

As noted earlier, business entertainment can reinforce the power of social sanctions by inducing an individual's reciprocal behavior, which also promotes long-term orientation in relationship building. In business settings, a host manager can choose to entertain a guest through intimate business entertainment activities that can increase the intimacy between them, so that such entertainment activities can trigger stronger reciprocal behavior and induce long-term orientation from the guest manager. For instance, in leisure- and pleasure-based intimate business entertainment, such as drinking in a bar, taking a sauna, or singing together in a KTV club, the host manager can interact intimately with his or her guest, share secrets with the guest, and win over the guest's trust in a much easier manner (see Geiger & Turley, 2003; Hare, 1952; Mintz & Du Bois, 2002). Repeating such events will build up a higher degree of intimacy and eventually bring the guest manager closer to the host manager sentimentally (see Wilson, 1995). Consequently, the higher degree of intimacy developed through those entertainment practices will help to build a reciprocal long-term relationship between those managers so that social sanctions become more effective in regulating their behaviors as well as the business transactions between them (see Crosby, Evans & Cowles, 1990; Taylor, De Soto & Lieb, 1979). As such, I propose that:

> Hypothesis 3: Intimate entertainment activities have a positive relationship with the overall effectiveness of business entertainment in reinforcing social sanctions to facilitate transactional relationships.

5.1.4. Observable entertainment events

I argued earlier that, at the group level, business entertainment has the potential to enact group dynamics to make social sanctions function more effectively. In business settings, a host manager can choose to entertain a guest through activities that are observable to a broader range of witnesses so that the guest manager's individual behavior will be put under group surveillance. In such occasions, business entertainment can strengthen the power of social sanctions to regulate individual behavior and govern transactions. I define this format of entertainment as observable entertainment events and propose that they also have a positive relationship with the overall effectiveness of entertainment practices in reinforcing the power of social sanctions to facilitate transactional relationships.

There are three reasons supporting the above argument. First, in observable business entertainment events, such as a formal banquet, a concert, and a golf game, certain established routines are followed and formal dress codes are observed that all serve a ritual and ceremonial purpose that can increase the commitment, dedication, loyalty, and allegiance between the guest manager and the host manager and enhance their group orientation which translate into stronger social sanctions (Gusfield & Michalowicz, 1984; Knottnerus, 2010).

Second, individuals often hold two sets of norms, one for intra-group members or insiders and the other for inter-group members or outsiders, and uncertainty reduction and management and control of deviant behaviors can happen only among insiders who share the same set of intra-group norms (see Merton, 1972). Observable entertainment events can turn strangers or outsiders into acquaintances or insiders. At such events, the behaviors and activities of the participants are observable to the general public, which not only strengthens the participants' group identity but also gives other observers the perception that they should be treated as being in the same group (see Yang, 1994). This process helps to foster group orientation and eventually turns the host and guest managers into insiders of the same group. As insiders of the same group, they will internalize and abide by the intra-group norms of this group and their behaviors are under the surveillance of all group members. In addition, these events give more opportunities for frequent interactions and therefore provide more opportunity to establish a reciprocal long-term relationship. These conditions are all conducive to the working of social sanctions.

Finally, the co-presence of business managers at observable entertainment events exposes individual behaviors to other participants who have observed and experienced the same event, so that misbehavior or default of the guest manager would be subjected to social sanctions of other participants of the same event, or even from those who were not active in the focal event but witnessed it. If a guest manager accepted entertainment but failed to reciprocate the host manager, such a deviant behavior would be punished or perceived negatively by others who observed the event. These observers could collectively spread the guest manager's bad reputation around in the community and refuse to do business with him or her in the future. The more people who have observed the event, the more likely that the manager's deviant behavior and bad reputation will be spread to a larger population. Deterrence through fear of such a consequence will force the guest manager to abide by the norm of reciprocity and maintain a business relationship with the host manager, which indicates stronger social sanctions. Hence, I propose that:

> Hypothesis 4: Observable entertainment events have a positive relationship with the overall effectiveness of business entertainment in reinforcing social sanctions to facilitate transactional relationships.

5.1.5. Moderating effects from the time factor -- stage of relationship

Time is a key factor in promoting reciprocal behavior and long-term and group orientation in relationship building (Sharma & Patterson, 1987), conditions which in turn are critical to social sanctions working more effectively (see Altman & Taylor, 1973). Knapp (1984) has classified the time factor in a relationship into five stages, from early to late: initiating, experiencing, intensifying, integrating, and bonding stages. In this study, I conceptualize the time factor in a business relationship as either at early stage (i.e., initiating and experiencing) or at late stage (i.e., intensifying, integrating, and bonding). I propose that the positive association between the amount of business entertainment spending and its effectiveness is stronger, whereas the frequency of business entertainment practices and the intimacy-based and observability-oriented business entertainment activities have diminishing effectiveness, in a late stage of relationship.

5.1.5.1. Stage of relationship's moderating effects on amount and frequency

The stage of relationship determines the degree of familiarity between host and guest managers, which can potentially moderate the relationship between business entertainment's amount and frequency and its effectiveness in boosting the power of social sanctions. In a later stage of relationship, there are the possibilities that the host manager is familiar with his or her guest manager, that they are close friends in non-business settings, that they are insiders of the same social group who share common friends, that they interact with each other frequently both in private life and during business transactions, et cetera. In all of those or similar circumstances, the host manager may have a net credit of favor over the guest manager in such forms as a sunken direct investment in the relationship in the past. A longer duration of relationship means the possibility of a higher amount of sunken direct investment in the guest manager from the host manager. Accordingly, in the current business entertainment, even if the amount is low, a longer duration of relationship would still compensate its effectiveness.

As for frequency, in a later stage of relationship at a higher degree of familiarity between host and guest managers, frequent interactions on other occasions than business entertainment may still serve the same purpose as that served by business entertainment. In such a case, the guest manager may become less “sensitive” to business entertainment, and so increasing the frequency of business entertainment practices may not generate the same level of social sanctions as it could do in an earlier stage of relationship at a lower degree of familiarity. As such, I hypothesize that:

> Hypothesis 5a: The positive relationship between the dollar amount of entertainment expenses and the effectiveness of business entertainment is stronger in a later stage of relationship between the host and guest managers.
>
> Hypothesis 5b: The positive effect that the frequency of entertainment practices has on the effectiveness of business entertainment diminishes as the duration of relationship between the host and guest managers increases.

5.1.5.2. Stage of relationship’s moderating effects on intimacy and observability

In this line of reasoning, it follows that the stage of relationship also has an important impact on the effectiveness of intimate and observable business entertainment activities in reinforcing social sanctions to facilitate transactions. An early stage of relationship features low-level intimacy between host and guest managers. Therefore, intimacy-based entertainment activities can help to break the emotional barriers and psychological guarding between them so that they develop a higher degree of intimacy at a faster pace and greater scale (see Hays, 1985), which indicates that intimacy-based business entertainment is more effective in reinforcing social sanctions to facilitate transactions in an early stage of business relationship. When the relationship enters its later stage, however, the increased degree of intimacy between the host and guest managers makes it harder to keep the same pace and scale as before in promoting higher degrees of intimacy. As such, intimacy-based business entertainment’s effectiveness should diminish along with the development of the business relationship.

Similarly, at the early stage, a higher degree of observability can put the guest manager's individual behaviors under broader group surveillance, which could help to initiate and intensify this manager's reciprocal behavior and long-term and group orientation. In contrast, at the late stage of the relationship, observability's impact gradually weakens. On the one hand, the focal relationship is already well-publicized at this stage and more observability may not play its role at the same level of effectiveness as in the early stage. On the other hand, at the later stage, the relationship between the host and guest managers is more focused, therefore the network pertinent to this focal relationship has actually shrunk (see Milardo, 1982). Accordingly, observability-oriented business entertainment has weakened effectiveness in a later stage of relationship. As such, I hypothesize that:

> Hypothesis 6a: The positive effects of intimacy-based business entertainment are weaker in a later stage of relationship.

> Hypothesis 6b: The positive effects of observability-oriented business entertainment diminish in a later stage of relationship.

5.2. Methods

5.2.1. Sample and data collection

The sampling frame. The data for this study were collected from companies affiliated with a business association based in the northern Chinese city of Shijiazhuang. The association is a nonprofit, nongovernmental club consisting of companies from both the private and the public sectors. The functions of the association include, but are not limited to, facilitating business information exchange among member firms, organizing social events among members, and coordinating with the government for regulatory or other issues in which member firms are involved. Senior government officials often serve as honorary presidents or sit on the council at the association, which greatly increases its prestige.

There are three major considerations for sampling from corporate client sales managers at firms affiliated with a business association based in a single Chinese city (i.e., Shijiazhuang). First, my analyses are built on the model of transaction governance structure (TGS), which holds that business transactions are regulated through a combination of market, social, and legal sanctions and that business entertainment reinforces social sanctions to compensate for the failure of market sanctions, particularly under the conditions where market and legal infrastructures are underdeveloped. Accordingly, the variation of the development level of market and legal infrastructures at the society level determines the degree of dependence on social sanctions to compensate for market imperfections and hence the effectiveness of business entertainment. For instance, in cities with better developed market and legal systems, social sanctions and hence business entertainment are less necessary or effective in regulating economic transactions. On the other hand, in cities that are less developed, transaction governance relies mainly on social sanctions that are often more effective. As such, framing my sample in a single city allows me to control for all market and legal effects to ensure the reliability and accuracy of tests on business entertainment's effects on transactional relationships.

Second, the city of Shijiazhuang where data were collected (population of 450,000 at city core) is located between coastal and inland China. It has experienced some degree of change in China's economic reform yet still keeps traditional Chinese social and economic features. This characteristic offers a better setting for studying the effects of business entertainment, which is widely practiced in the city. At the same time both market and legal sanctions are used quite frequently in business transactions in the city, though they are not used as widely as in coastal cities like Shanghai.

Finally, my focus on corporate client sales managers, whose targeted clients are mainly business customers, provides perfect control for client type, which otherwise affects the relationship that I investigate, simply because social sanctions (and hence business entertainment) are not equally effective between transactions with business customers and individual consumers (see Crosby et al., 1990; Stanton, 1981). For instance, selling to individual consumers usually adopts a pull strategy where direct contact is not possible, therefore social sanctions play a less important role; however, selling to business clients in face-to-fact contacts often takes a push strategy, where social sanctions play a bigger role.

The procedures. At the time this survey was administered (May 2011), there were 327 active (dues-paying) member firms at the association. Since the unit of analysis in this study is business-to-business transaction, I excluded from the sample retail stores targeting individual consumers, company headquarters that did not have direct business operations, and firms that mainly provided internal services. The final list contained 303 firms, which I contacted for an interview. The secretaries of the association's standing committee helped in the initial contact that announced the purpose of the study, offered to provide a gift to the informant as a token of appreciation for participation, and assured confidentiality and voluntary participation. Specifically, these firms were asked to designate a sales representative of their key account as an informant to cooperate in the survey, who upon completion of the survey would receive a gift that had a market value of 50 Chinese yuan. It was repeatedly assured that the names of the company and the participating individual as well as the survey event would be used only in aggregated analyses and would never be disclosed to any third party.

The final sample. Two hundred and fifty-six out of a total of 303 firms (84%) agreed to designate a sales representative to participate in the study, but 21 of them failed to do so, and it was determined in later interview conversations that of the remaining participants, 16 were not in fact sales personnel. Excluding these 37, the sample size for final analysis was 219. This relatively high response rate was likely due to the sponsorship of the standing committee of the business association, the gift incentive, and the facilitation by sales managers from a high-profile local firm. The average age of the firms that those informants represented was 14.97 years (s.d. = 13.91), and their average size was 2025.88 employees (s.d. = 19341.20). They represented 18 industries and had a state ownership of 28.76 percent on average (s.d. = 37.64%).

The survey questionnaire. The questionnaire items for this study were designed, and the survey conducted, in Chinese following Campbell and Fiske's (1959) rules on self-reported data. In order to generate data in compatible types for statistical analysis, most questions were structured as seven-point Likert items. Industry sectors were classified into eighteen categories based on the two-digit Standard Industry Classification (SIC) scheme. To alleviate the potential concerns about common method variance, I intentionally put items that measure the dependent variable before independent variables and arranged all other items in a random order (e.g., Chang, Witteloostuijn, & Eden, 2010, Podsakoff, MacKenzie, Lee, & Podsakoff, 2003). As shown in Appendix B, the survey questionnaire contains 28 questions. Each informant was asked to provide answers based on information about the client relationship of the key account he or she was handling. For privacy purposes, the respondents could disguise the names of their clients with a code.

Before the formal survey, the questionnaire was tested in a focus group discussion with eight local sales managers to make sure that the meaning of each question could be understood easily and that the answers to the questions reflected what the questions were intended for. The focus group discussion turned out to be very helpful for this study. For example, all eight managers believed that basic information such as the firm name was too sensitive for the research topic (e.g., entertainment activities are often viewed as corruption in general). Therefore, I removed the item in the new version for fear that it might affect response rate (removing the item in fact does not affect the results). Six out of the eight managers also suggested that governmental or supervisor interruptions should have influences on business entertainment's overall effectiveness. Accordingly, I added relevant items in the revised version to create control variables for this factor.

Information verification from the client side. Business entertainment involves both the giver and the recipient. While interviewing sales managers garners information from the entertainment giver's side, it is also necessary to verify such information from the entertainment recipient's side, to make the story two-sided and therefore complete. To fulfill this purpose, during the survey process, fifty randomly selected informants were asked to release the names of the focal clients, to verify the survey information at the clients' side. Thirty-nine out of those 50 informants agreed to do so and 27 out of those 39 clients were willing to talk about the surveyed relationship. Most of them agreed that the information on the completed survey questionnaire was close to reality.

5.2.2. The model

I used a vector of factors that capture the behavioral and social structural features of business entertainment to test its effectiveness in reinforcing social sanctions to facilitate transactional relationships. The model is specified as follows,

$$Y = \alpha + \beta_1 X_1 + \beta_2 X_2 + \epsilon$$

where Y captures the effectiveness of entertainment activities. On the right-hand side of the equation, X_1 is a vector of independent variables that measure the nature of entertainment activities, including amount, frequency, intimacy, and obervability; X_2 is a vector of control variables listed later; α is the intercept; β_1 and β_2 are vectors of estimated coefficients; and ϵ is the error term.

The dependent variable is the effectiveness of business entertainment, i.e., whether business entertainment can enhance the quality of a transactional relationship. I measured the quality of a transactional relationship (i.e., effectiveness of business entertainment) with an index that is constructed through the factor analysis method based on nine items included in the survey questionnaire. These nine items cover the quality aspects of a transactional relationship regarding the overall profitability; perceived overall smoothness of the transaction; loyalty of the client; and disputes (which is the reverse of good quality) on the quality of supplies/services; timing of payment/delivery; quantity of payment or delivery; change of order; change of delivery/payment format; and after-sales service. Previous studies have used similar items to measure the quality of business relationships (e.g., McMillan & Woodruff, 1999; Payne & Frow, 2005; Too, Souchon & Thirkell, 2001). In addition, the quality of a transactional relationship is in fact a performance issue. Therefore, the effectiveness or quality construct was also designed to capture the multi-dimensions of firm performance regarding market share, profit, and subjective assessment (see Rowe & Morrow [1999] for a discussion about dimensionality of firm performance).

The overall profitability is measured by the item “how profitable the transaction with this client is.” The overall smoothness of the transaction with a client is measured by responses to the item “how smooth you feel the transaction is.” Client loyalty is measured by the item “how likely you think the client would switch to a competitor.” All three items use the seven-point Likert scale. The instructions for the other six items regarding the quality of supplies/services, timing of payment/delivery, quantity of payment or delivery, change of order, change of delivery/payment format, and after-sales service read: “Based on your knowledge about the business disputes between your firm and this client, select the number from the following table that best describes the case of each type of disputes. (‘1’ indicates there were many disputes, ‘7’ indicates no dispute happened).” The Cronbach’s alpha reliability coefficient of this nine-item scale was .884, which is above the frequently recommended value of .70 (e.g., Nunnally, 1978). (Please refer to Appendix B for detail.).

5.2.3. Independent variables

As hypothesized, I used the features of business entertainment to predict its effectiveness in reinforcing social sanctions to facilitate transactional relationships. These predictors are specified below.

Amount. The variable *amount* was measured by the amount of money spent on entertaining the focal client in the previous fiscal year. Data were generated from respondents' answers to the survey question regarding how much they spent on entertainment with the focal client. I expected this variable to carry a positive sign.

Frequency. The variable *frequency* was measured by data aggregated from respondents' answers to the question of how often they entertain a focal client in various forms. This variable was also expected to bear a positive sign.

Intimacy. In hypothesis development, I defined the variable *intimacy* as the sentimental and physical closeness between individuals. As a critical factor that affects reciprocal behavior and long-term orientation in relationship building (see Lowenthal & Haven, 1968), intimacy can be effectively promoted through such business entertainment activities as drinking in a bar, singing in a KTV club, or having a sauna together. I measured the variable *intimacy* with responses on questions regarding intimate entertainment activities including "bar/tea-house drinking", "foot-care, massage, sauna", and "karaoke" (please refer to Appendix B "Question 25" for detail). I predicted that this variable had a positive relationship with the effectiveness of business entertainment.

Observability. As argued in developing the relevant hypothesis, observability is a key feature of business entertainment, particularly in such entertainment activities as having a well-publicized banquet in a big dining hall or in events that have other parties than the buyer and sellers involved, which enables it to promote reciprocal behavior, enhance long-term orientation, and enact group dynamics to boost the power of social sanctions to regulate individual behaviors. I measured the variable *observability* with responses on questions regarding observable entertainment activities including "formal banquets", "golf and other sports", "fishing and other outdoor activities", "travel and sightseeing", and all events with "third-party participation" (please refer to Appendix B “Question 25” for detail). Again, I expected to find a positive sign on this variable.

Interaction terms. Hypotheses 5a, 5b, 6a, and 6b suggested the moderation effects from the time factor on the quality of a relationship or the effectiveness of business entertainment in enhancing a transactional relationship, and the time factor was conceptualized as the stage of a relationship. I measured the moderator variable *stage of relationship* (i.e., *duration*) with responses from the item “how long you have been doing business with the client,” with a shorter relationship indicating an earlier stage and a longer relationship representing a later stage of transactional relationship. Following a widely practiced procedure in generating interaction terms, I mean-centered the moderator *stage of relationship* and the other variables that it was hypothesized to moderate (i.e., amount, frequency, intimacy, and observability) before creating those four interaction terms.

5.2.4. Control variables

On the basis of Hitt, Beamish, Jackson & Mathieu’s (2007) recommendation that multilevel approaches can better address major real-world problems, I believed that including multilevel factors in the analyses could provide a better explanation for the effectiveness of business entertainment in facilitating transactional relationships. Hence, I controlled for industry-, firm-, and transaction-level factors to isolate out the effects I had hypothesized, expecting that these factors all would have an impact on the effectiveness of business entertainment in reinforcing social sanctions to facilitate transactional relationships.

Industry controls. At the industry level, different products involve different ways of selling, hence the effectiveness of business entertainment in facilitating transactions of different types of products may vary. For instance, consumer goods are mainly distributed through retail channels, and hence business entertainment is less effective in such transactions. On the contrary, industrial products are often sold in face-to-face interactions, and hence business entertainment might be more effective in facilitating such transactions. I controlled for general industry effects by including 17 industry dummies representing 18 two-digit Standard Industry Classification (SIC) sectors, using agricultural products (SIC 11) as the base industry.

Firm attributes. Firm size and age were controlled for because those variables were found to have effects on firm activities in previous studies (e.g., Peng & Luo, 2000). I believe these variables can also affect the effectiveness of business entertainment. For instance, larger and older firms may have set up larger social networks and accumulated richer social capital that empower them to deal with business partners in a more favorable position, which should strengthen the effectiveness when they entertain other clients. On the other hand, the effectiveness should be mitigated when a comparatively smaller firm entertains a larger client. I measured the size of both host and client firms by their total employees, and used the current year less firm inception year as a proxy for the age of the host firm. Data for those variables were collected with relevant survey items.

Transaction features. At the transaction level, as governmental regulators or supervisory directives may interrupt with business transactions (which is a common problem faced by Chinese businesses) and hence mitigate the effectiveness of business entertainment in a focal transactional relationship, I controlled for these effects with responses to the item "how much interference this client relationship gets from governmental administrators or supervisors." I expected this variable to carry a negative sign. In addition, as frequent human interactions can generate stronger social approval (e.g., Axelrod, 1984), I also expected that the stage of a transactional relationship and the frequency of business transactions might generate strong social approval as well, which in turn would have positive effects on the effectiveness of business entertainment. Hence, I controlled for those variables with measures generated from items "how long you have been doing business with this client" and "how often you do business with this client." In addition, I also controlled for the perceived quality of the focal firm's products, assuming that products with better quality are easier to sell and that quality might have an impact on the effectiveness of business entertainment. The measure for this variable was collected from responses to the item "how you perceive your products' quality relative to that of your major competitors who also sell to this client." Finally, the effectiveness of business entertainment in reinforcing social sanctions to facilitate transactions is also determined by the geographic distance of a client (i.e., local vs. long-distance trade), given the fact that social sanctions are not equally effective in governing different types of transactions along that dimension (i.e., social sanctions work more effectively in local communal settings rather than between long-distance partners). Hence, I also controlled for such effects. The variable *distance* is measured with responses to the question about the client's location ranging from within city (closest) to overseas (the longest distance).

5.3. Results

The statistics of all variables and the correlation matrix are given in Table 5.1. The variance inflation factors (VIFs) generated from ordinary least square (OLS) tests are well below the critical value of 10, indicating that multicollinearity is not a concern in the dataset (e.g., the largest VIF is 3.11). A test of skewness and kurtosis returned the values of 2.9 and 1.4, respectively, indicating normal distribution in the dataset.

The results of the OLS regression analyses are reported in Table 5.2. In addition to industry controls (which I will report later), I entered into Model 1 the other nine control variables (i.e., *interruption, quality, stage, transaction frequency, client-size, host-size, host-age,* and *distance*) to capture the effects of firm and transaction level variables on the effectiveness of business entertainment. As predicted, the control variables *quality*, *transaction frequency*, and *host-size* carry positive coefficients that are significant at the 0.05 or even higher level; *host age* is positively significant at the 0.10 level; and *interruption and client-size* both carry a negative sign that is significant at the 0.05 level. The coefficients of *stage* and *distance* have the predicted signs but are not significant.

Table 5.1. Means, Standard Deviations & Correlations [a]

	Mean	S.D.	1	2	3	4	5	6	7	8	9	10	11	12
1. Effectiveness	5.78	1.15												
2. Interruption	3.60	1.88	-.13*											
3. Quality	5.13	1.22	.48***	-.07										
4. Duration	4.46	4.29	.01	-.07	-.09									
5. Transaction frequency	4.45	1.56	.20**	.16**	.23***	.18**								
6. Client size	1,740	9,057	-.10*	-.03	-.07	.47***	.12*							
7. Host size	2,025	19,341	.05	.08	-.07	.01	-.06	.15**						
8. Host age	14.97	13.91	.04	.08	-.08	.28***	.01	.21**	.00					
9. Distance	1.93	1.39	.01	-.06	.07	.07	-.13*	.03	-.05	-.01				
10. Amount	81	377	.11*	-.07	-.03	.22**	.22***	.22***	.09	.04	.13*			
11. Frequency	55.41	269.40	.14**	-.07	-.08	.17*	.17**	.25***	.07	.01	.08	.69***		
12. Intimacy	30.27	118.14	.14**	-.03	-.09	.19**	.10	.32***	.09	-.02	.07	.43***	.67***	
13. Observability	11.21	70.84	.05	-.11*	-.11*	.20**	.11*	.53***	-.03	-.00	.03	.47***	.55***	.43***

1. [a]n = 219.
2. * P < .05; ** P < .01; *** P < .001 (2 tailed p-value)

Table 5.2. Results of Regression Analyses of Effectiveness of Business Entertainment [a]

	Model 1	Model 2	Model 3	Model 4	Model 5	Model 6
Control variables						
Interruption	-.19* (.07)	-.17* (.07)	-.16* (.07)	-.17* (.07)	-.15* (.07)	-.14* (.07)
Quality	.88*** (.11)	.89*** (.12)	.92*** (.11)	.94*** (.11)	.96*** (.11)	.95*** (.11)
Duration	.03 (.03)	.03 (.03)	.03 (.04)	.02 (.03)	.04 (.03)	.06 (.04)
Transaction frequency	.20* (.09)	.16 (.09)	.15 (.09)	.15 (.09)	.16 (.09)	.15 (.09)
Client size	-4.03E – 5* (.00)	-4.40E – 5* (.00)	-4.99E – 5** (.00)	-5.78E – 5** (.00)	-7.91E – 5*** (.00)	-4.83E – 5† (.00)
Host size	1.48E – 5* (.00)	1.36E – 5† (.00)	1.37E – 5† (.00)	1.33E – 5† (.00)	1.61E – 5* (.00)	1.64E – 5* (.00)
Host age	.02† (.01)	.02† (.01)	.02† (.01)	.02* (.01)	.02 (.01)	.03* (.01)
Distance	-.01 (.10)	-.04 (.08)	-.04 (.10)	-.04 (.10)	-.04 (.09)	-.06 (.10)
Industry controls (see Table 5.3)						
Independent variables						
Amount		.15† (.08)	-.04 (.11)	-.02 (.11)	-.06 (.11)	-.09 (.12)
Frequency			.35* (.13)	.15† (.16)	.05 (.16)	-.05 (.19)
Intimacy				.37* (.16)	.38* (.17)	.40* (.17)
Observability					.01* (.00)	.02* (.01)
Interactions						
Amount x duration						7.62E – 7* (.00)
Frequency x duration						-.00 (.00)
Intimacy x duration						-5.17E - 5 (.00)
Observability x duration						-.01* (.00)

1. [a] n = 219
2. † P < .10; * P < .05; ** P < .01; *** P < .001 (two tailed p-value).
3. Enclosed in parentheses are standard errors.

In Model 2, I added the variable *amount* to capture its influence on the effectiveness of business entertainment. As expected, the variable carries a positive sign that is significant at the 0.10 level. This result lends support for Hypothesis 1, which predicted that the amount spent on business entertainment is positively associated with its effectiveness in enhancing the quality of transactional relationships. But surprisingly, when more predictors were added into the model, the significant effect disappeared. I have two explanations for this situation. First, the empirical test was designed to test the overall effectiveness of business entertainment in enhancing each pair of client relationships with a yearly cumulative amount of entertainment spending on each particular client. The test is not able to examine the effects of spending in each event on each particular sale. Failing to reduce analysis to the level of each particular event and sale may have caused this inconsistency. Second, when other factors are involved, the intensity of entertainment spending, like dollar amount and frequency, may not be the major factors in enhancing relationship quality. For instance, an old Chinese saying goes that "the gift sent from afar, as light as a goose feather, conveys deep affections," which indicates that other factors can outweigh the intensity of spending in improving relationships. Future studies can design different models to test the effects of individual entertainment events on individual sales.

Model 3 also takes the variable *frequency* into consideration to predict its impact on the effectiveness of business entertainment. The variable bears a positive coefficient that is significant at the 0.05 level. The finding confirms Hypothesis 2, where I predicted that the frequency of business entertainment practice is positively associated with its effectiveness. As in Model 2, again, when more predictors were added into the model, the measure becomes insignificant. Because frequency, like dollar amount, is also an indicator of the intensity of entertainment practices, I have a similar speculation as that for dollar amount in explaining this empirical inconsistency.

In Model 4, the variable *intimacy* was added to predict its impact on the effectiveness of business entertainment. The variable returns a positive coefficient that is significant at the 0.05 level. The finding renders support to Hypothesis 3, where I predicted that the intimacy of business entertainment practice is positively associated with its effectiveness.

Model 5 further tests the impact of *observability* on the effectiveness of business entertainment. The returned coefficient is positively significant at the 0.05 level. The finding supports Hypothesis 4, which suggested that the more observable business entertainment practices are, the more effective they are in reinforcing social sanctions to facilitate transactions.

Model 6 is the full analysis that also considers the moderating role of the time factor, i.e., the *stage of relationship*, in the associations between the effectiveness of business entertainment and the predictors *amount*, *frequency*, *intimacy*, and *observability*. The *stage of relationship*'s moderation effect on *amount* is positively significant at the .05 level, indicating that the *stage of relationship* strengthens the association between *amount* and the effectiveness of business entertainment. Such a result supports Hypothesis 5a, which predicted that the impact from *amount* on the effectiveness of business entertainment increases in the later stage of a transactional relationship. In addition, the results also show that the interaction term between stage of relationship and observability carries a positive coefficient that is significant at the 0.05 level, supporting Hypothesis 6b, which predicted that the impact of observability on the effectiveness of business entertainment diminishes in the later stage of a transactional relationship. Hypothesis 5b and 6a also predicted diminishing effects of *frequency* and *intimacy* on the effectiveness of business entertainment in a later stage of relationship. Nonetheless, the results are negative as predicted but not significant. Therefore, Hypothesis 5b and Hypothesis 6a are not supported. In line with Hypotheses 5a, 5b, 6a, and 6b, following the procedures suggested by Cohen, Cohen, West, and Aiken (2003), I plotted these interactions at conditional values of *stage of relationship* (one standard deviation [1 s.d.] above and below the mean). As illustrated in Figure 5.1 (a) and (d), the association between *amount*, *observability*, and effectiveness is stronger in a later rather than earlier stage of relationship; and such a pattern is not significant between *frequency*, *intimacy*, and effectiveness, which is apparent in Figure 5.1 (b) and (c).

The results of all industry dummies are reported in Table 5.3. When the model covers only industry dummies (Column 1), it has an R-Square of .11 that is not significant, indicating that there is no obvious industry effect on the effectiveness of business entertainment. In fact, industry controls in most of the models are not significant. In the full model that covers all independent and control variables (Column 7), the R-Square is .38 ($p < .001$), which indicates consistent model fit.

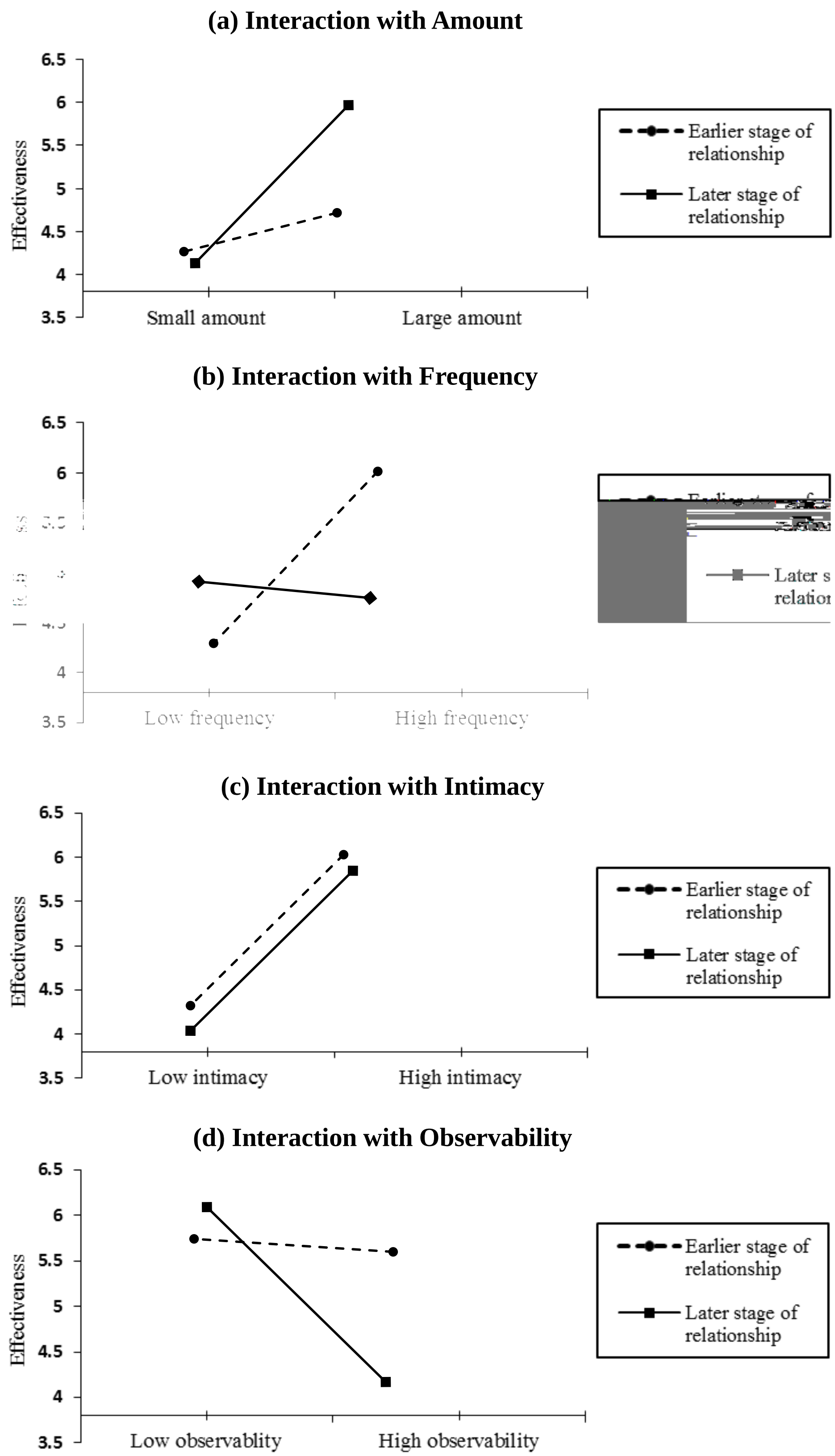

Figure 5.1: Simple Slopes of Stage of Relationship's Moderation Effects

Table 5.3. Results of Regression Analyses of Industry Control

	Industry control	Model 1	Model 2	Model 3	Model 4	Model 5	Model 6
Independent and other control variables (see Table 5.2)							
Mining	.36 (1.40)	-.68 (1.24)	-.81 (1.24)	-.63 (1.23)	-.58 (1.42)	-.58 (1.43)	-.93 (1.44)
Utilities	-.23* (1.23)	-2.18* (1.07)	-2.17* (1.07)	-2.04* (1.06)	-3.21* (1.23)	-3.18* (1.23)	-3.40** (1.24)
Construction	.01 (.92)	-.79 (.81)	-.85 (.82)	-.74 (.80)	-1.01 (.90)	-.96 (.91)	-.99 (.93)
Manufacturing	.14 (.92)	-.70 (.82)	-.68 (.81)	-.64 (.80)	-.31 (.88)	-.28 (.88)	-.37 (.88)
Wholesale	-.61 (.91)	-1.00 (.79)	-1.02 (.79)	-.95 (.78)	-1.29 (.85)	-1.27 (.86)	-1.38 (.84)
Retail	-.49 (.91)	-.77 (.79)	-.75 (.78)	-.69 (.77)	-1.07 (.95)	-1.02 (.96)	-1.19 (.98)
Transportation	1.64 (1.23)	.95 (1.07)	.95 (1.07)	1.26 (1.06)	1.21 (2.16)	1.23 (2.18)	.76 (2.14)
Information	.79 (1.40)	-.51 (1.22)	-.64 (1.23)	-.61 (1.20)	-.63 (1.24)	-.61 (1.24)	-.63 (1.23)
Finance	-1.14 (1.00)	-1.53* (.87)	-1.53* (.86)	-1.33* (.86)	-1.34 (1.05)	-1.28 (1.06)	-1.47 (1.10)
Real estate	1.25 (1.54)	-.04 (1.36)	-.05 (1.37)	-.24 (1.35)	-1.95 (2.21)	-1.90 (2.22)	-1.65 (2.55)
Professionals	-1.18 (.96)	-.56 (.84)	-.66 (.84)	-.63 (1.83)	-.88 (.90)	-.87 (.90)	-.90 (.92)
Administration	.01 (1.80)	-1.11 (1.57)	-1.15 (1.56)	-1.24 (1.54)	-1.20 (1.57)	-1.18 (1.57)	-1.49 (1.56)
Education	.81 (1.80)	-.32 (1.60)	-.42 (1.60)	-.38 (1.58)	.22 (1.63)	.17 (1.64)	.66 (1.62)
Health care	– 1.15 (1.06)	-1.49 (.92)	-1.54 (.92)	-1.70 (.91)	-1.64 (1.01)	-1.67 (1.01)	-1.87 (1.01)
Recreation	-2.21 (1.54)	– 2.84* (1.36)	– 2.81* (1.36)	– 2.62* (1.34)	– 2.51* (1.38)	-2.48 (1.38)	-2.61 (1.36)
Food services	.79 (.98)	.12 (.86)	.02 (.87)	-.03 (.85)	-1.67 (1.07)	– 1.72 (1.08)	– 1.71 (1.07)
Public services	-.93 (1.06)	-1.37 (.95)	-1.40 (.96)	-1.22 (.94)	-.23 (1.10)	-.14 (1.13)	.06 (1.12)
Total R^2	.11	.29***	.30***	.33***	.35***	.36***	.38***
F (df)	1.46 (17, 201)	11.16 (8. 210)	10.36 (1, 209)	10.23 (1, 208)	9.94 (1, 207)	9.60 (1, 206)	7.77 (4, 202)
ΔR^2	.11	.18**	.01†	.03*	.02*	.01*	.02

1. [a]n = 219
2. † P < .10; * P < .05; ** P < .01; *** P < .001 (two tailed p-value).
3. Enclosed in parentheses are standard errors.

5.4. Summary

In this chapter, I developed a group of hypotheses to test the effects of the social and behavioral features of business entertainment on its effectiveness in reinforcing social sanctions to enhance transactional relationships. Particularly, I used the features of business entertainment including the *amount* spent on entertainment activities, the *frequency*, *intimacy*, and *observability* of entertainment practices to predict its effectiveness. Empirical tests were conducted on a sample of sales managers recruited from firms affiliated with a business association based in a northern Chinese city. The results indicate that the effectiveness of business entertainment is significantly related to the *amount* spent, plus the *frequency*, *intimacy*, and *observability* of entertainment practices. In addition, the association between *amount* and effectiveness strengthens in a later stage of relationship, while that between *observability* and effectiveness weakens in a later stage of relationship. These results provide additional evidence supporting my transaction governance approach to business entertainment.

Chapter 6

6. Conclusion

In this dissertation, I take a governance approach to examine the role of business entertainment in reinforcing the power of social sanctions to facilitate economic transactions. My basic premise is that each society, depending on its cultural and historical heritages, uses a unique transaction governance structure (TGS) that combines social, market, and legal sanctions to regulate the behaviors of economic agents. I further argue that business entertainment reinforces the role of social sanctions in regulating economic transactions, particularly under the conditions where market and legal infrastructures are less developed. In cases where social sanctions play a greater governance role, firms will spend more on business entertainment and such entertaining activities will also be more effective in facilitating transactional relationships.

To verify the pervasiveness of business entertainment under different conditions of social, market, and legal sanctions, I ran empirical tests on a sample of manufacturers listed on the Shanghai Stock Exchange in China. The results indicate that firms spend more on entertainment when they are operating under the conditions where market and legal infrastructures are less developed and where social sanctions play a bigger role in governing business relationships. These findings confirm the transaction governance account for business entertainment.

To predict business entertainment's effectiveness in facilitating exchange relationships, I conducted empirical tests on survey data collected from a sample of Chinese sales managers. The results suggest that the social, behavioral, and economic features of business entertainment, including the dollar amount, frequency, intimacy, and observability, all have an impact on its effectiveness in reinforcing the power of social sanctions to facilitate exchange relationships. Such findings further support my governance approach to business entertainment.

This dissertation bridges a major literature gap between economics and social studies regarding business entertainment. Despite the prevalence of business entertainment in economic life, most studies investigated the phenomenon with a social rather than an economic approach. Meanwhile, despite economists' recognition of the role of social sanctions in regulating economic activities, few studies have examined the relationship between entertainment activities and social sanctions in business settings. My dissertation bridges the gap by arguing that the social practice of business entertainment plays a role in economic transaction governance by reinforcing social sanctions to supplement market sanctions in regulating exchange relationships.

This dissertation also answers the questions I raised earlier regarding whether or not business entertainment plays a positive role, how it plays such a role, why the pervasiveness of business entertainment varies across societies, and how to make it more effective in facilitating transactional relationships. Particularly, I have established that business entertainment plays a positive role in economic life through reinforcing the power of social sanctions to regulate individual behaviors in economic transactions. In addition, the pervasiveness of business entertainment across societies depends on the degree of reliance on social sanctions to supplement market sanctions in different societies; and its effectiveness in playing that role depends on its social and behavioral features.

To the best of my knowledge, this is the first study that provides a systematic explanation for business entertainment from a transaction governance perspective. As summarized below in this chapter, the theoretical arguments and empirical findings of this dissertation make important contributions to the management literature. They also contribute to organizational economics in general. Business practitioners and policy makers can all draw practical implications from this study. Before concluding this dissertation, I also point out its limitations that provide directions for future research to pursue.

6.1. Contributions

Business entertainment is a popular practice that is observable in business settings all over the world, though the degree of its pervasiveness varies across societies. While business entertainment is often simply condemned as corruption and a social vice, I believe that social practices such as business entertainment, if adopted by a population collectively, must have underlying reasons for their existence. This dissertation has identified those underlying social and behavioral roots of business entertainment and explored the working mechanisms through which business entertainment’s positive role in economic life is executed. In fulfilling that purpose, this dissertation makes three major contributions.

The foremost contribution of this dissertation is that it provides a transaction governance explanation for business entertainment with a multidisciplinary approach. It has systematically identified a positive economic role for the social practice of entertainment in business settings and helps people to understand this commonly practiced and widely observed but understudied and often misinterpreted business practice from an economic perspective. In general, it has confirmed the economic meaning of a social activity and contributed to the literature by setting up an example of rigorous "economic analysis of social interactions" with a coherent theoretical framework and well-crafted empirical tests (see Manski, 2000).

In addition to the above-mentioned theoretical contribution, this dissertation's unique approach in framing the integrated business entertainment construct and designing its measures also enables future research to use a similar construct and measures to investigate various topics in the management literature along an alternative route. Such topics include business ethics, *guanxi* (i.e., social connections) studies, organizational studies (i.e., studies on bribery), social capital, and (relational) marketing, et cetera. The approach is considered new because it differs from the previous studies in three aspects. First, instead of focusing on either the business entertainment giver's or taker's side, it views business entertainment giving and taking as an integrated interactive process (Hodgson, 1992) embedded in social relations (Zelizer, 1998). Second, instead of assuming that there are clear ways to distinguish which entertainment activities are bribes and which are gifts, it treats business entertainment as an integrated construct based on the understanding that defining business entertainment as either bribe or gift is relative to cultural and other contexts (e.g., Noonan, 1986; Philips, 1984; Salbu, 1997). Third, rather than focusing solely on public officials as entertainment takers, it denotes business entertainment takers as *all* economic transactors in business settings, including both private agents (e.g., Dunfee et al., 1999), principals (Fort & Noone, 2000), and any ordinary person (Smart, 1993). This new approach allows researchers to focus on the functions rather than the nature of social practices like business entertainment and to use it as a measure to operationalize the aforementioned studies. Take the research on social capital as an example. The process where business entertainment reinforces the power of social sanctions is in fact a process where social capital is created. While my study has identified the conditions where business entertainment is more effective in reinforcing the power of social sanctions, future research could take a similar approach to verify how to create social capital more efficiently.

Finally, the TGS model in this study also contributes to organizational economics by expanding the field and helping to generalize a number of theories across different institutional contexts. One of those is the theory of transaction cost economics (TCE). The traditional TCE theory was framed along the market-contract-hierarchy continuum where hierarchy is conceptualized as a special form of legal sanctions. Although the later, modified versions of TCE recognized social sanctions as another nonmarket institution that could compensate for market imperfections along with legal sanctions, the role of social sanctions has never been clearly carved out as an independent pillar upholding transaction governance. My TGS model explicitly split out the social dimension from nonmarket institutions and provided a full story of transaction governance. On this TGS platform, the relative power of the three governance devices can now be clearly understood. Also, given the relativity of TGS, the three elements are not used equally across societies, firms, or even products. As such, we now can better understand variations in transaction governance that puzzle scholars. For instance, TCE's focus on the choice of governance mechanisms based on relative costs makes its interpretation of economic organization in East Asia less accurate (e.g., Dyer, 1997; Hamilton & Biggart, 1988), where higher asset specificity does not necessarily raise transaction costs. My emphasis on the *relative availability and effectiveness* of social, market, and legal sanctions as antecedents of the *choice* of transaction governance mechanisms based on *costs* offers a theoretical explanation for the empirical discrepancies of TCE-based studies.

6.2. Managerial Implications

The theory I presented and the effects I found in this dissertation can help business practitioners to properly use entertainment as a marketing tool and to manage entertainment expenses more effectively. In April 2004, U.S. telecom equipment manufacturer Lucent Technologies fired four executives at its China unit on entertainment-related "bribery" allegations (*The New York Times*, 2004). In late 2008, Avon Products Inc., the world's largest direct seller of cosmetics, began to investigate its China operations over allegations of certain "improper" entertainment expenses (*Reuters*, 2008). Frequent reports of such issues among internationally prominent firms signify the importance and meaningfulness of my arguments and findings to business practitioners. First, based on my theory that business entertainment plays a positive role by reinforcing social sanctions to facilitate transactions, business practitioners should re-examine their policies on the practice of business entertainment. They should face the phenomenon with a realistic attitude based on a profound understanding of its underlying mechanisms, instead of merely applying superficial treatments such as banning entertainment practices in dealing with clients. Second, following my argument that the pervasiveness of business entertainment depends on the relativity of TGS, international business practitioners should adjust business entertainment policies to adapt to the TGS of each national market or even within different industries. Business entertainment practices that are considered illegal at home but are permitted in host nations can be used as a powerful tool to facilitate transactions. In emerging market ventures, for instance, business practitioners should take a more lenient approach toward entertainment practices to cope with the institutional environment where social sanctions play a bigger role in transaction governance. Third, based on my theory and empirical findings that the economic and social behavioral features of business entertainment (i.e., dollar amount, frequency, intimacy, and observability) determine its effectiveness in facilitating transactional relationships, managers could make better decisions regarding where to use business entertainment and how to manage entertainment expenses more efficiently in dealing with clients.

6.3. Implications for Policy Makers

My study is meaningful for public policy makers as well. For societies with a prevailing rational-legal system, legislators should consider variations in TGS across countries. Some scholars have argued that the U.S. Foreign Corrupt Practices Act of 1977, for instance, has been a serious hindrance that hurts the competitiveness of U.S. companies in foreign countries (Hines, 1995), especially in those emerging markets featuring a social sanctions–dominated TGS. My research suggests that the governments in developed countries (such as the United States) should design more feasible international business policies rather than merely bringing firms into legal procedures.

Likewise, the governments in emerging markets, especially in such collectivist societies as China, must recognize the evolutionary nature of TGS and the interaction effects among social, market, and legal sanctions. They must realize that a social sanctions–dominated TGS reinforced by business entertainment is transitional in nature. They should invest in market and legal infrastructures—to gradually weaken social sanctions' dominant role, on the one hand, and to restrain market forces during the transition for societal good, on the other hand—to cope with rapid industrialization and urbanization (see Orts, 2001; Potter, 2002).

6.4. Limitations

This study is the first to examine business entertainment from a transaction governance perspective. Inevitably, it cannot offer an exhaustive account, and the limitations of this study point out promising directions for future scholars to further our understanding of entertainment in business settings. There are five limitations in this study.

First, as noted earlier in delineating this study's boundaries, this study considers social sanctions that are secular in nature, and does not cover religious sanctions, which are also a very important form of social sanctions that can potentially govern the behaviors of economic agents. It would be interesting to see how religions play in the role of transaction governance and as a result affect the prevalence and effectiveness of business entertainment.

Second, my empirical test on the pervasiveness of business entertainment is conducted with data collected from different regions in a single country on a single industry sector (i.e., Chinese manufacturers). I am not sure of the generalizability of my research. In the meanwhile, my method may have caused some of the measures to be insignificant or even contrary to my expectations. For example, the control variable *firm size* has an insignificant result in my test of business entertainment's pervasiveness. While firm size in many studies is measured by the total employees of a firm, the workforce on the shop floor of manufacturers may not properly capture the size effect for the purpose of my study, because using entertainment to facilitate business transactions is basically a marketing and sales issue. Future studies can extend the test to other industry sectors and compare firms across different countries (e.g., between Japan and the U.S.) following my approach.

Third, unknown exogenous variables and uncontrolled potential mediators may affect the relationships I have studied in the pervasiveness test. For example, entertainment activities have the potential to create social capital that accumulates over time. It is possible that the pervasiveness of a firm's use of business entertainment diminishes while the effectiveness of entertainment (even if in reduced scale) in facilitating transactions increases over time because social capital takes incremental effects. My model can't fully capture such variance. Future studies can explore these issues.

Fourth, because of the limitations of second-hand data, I tested the pervasiveness determinants of business entertainment at society level without controlling for or digging into the individual level, which may also contain factors that can potentially affect the relationship I have studied. For example, at the individual level, the heterogeneity of human and social capital possession among firms' board members can influence firm outcomes (Lester, Hillman, Zardkoohi & Cannella, 2008) and hence may cause the use of entertainment to vary across firms. This is one promising topic for future studies to explore.

Finally, in collecting data for empirically testing the effectiveness of business entertainment in facilitating transactional relationships, some of the informants emphasized that entertainment activities were indeed a two-way back-and-forth, rather than a one-way, process: the buyer also treated the seller back upon receipt of entertainment from the seller. My one-way-based empirical design was unable to account for the contributions to the quality of a dyadic transactional relationship made by the back-ward entertainment from the buyer to the seller. This point might be a good topic for future research to address.

6.5. Conclusion

Having completed a critique on current literatures on business entertainment, transaction governance, and social sanctions, I set up the theoretical framework of this dissertation by summarizing transaction governance mechanisms into the TGS model and proposing the relativity of TGS across societies. I then drew on theories from various disciplines to theorize on how business entertainment plays its governance role in reinforcing social sanctions to regulate transactions. I further conducted empirical analyses to predict the pervasiveness and effectiveness of business entertainment across firms and between transactions, respectively, with two sets of hypotheses and data. In so doing, I mapped business entertainment onto the TGS framework to build an integrated model and carved out a positive (i.e., governance) role for business entertainment to play in economic life.

My study provides preliminary evidence on the role of business entertainment in facilitating market transactions and, hence, explains that the pervasiveness of entertainment activities among firms depends on their institutional environments. In particular, I found that my measure of entertainment pervasiveness is significantly related to factors that shape different transaction governance structures at the institutional level. I also found that the effectiveness of business entertainment is significantly related to the dollar amount, frequency, intimacy, and observability of entertainment practices. In addition, the association between amount and effectiveness strengthens in a later stage of relationship, while that between observability and effectiveness weakens in a later stage of relationship. These results provide additional evidence supporting my transaction governance approach to business entertainment.

This is the first study that examines business entertainment from a transaction governance perspective. By challenging the prevailing (and often negative) views on business entertainment, my conceptual arguments and empirical findings contribute to literatures in management, sociology, and economics and offer new and useful guidelines for business practitioners and policy makers to deal with entertainment-related issues in business settings.

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Appendix A. An Excerpt on Entertainment Expenses (EE)

Article 6: Entertainment Expenses (EE).

a. The Company would host ONE formal banquet for visiting clients. The rest of the meals for them should be standard working meals.

b. The budget for banquets is as follows: For a formal banquet hosted by a general manager, the standard is 50 *yuan* per person/time; for those hosted by a division manager, the limit is 30 *yuan* per person/time; for banquets hosted by other employees, the budget is 20 *yuan* per person/time.

c. Budget limit for regular working meals is 20 *yuan* per person/day.

d. The Company can give gifts and gift money to important clients; but the general manager's authorization regarding the type and value of gift must be sought for in advance.

e. Entertainment activities can be arranged for important clients; yet these activities should be restricted to ONCE per client per visiting time. The budget for karaoke is 100 *yuan* per person/time; for saunas, 150 *yuan* per person/time.

f. The Company provides meals for home–coming sales personnel and other employees on holiday duties at the budget of 15 *yuan* per person/time. Under circumstances when a formal banquet is necessary, the budget should be controlled at the level of not more than 40 *yuan* per person/time.

Source: Company Website. Company name is not disclosed here for privacy concerns.

Appendix B. Survey Questionnaire

SURVEY QUESTIONS ON THE EFFECTIVENESS OF ENTERTAINMENT IN FACILITATING BUSINESS RELATIONSHIPS

This survey is part of a private research on the role of business entertainment in facilitating transactional relationships. It is NOT related to any governmental investigations. All information obtained through this survey is strictly confidential, and I will not reveal any of your personal or firm information to any other third party. Please also refer to the attached information letter for further explanation on privacy issues. This survey consists of 28 questions. I highly appreciate your truthful and detailed answers.

SECTION I: INFORMATION ABOUT YOUR FIRM

1. Your firm was first founded in ___________.

2. There are _________ full time employees in your firm.

3. The percentage of state ownership in your firm is _______%.

SECTION II: QUESTIONS ON CLIENT AND BUSINESS ENTERTAINMENT

The following section includes 25 questions. Please identify one of the important clients of your firm and answer these questions based on your information on the client and its relationship with your firm. For privacy purpose, you may prefer to disguise the client's name with a code.

1. Client code ______

2. How far away is this client located?

   a. Within City;
   b. In a neighboring city of the same province/Municipality
   c. In other cities of the same Province/Municipality;
   d. In neighboring province;
   e. In other provinces;
   f. In Taiwan, Hong Kong, or Macao;
   g. In other overseas areas.

3. How many employees does this client have? ______________

4. What percentage of this client firm's shares is owned by the State? ___________%

5. What percentage does this client's business count in your total annual sales? ______%

6. What's the main line of business your firm is involved with this client? Please circle the major one.

1. Agriculture, forestry, fishing and hunting (11) ;	10. Finance and insurance (52);
2. Mining (21);	11. Real estate, and rental and leasing (53);
3. Utilities (22);	12. Professional, scientific, and technical services (54);
4. Construction (23);	13. Management and administrative services (55-56);
5. Manufacturing (31-33);	14. Educational services (61);
6. Wholesale trade (42);	15. Health care and social assistance (62);
7. Retail trade (44-45);	16. Arts, entertainment, and recreation (71);
8. Transportation and warehousing (48-49);	17. Accommodation and food services (72);
9. Information (51);	18. Public administration (92).

7. How do you compare the quality of your firm's products/services that are being sold to this client firm to that of your competitors who also sell similar products/services to this client? ("1" indicates better, "7" indicates worse)

Better 1 2 3 4 5 6 7 worse

8. How much negative interference does this client relationship get from governmental administrators or supervisors? ("1" indicates none, "7" indicates a lot)

None 1 2 3 4 5 6 7 A lot

9. How frequently do managers from your firm and this client interact with each other in other private occasions than business?
("1" indicates very rarely, "7" indicates very often)

Very rarely 1 2 3 4 5 6 7 Very often

10. How often have you been doing business with this client? ("1" indicates one shot, "7" indicates daily supplies)

One shot 1 2 3 4 5 6 7 Daily supply

11. How long have you been doing business with this client? ("1" indicates started recently, "7" indicates very long time)

Started recently 1 2 3 4 5 6 7 Very long time

12. Based on your knowledge about the business disputes between your firm and this client, select the number from the following table that best describes the case of each type of disputes. ("1" indicates many disputes, "7" indicates nothing happened)

Quality issues	1	2	3	4	5	6	7
Time of delivery/payment	1	2	3	4	5	6	7
Quantity of products or amount of payment	1	2	3	4	5	6	7
Change of order	1	2	3	4	5	6	7
Change of delivery or payment method	1	2	3	4	5	6	7
After-sales service	1	2	3	4	5	6	7

13. Has this client ever threatened to terminate the transactions with your firm? ("1" indicates never, "7" indicates very frequently)

Never 1 2 3 4 5 6 7 very frequently

14. Has this client ever threatened to file a lawsuit against your firm? ("1" indicates never, "7" indicates very frequently)

Never 1 2 3 4 5 6 7 very frequently

15. Did this client actually sue your firm in a court? ("1" indicates never, "7" indicates very frequently)

Never 1 2 3 4 5 6 7 very frequently

16. Did this client solve disputes with your firm through mediators? ("1" indicates never, "7" indicates very frequently)

Never 1 2 3 4 5 6 7 very frequently

17. Did this client communicate with your firm privately on disputes? ("1" indicates never, "7" indicates very frequently)

Never 1 2 3 4 5 6 7 very frequently

18. How smooth do you feel the transactions were with this client? ("1" indicates lots of disputes, "7" indicates very smooth)

Lots of disputes 1 2 3 4 5 6 7 Very smooth

19. What is your firm's overall profitability over this client? ("1" indicates huge loss, "7" indicates very lucrative)

Huge loss 1 2 3 4 5 6 7 Very lucrative

20. How is the competition in the business with this client? ("1" indicates no competition, "7" indicates many competitors)

No competition 1 2 3 4 5 6 7 many competitors

21. All else held equal, do you think your competitors have a better or worse situation on the following issues, comparing to that of your firm? ("1" indicates better, "7" indicates worse)

Quality issues	1	2	3	4	5	6	7
Time of delivery/payment	1	2	3	4	5	6	7
Quantity of products or amount of payment	1	2	3	4	5	6	7
Change of order	1	2	3	4	5	6	7
Change of delivery or payment method	1	2	3	4	5	6	7
After-sales service	1	2	3	4	5	6	7

22. All else being equal, how likely do you think this client may switch to your competitors? ("1" indicates not likely, "7" indicates very likely)

Not likely 1 2 3 4 5 6 7 Very likely

23. If your competitors have a better position, how likely do you think this client may switch to your competitors? ("1" indicates not likely, "7" indicates very likely)

Not likely 1 2 3 4 5 6 7 Very likely

24. Overall, what's the likeliness of losing this client? ("1" indicates not likely, "7" indicates very likely)

Not likely 1 2 3 4 5 6 7 Very likely

25. Please fill in the following form based on your knowledge about the entertainment activities between your firm and this client during last year.

	Seller & Buyer Participation Only			**Third-Party Participation**		
	Times	**Expenses**	**Decision-maker Participation Times**	**Times**	**Expenses**	**Decision-maker Participation Times**
Formal banquet						
Bar/tea-house drinking						
Golf and other sports						
Karaoke						
Fishing and other outdoor activities						
Travel and sightseeing						
Foot-care, massage, sauna						
Other activities						

Curriculum Vitae

FRANCIS Y. SUN

EDUCATION

Western University, Ph.D. in General Management/International Business, 2012
Yale University, M.A. 1999
Nankai University, B.A. 1988

AREAS OF SPECIALIZATION

- Cross-cultural management
- International business strategy
- Corporate and business unit strategy

CONFERENCE PRESENTATIONS

Sun, Francis, & Chen, Shih-Fen**.** 2012**. *The effectiveness of business entertainment in facilitating transactional relationships: The case of Chinese sales managers*.** Accepted for presentation at the *Academy of International Business Annual Conference*, Washington D.C., USA.

Sun, Francis, & Chen, Shih-Fen. 2010. ***A transaction governance approach to business entertainment in China.*** Presented at the *Academy of Management Annual Conference*, Montreal, Canada.

Sun, Francis, & Chen, Shih-Fen. 2009. ***Re-evaluating the role of bribery, entertainment, and gift-giving in private business settings.*** Presented at the *Academy of International Business Annual Meeting*, San Diego, CA, USA.

Sun, Francis, & Chen, Shih-Fen. 2008. ***The role of bribes, entertainment, and gifts in ameliorating market imperfections: A cross-cultural perspective***. Presented at the *Academy of Management Annual Conference*, Anaheim, CA, USA.

EXPERIENCE

2011 - Present: Assistant Professor of International Business, Woodbury School of Business, Utah Valley University, Orem, Utah, USA
2001 - 2006: Deputy GM of Strategy, China United Telecommunications Corporation.
1988 - 2001: Various business and research positions in China and the U.S.

PROFESSIONAL AFFILIATION AND SERVICE

Academy of Management, *Member and conference reviewer,* 2007 to present.
Academy of International Business, *Member and conference reviewer,* 2007 to present.