

Overcoming liability of outsidership in China: The experience of Brazilian companies in developing Guanxi

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ABSTRACT

In light of discussions on corporate internationalization, a theoretical approach advocates that the main barriers to internationalization are related to the burden of being outside international relationship networks, that is, so-called liability of outsidership. Given China's relevance to Brazil and the complexity of that country's business relations (guanxi), this study aims to investigate how Brazilian companies operating in China develop guanxi as a means of overcoming liability of outsidership, based on Chen and Chen's theoretical framework (2004). A descriptive and qualitative study was conducted analyzing multiple cases in four Brazilian companies from the services sector with offices in China. Data were collected through semi-structured interviews. Data were treated by content analysis using NVivo 8.0 software. The results identified the motives behind internationalization to China, the difficulties encountered due to the liability of outsidership, the significant benefits of guanxi, and activities carried out in order to develop it. This study is expected to contribute to generating knowledge on the internationalization of companies to China.

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1. Introduction

Research on corporate internationalization is becoming increasingly relevant due to both globalization and the growing movement of Brazilian companies seeking competitive advantages through insertion into the foreign market. Understanding Brazil and its emergence on the global stage is a relevant topic among many researchers, in addition to foreign direct investments (FDI) in the country (FLEURY; FLEURY, 2007).

According to Fleury and Fleury (2012), it was only from the 20th century onwards that the internationalization of Brazilian companies began to gain ground and consistency. Brazil's political, social and economic development from its colonization until the late 1980s shaped the context in which Brazilian multinationals emerged. Competition between Brazilian companies and subsidiaries of foreign firms in an environment characterized by

uncertainty and discontinuity created conditions for the development of abilities that boosted the internationalization of Brazilian companies (FLEURY; FLEURY, 2012).

Along with other BRIC nations (Brazil, Russia, India and China), Brazil has become increasingly relevant in terms of the global scenario and its power structure, thus impacting global economic relations. In light of this scenario, Brazil has strengthened its ties with China, its main commercial partner in exports and imports. However, in some cases, internationalization to China can be highly complex, particularly in terms of cultural differences.

According to Johanson and Vahlne (1977), culture is a major barrier in the internationalization process. Nevertheless, the problems and opportunities involved in internationalization are also related to whether companies are part of networks or not (JOHANSON; VAHLNE, 2009). In other words, the

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authors recognized that liability of outsidership, which refers to the disadvantage of being outside networks in both the domestic and international market, also affects companies' internationalization.

In this respect, there is an important cultural trait in China whereby relationships are highly valued, known as *guanxi*. According to Bell (2000), *guanxi* is a system of relationships that begins in the family environment and extends to other spheres established throughout life. It is a special type of relationship that unites partners through reciprocal obligations to obtain resources via continuous cooperation and exchanging favors (CHEN, 1995). Modern Chinese society still operates within the confines of these countless social and corporate *guanxi* networks. Thus, it is vital for both local of foreign businesses in China to understand and correctly apply *gaunxi* in order to gain advantages over competitors.

Given the relevance of the Asian market to Brazil, the China-Brazil Business Council (CBBC) conducted a study to map the experiences of Brazilian companies that internationalize their business to China (CEBC, 2012). The results demonstrated that the physical and cultural differences between the two countries, the peculiarities of the Chinese corporate environment and lack of knowledge on how to deal with the different Chinese authorities were the main obstacles faced by Brazilian companies. In order to overcome these challenges, companies adopted the following strategies: (1) establishing a *guanxi* network and (2) associating with a Chinese company.

Based on the above, this study aims to investigate how Brazilian companies that internationalize to China have developed *guanxi* as a means of overcoming the liability of outsidership. Moreover, it seeks to understand the importance of *guanxi* to the companies studied and the benefits this network offers within the Asian market. The study was based on Chen and Chen's (2004) theoretical framework, whereby the authors argue that that *guanxi* can be developed in three stages, reflecting the objectives and fundamental principles of each one.

2. Theoretical Framework

2.1 Liability of Outsidership

The Uppsala Model (JOHANSON; VAHLNE, 1977) explains the gradual internationalization of companies based on the underlying principles of

uncertainty and bounded rationality (PENROSE, 1959; CYERT; MARCH, 1963; AHARONI 1966). According to Johanson and Vahlne (1977), greater psychic distance implies a higher degree of liability of foreignness, that is, the cost or disadvantage of operating in foreign markets. In short, companies need a specific organizational advantage to offset the challenges of being a foreign firm exploring new markets outside its country of origin.

With the advent of social media, the focus then shifts to the company situated within an environment that is immersed in these networks (HOLM; ERIKSSON; JOHANSON, 1996; ERIKSSON *et. al*, 1997; JOHANSON; VAHLNE, 2003; 2009). The main argument is based on the market as a network of relationships in which companies are interconnected through complex, varied and largely invisible patterns. Thus, successful internationalization requires being an insider that is, belonging to a relevant network. Similarly, being an outsider is a barrier to the process. In addition, relationships offer the potential for learning and building trust and commitment, both understood as prerequisites for internationalization (JOHANSON; VAHLNE, 2009).

Johanson and Vahlne (2009) that if liability of foreignness is a barrier to internationalization, liability of outsidership can be an obstacle in both domestic and international markets. Inasmuch as it is important to be part of a business network and enjoy relationships in the domestic market, it is vital to become part of networks in foreign markets in order to achieve successful internationalization (JOHANSON; VAHLNE, 2009).

The Uppsala model centers on networks and recognition of the role of entrepreneurs in forming and maintaining these relationships (SCHWEIZER *et al*, 2010). Entrepreneurship is an important variable because entrepreneurs are understood to make emotional and intellectual internationalization decisions based on idiosyncratic characteristics, with experiential learning an important factor in these decisions.

In this respect, since psychic distance and liability of foreignness were considered influential, the question of where to internationalize can become one of who to internationalize with, given that liability of outsidership seems to be a new key point in the internationalization process. Companies, particularly in emerging countries, no longer follow the rule of gradual progressions, both in terms of psychic

distance and entry formats. Mathews (2006) argues that the innovative characteristics that these multinationals share, such as their accelerated internationalization and strategic and organizational innovation, fit particularly well with the features of emerging economies in a complex interorganizational connection.

Thus, Mathews (2006) studied Chinese companies and found that they followed an internationalization pattern known as LLL (Linkage, Leverage, Learning).

Linkage refers to the advantages a company can acquire externally. In other words, global orientation becomes an advantage more likely to be found in the global market than the domestic setting" (MATHEWS, 2006, p. 18). As an example the author cites Chinese companies that entered into joint ventures with Taiwanese firms in order to obtain technology. Leverage is related to partnerships that Chinese companies establish with multinational enterprises (MNEs) to improve the level and efficiency of the resources acquired through linkage. The focus is on own resources and their leverage potential. Learning involves organizational learning by repeating different linkage and leverage relationships. Companies learn to develop new products and services more quickly after acquiring knowledge in relationships to obtain resources (Linkage) and improving the level of these resources (Leverage).

Thus, business networks challenge discussions on internationalization models, in addition to the fact that business is done by people, meaning interpersonal relationships are therefore involved (KARIMIBABAK; SINCLAIR, 2011). Businesses can move and internationalize quickly and, particularly, adapt rapidly due to a direct link with business networks in the new environment.

Holm, Eriksson and Johanson (1996) highlighted international networks as important skills for achieving positive results in internationalized companies. The practice of establishing relationships with foreign partners in detriment of direct investment in the early stages of internationalization has been adopted by a number of companies, primarily those that opt for low commitment on the international market.

2.2 Guanxi

Although *guanxi* cannot be literally translated as 'network', as the term is widely known in the West,

there are a series of characteristics that classify this relationship as a network. The concept is incorporated into Confucianism and is a central concept in the formation and structure of Chinese society (LUO, 2001).

To understand the intricate relationship process of *guanxi*, it is important to understand how it was formed over time. Despite its enormous economic growth and industrialization in recent decades, most of China's population can still be found in rural areas, with significant agricultural and related activities. Given that the country's geography does not favor intensive land use, the Chinese population has always faced the challenge of planting and harvesting large quantities of food to tackle adverse conditions and social calamities and ensure the survival of a growing population, from the same piece of land (FAIRBANK; GOLDMAN, 2007). For this reason, Chinese citizens are never encouraged to think and act as individuals or treated as isolated entities. While Western values seem to be based on the premise that "everyone is born equal", the Chinese believe that "everyone is born connected" (HAIHUA; BAKER, 2008).

This context, marked by the tireless struggle for survival, was the cornerstone of *guanxi*, whereby depending on family was often not enough and it was necessary to move beyond family ties for support by participating in the village, work group or kinship group. This specific Chinese method of extending family support beyond the domestic setting is known as *guanxi* (BELL, 2000).

Guanxi is applied in a range of activities and also has a profound influence on the culture of Chinese people and their descendants, both in business as well as personal and family relationships. In this respect, the trust factor (*xinyon*) is essential in *guanxi*. If business is conducted with trustworthy people, there are no contracts or formal regulations. These are only applied if the other party is not a family member or part of a trusted network (KAO, 1991). With this in mind, when dealing with the Chinese, foreign companies should consider trust a top priority in all business relations, because without it, formal contracts are meaningless.

An important question to be clarified is: does *guanxi* occur between individuals or organizations? Standifird (2006) reports that *guanxi* is fundamentally a relationship between individuals, but can be turned into a competitive advantage for organizations. *Guanxi* only becomes an organizational asset to the

extent that individuals are willing to use it on behalf of the organization (STANDIFIRD, 2006). The existence of highly connected employees may have a multiplying effect and organizations should explicitly support the development of *guanxi* among individuals because its reputation will grow along with the connection (both internal and external) among its employees as these connections become associated with important organizational results.

2.3 How to develop *guanxi*

The growing acceptance and popularity of *guanxi* in the West has made understanding this phenomenon even more important, motivating researchers to study its impact on company performance and relationships and propose models on how to develop *guanxi*. The study by Chen and Chen (2004) on building *guanxi* is one of the most important papers on the subject.

The authors propose developing *guanxi* in three stages: (1) initiating, (2) building and (3) using. Figure 1 shows the three sets of variables per stage, initially presenting an integrated concept for developing *guanxi*.

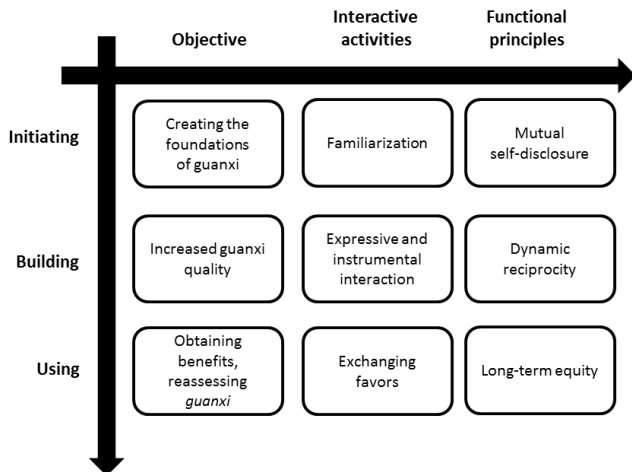


Figure 1: *Guanxi* development process
Source: Adapted from Chen and Chen (2004, p. 310)

In the first stage individuals become acquainted with one another through mutual self-disclosure. During this process both parties seek to identify points in common, creating the foundation of *guanxi*. Chen and Chen (2004) advise that people from Asian cultures, including the Chinese, do not easily “break the ice” with strangers and are less socially developed than Westerners, who quickly establish a rapport with people they do not know. As such, as an

indicator of the desire to initiate a relationship, the parties must show a mutual willingness for self-disclosure, as if they were old friends (CHEN; CHEN, 2004). Given the desire to lay the foundations for future *guanxi*, reciprocity is an essential complementary element in the self-disclosure initiative; the greater the mutual self-disclosure, the better the creation of bases for *guanxi*.

Successful initiation leads to the second stage – building *guanxi*. According to Chen and Chen (2004), the goal in this phase is to establish mutual trust and affection by building quality *guanxi*. Activities in this stage are based on expressive and instrumental interaction. Expressive interaction involves social activities such as parties, weddings, birthdays, etc., while instrumental interaction refers to pragmatic work and business activities, including mutual assistance in finding employment, job assignment, exchanging information, workplace cooperation, commercial transactions, etc. These two types of interaction are aimed at approximation that is, improving the quality of *guanxi* in terms of building trust, affection and reciprocity.

After *guanxi* has been built, companies can then benefit from its use. This stage is marked by the exchange of favors regulated by the principle of long-term equity. This principle advocates that individuals in an exchange situation have the right to share their results in accordance with their contribution to the exchange process. One of the parties may consistently request assistance from the other on a number of occasions, but even among close friends and relatives, efforts are made to consciously remember and maintain long-term social balance (YANG, 1994).

If a favor granted to B by A exceeds B’s expectations, then A will feel a sense of equity and the level of *guanxi* quality will be maintained or improved. However, when a favor is not granted as expected, there will be a sense of inequality and *guanxi* quality may be compromised. When the actual result falls below expectations there may be a sense of betrayal and both sides may withdraw. In order to protect quality *guanxi*, individuals who are unable to grant the requested favor often try to prove their desire for a continued relationship by offering other types of favors or on future occasions.

Chen and Chen’s model (2004) can be considered a significant advance in *guanxi* research since it portrays the concept as a dynamic process that can

be developed, even by Westerners. Differentiating between the attributes of *guanxi* not only facilitates its construction, but also contributes to examining its effects on the relationship between individuals and organizations.

2.4 Analytical framework

Given the objective of this study, a behavioral perspective that considers business networks in the internationalization process (JOHANSON; VAHLNE, 1977; 2009) seems more appropriate since it addresses two important aspects that are barriers to internationalization: psychic distance and the liability of outsidership. Given that networks can provide information that makes it easier to identify business opportunities, reducing the risks and uncertainties of the business environment, they can be considered a means of overcoming these barriers.

Since the object of this study is Brazilian companies that internationalize to China, the psychic distance is therefore even greater. According to a study by Silva, Rocha and Figueiredo (2007), China’s psychic distance in relation to Brazil is second only to that of Japan.

Similarly, liability of outsidership becomes a major deterrent for foreign companies that are still outsiders in Asian market networks (*guanxi*). In addition, how they enter these networks differs considerably how this process occurs in Western countries, for example. In China, relationships essentially occur between individuals as opposed to companies, with a very fine line separating personal and professional lives. Thus, *guanxi* is a challenge for foreign companies in China, but also one of the keys to successful internationalization in the country.

As such, understanding how businesses that operate in China have developed *guanxi* to overcome the liability of outsidership became the focus of this study. Considering the literature analyzed, we outlined the theoretical framework (Figure 2) and possible relationships between the constructs: (1) internationalization, (2) psychic distance, (3) liability of outsidership and (4) *guanxi*.

3. Research method

This is a qualitative and descriptive study that aims to understand the phenomena investigated based on the views of those involved at a given time, that is, the internationalization of the companies studied to China.

The qualitative approach was also motivated by academics from the field of International Business management, which encourages researchers to use qualitative methods more often. According to Oesterle and Wolf (2011), qualitative research is important in this field of study due to the many peculiarities that may not be adequately captured by quantitative data, particularly with regard to differences in countries’ cultural and institutional environments.

With respect to the research strategy, we studied multiple cases. According to Gil (2009), case studies favor the accumulation of evidence on phenomena in that these are studied in different contexts.

Four Brazilian companies from the services sector were studied, namely two law firms and two trading companies. The CEBC (2012) reports that of the 57 Brazilian companies mapped in China, 50.9% are service providers (law firms, trading companies, business consultancies and banks), mostly trading companies (15.8%). The choice to study these four companies followed two basic criteria: (1) being a service provider that acts as an intermediary between

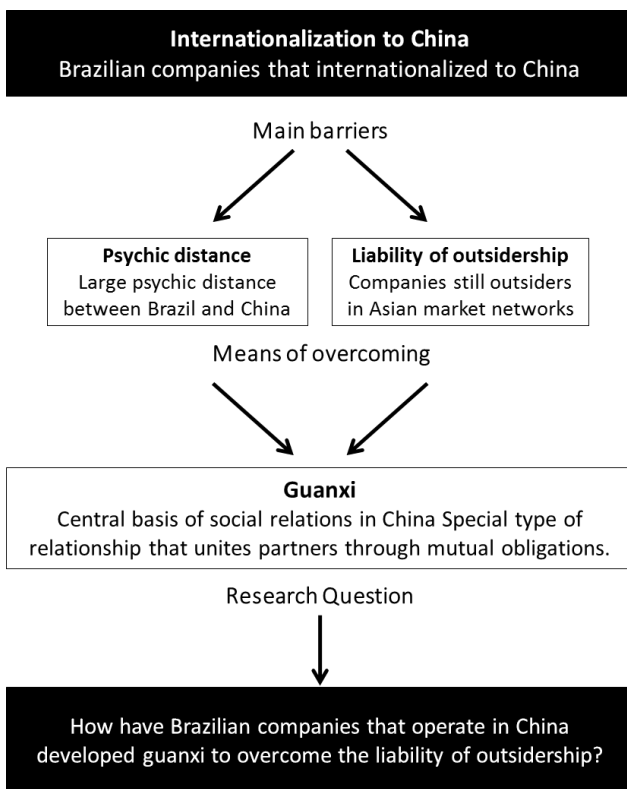


Figure 2: Analytical framework
Source: Compiled by the authors

and A2), with less commitment from Chinese suppliers (Companies T1 and T2). Additionally, the companies have no access to the market's limited opportunities, a prerequisite for successful internationalization (JOHANSON; VAHLNE, 2009).

In the third and final category, the development of *guanxi* was analyzed using Chen and Chen's model (2004), describing the activities carried out to build it (Table 6).

In the first stage, when individuals become acquainted with each other through mutual self-disclosure, Company T2 once again differs from the other firms. Whereas the other companies use some type of intermediary to initiate relationships, Company T2 initiated contact by phone, in a more impersonal manner. This attitude may be related to the notion that *guanxi* is not as essential to the company's success in China. Nevertheless, this position is not conducive to building trust, as demonstrated in the literature on the subject.

In general, the activities carried out in the initial stage were similar and consisted primarily of participating in events, lunches and dinners. The result of initial familiarization is proportional to the degree of self-disclosure, that is, how reciprocal the motivation was to establish the relationship base. In the case of Company T2, the motivation of Chinese stakeholders was related to their degree of interest in the product or service offered. For Company A1, reciprocity depended on how initial contact was made, that is, whether it was initiated by a stranger or someone recommended by a trusted person.

According to Chen and Chen (2004), reciprocity is a vital component in self-disclosure and heavily influences the creation of *guanxi* foundations. In this respect, the only company that achieved initial mutual reciprocity was T1, which received assistance from the company's Korean agents in its initial contact with the Chinese.

In the second stage the goal is to establish mutual trust and affection by building quality *guanxi* (CHEN; CHEN, 2004). In the law firms, *guanxi* was built through participation in events and dinners, while trading companies invested in regular visits to suppliers to establish trust and affection in the relationship.

All the companies studied performed instrumental activities, but only A1 and T1 invested in expressive activities. These are more likely to

establish trust and affection because they are more personal than professional. It is important to underscore that these activities were carried out in companies that believe in the importance of *guanxi* and used intermediaries for initial contact. This may have contributed to the occurrence of expressive activities.

All the companies, except T2, believe that reciprocity in this stage was mutual, that is, both sides were open to establishing *guanxi*. The minimal importance given to *guanxi* by Company T2 and its lack of investment in the concept may be the cause of the lack of reciprocity it experienced.

The third and final stage of development is using *guanxi*, involving exchanging favors based the principle of long-term equity (CHEN; CHEN, 2004). However, first it is important to know whether the company is part of the *guanxi* of its Chinese client or supplier. This moment is known as insidership, when the benefits of networks can be enjoyed. In this regard each company had a different experience, with no standard behavioral pattern. The exchange of favors only occurred in companies A1 and T2, with both believing it to be the driving force behind maintaining and strengthening *guanxi*. An example of exchanging favors was cited by one of the interviewees.

Once, a (Chinese) man ran over a woman when he was going to fetch me at the train station, and he paid her to keep quiet and not tell his boss. There are no rules about who starts offering favors. They can be returned in different ways (gifts, money, invitations to special events). The expectation is that the favor will be returned at least on the same or a better level. (INTERVIEWEE A1)

With respect to alignment between companies' experiences developing *guanxi* and Chen and Chen's model (2004), it was observed that activities performed by companies A1 and T1 are more keeping with the model than those carried out by A2 and T2. Both firms (A1 and T1) initiated contact through intermediaries, carried out instrumental and expressive activities and achieved mutual reciprocity in establishing the relationship. Company A1 also engaged in exchanging favors to strengthen *guanxi*. Alignment was slightly lower in firms A2 and T2.

The results indicate that the model developed by Chen and Chen (2004) shows a cause and effect relationship between the activities carried out in initiating, building and using *guanxi*. Activities performed at the outset influence use.

It is important to note that both interviewees comment on how highly valued *guanxi* is by foreigners and their caution when it comes to deepening these relationships. This is evident in the performance of instrumental activities alone and low mutual reciprocity.

5. Final Considerations

Analysis of the cases and theoretical framework enabled us to draw conclusions. The difference between *guanxi* and networking is in the intensity, with very similar applied to develop interorganizational relationships and *guanxi*. The issues of trust and reciprocity, for example, are present in both approaches. The main difference is in their intensity and the value placed on them by the Chinese, explained by the history and culture of Asian countries. The degree of dependence between an individual's life and relationship network is considerably higher than in Western individualist cultures, as opposed to the more collective Asian traditions. Nevertheless, trust, which is the basis of any relationship, is present both in *guanxi* and networks.

Similar perceptions on *guanxi* were also noted in accordance with companies' area of expertise (law firms and trading companies). Similar situations are faced as a result of the liability of outsidership, as are the benefits generated by *guanxi* and the importance given to it. However, few similarities were observed in terms of building *guanxi*. How it is developed is associated more with the level of importance it is given than the company's area of expertise.

Despite being aware that exchanging favors drives the development of *guanxi*, Brazilian companies are still wary of this practice. There is also a cultural barrier on the part of Brazilians in terms of exchanging favors with the Chinese. It is generally company policy not to promote this practice, and at times not even the exchanging of gifts is permitted. This is an important issue to be addressed when it comes to strengthening business relations with China.

Much like *guanxi*, face (*mianzi*) was cited by the interviewees as highly important in China. It is fruitless to spend years developing and strengthening *guanxi* if face is disregarded. This relationship of status and moral reputation is a form of approved self-image and social status (HWANG, 1987).

Foreigners with no knowledge of China's etiquette and relationship standards can easily lose *mianzi* and thus compromise the building of *guanxi*, or even lose it entirely.

In relation to the theoretical contributions of this study, it has improved empirical knowledge on the liability of outsidership and *guanxi* in the reality of Brazilian companies, as well as testing Chen and Chen's theoretical model (2004). In addition to the scientific relevance of this study, we believe that knowledge about the experience of Brazilian companies in developing *guanxi* can help define the internationalization strategies of other companies, particularly those seeking to establish themselves in China.

It is suggested that future studies prioritize this topic, primarily in descriptive approaches, since there are a number of theoretical models in the international literature. Moreover, it is important to understand the development of *guanxi* in other sectors and areas of expertise in order to compare the perceptions of different companies and better distinguish between the benefits of using networks and *guanxi*.

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Superando a *liability of outsidership* na China: A experiência das empresas brasileiras no desenvolvimento do guanxi

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China

RESUMO

À luz das discussões sobre internacionalização de empresas, uma abordagem teórica defende que as principais barreiras no processo de internacionalização estão relacionadas ao ônus de estar fora das redes de relacionamento internacionais, ou seja, enfrentam a chamada *liability of outsidership*. Considerando a relevância da China para o Brasil e a complexidade das relações de negócios no país (*guanxi*), este estudo se propôs a investigar como empresas brasileiras que operam na China desenvolvem guanxi como meio de superar a *liability of outsidership*, com base no modelo teórico de Chen e Chen (2004). Foi desenvolvida uma pesquisa descritiva e qualitativa, sendo realizado um estudo de casos múltiplos em quatro empresas brasileiras do setor de serviços que possuem filial na China. A coleta de dados ocorreu por meio de entrevistas semi-estruturadas. Para o tratamento dos dados, optou-se pela análise de conteúdo, com o auxílio do software NVivo 8.0. Os resultados identificaram as motivações na internacionalização para a China, as dificuldades enfrentadas decorrentes da *liability of outsidership*, a importância e os benefícios do guanxi, e as atividades realizadas para o seu desenvolvimento. Espera-se que este trabalho contribua para geração de conhecimento sobre a internacionalização das empresas brasileiras para a China.

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