

Guanxi and Business Ethics in Confucian Society Today: An Empirical Case Study in Taiwan

Dennis B. Hwang
Patricia L. Golemon
Yan Chen
Teng-Shih Wang
Wen-Shai Hung

ABSTRACT. *Guanxi*, or social networks common in Confucian cultures, has long been recognized as one of the major factors for success when doing business in China. However, insider networks in business are certainly not confined to Asian cultures, nor is the attendant possibility for corruption. This study obtained original data to investigate current Taiwanese perceptions of (1) how *guanxi* is established and cultivated; (2) how *guanxi* actually is practiced now and people's acceptance of it; and (3) the effects of *guanxi* on business operations, employment/promotion, and social justice and fairness. The researchers also hope to (4) verify some arguments made by pioneering researchers. The authors speculate on how these attitudes may affect behavior in business transactions in hopes of making readers more aware of differing cultural values that may create unexpected ethical dilemmas. They suggest that professional ethical codes should provide guidance on the practice of *guanxi* in a Confucian society and that special emphasis or training in interpreting those codes may be required.

KEY WORDS: auditor independence, Confucianism, corruption, culture, *guanxi*, social networks

Introduction

Guanxi has long been recognized as one of the major factors for success when doing business in China (Hwang and Staley, 2005; Lovett et al., 1999; Yau et al., 2000). In Chinese *guanxi* is a general term for social networking and is often translated as "relationship" or "connection" (Yeung and Tung, 1996). In their collection of essays on *guanxi* in the PRC, Gold et al. note "To some observers ... *guanxi* is an essential and defining element of Chinese culture,

handed down relatively unchanged through time and space. To others, [it] is little more than a Chinese word for the personal networks, social capital, and gift economies found in all societies" (2002).

Guanxi describes an intricate and pervasive personal relational network that the Chinese cultivate energetically, subtly, and imaginatively. It encompasses implicit mutual obligation, assurance, trust, and understanding, and governs Chinese attitudes toward long-term and social business relationships (Luo, 1997a). Yau et al. (2000) further argue that *guanxi* works on the basic, unspoken principles of trust, bonding, reciprocity, and empathy. Individuals belonging to a *guanxi* network will seek to meet their *guanxi* responsibilities, and failure to do so will result in damaged prestige, loss of face, and subsequent loss of trust by other members of the *guanxi* circle (Hwang and Staley, 2005). Gold et al. state that "one way scholars have gained analytical leverage over the issue lies in the study of cross-societal uses of *guanxi*, asking questions about the appearance of and reliance on *guanxi* in Chinese societies that vary institutionally, such as China, Taiwan, and Singapore" (2002). They add in a note that *guanxi* is "a pejorative term in the PRC but has a much less negative connotation in other societies, such as Taiwan, where the affective element is stressed" (2002). This study focuses on an examination done in spring of 2006 of Taiwanese *guanxi* practices in and around Taichung, Taiwan, to look at how the term was defined and applied there at that time.

The development and maintenance of *guanxi* has become a priority for many business people wanting to operate in the Pacific Rim (Hwang and Baker,

2000; Luo, 1995). In both China and Taiwan, business people first strive to build up personal relationships with a potential customer, and once admitted to a clan/*guanxi* family, business follows. Thus, mutual trust must be established before business may begin. *Guanxi* can have beneficial effects on business; once *guanxi* has been established, marketing costs and bad debt expenses decrease, as *guanxi* creates an obligation to conduct business with the clan and to pay one's debts (Hwang and Staley, 2005). In contrast to the Chinese way of conducting *guanxi* and business, western business practices tend to begin with transactions; if successful, a personal relationship may follow (Luo, 1997b).

Seligman (1999) notes that one of the rules in China for business success is the establishment of the right *guanxi*. Yeung and Tung (1996) researched the critical factors that contribute to business in China by asking managers of 19 diverse international companies to rank 11 key factors. They found that *guanxi* was the only item consistently chosen as a key success factor. In addition, Luo (1997a, b) found a direct correlation between a corporation's level of *guanxi* connections and its sales growth in China. Although PRC officers are legally constrained and officially discouraged from accepting favors, Wank found that local officials "under economic pressure, are willing to trade the flexible implementation of laws and policies for the gifts and favors that Taiwanese investors bring to the negotiating table. But they are only willing to do so as long as the investments stay local and therefore off the radar screen of higher-level governments" (cited in Guthrie, 2002). Taiwanese who do business in the PRC may have different expectations for their local operations, however. This study was designed to examine their attitudes on the issue.

In recent years, the practice of *guanxi* has also drawn much attention in the western world. The collapse of Enron resulted from malpractice in complicated personal relationships among the chairperson, Kenneth Lay, and some of his colleagues. The financial disaster was furthered by collusive relationships at the organizational level, i.e., between Enron and its CPA firm Arthur Andersen, its investment banks, and its outside counsel, Vincent and Elkins. In yet another American example of *guanxi* gone awry, Peter Boyer used the term "American *Guanxi*" for Bill Clinton's acceptance of

illegal campaign donations from Asian and Asian-American sources (*The New Yorker*, April 14, 1997). *Guanxi* certainly is not limited to Asian cultures.

In this study, we used a questionnaire written in Mandarin Chinese to obtain primary data from college students, professionals, and other individuals in examining current perceptions about *guanxi*. We set out to:

- (1) investigate how *guanxi* is currently established and cultivated in a Chinese society like Taiwan;
- (2) explore how *guanxi* is practiced and people's attitudes about the current practice of *guanxi*;
- (3) examine respondents' perceptions of the effects *guanxi* has on business operations, employment/promotion, and social justice and fairness; and
- (4) apply factor analyses to verify some particular arguments made by pioneering researchers.

Therefore, the paper is organized into four major parts. First, it discusses some related pioneering studies on *guanxi*. Second, it explores *guanxi* and the Chinese culture. Third, it presents the research method and the statistical results of the survey. Finally, it discusses the implications of the research findings and presents concluding remarks.

***Guanxi* and Chinese culture in Taiwan**

According to Hwang and Staley (2005), *guanxi* has been critically important to Chinese society for more than 2,500 years – since the time of Confucius (550–478 B.C.). According to the *Book of Analects*, written about the sayings and doings of Confucius by his followers, he postulated three major teachings: loyalty, benevolence, and performing the responsibilities inherent in the five fundamental relationships, named *wu lun* in Chinese. The five relationships are those between the following hierarchy of dyads: (a) ruler–subject, (b) father–son, (c) brother–brother, (d) husband–wife, and (e) friend–friend. All human relationships are derived from one or a combination of the above five relationships. A person's fulfillment of the responsibilities inherent in a given role ensures the smooth functioning of society (Yeung and Tung, 1996). Confucius' teachings have also encouraged

Chinese people to respect their elders and leaders and perform filial duties to parents (Huang, 2001). Therefore, Chinese society has been built around family clans. *Guanxi* is first built on the concept of the clan and then widened to include distant relations and finally unrelated individuals (Hwang and Staley, 2005).

Guanxi is cultivated by the exchange of gifts and favors (Pederson and Wu, 2006). This is a common and acceptable business practice in China and Taiwan. However, such gifts strike an ethical nerve in a western society, and are contrary to at least the spirit of the Sarbanes-Oxley Act in the U.S. (Hwang and Staley, 2005). Furthermore, some researchers, such as Su and Littlefield (2001), Hwang and Staley (2005), and Pederson and Wu (2006), argue that the practice of exchanging gifts and favors leads to widespread bureaucratic corruption as individual officials seek to charge “economic rent” for use of their *guanxi* connections. Pederson and Wu (2006) find that PRC Chinese endorse “facilitation payments” made to public officials to expedite government services necessary for normal business operations. During their interviews, some interviewees responded “All companies operating in [mainland] China, including foreign companies, are forced to engage in corrupt activities to make money” (Pederson and Wu, 2006, p. 32).

Hofstede (1984, 1997) and Hofstede and Bond (1988) have studied cultural patterns in various Eastern and Western societies and their impact on a society’s economic performance. Building on Hofstede’s work, Gray (1988) and Gray and Vint (1995) developed four sets of accounting values to describe a society’s accounting/auditing system – professionalism versus statutory control, uniformity versus flexibility, conservatism versus optimism, and secrecy versus transparency. According to Gray’s results, Hwang et al. (2000) postulate that the Chinese system can be described as exhibiting statutory control, uniformity, conservatism, and secrecy, behavior which puts them at odds, at least in theory, with their western counterparts. While these general categories certainly do not encompass all individuals in a culture, they do describe in broad terms the behavior of a *preponderance* of its members. Understanding that these differing behaviors may be encountered can prevent misunderstandings among business partners.

In particular, they can be important to accounting auditors and their clients.

Relevant to this discussion, trade links among the United States, Taiwan, and China are substantial and important to these three economies. The U.S. is China’s most important export market, purchasing roughly one-quarter of all Chinese exports. China has become the second largest source of U.S. imports since 2003, right after Canada but ahead of Mexico and Japan. According to the U.S. Census Bureau (2007), China was the second largest trading partner of the U.S. in 2006, and Taiwan was ranked ninth. Since both China and Taiwan have become key trading partners of the U.S., our research focusing on the Chinese culture and *guanxi* is appropriate and beneficial. Its results can provide useful knowledge for policymakers, business people, accounting and auditing professionals, and academics in both American and Chinese societies.

Theory and questionnaire

Theory

Guanxi can bring a business several competitive advantages, such as a reduction of business costs, improvement of business efficiency, avoidance of bad debts, help in obtaining government permits and loans, and assistance in winning projects and resources (Hwang and Staley, 2005; Warren et al., 2004). In addition, *guanxi* helps individuals in finding jobs, getting promotions, and winning contracts (Warren et al., 2004; Winn, 1994). Based upon the above prior studies, we formulated the following Proposition:

Proposition 1: Guanxi affects a person’s employment/promotion and a business’s contracts/transactions.

In the common Chinese practice, *guanxi* is created and nourished through the exchange of gifts and favors. Millington et al. (2005) argue that gift giving appears to be associated with illicit payments, corruption, and pursuit of self-interest. Pederson and Wu (2006) also state that PRC Chinese generally approve the use of gifts and favors to maintain *guanxi* networks and also endorse “facilitation payments”

made to public officials to get normal business done. They further indicate that companies operating in China, including foreign companies, are forced to engage in corrupt activities to make money. Corruption is an unfair use of both power and money for inappropriate personal benefit at the cost of others. According to the above prior research and arguments, we formulated the following Proposition:

Proposition 2: The practice of *guanxi* can lead to corruption and social injustice.

Through Confucius' teachings of courtesy/ethics (*li* in the Chinese language) and five cardinal basic human relations (*wu-lun* in Chinese), *guanxi* is developed from family clans and widened to include other relatives, friends, colleagues, and other people in the *guanxi* networking process (Hwang and Staley, 2005; Yau et al., 2000). In Confucian societies, an important factor motivating individuals to do right things or to deter against immoral behavior is shame. The sense of shame formulates the contexts of "face-giving" and "face-saving." *Guanxi* is strengthened or maintained via this process of give-and-take of favors and nourished through reciprocity which includes both "to respond" and "to repay" (Yau et al. 2000). Confucianism also encourages each individual to become a righteous person (*yi-ren* in Chinese). To become a *yi-ren*, a person must repay favors, and sometimes increase the value of a favor returned (Hwang and Staley, 2005; Yeung and Tung, 1996). The Chinese proverb "When you receive a drop of water as a rescue from death by thirst, you repay with a spring of water" describes accurately the practice of both *guanxi* and *yi-ren*. Therefore, *guanxi* is a personal asset because one may request and receive favors; it is also a personal liability because one must repay favors. According to the above factors, we developed the following Proposition:

Proposition 3: *Guanxi* is reciprocal, involving both the advantages of requesting/receiving favors and the obligation to repay.

Questionnaire

A survey questionnaire (see Appendix A) was specifically designed to collect data for this research.

A total of 1,050 questionnaires in Mandarin were distributed to individuals, business corporations, professional associations, and universities via mail or personal delivery in Taiwan during the spring of 2006. A total of 17 questions were created and classified into three groups. The first group (Group A) contains three questions regarding how *guanxi* is established, maintained, and influenced by the Chinese traditions and culture. The respondents are provided with six possible answers for ranking and also with a blank space for filling in other answers for each question. Each respondent is requested to use a scale of 1 through 7 to reflect the importance of each answer. The second group (Group B) contains eleven questions regarding the practice of *guanxi* in Taiwan. Finally, the third group (Group C) contains three questions necessary to collect information regarding the respondent's demographics, including age, gender, and education.

Two notable cases reflect the current practice of *guanxi* in Taiwan. In the first, a Taiwan congressman held a wedding banquet for his 16-year-old son, inviting and receiving more than 20,000 guests in early 2006. Many congressmen, high-ranking government officials, powerful business tycoons, and gang members attended (*Apple Daily News*, 1/22/06). As locals know, at weddings in Taiwan customarily guests make cash presents to the celebrating family, so people who attended this huge event made cash contributions to the congressman, the more substantial according to their rank in his *guanxi* network. This extravagant high-profile wedding amazed many people in Taiwan; they were surprised that this controversial congressman was capable of creating and maintaining such a huge political and business *guanxi* network and would brandish it so openly. A second *guanxi* story which drew worldwide attention was the growing number of corruption cases surrounding the President of Taiwan, Shui-Bian Chen. President Chen, his wife, his son-in-law, the father of the son-in-law, Chen's family accountant and doctor, and several other high-ranking government officers appointed by Chen became a close *guanxi* network and apparently committed graft and corruption in the form of insider trading, embezzlement, business interest exchanges, justice interruptions, and forgery¹ (*China Times Electronic News*, 9/1/06). This was a case involving both political power and business interests

in which, sadly, the ruling “ethics” were those of unbridled *guanxi*.

The above two stories are incorporated into Group B as Questions B1 and B2, respectively, to get feedback about the respondents’ reaction to these events; Group B also has other questions about the current practice of *guanxi* in Taiwan.

Empirical results

A 7-point Likert-type scale was anchored to each question in Group B, where 1 indicated “strongly disagree” and 7 indicated “strongly agree.” Every respondent was asked to express a preferred value for each question. This is similar to the type of scale used by Chow et al. (2001, p. 10) when they investigated the organizational culture of public accounting firms in Taiwan. The respondents’ background information was used to pool the data for factor analysis.

A total of 411 questionnaires were returned with a return rate of 39%; 337 of those questionnaires had all questions answered and thus became effective samples for this research. Cronbach’s alpha for the scales was 0.59 for the B group of questions, indicating a moderately high degree of internal consistency.

Table I reveals the background information of the respondents. Note that

- 40% of the respondents are 21–25 years old;
- 7% are 26–30 years old;
- 10% are 31–35 years old;
- 24% are 36 years or older;
- 75% have a college/university degree;
- 17% have master’s degrees;
- 5% are senior high school graduates;
- 3% have doctorates;
- 67% are female; and
- 33% are male.

Table II reveals the statistical results of the techniques used to establish the *guanxi* network. The order of importance of the techniques as ranked by the respondents is

- (1) strengthening interactions with relatives and friends;
- (2) strengthening interactions with classmates and colleagues;

TABLE I
Demographic information for the respondents

	Number	Percentage
<i>General information</i>		
Total distribution	1050	100
Total returned	411	39
Total effective	337	32
<i>Age</i>		
15–20 years	63	19
21–25 years	137	40
26–30 years	22	7
31–35 years	33	10
36 and over	82	24
Total	337	100
<i>Education</i>		
Junior high	1	0.3
Senior high	17	5
College/university	253	75
Master	58	17
Ph.D.	8	2.7
<i>Gender</i>		
Female	226	67
Male	111	33

- (3) taking opportunities to get acquainted with other people;
- (4) through introduction by relatives and friends;
- (5) through introduction by classmates and colleagues; and
- (6) attending social organizations or the activities at gatherings such as weddings, birthdays, and funerals.

The above rankings confirm the argument by Hwang and Staley (2005) and Luo (1997a, b), among others, that *guanxi* begins with family clans and expands to friends, friends’ friends, colleagues, and other people. In addition, twelve respondents filled the blank space with “through internet.” These responses reflect a new approach to create *guanxi* in this high-tech era. Other techniques shown in the blank space include “self-presentation,” “neighbors,” and “leisure activities.”

Table III reveals the techniques to maintain the already established *guanxi*. The order of importance as ranked by the respondents is

TABLE II
Techniques to establish the network of *guanxi*

Techniques	Mean	Median	Mode	Max.	Min.	S.D.
1. Strengthening the interactions with relatives and friends	2.00	1	1	6	1	1.50
2. Through introductions by relatives and friends	3.59	4	5	6	1	1.48
3. Attending social organizations or weddings, birthdays, funerals	4.14	4	6	6	1	1.62
4. Taking opportunities to get acquainted with other people.	3.15	3	3	6	1	1.66
5. Strengthening the interactions with classmates and colleagues	2.21	2	2	6	1	1.19
6. Through introductions by classmates and colleagues	3.66	4	4	6	1	1.43

The order of importance is 1 through 7, in which 1 means the most important and 7 least important. Max = Maximum; Min = Minimum; S.D. = Standard Deviation.

TABLE III
Techniques to maintain the already established *guanxi*

Techniques	Mean	Median	Mode	Max.	Min.	S.D.
1. Giving gifts	4.48	5	6	6	1	1.54
2. Treating at meals	3.54	4	4	6	1	1.49
3. Greetings by telephones or cards	2.44	2	2	6	1	1.33
4. Attending the activities of weddings, birthdays, funerals, etc.	4.05	4	4	6	1	1.53
5. Taking opportunities to visit residence or office	2.97	3	3	6	1	1.30
6. Getting him/her out for tea, coffee, and chats	1.75	1	1	6	1	1.29

The order of importance is 1 through 7, in which 1 means the most important and 7 least important. Max = Maximum; Min = Minimum; S.D. = Standard Deviation.

- (1) getting the person out for tea, coffee, and chat;
- (2) greeting by telephone or cards;
- (3) taking opportunities to visit residence or office;
- (4) treating at meals;
- (5) attending weddings, birthdays, funerals; and
- (6) giving gifts.

Other approaches as reflected by the respondents include “internet,” “treating people with warmth and sincerity,” “caring and sharing,” “good cooperation,” “inviting him/her for golf, jogging or vacation.” Note that both “weddings, birthdays, funerals” and “interacting through Internet” are viewed as the means for both establishing and maintaining *guanxi*.

Table IV reports the importance of the factors contributing to the establishment of *guanxi*. The order of importance as ranked by the respondents is

- (1) mutual benefit to people in the circle of *guanxi*;
- (2) being able to help others through my own *guanxi*;
- (3) the sense of righteousness and returning the favors to grantors;
- (4) Confucius’ five basic human relations and Chinese traditional culture;
- (5) the sense of saving face and honoring the family; and
- (6) favorably impressing others.

Other factors as filled in the blank space by the respondents include: “For the benefit of job and career,” “*Guanxi* as investment,” and “For self benefit.” The above results reconfirm the findings of Luo (1997a, b), Yeung and Tung (1996), and Hwang and Staley (2005) that *guanxi* is a practice of mutual benefit and originates from Confucius’ five basic human relations and their attendant responsibilities.

TABLE IV
Factors contributing to the establishment of *guanxi*

Factors	Mean	Median	Mode	Max.	Min.	S.D.
1. Confucius' five basic human relations and Chinese traditional cultures	3.27	3	1	6	1	1.94
2. The sense of saving face and honoring the family	3.69	4	5	6	1	1.63
3. The sense of righteousness and returning the favor to grantors	2.81	2	2	6	1	1.47
4. Mutual benefit to people in the circle of <i>guanxi</i>	2.37	2	1	6	1	1.51
5. Favorably impressing others	3.83	4	3	6	1	1.54
6. Be able to help others through my own <i>guanxi</i>	2.74	2	1	6	1	1.59

The order of importance is 1 through 7, in which 1 means the most important and 7 least important. Max = Maximum; Min = Minimum; S.D. = Standard Deviation.

Table V reveals the mean, median, mode, and standard deviation of the questions in Group B. Using a 7-point Likert scale, an average of 4 indicates the respondents are neutral on this question, whereas the respondents disagree more strongly when a mean is closer to 1, and agree more strongly when a mean is closer to 7.

To make our analysis practical and rational, we would infer that the respondents agree strongly with a statement if it receives a mean between 6 and 7. Three questions fall into this group:

- B2: *Guanxi* has been abused in Taiwan with the evidence of recent fraud scandals.
 B4: *Guanxi* affects a person's success for employment/promotion.
 B5: *Guanxi* affects the success of business contracts/transactions.

Note that both questions B4 and B5 are designed to test Proposition 1. Therefore, our results strongly support Proposition 1, that *guanxi* affects employment/promotion and contracts/transactions in a Chinese society.

We would infer that the respondents agree highly with a statement if it receives a mean between 5 and 5.99. The majority of questions fall into this category. They include:

- B6: *Guanxi* affects social justice.
 B7: *Guanxi* is a source factor for corruption.
 B9: If I have nice *guanxi* with someone, I feel more comfortable to ask for help when needed.
 B10: The fact whether I have good *guanxi* with someone does affect my willingness to render my help.

- B11: Professional ethical codes of each profession should provide guidance on the practice of *guanxi*.

Note that both questions B6 and B7 are designed to test Proposition 2. These questions received a mean of 5.98 and 5.94, respectively. Therefore, our statistical results highly support Proposition 2, that the practice of *guanxi* can possibly lead to corruption and social injustice. Since both Propositions 1 and 2 are confirmed, we infer that the practice of *guanxi* in a Confucian society may be cause for serious concern about business ethics and social justice, because this practice receives high tolerance in Confucian culture.

Please also note that the questions of B9 and B10 are formed to test Proposition 3. They received a mean of 5.47 and 5.19, respectively. Therefore, our results highly confirm Proposition 3, that *guanxi* is reciprocal, involving both the advantages of asking for/receiving favors and the obligation to repay them.

We would infer that the respondents agree moderately with the statement of a question if it receives a mean between 4 and 4.99. None of the questions fall into this group. We would infer that the respondents slightly disagree or have a slightly negative feeling if a question receives a mean between 3 and 3.99. Three questions fall into this group. They are as follows:

- B1: I am comfortable with a congressman's practice of *guanxi* and the extravagant wedding for his 16-year-old son.
 B3: I generally accept the practice of *guanxi* in Taiwan at the present time.

TABLE V
Statistical results of questions in Group B

	Questions	Mean	Median	Mode	S.D.
B1	I am comfortable with a congressman's practice of <i>guanxi</i> and the extravagant wedding for his 16-year-old son	3.18	3	4	1.79
B2	<i>Guanxi</i> has been abused in Taiwan with the evidence of several recent fraud scandals	6.16	7	7	1.53
B3	I generally accept the practice of <i>guanxi</i> in Taiwan at present	3.10	3	3	1.39
B4	<i>Guanxi</i> affects a person's success for employment/promotion	6.00	6	7	1.14
B5	<i>Guanxi</i> affects success in business contracts/transactions	6.02	6	7	1.15
B6	<i>Guanxi</i> affects social justice	5.98	6	7	1.11
B7	<i>Guanxi</i> is a source factor for corruption	5.94	6	7	1.33
B8	The factor that makes me determine to be a friend of a new person is whether he/she will be beneficial in my future	3.41	3	1	1.82
B9	If I have good <i>guanxi</i> with someone, I feel more comfortable to ask for help when needed	5.47	6	6	1.17
B10	The fact whether I have good <i>guanxi</i> with someone does affect my willingness to render my help	5.19	5	6	1.47
B11	Professional ethical codes of each profession should provide guidance on the practice of <i>guanxi</i>	5.79	6	7	1.13

1 indicates "strongly disagree", while 7 indicates "strongly agree" for all questions, except question 9 where 1 for Taiwan/China and 7 for US/Europe.

Max = Maximum; Min = Minimum; S.D. = Standard Deviation.

B8: The factor that makes me determine to be a friend of a new person is whether he/she will be beneficial in my future.

Table VI provides the results of factor analysis within different groups of age and education, respectively. We found that older people are less tolerant of the particular congressman's behavior (B1) and the general practice of *guanxi* in Taiwan today (B3), since the mean of the age group decreases when the age of respondents increases (becomes older).² Interestingly, the younger (ages 15–20) respondents believe more strongly that *guanxi* affects a person's success for employment and promotion (B4) and for business contracts/transactions (B5). The Shanghai survey by Chu and Ju (1990) also came to the same conclusion. In this study, we further find that people above 30 are less likely to believe that *guanxi* would affect employment/promotion (B4) and contracts/transactions (B5). The younger people generally lack work experience and a *guanxi* network, and thus they would believe that *guanxi* is more important than do the older. However, when people get older, they are

more likely to have built up their work experience and capability, and thus they would not depend as much on *guanxi* to be successful. Our data also show that older people believe more strongly that ethical codes of each profession should provide guidance on the practice of *guanxi* (B11). This result might reflect the older people's negative feeling about the harmful impacts of *guanxi* after their longer life experience with the actual practice of *guanxi* in Taiwan. Therefore, they believe more strongly that the practice of *guanxi* should be self-regulated through the establishment of professional ethical codes.

With regard to the impact of education on the responses, the data show that the people with a doctorate degree have the smallest comfort level with the particular congressman's *guanxi* practice, while people with college educations have the highest tolerance (B1). Further in this direction, people with a high school education have the strongest consent/acceptance regarding the current *guanxi* practice in Taiwan (B3); *guanxi* affecting employment/promotion (B4) and contracts/transactions (B5); feeling more comfortable to ask for

TABLE VI
Factor analyses: age and gender

Questions	Age		Education	
	F-value	Significance	F-value	Significance
B1 I am comfortable with a congressman's practice of <i>guanxi</i> and the extravagant wedding for his 16-year-old son	6.99	0.00***	4.47	0.00***
B2 <i>Guanxi</i> has been abused in Taiwan with the evidence of several recent fraud scandals	0.88	0.48	0.26	0.90
B3 I generally accept the practice of <i>guanxi</i> in Taiwan today	2.44	0.05**	2.57	0.04**
B4 <i>Guanxi</i> affects a person's success for employment/promotion	2.46	0.05**	3.25	0.01***
B5 <i>Guanxi</i> affects success in business contracts/transaction	3.13	0.02**	2.46	0.05**
B6 <i>Guanxi</i> affects social justice	1.31	0.27	0.20	0.94
B7 <i>Guanxi</i> is a source factor for corruption	1.69	0.15	0.88	0.48
B8 The factor that makes me determine to be a friend of a new person is whether he/she will be beneficial in my future	0.58	0.68	1.37	0.24
B9 If I have good <i>guanxi</i> with someone, I feel more comfortable to ask for help when needed	0.82	0.51	5.12	0.00***
B10 The fact whether I have good <i>guanxi</i> with someone does affect my willingness to render my help	1.39	0.24	3.63	0.01***
B11 Professional ethical codes of each profession should provide guidance on the practice of <i>guanxi</i>	4.68	0.00***	1.06	0.38

*Implies slightly significant, ($0.06 \leq p \leq 0.1$); **implies moderately significant, ($0.02 \leq p \leq 0.05$); ***implies very significant, ($0 \leq p \leq 0.01$).

help if I have nice *guanxi* with someone (B9); and *guanxi* affecting my willingness to render my help (B10). The degree of consent/acceptance declines regarding these issues when the education level increases. This decline may be because the people with more education presumably have the advantages of better knowledge and competence, and thus *guanxi* would become less important in their career.

The perceptions of respondents presumably reflect how *guanxi* has been practiced in Taiwan. A CEO of a small dry good process company in northern Taiwan expressed this at an interview during the survey:

My parents and I did not have good *guanxi* when I had just graduated from high school in the late 1960s. It was very difficult to find a job without *guanxi* and/or a good education when the economy was still poor. That's why my family tried hard to establish this family business in the mid-1970s. Establishing a *guanxi* network was essential to open up our business opportunities and keep our business moving on in the 1970s and early 1980s. Now the economy of Taiwan has

become more industrialized and advanced. Quality and price are more important than before, however *guanxi* still plays a role. I purchase some of my supplier's products when I deliver my products to them. This mutually benefits both parties.

A general manager of a corporation with about 400 employees said:

I feel that quality, price, and corporate image are more important than *guanxi* when doing business with large companies. But there is no doubt that *guanxi* promotes business. Our managers and sales representatives build *guanxi* with other individuals and companies through transactions. Our corporation does not want to emphasize *guanxi* too much because *guanxi* likely leads to under-table commissions or favors. As a general manager, every day I receive many calls and letters to request jobs and favors from the so-called "people in the *guanxi* circle." I have to deal with it because it's our tradition and culture. We have established corporate policies on recruiting and procurement. I should admit that the corporate policies exist explicitly and *gaunxi* implicitly.

A cost accountant with an MBA expressed “I feel *guanxi* is not so critical in today’s economy. I believe that products with good quality and price eventually can sell themselves, and people with good qualifications can get jobs and promotions too.”

Implications of *guanxi* for business practices and ethics

The stories above of the congressman and President Chen illustrate *guanxi* can be expanded from family to friends, colleagues, and others. The majority of the respondents to this survey have a strong negative feeling about these two cases and felt that *guanxi* has been abused in Taiwan. In addition, these two stories also demonstrate that while on the one hand *guanxi* can bring great benefits to the people in the circle of the *guanxi* network, on the other hand it can also bring harm to individuals, societies, and nations if misused or abused. In his study “*Guanxi* and Conflicts of Interest,” Provis notes that *guanxi* “involves interpersonal obligations which may conflict with other obligations people have ... based on general or abstract moral considerations.” He continues, saying that although the practice can at times be justified, when “it reduces societal wealth, benefits a few at the expense of the many” or violates ethical duties inherent in a professional position, it causes problems, and asks “what supportive mechanisms can we set in place to assist or ensure compliance with those rules, standards or guidelines?” (2008).

In practice, *guanxi*, a social construct for showing respect to another person, extends outside business and strengthens personal relationships. The most important element of *guanxi* is reciprocal obligation, but the obligation is neither immediate nor specified. The difference is that people in the *guanxi* circle understand they have mutual reciprocal obligations to do favors and help each other, but the time and method and quantity are never specified during the period when the *guanxi* is maintained. One party in this *guanxi* circle can certainly use personal discretion to return the favors at a personally convenient and appropriate time or to help ethically at the time when the other party requests help.

The use of *guanxi* in doing business with societies of Chinese culture has been widely discussed (Kao, 1993; Lovett et al. 1999; Luo, 1997a, b; Yeung and Tung, 1996; among others). Recently, some researchers have extended their studies to relate *guanxi* to accounting and auditing. Hwang and Baker (2000) and Hwang and Staley (2005) argue that *guanxi* is an asset, but is also a liability since a potential “*guanxi* debt” or “face debt” is to be repaid for a business. They further postulate that *guanxi* could affect auditor independence and therefore jeopardize audit quality and violate professional ethics as well.

Guanxi has a significant implication to the U.S. firms and their U.S. auditors operating in Confucian cultures. First of all, managers and employees must exercise their judgment carefully to manage situations when their Chinese colleagues and business partners are practicing *guanxi*. This and other studies (Au and Wong, 2000; Pederson and Wu, 2006) suggest that American business firms and CPA firms must provide particular appropriate corporate policies and conduct rules as guidelines when they are operating in a Confucian business environment. Many companies, for example, separate the functions of specifying, authorizing, purchasing, and inspecting to reduce the potential for the “red envelope [used to convey gifts of cash in the Chinese culture]” problem (Millington et al., 2005). In a study of risk trade-offs in *guanxi*-based IJVs in the PRC, Rahman (2008) notes that “the foreign partner does not have *guanxi*, the Chinese partner does” (p. 234). He warns that the “key lesson ... is that *guanxi* is necessary, but not sufficient to succeed in collaborative projects in China. ... Formal training of local partners to bridge the competence gap may be one way to overcome this apparent problem” (p. 248).

Von Weltzein-Hovik (2007) notes that “many western companies still simply translate codes of ethics into Chinese, while paying little attention to what is really considered ethical by the Chinese themselves” (p. 458), often with negative consequences. Hovik (quoting a Chinese manager) also notes that the mainland Chinese have learned to be “fast-forgetting” about company codes (p. 465) because they learned to be fast-forgetting about PRC laws, which are powerfully enforced in the

first month following enactment but are weakly enforced thereafter. Hovik concludes that western management systems, which would include internal control systems that rely on accountants' and auditors' willingness to blow the whistle, will not work as well in Chinese cultural environments "unless they are reassessed and adapted" (p. 467). He also recommends finding "the most pragmatic approach to align ... differences without compromising" on meeting the needs of Western and Chinese managers (p. 467).

In particular, the U.S. Congress enacted the Sarbanes-Oxley Act (S-O Act) in 2002 in response to a series of financial frauds such as Enron, WorldCom, Tyco International, and others. The S-O Act has strengthened corporate governance and required high standards for auditor independence and audit quality. *Guanxi* can have a significant impact on an auditor's judgment. Therefore, a U.S. business or CPA firm must be aware of provisions in the S-O Act when they are operating in a Confucian culture. The U.S. Foreign Corrupt Practices Act (FCPA, 1997) must also be considered whenever an audit on a business is conducted in a society where *guanxi* is commonly practiced. As *guanxi* is established on the premise of exchanging gifts and favors, the practice clearly leads to the potential violations of the FCPA, which explicitly forbids U.S. companies from using bribes to win contracts (Hwang and Staley, 2005).

Chen and Tjosvold (2007) did an interesting study about dialogues between American managers and Chinese employees, suggesting that "constructive controversy [personal discussions between Chinese employees and foreign managers] contributes both to resolving issues and strengthening relational bonds and understanding between managers and employees." The authors note that managers and employees "have been found to express their views directly, curiously explore and understand each other's perspective, and integrate their views to make high quality decisions they are committed to implement" (p. 172). Such understanding could help overcome the tendency of Chinese employees to use *guanxi* inappropriately and point them in the direction of the codes of ethics, while strengthening the personal *guanxi* between the manager and the employees. The need for foreign managers to adapt to their host

country's culture can thus be used to develop relationships that "very much affect employee effectiveness" (p. 173).

As the previous discussions indicate, establishing professional codes of ethics to meet the business/social norms of a particular culture is important. In this study the respondents strongly agreed that the professional ethical codes of each profession should provide guidance on the practice of *guanxi* in a Confucian society. Clearly the implications of *guanxi* for audits and attestations cannot be ignored. Au and Wong (2002) find a correlation between an auditor's level of *guanxi* with a client and their ethical judgment on that client's affairs. They also find that the impact of *guanxi* connections on auditor independence is minimized when the auditor holds high ethical principles. Hwang et al. (2008) find that the majority of correspondents in Taiwan believe that *guanxi* affects auditor independence and discourages whistle-blowing. Foreign managers working in Chinese organizations must not fail to develop and use *guanxi*; the company's employees should participate in the social and cultural community activities and build *guanxi* for themselves and for the company. Such actions will make them valuable community members, just as they would in the U.S. Western companies can enjoy great benefits by becoming part of the local culture where they are operating, and as Chen and Chen note (2004), "reform-oriented and entrepreneurial Chinese are more likely to look to Westerners as future partners" (p. 321). The Chen and Tjosvold (2007) study provides further support for the idea of using personal *guanxi* between managers and employees to ensure appropriate employee behavior in other *guanxi* situations. The findings in this study certainly suggest that the business and accounting professions should incorporate extra guidance on the practice of *guanxi* in their codes of professional ethics since it may result in a greater propensity for fraud, waste, and abuse.

Conclusions

When we look at the three Propositions, we find them confirmed by the data collected. *Guanxi*

definitely plays a role in employment and business success through its reciprocal nature, and under certain circumstances can lead to corrupt business practices. Western managers must take care that their own audit practice values and standards are not a source of conflict but are also not abandoned. Such concepts as merit, ethics, family values, social harmony, and mutual respect and trust exist in Confucian teachings and will prove valuable in China as well as in the U.S. Chen and Tjosvold (2007) show that foreign managers can use personal *guanxi* to increase Chinese employee effectiveness. Chen and Chen (2004) note that foreign managers are in a better position to achieve such a balance because their work relationships with the Chinese may not be as deeply embedded or entangled with other social relationships such as family, kinship, and local communities. By balancing personal *guanxi* with organizational and professional performance standards, managers may contribute to curtailing some of the negative consequences of *guanxi* (p. 321).

To sum up, *guanxi* is a double-edged sword. When properly practiced, it can bring great benefits to individuals and organizations within its networks and be a valuable business asset. However, if abused or misused, *guanxi* can bring harmful outcomes to individuals and organizations involved, moreover, to a whole society. In addition, it can also be an enormous liability because there is an obligation to return favors to the people in the *guanxi* circle.

Notes

¹ By the end of August 2008, several government officials appointed by Chen were convicted on various charges and sentenced to prison terms in Taiwan. Chen has been prosecuted since he finished his presidency term in May 2008. His wife's case was postponed because of her illness.

² The mean value of each factor group, such as for each age group, is automatically reported in our factor analysis. The means of factor groups are not summarized in tables because of space constraints.

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Appendix A

Guanxi and business ethics questionnaire

This questionnaire is for professionals and students studying to be professionals. It is composed of Sections A through C. The instructions for each section are at its beginning. Please respond to all items.

Section A

1. *Guanxi* (personal connection/relationship) is part of the Chinese culture. Listed below are seven proposed methods to establish *guanxi*. Please use numerals to indicate the importance of each method. For example, 1 indicates most important, 2 indicates next most important, and so on. You may use the same number for the methods which you feel have the same level of importance to you.

_____ Strengthening the interactions with relatives and friends.

_____ Through the introduction by relatives and friends.

_____ Attending social organizations or the activities of weddings, birthdays, funerals.

_____ Taking opportunities to get acquainted with other people.

_____ Strengthening the interactions with classmates and colleagues.

_____ Through the introduction by classmates and colleagues.

_____ Others. Please indicate: _____

2. Once the *guanxi* has been established, it must be maintained to make it work/last longer. Listed below are seven proposed methods to maintain the *guanxi*. Please use numerals to indicate the importance of each method. For example, 1 indicates most important, 2 indicates next most important, and so on. You may use the same number for the methods which you feel have the same level of importance to you.

- _____ Giving gifts.
 _____ Treating at meals.
 _____ Greetings by telephones or cards.
 _____ Attending the activities of weddings, birthdays, funerals, etc.
 _____ Taking opportunities to visit residence or office.
 _____ Getting him/her out for tea, coffee, and chats.
 _____ Others. Please indicate: _____

3. Listed below are seven proposed factors that contribute to the establishment of *guanxi* in a Confucian society. Please use numerals to indicate the importance of each method. For example, 1 indicates most important, 2 indicates next most important, and so on. You may use the same number for the methods which you feel have the same level of importance to you.

- _____ Confucius' 5 basic human relations and Chinese traditional cultures.
 _____ The sense of saving face and honoring the family.
 _____ The sense of righteousness and returning the favor to grantors.
 _____ Mutual benefit to people in the circle of *guanxi*.
 _____ Favorably impressing others.
 _____ Be able to help others through my own *guanxi*.
 _____ Others. Please indicate: _____

Section B

Please indicate your disagreement or agreement with these statements by circling a number along the scale associated with each statement.

- | | |
|--|--|
| 1. My comfort level with the congressman's (Mr. Ching-biau Yan's) practice of <i>guanxi</i> and the extravagant wedding for his 16-year-old son. | 1 ... 2 ... 3... 4 ... 5 ... 6 ... 7
Strongly Disagree Strongly Agree |
| 2. <i>Guanxi</i> has been abused in Taiwan with the evidence of several recent fraud scandals. | 1 ... 2 ... 3 ... 4 ... 5... 6... 7
Strongly Disagree Strongly Agree |
| 3. I generally accept the practice of <i>guanxi</i> in Taiwan at present. | 1 ... 2 ... 3 ... 4 ... 5 ... 6 ... 7
Strongly Disagree Strongly Agree |
| 4. <i>Guanxi</i> affects a person's success for employment/promotion. | 1 ... 2 ... 3 ... 4 ... 5 ... 6 ... 7
Strongly Disagree Strongly Agree |
| 5. <i>Guanxi</i> affects success in business contracts/transactions. | 1 ... 2 ... 3 ... 4 ... 5 ... 6 ... 7
Strongly Disagree Strongly Agree |
| 6. <i>Guanxi</i> adversely affects social justice. | 1 ... 2 ... 3 ... 4 ... 5 ... 6 ... 7
Strongly Disagree Strongly Agree |
| 7. <i>Guanxi</i> is a source factor for corruption. | 1 ... 2 ... 3 ... 4 ... 5 ... 6 ... 7
Strongly Disagree Strongly Agree |
| 8. The factor that makes me determine to be a friend of a new person is whether he/she will be beneficial in my future. | 1 ... 2 ... 3 ... 4 ... 5 ... 6... 7
Strongly Disagree Strongly Agree |
| 9. If I have good <i>guanxi</i> with someone, I feel more comfortable to ask for help when needed. | 1 ... 2 ... 3 ... 4 ... 5 ... 6 ... 7
Strongly Disagree Strongly Agree |
| 10. The fact whether I have good <i>guanxi</i> with someone does affect my willingness to render my help. | 1 ... 2 ... 3 ... 4 ... 5 ... 6 ... 7
Strongly Disagree Strongly Agree |
| 11. Professional ethical codes of each profession should provide guidance on the practice of <i>guanxi</i> . | 1 ... 2 ... 3 ... 4 ... 5 ... 6 ... 7
Strongly Disagree Strongly Agree |

Section C

Please complete the following questions.

1. What is your age? _____.
2. You are 1. Female _____, 2. Male _____.
3. Your highest education is 1. Elementary _____, 2. Junior High _____, 3. Senior High _____, 4. College/University _____, 5. Master's Degree _____, 6. Doctorate Degree _____.

Please return the completed questionnaire in the postage-paid envelope, or to the person who came to visit you. Thank you for your time and effort.

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Dennis B. Hwang
Bloomsburg University of Pennsylvania,
Bloomsburg, PA, U.S.A.
E-mail: dhwang@bloomu.edu

Patricia L. Golemon
University of Houston-Downtown,
Houston, U.S.A.
E-mail: patriciagolemon@comcast.net

Yan Chen
Dongbei University of Finance and Economics,
Dalian City, China
E-mail: chenyan2001@126.com

Teng-Shih Wang
Feng Chia University,
Taichung City, Taiwan R.O.C.
E-mail: dans0617@yahoo.com.tw

Wen-Shai Hung
Providence University,
Taichung City, Taiwan R.O.C.
E-mail: wshung@pu.edu.tw

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