



VICTIMIZER, VICTIM OR WHAT: UNRAVELING THE MULTINATIONAL CORPORATION'S PUBLIC CRISIS IN CHINA AND RUSSIA



SIEMS EMERGING MARKET BRIEF

SKOLKOVO Institute for Emerging Market Studies
Moscow School of Management
November 2011 / Vol. 11-10

I. INTRODUCTION ²

II. THE TOP ACCUSED MNCs IN CHINA AND
RUSSIA ⁶

III. WHAT THE CRISIS WAS ABOUT:
NOT NECESSARILY FOR BAD APPLES ⁸

IV. HOW THE CRISIS STARTED:
A RISING NETWORK OF ACCUSERS IN CHINA
AND RUSSIA ¹²

V. ENCOUNTERING REGULATION
DEFICIENCY: VICTIMIZERS OR VICTIMS ¹⁶

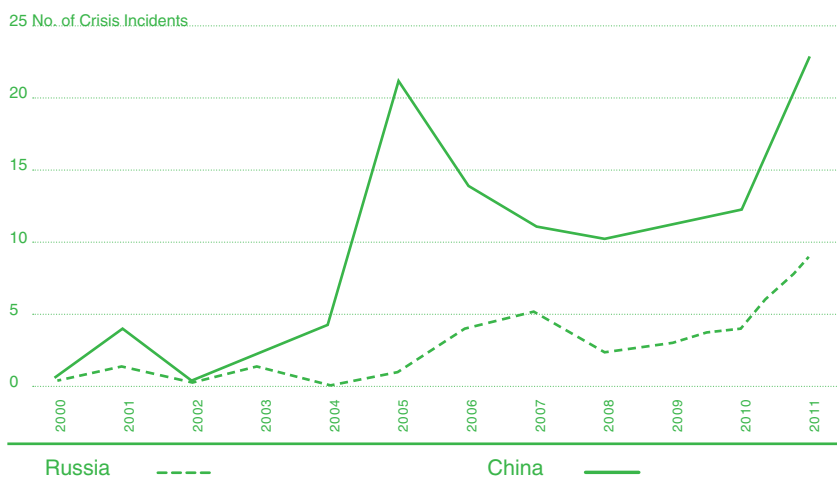
IV. CONCLUSIONS AND SUGGESTIONS ²⁰

I. INTRODUCTION

Multinational corporations (MNC) have made respectable efforts to build local institutions and to improve the local business environment in developing countries. In recent years, however, the Chinese and Russian media have enthusiastically disclosed and condemned foreign MNCs. A large number of stakeholder accusations have become a public crisis. A public crisis refers to an unexpected, non-routine, and media-exposed event in which affected stakeholders (e.g., community members, employees or customers) charge that a company has compromised their interests. A wave of accusations has covered a wide range of issues, such as marketing fraud, product quality flaws, environmental pollution and abusive labor practices. A public crisis can harm MNCs reputationally and financially. The recent Wal-Mart China crisis provides a case in point. Since Wal-Mart entered Chongqing City in 2006, it has been penalized 21 times by the local Industrial and Commercial Administration. On October 9th, Wal-Mart received the largest ever penalty in Chongqing—2.69 million RMB (416 thousands USD). One week later, the China CEO stepped down. MNCs in Russia encountered a rising wave of attacks as well. In November 2006, a Russian woman won a one-year lawsuit against Coca-Cola at the Khimki City Court. She charged that her gastritis was exacerbated after drinking Coca-Cola for years. Lawyers noted the case to be the first Russian court decision to punish a large MNC for a customer protection issue. Many now expect a rise in similar lawsuits in Russia. Indeed, the MNC public crisis in China and Russia has increased during the past decade. Figure 1 shows the number of public

The MNC public crisis in China and Russia has increased during the past decade

FIGURE 1/ Growth of MNC Public Crisis in China and Russia, 2000-2011



NOTE: Compiled by SIEMS.

crises that the 2010 Fortune 500 American companies have encountered from 2000 to present.

The public crisis has caused three types of costs for MNCs: companies' corrective actions, official punishments and market performance. Among all public crises encountered by American MNCs since 2000, forty-one percent in China and thirty-three in Russia have led explicitly to the related company's reactive or proactive corrective actions, such as product recall or compensation. In China's Bohai Bay oil spill case, for example, the crisis commenced with a citizen blog accusation and cost ConocoPhillips about seven million USD per day due to the clean-up work and the halt in operations. Twenty-eight percent of crisis incidents in China and thirty-seven percent in Russia have led to government or court penalization, such as fines, forfeit or operation suspension. Twenty-two percent of cases in China have caused declined sales or stock prices. A public crisis also would weaken the company's reputation, which is widely recognized as a valuable asset that can attract customers, improve financial performance, attract top employee talent and/or garner positive comments from financial analysts.

The mounting stakeholder accusations against American MNCs in China and Russia remind us that emerging markets are growing in both economic and social terms. Social and political expectations on MNCs in terms of social-environmental responsibility are going high, and the regulation system is improving. While current institutional deficiencies allow MNCs to exploit through substandard ethical behavior, the increasing efforts of institution building are adding costs to MNC unethical behavior. Numerous stakeholder dynamics are at play: Customers' low trust in domestic companies and the regulation environment; customers' high expectations of MNCs; as well as an increase of active grassroots non-governmental organizations (NGOs), government-NGO alliances, and critical Internet users. These stakeholders have enormous power to push MNCs into the spotlight of public supervision. Sustaining operations in an emerging market means adapting to (i.e., understanding, engaging and benefiting from) this change.

The mounting stakeholder accusations also indicate that MNCs lag behind in building capacity to adapt to this changing environment. MNCs need to reconsider the relationship between business and society in emerging markets and employ a long-term strategic approach to handle business ethics. Hence, it is critical for managers to understand changes in the institutional background and in the underlying reasons for specific crisis incidents. This report aims to reveal the pattern of crisis incidents, analyze the difference between China and Russia, and make suggestions to MNC managers working in both countries.

The mounting stakeholder accusations against American MNCs in China and Russia remind us that emerging markets are growing in both economic and social terms

DATA COLLECTION AND ANALYSIS

We collected data on Fortune 500 American companies that endured public crises in mainland China since 2000. According to the definition, a public crisis entails being exposed through the mass media. We therefore focus on three sources of media articles: 1. the newspaper article database Factiva; 2. articles via Google and major local search engines in China (Baidu) and Russia (Yandex); 3. local databases about MNC scandals¹. Two Russian research assistants (RA) and two Chinese RAs used company names to search each foreign Fortune 500 MNC using Factiva, Google and domestic search engines. These searches aimed to locate all information related to public accusations against each Fortune 500 MNC since 2000. We then went through these articles to identify public crisis incidents². We found that Google searched out the most comprehensive information covering all results available through Factiva and domestic search engines. As a result, we found 112 public crisis incidents in China and 30 in Russia between January 1st 2000 and October 1st, 2011.

We did a content analysis of 2,093 Chinese news articles and 311 Russian articles to understand eight aspects of each public crisis: *the company and industry involved, the accusation content, the accusation's origin, the grievance channel, the company's response, the crisis outcome, the regulation deficiencies related to the crisis, and the influence of the crisis on the regulation system*. Four RAs attended a training session in which definitions and coding schemes were provided. Then each of them worked independently, two on Chinese cases and two on Russian ones. We calculated Cohen's kappa for all eight elements. The score was larger than 0.8, which shows strong inter-rater reliability between coders. We then discussed and analyzed any discrepancies.

¹ People.com is among the most authoritative online news content providers in China. It has a special section on MNC scandals since July 2011. The section has full-time staff members who collect related news articles from electronic media throughout the country everyday. We also cross-checked a special section on company scandals at sina.com.cn. Sina.com is one of the largest Chinese news content providers. It has been reporting on company scandals since 2009.

² An event needs to meet the following criteria to count as a public crisis incident: 1) the company received accusations (critiques, lawsuits, etc.) from domestic stakeholders; 2) the accusers charged that the company has caused or potentially will cause a loss of their interests due to unethical behavior, such as environmental pollution, bribery, abusive labor practices, and marketing fraud; 3) the accusation needs to cause or potentially cause harm to the company's financial interests or reputation in the host country.

II. THE TOP ACCUSED MNCS IN CHINA AND RUSSIA

Table 1 lists industries ranked by the number of crisis incidents. Fast consumer goods providers in areas of food service, household products, beverages, computer equipment and supermarkets represent the top five public crisis spots in China. They account for 67% of all incidents that have taken place in the past ten years. In Russia, automobile companies, beverage and tobacco companies, household product producers and petroleum refining companies are the top five crisis locations, making up 70% of all incidents. Table 1 also gives the largest accusation target in each industry, measured by the number of incidents a company has encountered since 2000. In both China and Russia, Procter & Gamble, McDonald's, Coca-Cola, and Motorola are the top targets of stakeholder's attacks in their respective industries.

TABLE 1. TOP ACCUSED INDUSTRIES AND MNCs IN CHINA AND RUSSIA, 2000-2011

Top Crisis Industries ^a in China	Top Accusation Targets in the Industry ^b in China	Top Crisis Industries ^a in Russia	Top Accusation Targets in the Industry ^b in Russia
Food services	McDonald's	Motor Vehicles and Parts	Ford
Household and Personal Products	Procter & Gamble	Beverages	Coca-Cola
Beverages	Coca-Cola	Tobacco	Philip Morris International
Computer, office equipment	Apple	Household and Personal Products	Procter & Gamble
General Merchandisers	Wal-Mart	Petroleum refining	Exxon Mobil
Food consumer products	H.J. Heinz, Kraft Foods	Network and Other Communication Equipment	Motorola
Pharmaceuticals	Johnson & Johnson	Pharmaceuticals	Eli Lilly, Pfizer
Apparel	Nike	Construction and Farm Machinery	Deere
Chemicals	DuPont	Food Consumer Products	PepsiCo
Internet Services and Retailing	Google	Food Services	McDonald
Computer software	Microsoft	Metals	Alcoa
Network and Other Communications Equipment	Motorola	Miscellaneous	Mattel
Mail, Package, and Freight Delivery	FedEx		
Petroleum refining	ConocoPhillips		

Note: a: ranked by the number of crisis incidents b: the MNC that encountered the most crisis incidents in the industry

III. WHAT THE CRISIS WAS ABOUT: NOT NECESSARILY FOR BAD APPLES

Stakeholders like employees, customers, mass media, NGOs and government agencies have exposed MNCs as unethical for various reasons. These accusations have turned into different publically-exposed crises areas. Table 2 points out that the customer protection issue (e.g., hazardous substances, labeling flaws, product quality flaws, etc.) is a dominant crisis area in China, accounting for 69% of incidents. The public crisis around customer protection has increased at an average annual rate of 180% since 2000. MNCs in China have a significantly higher chance of being accused for the sake of customer protection than those in Russia. Hazardous substance and marketing fraud account for 51% of customer-benefit-related accusations in China. Although the number of consumer complaints received by the China Consumers Association has shown a slight decline since 2004, the number of accusations associated with hazardous substances in food and other fast consumption goods has increased in recent years.³ This point suggests that customers are becoming highly alert to messages related to the hazardous substances. This situation could rapidly turn an accusation against MNCs, even ungrounded, into a public crisis.

In fact, misleading public opinions and technical uncertainties are manifest in substance-related crisis incidents in China. Forty-four percent of hazardous substance accusations have been proven to overestimate the harm since the substance level actually falls within a safe range. These cases were consequently acquitted by the government. Examples include dioxane and methanol in shower gel, triclosan in toothpaste and fluorescent whitening agents in food containers. Thirty-seven percent of accusations end up with no official punishment because either the scientific evidence of the substance's harm to health remains inconclusive or the substance has actually not been used in products sold in China. Examples include acrylamide in French fries, fluorescence in napkins, or fluoropolymer used in frying pans. Only 19% of government inspections confirmed illegal substance additives and led to penalties. Examples include potassium bromate in potato chips and toxyred in Heinz dressing. The unfortunate news for MNCs is that twenty-five percent of substance- or marketing-related accusations that did not receive a government penalty still caused product recalls and/or losses in sales.

The customer protection issue (e.g., hazardous substances, labeling flaws, product quality flaws, etc.) is a dominant crisis area in China

Customers are becoming highly alert to messages related to the hazardous substances. This situation could rapidly turn an accusation against MNCs, even ungrounded, into a public crisis

³ Calculated by SIMES based on statistics from China Consumers Association.

The lack of public trust in product safety has heightened costs for non-ethical MNC practices in China.

Perceived cultural discrimination occupies 12% of MNC accusations and is becoming increasingly important in China. In July 2007, the administration of the Forbidden City in Beijing terminated a contract with Starbucks in the name of field repair. Eight years after Starbucks operation in the Forbidden City, the administration announced that it will only allow its own brands to do business there. This incident commenced with a blog posted by a TV presenter earlier in the year. The blog charged that having Starbucks in the Forbidden City

erodes Chinese culture. In March, a member of the National People's Congress submitted a proposal asking Starbucks to move out of the Forbidden City immediately. Advertisements are often accused of showing cultural disrespect. In December 2004, the State Administration of Radio, Film and Television banned a Nike TV commercial claiming that it caused extensive discontent among the Chinese audience and hence had violated a regulation requiring commercials to maintain the nation's dignity and traditional culture. In the commercial, an NBA star challenged and beat stone lions, a Kung Fu master, flying Apsaras and a dragon that symbolized Chinese culture. What Nike interpreted as promoting a brave and fear-defying attitude became an utter insult to the Chinese audience.

In contrast, MNCs in Russia only experienced one discrimination-related public crisis in the past decade. In January 2008, the Coca-Cola Company withdrew a street advertisement that displeased the Orthodox Christians in the Nizhny Novgorod region. In the advertisement, inverted crosses and Orthodox churches were put in a Coca-Cola bottle. 440 people, with the moral support from the Nizhny Novgorod diocese priest, signed an appeal to various government authorities. The appeal described the advertisement as an American desecration of Russian holy sites and compared it to how Americans destroyed Orthodox churches in Serbia in the past. Ironically, Coca-Cola argued that the commercial was intended to symbolize the preservation of Russia's cultural heritage.

A double-standard is another form of discrimination that often has been questioned in China. Customers have questioned why Abbott Laboratories did not recall the problematic milk powder in China while it did in the US, or why Wal-Mart sold genetically modified food (GMF) in China while promising as early as 2005 that it would not sell any GMFs in the UK. Although MNCs successfully clarified such misunderstandings in some cases, most accused companies admitted the misdeed and took corrective actions, including compensation and product recall.

Perceived cultural discrimination occupies 12% of MNC accusations and is becoming increasingly important in China

Government relations dominate the MNC public crisis areas in Russia. Government-centered crises have increased at an average rate of 30% per year. Compared to China, American MNCs in Russia are significantly more likely to encounter such crises. Thirty-three percent of the accusations point to government-related bribery. These companies' corruption scandals in Russia were largely set off by the US government. This August, the U.S. Justice Department accused Deere & Co., the largest agricultural equipment manufacturer in the world, of paying bribes to Russian officials to obtain contracts. One year ago, the U.S. Congress Helsinki Commission opened an investigation on the involvement of Philip Morris' Russian distributors in the corrupt behavior of Russian government officials. Another 33% of accusations relate to tax evasion. In 2011, the Russian government charged Ford with understating taxes. The same accusation was directed at Procter & Gamble in 2007. In the Ford case, the Leningrad region's prosecutor's office disagreed with the local government over a tax benefit to the company and wanted the company to return the money it underpaid. In the latter case, the Federal Tax Service in Moscow charged Procter & Gamble of miscalculating royalty costs as operation expenses and thus understating the tax base. Both companies firmly denied the accusations and won their cases. Compared to China, corrupt official requests or controversial tax agency claims are more explicitly driving the MNC's public crises. Finally, a similar proportion of public crises in China and Russia can be attributed to the MNC's abusive or unsatisfactory labor practices, environmental pollution, or conflicts with local companies, such as business partners, suppliers or dealers.

TABLE 2. PUBLIC CRISIS AREAS IN CHINA AND RUSSIA, 2000-2011^a

	Freq. in China	Freq. in Russia	Significance Level of the Freq. Diff. ^b	Annual Growth Rate in China	Annual Growth Rate in Russia
Customer relations (product and service)	69%	33%	P<0.001	180%	40%
Cultural/national discrimination	12%	3%	No significant difference	30%	0
Government relations	7%	33%	P<0.001	0	30%
Local company relations (partners, suppliers, dealers)	7%	13%	No significant difference	0	0
Employee relations	6%	13%	No significant difference	10%	0
Environment	4%	10%	No significant difference	30%	10%

a: Note that one crisis incident can belong to more than one category. E.g., a case of cultural discrimination can also concern customer benefits. b: Two sample t-test, N for China=112, N for Russia=30

IV. HOW THE CRISIS STARTED: A RISING NETWORK OF ACCUSERS IN CHINA AND RUSSIA

Starting a crisis involves individuals and/or organizations that make an accusation and involves their chosen grievance channels. Table 3 shows that the mass media along with consumers and government agencies are the top three accusers in China. They account for 72% of crisis incidents. Government agencies, domestic companies and labor unions are the top three accusers in Russia, accounting for 69% of incidents. This statistic is consistent with our previous finding that the customer protection issue and government relations are the top reasons for crises in China and Russia. The mass media and consumers in China are significantly more likely to start accusations against large MNCs than those in Russia. The government and labor unions in Russia are significantly more likely to start accusations than their counterparts in China. Along with the increase of public crises in China is a wide range of stakeholders who are becoming active in questioning MNCs. Mass media, government, consumers, domestic NGOs, international NGOs and various individuals, such as lawyers and even college students, are joining a community to challenge MNCs. The challenge from each stakeholder has increased at a minimum rate of 20%, while the number for the media's and customer's accusations is 60% and 70%. In Russia, the government is a major source of challenge in terms of increasing accusations, with an average annual rate at 40%.

It is noteworthy that, although domestic NGOs in China and Russia initiated only a small percent of accusations against MNCs, such cases have increased at an annual rate of 20% in both countries. The rising NGO sector is particularly impressive in China. Since the turn of the century, there have been unprecedented cases of partnership between the Chinese government and grassroots NGOs as well as alliances among grassroots NGOs⁴. These newly-formed bonds not only reflect the enhanced influence of the NGO sector, but also imply a nontrivial source of pressure for MNCs' social-environmental performance. For example, this January, thirty-six green NGOs co-published a report to criticize Apple's factory pollution. This summer, government agencies and grassroots NGOs joined forces to develop investigations and litigation against ConocoPhillips, an act of defiance that was rarely seen before. In 2006, Wal-Mart also encountered a government-supported civil challenge. All China Federation of Trade Unions (ACFTU), the only legitimate labor union in China known for its close affiliation with the government, blamed Wal-Mart for its refusal to set up labor unions. After making fruitless requests to the company, ACFTU organized Wal-Mart workers and successfully pressed the company to establish labor unions in all stores in China. The labor unions then negotiated a pay raise with the management.

⁴ Zhao, M. and M. J. Ventresca. 2011. "When Legitimacy Strategies Meet Political Opportunities and Constraints: State-Organization Struggles in the China NGO Sector, 1995-2005." Working paper.

TABLE 3. TOP ACCUSERS IN CHINA AND RUSSIA, 2000-2011

	Freq. in China	Freq. in Russia	Significance Level of the Freq. Diff. ^a	Annual Growth Rate in China	Annual Growth Rate in Russia
Media	35%	0	P<0.001	60%	0
Consumers	27%	7%	P<0.05	70%	10%
Government	10%	46%	P<0.001	20%	40%
International NGOs	7%	7%	No significant difference	20%	10%
Domestic companies	6%	13%	No significant difference	10%	0
Other individuals (journalists, lawyers, students, etc.)	5%	7%	No significant difference	20%	0
Employees	4%	0	No significant difference	20%	0
Domestic NGOs	4%	7%	No significant difference	20%	20%
Foreign companies	2%	0	No significant difference	0	0
Labor unions	0	10%	P<0.001	0	0
Foreign governments	0	3%	No significant difference	0	0

a: Two sample t-test, N for China=112, N for Russia=30

Table 4 illustrates that the mass media not only leads the accusation effort in China, it is also the most important grievance channel to which other accusers appeal. Sixty percent of accusers complained to the media as their first choice. The Chinese accusers are significantly more likely to start with the mass media than Russian counterparts. The growth of complaints going to the media has grown at an astonishing rate of 140% over the past decade. This number dwarfs government agencies, which are the second largest grievance channel in China. In contrast, Russian accusers are significantly more likely than Chinese counterparts to file complaints through formal grievance channels like government agencies or courts. Particularly, lawsuits against MNCs in Russia have grown at an annual rate of 80%. It is interesting to note that the formal grievance channel in Russia has been used primarily by the government itself (54%), while in China, it is the individual customer who used this channel most (47%).

A stark contrast between China and Russia is the role of the Internet (e.g., citizen blogs and BBS) in triggering MNC public crises. Internationally, the widely-reached media and Internet has facilitated exposure of firms' unethical behavior around the world (Falkenberg, 2004⁵; Smith, 2003⁶). This is no exception in China in Russia where respectively about 380 million people and 60 million people are active on the Internet as of 2009⁷. Although the number of Internet users per 100 people in 2009 is 42 in Russia and 29 in China, Chinese people are more likely to disclose MNC issues on the Internet. While no crises were ignited through the Internet in Russia, 10% of accusa-

⁵ Falkenberg, A. W.: 2004, 'When in Rome ... Moral Maturity and Ethics for International Economic Organizations', *Journal of Business Ethics* 54, 17-32.

⁶ Smith, N. C.: 2003, 'Corporate Social Responsibility: Whether or How?', *California Management Review* 45(4), 52-78.

⁷ World bank online dataset: data.worldbank.org

tions in China started and spread in cyberspace. Internet-based crises have increased at an annual rate of 40%. Meanwhile, strikes on the streets as a means of complaining has occurred more often in Russia than in China. This finding is no surprise considering that the weak labor union system in China makes it difficult for workers to organize themselves. Also, the government would not encourage strike-like rallies that may arouse social disturbance.

The above findings clearly show the increasing importance of media and customers in China and the government in Russia as the source of pressure on MNCs. We shall distinguish between when an accusation started and when this problem turned into a public crisis. The citizen blog and the BBS manifest their importance in both stages, particularly in the second stage. The ConocoPhillips oil spill crisis provides a strong example. As early as June 4th this year, the State Bureau of Oceanic Administration in China received a report from the company saying that it found a small amount of oil slick around an oil well platform. On the 17th, an ocean surveillance ship reported to the administration that it found a large amount of oil spilling at another platform. However, the event was not brought to the public's attention until an employee of China National Offshore Oil Corporation (CNOOC), the Chinese partner of ConocoPhillips, posted a note on the MicroBlog (the Chinese version of Twitter) on the 21st. This one sentence note revealed that the Bohai Bay oil field had been spilling for two days. Immediately after this Tweet, several domestic media agencies tried to contact CNOOC but in vain. On the 29th, a newspaper reported the event based on its own investigation. On July 1st, CNOOC provided its first official response, which started unveiling an unprecedented marine ecological disaster in China. This crisis is costing ConocoPhillips about seven million USD per day and is leading to lawsuits for compensation of more than 20 million USD. The State Council Standing Committee now may slow down oil exploration projects in Bohai Bay that amount to more than 20 billion USD. While the Chinese government attaches great importance to social stability, civil blogs and media can trigger great protest against the unethical behavior of MNCs.

TABLE 4. CHANNEL OF ACCUSERS' APPEALS IN CHINA AND RUSSIA, 2000-2011

	Freq. in China	Freq. in Russia	Significance Level of the Freq. Diff. ^a	Annual Growth Rate in China	Annual Growth Rate in Russia
Media	60%	0	P<0.001	140%	0
Government	17%	20%	No significant difference	40%	0
Lawsuits	13%	67%	P<0.001	10%	80%
Internet (Blog/BBS)	10%	0	P<0.1	40%	0
Strikes	0	10%	P<0.001	0	0
INGO	0	3%	No significant difference	0	0

a: Two sample t-test, N for China=112, N for Russia=30

V. ENCOUNTERING REGULATION DEFICIENCY: VICTIMIZERS OR VICTIMS

Effective regulations that support markets in developed countries often fail to function well in emerging markets. Scholars have found that regulation deficiencies in developing economies are able to motivate MNCs to adopt sub-standard corporate responsibility practices to maintain competitiveness. However, the influence of regulation deficiency on business operation in emerging markets is more complex. Product quality and safety is a popular concern in China. Loose government supervision limits the capacity to block flawed products from entering the market. Consumers, therefore, have little trust in companies and supervisory agencies and tend to overreact to unconfirmed information about product problems. As a result, crises often result from the lack of social trust and transparency in the company's communication rather than genuine unethical behavior. Regulation deficiencies can make a crisis worse when the government is unable to provide a confirmed conclusion based on existing regulation. For example, in 2010, CNN claimed that McDonald's chicken McNuggets contained PDMS and TBHQ, which may cause suffocation and other ailments. The Chinese media asked McDonald's China to provide an explanation. The health inspection administration quickly started an investigation, but claimed that they did not have an official method for detecting TBHQ. This uncertainty caused product quality to be open to doubt, although McDonald's quoted the State Food and Drug Administration as saying that both chemicals are allowed to be used in making deep fried food. The media asserted that foreign fast food companies were able to get away with bad behavior again by "meeting current national standards," due to loopholes in food safety regulation. Several stores recorded a decline in McNugget sales following the event.

In another case, an NGO in the US published a report in March 2009 claiming that Johnson & Johnson's baby skin care products contained hazardous substances like methanol and dioxane. The same day, an article entitled "JNJ almost disfigured my one-year-old daughter's face" appeared in a famous BBS in China. This article was browsed by more than 200,000 people and hundreds responded. One week later, six hundred parents whose children got skin allergies after using JNJ products planned joint litigation against the company. The next day, the State Quality Inspection Administration announced that JNJ China only had one product that included very little dioxane. The administration also confirmed that the raw material will unavoidably bring dioxane into the final product. China, however, has no regulations on the legal amount of such substances. It remains unclear

Crises often result from the lack of social trust and transparency in the company's communication rather than genuine unethical behavior

if a small amount of dioxane will cause health problems. JNJ considered this announcement as official approval of product safety and refused to withdraw the product. Nonetheless, JNJ's sales immediately dropped 70% in some markets and dropped 7.4% in the entire country. These two cases show that, while a crisis breaks Chinese customer's expectation of higher product quality from MNCs, regulation uncertainty pushes distrustful and angry consumers away from the market.

The loose implementation and supervision of existing regulations, fueled by the lack of regulation specification, has contributed to the normalization of unethical practices in some industries. This January, three Chinese green NGOs jointly released a report about Apple suppliers' problematic environment and labor practices in China. In March, eight female workers sued an Apple supplier in China for n-hexane poisoning. The head of the factory, as the defendant, felt he was treated unjustly because he simply followed the industry routine to use n-hexane to clean cell phone lenses. He had done so for twenty years and had never received a single citation from the government about occupational disease. The existing regulation asks a company to apply for Occupational Health Protection Permission, according to which the government conducts

periodical examinations and trainings. However, a company does not need this permission to obtain a business license. Theoretically, the government should warn or penalize all companies that do not voluntarily apply for the permission. However, this rarely has been done because it would mean that 120 inspectors at the local administration would have to check out 17,000+ enterprises. Meanwhile, penalty regulations remain ambiguous. According to the Occupational Disease Prevention Law, the government should close or fine a company when a disease with significant harm to employee health is found. However, the law does not define "significant harm." Therefore, very few enterprises have received penalties for the occupational disease problem. Flawed regulation and weak supervision allow for the existence of unethical practice norms in industry. Given the lack of effective routine supervision mechanisms, the government's anecdotal assault is subject to the questioning of political action against MNCs. The charge is that government officials choose the timing of inspection and punishment to favor their political needs. This is manifest in the recent reaction of foreign media to Chongqing city's shutting down of Wal-Mart stores for marketing fraud.

Another problem of the regulation system in emerging markets is the lack of consistency of the same regulation over time or between different regulations on the same issue. The Ford Motor crisis in Russia speaks to the

The loose implementation and supervision of existing regulations, fueled by the lack of regulation specification, has contributed to the normalization of unethical practices in some industries

former point. Before June 16th, 2006, Ford was entitled to import automobile parts to Russia free of duty. To do so, Ford needed to reach a 40% level of production localization. However, the customs service changed the rules for calculating the localization level at the end of May. The new rules perform the calculation on the basis of production cost, which makes the localization level lower considering the decline of staff salaries, fuel and land rent. Hence, the customs service accused Ford of failing to satisfy the localization requirement and asked Ford to pay 140 thousand rubles per vehicle for customs clearance. As for the inconsistency between existing regulations, the disorder of the food additive administration in China provides a typical case. China has applied multiple official standards regarding food safety. The food hygienic standard is set up according to Food Safety Law, while the food quality standard is made based on the Product Quality Law. In addition, some food products are also subject to industrial standards. A product that has satisfied one standard could be rejected by another. This inconsistency has caused consumer confusion and exposed companies to a risk of being accused of using illegal food additives.

The MNC's public crises have driven regulation improvement efforts in both China and Russia, albeit to different degrees. Table 5 shows that, compared to Russia, China has had a significantly larger percentage of crisis incidents that caused media-based public complaints and reflection about regulation deficiencies. China also witnessed more government initiatives for regulation drafting or revision following the crisis incidents. This comparison suggests a more explicit influence of the MNC public crises on China's regulation system.

Another problem of the regulation system in emerging markets is the lack of consistency of the same regulation over time or between different regulations on the same issue

TABLE 5. CRISIS-DRIVEN REFLECTION AND ACTION ON THE REGULATION SYSTEM IN CHINA AND RUSSIA, 2000-2011

		China	Russia	Significance Level of the Difference ^a
Public Discussion on Regulation Deficiency	Low specification	44%	10%	P<0.001
	Low implementation	13%	0	P<0.05
	Low consistency	1%	3%	No significant difference
Regulation Improvement	New regulation or regulation revision	29%	7%	P<0.05

a: Two sample t-test, N for China=112, N for Russia=30

VI. CONCLUSIONS AND SUGGESTIONS

UNDERSTANDING THE DIFFERENCES BETWEEN MNC PUBLIC CRISES IN CHINA AND RUSSIA

This report reveals different patterns for MNC public crises in China and Russia. First, the customer protection issue is a dominant and rapidly growing crisis area in China, while government relations dominate the MNC crisis area in Russia with a steady increase in the past decade. MNCs in China have a significantly higher chance of being accused for the sake of customer protection than in Russia. Compared to China, corrupt official requests or controversial tax agency claims are more explicitly driving the MNC public crisis in Russia. Meanwhile, mass media, consumers and government agencies are the top three accusers against MNCs in China, while government agencies, domestic companies and labor unions are the top three accusers in Russia.

This report also reveals that Chinese customers and other accusers show more trust in informal grievance channels like the Internet and mass media rather than formal ones like lawsuits or complaints to government agencies. The mass media is not only a top attacker, it is also the first choice channel for other accusers. Russian accusers are significantly more likely to file complaints through formal grievance channels. While the formal grievance channel in Russia has been used primarily by the government itself, it is the individual customer who used this channel most in China. Chinese people are more likely to disclose the MNC problem on the Internet than Russian people. However, street strikes are a means for complaints more often in Russia than in China.

Finally, MNC public crises have driven regulation improvement efforts in both China and Russia, albeit to different degrees. Compared to Russia, a significantly larger percent of crisis incidents in China has raised media-based public complaint and reflections about regulation deficiencies and has led to government initiatives for regulation drafting and/or revision.

LESSONS AND SUGGESTIONS FOR MNC STAKEHOLDER AND RISK MANAGEMENT IN EMERGING MARKETS

The MNC's public crisis calls for reshaping the understanding of risk management in emerging markets. Attention needs to move from a post-crisis communication strategy to broader stakeholder dynamics and to the evolution of social-political expectations and regulations on MNCs. Minimizing the risk of public crisis in a transitional economy requires both keeping to a high-level global standard in operations and a highly-engaged rather than cost-driven localization.

MNCs must first begin to watch and engage in an emerging crisis network. A critical part of the institutional change in China is the emergence of a crisis network, which refers to a community of different types of stakeholders

who are active and capable of filing accusations against MNCs. Operating in China means getting involved in this crisis network. This network includes employees, customers, mass media, government agencies, domestic and international NGOs, local companies and Internet users. While in developed countries, these stakeholders have established formalized pressure on companies, in emerging markets, they are learning to become more challenging, more self-organized and more mutually allied. They have a rising awareness of CSR, using the Internet as a facilitative tool of challenge, and are supported by a regulatory environment that is increasingly restrictive and specific regarding MNC ethical behavior. This network of stakeholders can unite around an issue and turn it into a crisis. Therefore, an approach of localization that allows MNCs to enhance stakeholder awareness and engagement is a crucial part of a strategy to survive and sustain in emerging markets. They not only need to strengthen relations with conventional stakeholders like government agencies and employees, they also need to take into account the influential parties in a crisis network, such as grassroots NGOs, local suppliers and Internet users. Keeping to an operation of global standards and proactively generating social values in alliance with crisis network stakeholders is becoming critical for MNCs to catch up with the changing stakeholder dynamics.

Keeping to an operation of global standards and proactively generating social values in alliance with crisis network stakeholders is becoming critical for MNCs to catch up with the changing stakeholder dynamics

Second, companies must transform from victims of regulation deficiencies to change makers. An important lesson in MNC public crises is that one does not have to be a bad apple to get punished. Customers in emerging markets are becoming highly alert to messages related to product and service quality. This could rapidly turn an accusation against MNCs, even if ungrounded, into a public crisis. Misleading public opinions, technical uncertainties and regulation ambiguities are important drivers of MNC product-related public crises in China. Indeed, 25% of substance or marketing related accusations that did not receive government penalization still suffered product recalls or losses in sales. Meanwhile, the influence of regulation deficiencies on MNCs is not as simple as bad apples exploiting advantage. The loose implementation and supervision of existing regulations, fueled by the lack of regulation specification, has contributed to the normalization of unethical practices in some industries. It is often the lack of social trust and transparency in company communication rather than genuine unethical behavior that lead to public crisis. Actually, both the Chinese and Russian governments are making efforts to redress regulatory deficiency, often driven by such public crises. What is a cost to MNCs is actually part of the emerging market govern-

ment's self-learning process. Therefore, MNCs that maintain their old logic of exploiting institutional deficiency are turning into victims of the state's institution building ambition. Understanding this point, MNCs need to turn attention away from defending themselves from institutional problems and instead play an active role in improving social and regulatory environments. Getting involved in a process of improving regulations and standards in emerging markets should be treated as a strategy as important as expanding markets or strengthening R&D.

Finally, companies should target tomorrow rather than today. MNCs' early stage investment in emerging markets, similar to the 1980s in China, focused on establishing low-cost offshore production operations. At this time, MNCs engaged in very limited marketing activities. The low-cost mindset may easily lead MNCs to ethical dilemmas. However, the trend is that they are increasingly competing with domestic companies in the mass product market. Consumers in emerging markets have more choices between foreign brands, domestic brands, and buying directly from foreign countries. The low-cost logic, the fast expansion and the reliance on under-trained local staff may fail the market expectations of MNCs by incurring problems like flawed products, poor service, irresponsive management and so on. These issues are exactly the areas where domestic competitors are making progress and where consumers are showing decreasing tolerance. Therefore, MNCs need to focus on strategies that can transfer the global standard of practice to emerging markets while avoiding dilution of this standard during the rapid expansion. That is to say, MNCs need to focus the strategy towards the future status of the market, which is what the customer expects and grows up to rather than what the customer used to afford or what the current weak regulation system will allow today.

MNCs need to focus the strategy towards the future status of the market, which is what the customer expects and grows up to rather than what the customer used to afford or what the current weak regulation system will allow today

AUTHOR:

Meng Zhao, Ph.D. (Research Fellow at SIEMS)

EDITOR-IN-CHIEF:

Sam Park, Ph.D. (President of SIEMS)

CONTACTS:

siems@skolkovo.ru

SIEMS RESEARCH MONTHLY BRIEFS

- Vol. 09-01 "The global financial crisis: impact and responses in China and Russia" (February 2009).
- Vol. 09-02 "Managing through the global recession: Opportunities and strategic responses in China and Russia" (March 2009).
- Vol. 09-03 "Global expansion of emerging multinationals: postcrisis adjustment" (May 2009).
- Vol. 09-04 "Operational challenges facing emerging multinationals from Russia and China" (June 2009).
- Vol. 09-05 "MNC Operations in Emerging Markets: Post-Crisis Adjustments of FDI Inflows in China and Russia" (August 2009).
- Vol. 09-06 "Is Demographics Destiny? How Demographic Changes Will Alter the Economic Futures of the BRICs" (September 2009).
- Vol. 09-07 "Executive leadership structure in China and Russia" (December 2009).
- Vol. 10-01 "Size Matters: Just How Big Are The BRICs?" (January 2010).
- Vol. 10-02 "Decoupling Revisited: Can the BRICs Really Go Their Own Way?" (February 2010).
- Vol. 10-03 "The "New Geography" of International Trade "How the Emerging Markets are Rapidly Changing Global Trade" (March 2010).
- Vol. 10-04 "Chief Executive Officer Turnover in China and Russia: Implications for Corporate Governance and Strategic Management" (April 2010).
- Vol. 10-05 "Sovereign Wealth Funds and the New Era of BRIC Wealth" (July 2010).
- Vol. 10-06 "Corporate Giants and Economic Growth — A Case for China and Russia" (August 2010).
- Vol. 10-07 "Is Low Wage Manufacturing in China Disappearing? - Who will be the World's next Workshop?" (November 2010).
- Vol. 11-01 "The New Oil Paradigm: Can the Developing World Live with \$100 Plus Oil?" (January 2011).
- Vol. 11-02 "Beyond Business, Not Beyond Government: How Corporate Social Responsibility Leaders in China and Russia Do Philanthropy" (February 2011)
- Vol. 11-03 "All Roads Lead to Rome: High Performance Firms in China and Russia" (June 2011).
- Vol. 11-04 "Stock Market Development and Performance in the Emerging Economies" (July 2011).
- Vol. 11-05 "The Political Dimension Of Doing Good: Managing the State Through CSR In Russia And China" (August 2011).
- Vol. 11-06 "Food Prices: Drivers and Welfare Impacts in Emerging Market Economies" (September 2011).
- Vol. 11-07 "The Rapid Ascendency of the Emerging World's Financial Markets. A Snapshot of their Development" (September 2011).
- Vol. 11-08 "World Financial Crisis and Emerging Market Bank Performance: A Bank Efficiency Study" (September 2011).
- Vol. 11-09 "The Rising Cost of Doing Business in Emerging Markets: Targeting Entrepreneurs in Tough Economic Times" (October 2011).
- Vol. 11-10 "Victimizer, Victim or What: Unraveling the Multinational Corporation's Public Crisis in China and Russia" (November 2011).

SIEMS ISSUE REPORTS

- Vol. 10-01 "The World's Top Auto Markets in 2030: Emerging Markets Transforming the Global Automotive Industry" (May 2010).
- Vol. 10-02 "The Productivity Prize. Accounting for Recent Economic Growth among the BRICs: Miracle or Mirage?" (June 2010).
- Vol. 10-03 "The Great Equalizer. The Rise of the Emerging Market Global Middle Class" (September 2010).
- Vol. 10-04 "Central Bank Independence and the Global Financial Meltdown: A View from the Emerging Markets" (November 2010).
- Vol. 11-01 "Brave New World. Categorizing the Emerging Market Economies – A New Methodology, SKOLKOVO Emerging Market Index" (February 2011).
- Vol. 11-02 "The New Geography of Capital Flows" (March 2011).
- Vol. 11-03 "All That's Old is New Again: Capital Controls and the Macroeconomic Determinants of Entrepreneurship in Emerging Markets" (April 2011).

The Moscow School of Management SKOLKOVO

is a joint project of Russian and international business representatives, who joined their efforts to create a business new-generation school from scratch. Focusing on practical knowledge, the Moscow School of Management dedicates itself to training leaders, who intend to implement their professional knowledge in the conditions of rapidly developing markets. SKOLKOVO is defined by: leadership and business undertakings, rapidly developing markets focus, innovative approach towards educational methods.

The Moscow School of Management SKOLKOVO project is fulfilled by the governmental-private partnership within the framework of the Education Foreground National Project. The project is financed by private investors, and doesn't use governmental budget recourses. The President of the Russian Federation Dmitry Anatolyevich Medvedev is Chairman of the SKOLKOVO International Advisory Board.

Since 2006 SKOLKOVO conducts short educational Executive Education programmes for top and medium-level managers – open programmes and specialized, integrated modules based on the companies requests. SKOLKOVO launched Executive MBA programme in January 2009, first class of the international Full-time MBA programme – in September 2009.

The SKOLKOVO institute for Emerging Market studies (SIEMS)

is a knowledge centre at the Moscow School of Management SKOLKOVO that specializes in the research of the economies and businesses of the emerging markets. It provides a research platform that attracts and links leading thinkers and experts from around the world, who can collaborate on studying timely and critical issues in emerging markets. Its research is rigorous, field-driven, and comparative across emerging markets and offers practical, broadly applicable, and valuable guidelines and frameworks for business leaders, entrepreneurs, policy-makers, and academics with interests in emerging markets.

It currently has offices in Moscow and Beijing and plans to open the India office in the near future. Its researchers include several full-time and part-time research fellows who are leading scholars and experts in various fields. Its current research focus covers economic and financial development, firm growth and sustainability, CSR practices, and indigenous innovations in fast growing countries. Its research output is distributed through various forms of reports, publications, forums, and seminars. We welcome feedback and suggestions from our readers on the research findings and future research directions.

Moscow School of Management SKOLKOVO

Novaya ul. 100, Skolkovo village,
Odintsovsky district,
Moscow region, Russia
tel.: +7 495 580 30 03, fax: +7 495 994 46 68

SKOLKOVO Institute for Emerging Market Studies

Unit 1607-1608, North Star Times Tower
No. 8 Beichendong Road, Chaoyang District
Beijing, 100101, China
tel./fax: +86 10 6498 1634

INFO@SKOLKOVO.RU
WWW.SKOLKOVO.RU



Ernst & Young is a global leader in assurance, tax, transaction and advisory services. Worldwide, our 144,000 people are united by our shared values and an unwavering commitment to quality. We make a difference by helping our people, our clients and our wider communities achieve their potential.

With the opening of our Moscow office in 1989, we were the first professional services firm to establish operations in the Commonwealth of Independent States. Ernst & Young expands its services and resources in accordance with clients' needs throughout the CIS. 3,400 professionals work at 16 offices throughout the CIS in Moscow, St. Petersburg, Novosibirsk, Ekaterinburg, Togliatti, Yuzhno-Sakhalinsk, Almaty, Astana, Atyrau, Baku, Kyiv, Donetsk, Tashkent, Tbilisi, Yerevan, and Minsk.

Across all industries, and at local and international levels, our professionals are recognized for their leadership, know-how, and delivery of accomplished results. We aim to help you identify and reduce business risks, find solutions that will work, and open new opportunities for your company. Through more than 20 years of our operations in the CIS, we have provided the critical information and the trusted resources to pave the way for improved business performance and profitability.

Ernst & Young
Sadovnicheskaya Nab. 77, bld. 1 | 115035 Moscow | Russia
Phone: +7 (495) 755 9700
Fax: +7 (495) 755 9701
E-mail: moscow@ru.ey.com
Website: www.ey.com

Moscow School of Management SKOLKOVO
Novaya ul. 100, Skolkovo village,
Odintsovsky district,
Moscow region, Russia
tel.: +7 495 580 30 03, fax: +7 495 994 46 68
info@skolkovo.ru
www.skolkovo.ru

SKOLKOVO Institute for Emerging Market Studies
Unit 1607-1608, North Star Times Tower
No. 8 Beichendong Road, Chaoyang District
Beijing, 100101, China
tel./fax: +86 10 6498 1634