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Managing corporate crisis in China: Sentiment, reason, and law

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Abstract Why has the incidence of corporate crisis risen markedly in China? Why are foreign firms frequently targeted by the Chinese authorities and how should they deal with it? Addressing these pivotal questions is essential for effective management of corporate crisis in the Chinese market. Herein, we describe the background of relevant institutional and market environments in China. Then we introduce three prominent principles deeply rooted in Chinese thinking and business practice—sentiment, reason, and law—and pinpoint how they relate to crisis management. Several cases drawn from well-known corporate crises are utilized to illustrate the dynamic relationships among these three fundamental principles. We proceed to highlight the importance of sentiment and emphasize the delicate balance between sentiment and law. Finally, we elaborate how different forms of institutional capital and social media can be employed to manage sentiment, reason, and law so as to curtail and tackle corporate crisis.

1. Foreign corporate crisis in China

With the rapid growth of the Chinese market, foreign corporations operating in China have recently witnessed and experienced increasing crises and scandals. In the past 5 years, even well-known multinational corporations (MNCs) have been periodically criticized by China Central Television (CCTV), the state-owned media behemoth; other media outlets have also widely disseminated negative coverage, particularly on March 15th, World Consumer Rights Day. Several noteworthy crises include the Nikon D600 camera flaw, the GlaxoSmithKline bribe scandal, Johnson & Johnson's foul-up with harmful additives in baby products, Toyota's vehicle recalls, HP's laptop problem with black screens and overheating, Apple's after-sales discrimination, McDonald's expired food predicament, and Carrefour's food safety scandal. These

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MNCs, among others, have suffered highly negative consequences such as significant drops in share price, business suspension, and market share loss. MNCs feel they have been subjected to unfair discrimination and their domestic competitors have received preferential treatment. Foreign media tend to challenge the underlying motives behind these attacks, ascribing them to economic and political motives such as protectionism, forcing MNCs to accept government censorship, and urging offenders to generate more advertising at CCTV ("Beijing's Bite," 2013; Shobert, 2013).

Despite speculation regarding motives behind the recent crises, foreign corporations have to assume the challenge of navigating the complex, dynamic, uncertain, yet enormously lucrative Chinese market. Given this reality, managers are mandated by their boards to clearly grasp and effectively deal with the institutional and socio-cultural environments that are contributing to a noticeable increase in the incidence of corporate crises.

First, China has been undergoing major institutional and economic changes since it opened its doors to the world in the mid-1970s. These changes led gradually to mature consumers, tougher consumer protection laws and regulations, the widespread adoption of social media, and evolving labor markets. However, many institutions are still informal, weakly structured, or even non-existent structurally in some business arenas. Yang and Su (2013) point out that informal institutions, such as cultural norms and customs, remain potent in affecting Chinese business practices. MNCs bear liability for essentially being foreign due to cultural and institutional distances and the difficulties of understanding the ubiquitous implicit norms and rules of a collective society (Kostova & Zaheer, 1999; Zaheer, 1995). As a result, managers have to confront well-entrenched difficulties in differentiating unethical, illegitimate, and illegal practices and in deciding which standard they should maintain. Such institutional disadvantages tend to lead to pressure for legitimacy (Yang, Su, & Fam, 2012) and form palpable obstacles in managing corporate crisis when it occurs.

Second, domestic firms have become more competitive in the past decade. Fierce competition has compelled foreign companies to focus on lean production and cost-saving strategies. When firms try to find ways to bolster profits by lowering quality and services, they are easily targeted by the Chinese authorities and consumer watchdogs. Moreover, Chinese government agencies are inclined to maintain high standards for leading MNCs and expect them to model proper behavior for domestic companies. MNCs, however, find that they are unable to meet such expectations, especially when confronting tremendous pressures from market competition. As pointed out by Berman and Swani (2010), managing product safety in China has always proven to be a major challenge and requires effective strategies and careful planning.

Third, foreign managers have enormous difficulty in assessing customer sentiment due to (1) cognitively based cultural differences, (2) dramatic changes in customers' values and lifestyles in recent years, and (3) complicated political environments (Zhao, 2013). Indeed, China's complex, dynamic institutional environment poses a formidable obstacle not just for MNCs but also for local firms to devise effective crisis management strategies. The effective crisis management practices implemented in the West do not always work well in China. Due to this deficiency in Western understanding of Chinese business modalities, interest is growing among executives seeking to acquire in-depth insights regarding cultural and institutional aspects of crisis management.

To overcome ingrained Western institutional disadvantages and to effectively navigate the complicated yet lucrative market in China, it is meaningful for foreign managers to acquire the skills necessary to master the Chinese thought process and mindset and to integrate these skills into crisis management. Zhao (2013) suggests that MNC managers should clearly understand four categories of contextual challenges (i.e., global-national, social-trust, institutional-void, and normalized-misdeed) and undertake effective strategies to tackle them. Our study goes a step further by looking into the fundamental principles that constitute the key to understanding and designing effective strategies for crisis management. Based on our field interviews with MNC managers and analysis of several recent corporate crises, we propose a framework to manage crisis from the Chinese cultural and institutional perspective.

2. A Chinese perspective of crisis management

Throughout several millennia of Chinese history, three pronounced principles have comprised a strong tradition in governing how disputes and lawsuits are handled and resolved (Martin, 2007). They are:

1. sentiment (*qing*, 情 in Chinese), which refers to people's feelings;

2. reason (*li*, 理 in Chinese), which is regarded as being reasonable and rational; and