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Managing Greater Scrutiny of MNCs in China

How MNCs Operating in China Can Use Communications to Ensure Reputational Risks Do Not Hinder Growth

When New Zealand's premier John Key met Chinese President Xi Jinping at October's APEC summit, their discussion was led not by strategic geopolitics, but by milk formula. The issue topped the agenda because of a food safety scare at Fonterra, New Zealand's biggest dairy producer. This is a sure sign that multinational brands operating in China have entered an era of heightened scrutiny and political interference, making a review of issues management and crisis strategy a priority for those keen to protect and promote corporate reputation.

A government drive against a range of business violations, including price fixing, 'consumer rights' violations, bribery and corruption, has brought some of the world's biggest brands, as well as domestic players, into the crosshairs of a crackdown on corporate abuses. The harsh reality is that foreign companies operating in China make easier targets and they should be prepared for orchestrated attacks against them. Furthermore, recently effected consumer protection law could mean there are further challenges ahead.

As well as concentrating on certain categories of corporate abuse, state-led probes are focusing their attention on specific industry sectors, including automotive, consumer electronics, dairy, pharmaceuticals and, to some extent, retail.

Over the course of last year, dairy companies were fined more than US$100 million for price-fixing. Fearing an unwinnable war, all of the brands involved reduced their prices. Also in the dairy industry, in what became one of the most high profile brand crises internationally and an illustration of how nationalism can fan the flames of crises, Fonterra announced that a botulism-causing bacteria had been detected in a batch of whey protein used to make milk powder, prompting a worldwide recall.

China, New Zealand's biggest dairy customer, buying NZ$3 billion (US$2.5 billion) worth of products annually, immediately suspended almost all New Zealand milk powder imports, with Russia and other countries following suit. Despite Fonterra's public apology and strong reassurances – the scare turned out to be a false alarm – the Chinese state-run media wasted no time in slamming not just Fonterra but New Zealand's entire dairy industry. The politically driven message was clear: Chinese manufacturers are just as safe and a lot cheaper.

Investigations by FTI Consulting's Global Risk and Investigations Practice (GRIP) on behalf of multinational clients (MNCs) reveal that companies face the threat of so-called 'black PR' attacks on their reputation by domestic companies, who have a history of using the media to undermine each other. "There is increasing evidence of a growing professional group of PR specialists who are specifically looking out for opportunities to undermine the international brands on behalf of domestic Chinese competitors," says Bill Sims, Managing Director in FTI Consulting's Global Risk and Investigations practice based in Hong Kong.

Two other factors beyond Fonterra's control explain why the recall was such a big deal and why other brands should take note. Plagued by a history of food safety scandals and in the midst of a 'consumer protection' drive, the Chinese government felt compelled to act decisively. Moreover, the ghost of the melamine scandal, the shocking infant formula cover-up which led to the death of babies in 2008, still looms large in the public consciousness.

Another major lesson from Fonterra is that one brand's crisis can rapidly create a domino negative effect for its peers. Through no fault of their own, other New Zealand producers also have to rebuild. Smaller New Zealand baby milk exporters say they are losing up to $2 million (US$1.65 million) in weekly sales as a result of the scare, according to the New Zealand Herald newspaper. Whether this becomes a short-term blip or a much bigger problem relies to a large extent on both the business brands and 'brand New Zealand' restoring faith in their reputations as suppliers of safe, quality food.

Viewed in wider context, Fonterra's crisis occurred in the midst of an offensive against several of the world's leading international companies. The Chinese government and state-run media have attacked the likes of Apple, GlaxoSmithKline, Samsung and Starbucks. The burgeoning popularity of social media channels adds another dimension that enables the viral spread of negative information on international brands.

Starbucks is an interesting example because it bucked a trend by launching a robust defence of its pricing. The response focused on messages around unique operating costs, such as labour, raw materials and infrastructure investment. Beyond profit motives, maintaining a high price point may in fact be of strategic importance to the Starbucks brand since branded coffee is a luxury good and in a rapid growth market and people are willing to pay for the experience.

The world's biggest coffee chain has over several years invested in building a reputation as a responsible corporate citizen and this has helped create a reservoir of goodwill. China's influential netizens would seem to agree and – in contrast to the state-run media outlets – there was plenty of support for Starbucks on Sina Weibo, China's biggest micro-blog.

Understanding China's Brand Climate

At a time when the Chinese media and authorities are in activist mood, swift and decisive action in the face of a severe reputational issue is critical. Understanding what the political priorities are and who the key stakeholders are as well as their point of view is fundamental to planning an effective containment strategy. FTI Consulting's Sims adds that "an important part is also understanding the (often hidden) political and business connections and relationships of the key stakeholders."

Of course, many international businesses still see China as a highly attractive market and it would be wrong to suggest that the Xi Jinping administration is waging a war against international brands. But there is plenty of evidence that shows the climate is riskier and key factors explain why this trend is only likely to grow in the near term:

- As China seeks to shift its macroeconomic strategy more towards consumption, the stakes for consumer brands will get higher and home-grown businesses will be pitching themselves harder against multinational competitors with superior reputations for safety and quality. Economic restructuring will also drive reforms in key sectors.
- At the same time, President Xi is pursuing a populist agenda that makes rooting out corruption and other abuses against the people a priority. Foreign companies are often an easy target and unlike their domestic peers, are unable to call on an extensive support network within the state bureaucracy.
- In the face of the spiralling cost of living, the state is keen to be seen to be actively driving down prices. Western brands which enjoy a premium price point are in the crosshairs. What's more, attacking foreign firms has the benefit of assisting home-grown competitors.

Anticipating the Unexpected

MNCs face a host of potential issues as they pursue growth in China. While no amount of planning can anticipate each and every risk a business faces, a coordinated approach that is informed by an organisation's strategic goals and a consistent set of messages will allow the flexibility to deal with problems as they arise. Developing appropriate protocols to manage crises should involve the following:

- Gaining a detailed understanding of the stakeholder landscape that your business faces.
- Building connections and allies and listening to stakeholder points of view.
- Knowing your weaknesses and planning for likely scenarios by creating detailed response strategies that includes critical actions and targeted assignments.
- Creating realistic simulations to familiarise executives with how crises unfold and how they can best be handled.
- Growing local communications resources and aligning global strategy as crises are borderless and what happens in China can have a major impact in other markets.
- Developing a communications response plan to troubleshoot unforeseen crises and defend against negative perceptions.

China's new Consumer Protection Law came into effect just recently and contains a host of additional measures designed to safeguard consumers. The interpretation of the laws is a huge unknown as of yet, posing yet more uncertainty for global brands. What is clear, however, is that MNCs are now operating in a more challenging environment in China. Addressing your company's exposure to reputation risks is a priority that should not wait until the next high profile brand crisis prompts an internal rethink.

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